THE LAHORE JOURNAL OF ECONOMICS

Lahore School of Economics

Volume 4, No.2 **July-Dec, 1999**

THE LAHORE JOURNAL OF ECONOMICS

Editorial Staff: Tele. No: 874385

Telefax: 0092 - 42 - 5714936

E-mail: les@brain.net.pk

Publisher : Lahore School of Economics, Lahore, Pakistan.

Correspondence relating to subscriptions and changes of address should be sent to The Lahore Journal of Economics, 105-C-2, Gulberg III, Lahore - 54660 - Pakistan

Instructions to authors can be found at the end of this issue.

4 1999

THE LAHORE JOURNAL OF ECONOMICS

Contents **Vol. 4, 1999**

Lessons of Survival in Managing Economic and Banking Crises

Abdul Raoof Butt[*], Abdul Raoof[**] & Mehmood-ul-Hassan[***]

Abstract

Pakistan is enduring a serious economic downturn and facing the probability of the collapse of the banking and financial systems. The growth outlook is meek and risk of default is hanging over the head of the nation as a sword. Banking and financial institutions and economic systems of Pakistan like that of ASEAN and other crises hit countries, suffer from bad loans, political interference, corruption, declining exports, budget and trade deficits, internal and external debts, crashes of stock exchanges, currency mismanagement, and double digit inflation. While 'survival of the fittest' is ever a self-evident truth, the lessons of the rise and fall of nations are important for survival. In order to meet the challenge of survival, it may be crucial to learn the underlying causes that accounted for and understand the strategies and reforms that attempted to manage the economies of the countries suffering from the crises.

The banking and financial sectors play significant roles in the contemporary world of business and economic growth. They influence economic activities in the field of production and facilitate the distribution of financial resources in diverse and integrated ways. The experiences of developed countries such as the United States of America, Germany and U.K. clearly demonstrate that organised economic structures and sound banking and financial systems not only boost their macro and micro economies but also may save them from any sudden banking and financial crisis.

Economic and banking crises vividly illustrate the consequences of weak financial systems and inadequate macroeconomic policies. Many countries of the world faced crises in their economic and banking systems that tended to worsen the structure of their entire economies. Rapid trade, globalisation, financial integration of world economies and technological developments are considered as catalysts for the 'East Asian Crisis' that hit many Southern Asian countries especially and the rest of the world generally.

[*] Chairman Department of Economics, University of the Punjab, Lahore.
[**] Chairman Department of Business Administration, Deputy Chairman Research Division, Yang-En University, China.
[***] Officer National Bank of Pakistan.

Economic and banking problems require major and expensive reforms in the banking systems. Often, the problems have domestic causes, such as weak banking supervision, superfluous political interference, inadequate capital, and bad loans. Weakness of banking systems is considered as the main cause of the East Asian, Mexican, and Swedish crises. The countries adopted diverse strategies in order to survive in the crises with different levels of successes. Their experiences of banking and financial reforms may be useful to the rest of the world in order to minimise the risks of any probable crisis. This study investigates economic and banking crises in East Asian countries, Mexico and Sweden and deduces the lessons of survival.

Economics, culture, environment, production systems, and financial institutions are connected with one another in a circular cause and effect relationship. The study indicates that the survival in part is in producing environmentally safe quality products, creating sound alliances with international communities and institutions, promoting sustainable growth patterns, and following balanced trade pursuits. Survival is in the vitality of our culture and in the potency of our ideals. It is very important to improve the standards of supervision, regulation, and transparency of financial systems. In this connection, a central bank may be given a free hand through more autonomy. Consolidation of the credit markets, liberalisation of interest rates, application of prudential regulations, and sensible administration of privatisation policies may be useful in order to avoid a banking and financial crisis in Pakistan. The beneficiaries of this study may include banking experts, policy makers, financial analysts, and associated students and teachers.

I. Introduction

Banking and economic crises have many causes and have effects on growth and the survival of countries. Notorious crises include the Great Depression of the 1930s, the U.S. exchange rate crisis of 1894-96, the British sterling and French franc crisis of the 1960s, and global debt crisis of the 1980s. Various methods have been tried to recover from the banking and economic crises of Mexico, Chile, Spain, Sweden, and then the recent crisis of East Asian economies (Lyle, 1998).

The main factors considered for the breakdown of financial and economic systems in South East Asian nations are financial oversight, sizable short-term international capital outflows, and untenable attempts to maintain dollar-pegged domestic currencies. The list of factors also include a slowdown in growth resulting from overvalued currencies relative to the Japanese Yen and the Chinese RMB, competition from China's expanded productive capacity, declining demand for semiconductors in 1996, and

increasing current account deficits both absolutely and as a percentage of GDP (Demirguc, Asli and Enrica, 1998).

There has been extensive research on the role of the banking sector in the macro economy and its importance in propagating business cycles. In this connection, earlier studies include Bernanke (1983) on the Great Depression, Bernanke and Gertler (1995), King (1994), Kiyotaki and Moore (1997), and Allen and Gale (1997). These studies indicate that a stable banking sector can amplify the magnitude of the business cycle, facilitate overall economic expansion and sustain financial markets.

The countries of East Asia, Indonesia, Malaysia, the Philippines, Thailand, South Korea, Hong Kong, and Singapore have long been called "Asian tigers" because of their roaring economies. Their economies have been characterised by growth rates averaging over 8 per cent annually for the last two decades, per capita incomes rising over the last 30 years by extraordinary amounts, very high domestic savings rates, low budget deficits, and low inflation. Singapore's growth exceeded 10 per cent in 1993-94, South Korea was 9 per cent in 1994-95, and Malaysia and Thailand also averaged growth rates of over 7 per cent during this period (Khan, 1998). The growth rates of the Philippines, Indonesia, and Taiwan were 5.1 per cent, 7.6 per cent and 6.3 per cent respectively in 1995 (World Bank, 1995).

Table-1: Key Indicators: East Asia

Country	GDP per Capita	GDP per Capita	Average Annual Rate of Inflation	Average Annual Rate of Inflation	Export /GDP	Export /GDP
	($)	($)	%	%	%	%
	1980	1995	1970-80	1985-95	1980	1995
South Korea	1,520	9,700	19.8	6.7	34	33
Philippines	690	1,050	13.2	9.5	24	36
Malaysia	1,620	3,890	7.5	7.6	58	96
Thailand	670	2,740	9.9	5.0	25	42
Indonesia	430	980	20.5	8.8	33	25
Japan	1,980	1,995	7.5	1.4	14	9
Singapore	4,430	26,730	5.1	3.9	207	-

Source: World Bank (1982) and World Bank (1995)

Table-2: Saving and Investment: East Asia

Country	Per cent of GDP			
	Gross Domestic Saving	Gross Domestic Saving	Gross Domestic Investment	Gross Domestic Investment
	1980	1995	1980	1995
South Korea	25	36	32	37
Philippines	24	15	29	23
Malaysia	33	37	30	41
Thailand	23	36	29	43
Indonesia	37	36	24	38
Japan	31	31	32	29
Singapore	38	-	46	33

Source: World Bank (1997), World Bank (1982) and Asian Development Bank (1997-98).

The initial business gains led domestic and foreign investors to underestimate the countries' inherited economic weaknesses. Large financial inflows overwhelmed the policies and institutions of these nations. Money went through loans and investments, into unneeded and unproductive real estate and corporate expansion programmes (Wolf, 1998, March 3). The disguised unfeasible decisions slowly yielded bubbles of huge disruptive prices, inefficient companies and surplus buildings. International agencies tried to rescue the suffering countries from a deep depression. The IMF-led rescue package this time totalled over $113 billion (Lissakers, 1988, October 8) and total lending from the World Bank was $18 billion (World Bank, 1998).

Table-3: Total External Loan to East Asian Countries February, 1998 to February, 1999

Country	Total external loan	
	Year-1998	Year-1999
Indonesia	703.20 Million	1.65 Billion
Korea	5.00 Billion	2.48 Billion
Thailand	38.00 Million	700.00 Million

Asia's banking systems are the legacy of years of bad lending practices and inadequate supervision and regulation that led to rapid lending growth and excessive risk taking (Stijn & Thomas, 1997). There was a collapse in currency values after a period of turmoil in foreign exchange markets. Asset values declined sharply and economic activity became negative. The crisis occurred at great economic cost in these countries in terms of output, investment and jobs (Shelby & Davis, 1997). The banking and economic crisis in Southeast East Asian countries first affected Thailand, and then rippled outward to Indonesia, Hong Kong, Taiwan, and Korea. It also cast its shadow on Japan.

In 1997, more than $ 100 billion of Asia's hard currency reserves had been transferred (in a matter of months) into foreign countries (*South China Morning Post*, 1997), such as Thailand, Malaysia, and the Philippines that approximated over $ 600 billion, or about 60 per cent of their combined pre-crisis GDP (Stiglitz, 1998). Chinese economies also suffered badly as a result of the crisis. The total bad loans of China were RMB 6.173 billion in 1994 (Mehran, 1996) and total internal and external debt of Korea was $153 billion in 1997 (Choi, 1997). Thailand's foreign debt rose to 50 per cent of GDP, of which 80 per cent was private-sector borrowing (*The New York Times*, 1999, March 19).

Table-4: Growth Rates of Selected Asian Countries

(GDP Growth) US$			
Crisis Country	**Per Capita 1996**	**Annual Average % 1970-1996**	**Forecast 1998%**
Indonesia	4,280	6.8	-5.2
South Korea	12,410	8.4	-2.5
Thailand	8,370	7.5	-4.0
Malaysia	9,730	7.4	1.6
Philippines	360	3.6	1.9
Singapore	25,650	8.2	2.7
China	3,120	9.1	6.3
Taiwan	17,720	8.3	5.0

Source: Institute of International Finance (1998).

Table-5: Selected External Financing Measures for Five Asian Countries: South Korea, Indonesia, Malaysia, Thailand and Philippines

Factor/Year	(Billions of Dollars) US$	(Billions of Dollars) US$	(Billions of Dollars) US$	(Billions of Dollars) US$	(Billions of Dollars) US$
Year	**1994**	**1995**	**1996**	**1997**	**1998**
Current A/C Balance	-	41.3	-54.9	-26.0	17.6
Net Private Capital Flow	40.5	77.4	93.0	-121.1	-9.4
Equity Investment	12.2	15.5	19.1	-4.5	7.9
Commercial Bank Loans	4.2	12.4	18.4	13.7	-3.2

Source: Institute of International Finance (1998).

Origin of the Banking and Financial Crisis

In 1997-98, the economies of some Asian countries, popularly known as the Asian Tigers, suffered a serious setback. Stock markets crashed drastically, companies fell, banks collapsed and growth rates declined (Nizamani, 1999, October 4). Domestic mismanagement, corruption and the politicisation of loans through an unaccountable and non-transparent banking system played a central part. Over-borrowing in dollars in relation to foreign currency reserves, left companies and the banking systems exposed to the effects of interest rate rises and currency devaluation (Kaminsky & Carmes, 1996).

A number of factors are alleged to have triggered the crisis. The list of factors include a weak financial system, massive non-forming loans, oversight, surging international capital flows, untenable attempts to maintain dollar-pegged domestic currencies, and a slowdown in growth resulting from overvalued currencies and increased competition from China's expanded productive capacity (McCall, 1998, April 27). China's 1994 currency devaluation undercut the export competitiveness of the crisis countries particularly Thailand and Indonesia, and was one of the contributing causes of the Asian crisis (Davies, 1998).

Table-6: Currency Depreciation against US Dollar (June 1997 – May 1998)

Country	Depreciation (%)
South Korea	38.0
Philippines	37.9
Malaysia	38.2
Thailand	44.6
Indonesia	83.5
Japan	21.2
Singapore	18.3

Source: *Asia Week* (1998, June 26).

The sudden currency devaluations of Thailand, Korea, the Philippines and Indonesia began in July 1997 when foreign investors started demanding their dollar-denominated loans. Banking policies and practices have been limited to narrow segments of economic development in the ASEAN region (Caprio & Gerard, 1997).

Asian governments utilised the banking system to direct funds into favoured investments and toward favoured investors in order to fulfill their own selfish ends. Interest rate ceilings, government-directed lending and closed relationships between banks and borrowers destabilised the financial health of the countries. Unfeasible commercial bank credits had risen from $23 billion in 1994 to $56 billion in 1996 and $83 billion in 1997 (Poon, 1998).

Experience shows that in an inexorable banking crisis such as that of the East Asian countries, depositors, lenders to banks, and owners of bank capital, all lose confidence and simultaneously seek to salvage their resources by withdrawing them. A single bank can fail without national repercussions, but when a large proportion of the deposits in a national banking system are involved, the problem becomes systemic and paralysis threatens the entire economy. The collapse of BCCI, Barings Bank, Daiwa Bank, Taj Company, Sachon Bank, Mehran Bank, and Banker's Equity Limited are but examples of the systemic paralysing phenomena (Baker, 1998). The governments have no option but to act. As always said, everything in this world has a price. The remedies available in a crisis are difficult and costly. The bubble of the crisis may be managed at costs but sometimes the roots are still alive and may hit like a hurricane later.

The crisis in the ASEAN economies is perhaps the most serious banking and economic crisis since the collapse of the Bretton Woods system in the early 1970s, in terms of both its scope and its effects. Its impact is much more global than that of the financial crises we have seen in the past two or three decades, including those in Latin America (Goldstein & Philip, 1996).

The banking and economic crisis of East Asian countries was the result of multi dimensional complicated but interrelated flaws in the banking and financial structure especially in the case of Korea. Other factors included permissive international capital markets, savings and investments imbalances in the private sector, real estate speculation in the case of Japan and Thailand, the nature of Asia's political economy, and finally the crash of the market in the mid-1990s, all contributed to the crisis. The Malaysian PM Mahathir, blamed international foreign exchange speculators for the incidence of the crisis (Nizamani, 1999, October 4).

Unlike in the United States, governments in Asia are more involved in business development (Poon, 1998). This reliance on more personalised and a cozy relationship based transaction increases the potential for corruption. That was one of the reasons of the crisis. The critical turn in the global economic environment caused an economic downturn in the case of Japan. The situation worsened with the increasing internal debt and non-performing loans of major banks totalling about 44 trillion yen or $360 billion (Toole, 1999, March 17). Massive capital flight in the case of Malaysia, inadequate legal structure, under developed securities markets, practices of unsound central banking, high interest rates and currency exposures, certainly in Korea, probably in Thailand and elsewhere, and large debt to equity leverage ratios appear to be the triggering factors for the crisis. Weaknesses in regulation and lax banking practices as in the obvious cases of Malaysia and Indonesia magnified the crisis (Marcus, 1997).

The governments of the ASEAN countries took serious measures to deal with the crisis. Thailand reduced reserve requirements, eased the rules governing non-bank financial institutions, expanded the scope of permissible capital market activities such as allowing banks to finance equity purchases on the margin, and increased access to off-shore borrowing. 'Korea eliminated many interest rate controls, removed restrictions on corporate debt financing and cross-border flows, and permitted intensified competition in financial services (Shirazi, 1998). The famous Bank Bali Scandal in Indonesia worth US$80 million is the prime example indicating basic flaws and a loose concept of supervision and regulations in the banking system of Asean countries (Belchere, 1999).

Table-6: Non-Performing Loans across Countries

Country	Non-Performing Loans %
Indonesia	75 per cent of GDP : 1998-99
Thailand	44 per cent of GDP : 1998-99
Malaysia	19 per cent of GDP : 1998-99

Source: *The News,* (1999, September 8).

In these countries, day to day banking business was done on the basis of personal relationships and there was a lack of transparency in the overall banking and financial transactions especially in the case of Thailand (Moegan, 1998). Some critics observed that lending ratios of 80-100 per cent (20 per cent in Japan) and high to very high corporate risks (Indonesia, Thailand, South Korea) were also the causes of turbulence in the ASEAN economies.

In the absence of effective steps to counter the currency pressure, international commercial and investment banks, along with domestic investors seeking to limit their foreign currency exposure, withdrew support for these currencies. Between early July and mid-October, 1997, the currencies of Thailand and Indonesia had fallen 30 per cent relative to the dollar. Poor financial disclosure and underdeveloped securities markets, speculative investment in assets (Japan) rather than in productive channels and fragile financial structures (Philippines) are the main reasons for that vicious circle in which the banking crisis aggravated the corporate crisis (Caprio, Gerard and Klingebiel, 1996). Also there were very high current accounts deficits before the crisis in the East Asian countries. Loan defaults furthered the disastrous banking crisis in East Asian countries (Hudson & Bill 1998, August 12). The crisis caused currencies to depreciate, share prices to drop, and interest rates to soar in Korea, the Philippines, Thailand, and Malaysia.

Table-8: External Current Account Deficits before Crisis

Country	1995 (Per cent of GDP)	1996 (Per cent of GDP)	1997 (Per cent of GDP
Korea	-3.3	-3.3	-2.9
Philippines	-4.4	-4.7	-4.5
Thailand	-8.0	-7.9	-3.9
Malaysia	-10.0	-4.9	-5.8

Source: IMF (1998).

Table-9: Changes in Currency Value, Share Price Index and Interest Rates July 1, 1997 to February 16, 1998

Country	Depreciation of the currency vis-à-vis the Dollar (Per cent)	Changes in the share price index (Basic Points)	Changes in the interest rates (Basic Points)
Philippine	51.37	-49.17	0.00
Indonesia	231.00	-81.74	2,398
Korea	83.04	-63.06	965
Malaysia	55.43	-58.41	373

Source: Blooming Financial Services LP (1999).

Role of Multinational Companies

Multinational corporations have been carrying out business in South East Asia since the second half of the 1980s. They are alleged to cause structural imbalances in ASEAN economies and intensified socioeconomic contradictions. In 1995, East Asian countries in the region received an estimated $108 billion in foreign capital flows, of which $98 billion was from private sources, including $54 billion in direct investment of multinational companies (World Bank, 1995). Simultaneous pursuit by several countries of export-oriented growth inherently led to situations of excess capacity, intensifying pressure on wages and living standards, as well as increasing vulnerability to potentially destabilising currency fluctuations that were the outcome of unplanned foreign investment in all these countries. A sudden, unexpected and large-scale reversal of international capital flows out of ASEAN economies caused a serious economic situation in the subject countries (Stiglitz, 1998). Attempting to rescue the economies, during 1996, private foreign investors put $93 billion into the ASEAN region (IMF, 1998, October).

Table-10: Capital Inflow in East Asia (1987-96)

Country	Net Capital Inflow (Average Annual	Percentage of Capital Inflow to GDP (Average Annual)
South Korea	80	5.1
Thailand	75	7.4
Indonesia	68	5.7
Malaysia	68	12.0
Philippines	23	4.3

Source: Asian Development Bank (1999).

Investors from the U.S., Western Europe and Japan poured capital into the region in the form of both bank loans and equity investments. The magnitude of the foreign capital inflows helped fuel a surge in domestic asset prices, particularly that of real estate (*The Economist*, 1999, October 2). Owing to massive industrialisation and direct involvement of foreign investment made by the multinational companies in the East Asian countries, traditional industries such as agriculture, and cotton and cottage industries have been replaced with golf courses and luxury hotels (Thailand), commercial property (Indonesia, Thailand, Malaysia), and steel, ships, semi-conductors, and cars (Korea) (Bhagwati, 1998, March 25). There has been an increase in share investment (Japan) and margin lending to share investors (Japan, Malaysia, Korea, and Thailand). Massive industrialisation by foreign investors produced environmental destruction. The Institute of International Finance estimates that net private capital flows to Indonesia, Korea, Malaysia, the Philippines, and Thailand had increased from US$38 billion in 1994 to $97 billion in 1996 (Sharizi, 1998).

There has been a trend of conversion of production channels into a bubble economy. Income disparities between the people have widened so much that they have been divided into two groups with a handful of the rich on the one hand, and a great majority suffering from unemployment and poverty on the other. Consequently, the ASEAN economies have come to face insufficient domestic demand, decline of competitive ability due to a rise in personnel expenses, decline in savings, slowing of export growth, speculation in real estate, frequent occurrence of labour disputes, ethnic riots, political instability, corruption, massive capital flight, and unstable currency rates. Speculation in currency management, structured control over all productive channels, the philosophy of maximisation of profits, and concealed colonialism schema caused by the multinational companies had an adverse effect on the overall financial and banking assets of these countries. The crisis has driven the subject countries back many years in terms of development and probably created something like 12 to 15 million additional absolute poor in this region (International Labour Organisation, 1998, April).

Excessively rapid financial liberalisation and unrestrained role of multinational companies, foreign banks, consumers' services agencies and production plants can, in fact, undermine the optimal functioning of financial systems, thereby reducing growth and productivity. In some ways the business pursuits of multinationals are the main factors that hinder Asian nations from achieving autonomous industrialisation. Multinationals thrive on the dependency of nations upon the import of machinery and products from abroad. The pursuits of multinational companies have sometimes become an obstacle for Asian countries in building a well-

balanced and independent industrial infrastructure that can boost overall macro economic expansion, solidity of the banking industry, productivity of the financial sector, sustained employment level, and inflation and ultimately produce stability in monetary management.

The crisis has exposed the inherent instability of the global market economy and the devastating impact of panic behaviour and large-scale shift of funds out of domestic financial markets by the foreign multinational companies and other corporations. Unfortunately in their pursuit of the growth objective, the policy makers and business managers ignored the difficulties stemming from the over-heating of the economy and over capacity production. There were false indications of pressures on resources as reflected in increasing real estate and equity markets. Consequently, the stock markets collapsed and massive foreign capital outflow encouraged speculation against the local currency (Haque, 1998).

Again, while the fiscal conditions may not have been a direct cause of concern, the excessive growth of financial system credit for the private sector resulted in high demand pressures. Standards of loan appraisal and portfolio management were generally inadequate and poorly enforced (Aziz, 1998, May 27). Saleem (1998, January 12-18) indicated that the large-scale increase in private sector credit was attributable to massive credit funds flowing directly into banking systems, yielding superficial escalation of foreign exchange reserves and the expansion of commercial bank liquidity and solvency. High domestic interest rates by international standards and relatively fixed exchange rates stimulated excessive foreign borrowing and hence easy availability of credit. All these are supposed to be important interrelated factors in the severe economic and banking crises across the global scene.

Cost of the Crisis

The ASEAN banking and financial crisis is one of the worst in modern history. It caused a restoration cost needed for a troubled banking system, ranging from 20 per cent of one year's GDP in Indonesia, Malaysia, and Japan to 30 per cent in Korea and Thailand. (Asian Financial Markets 1998, April 24). Only Chile in the 1980s with 33 per cent and Kuwait 45 per cent following the Iraqi invasion in 1990 had restoration costs greater than the ASEAN countries (*Latin American Weekly Report*, 1996, July 25). America's saving and loan crisis, by comparison, had a recapitalisation cost of 4-5 per cent of GDP over 1984-91 (Gart, 1993) and that of Mexico's crisis represented 12-15 per cent of GDP over 1995-97 (*Financial Times*, 1996, October 28).

Table-11: Fiscal Costs of Selected Banking Crisis Countries Percentage of GDP

Country (Date)	Cost (Percentage of GDP)
Argentina (1980-82)	55.3
Uruguay (1981-83)	31.2
Spain (1977-85)	16.8
Bulgaria (1990s)	14.0
Hungary (1991-95)	10.0
Finland (1991-93)	8.0
Sweden (1990)	6.4
Norway (1987-89)	4.0
Cote d'Ivoire (1998-91)	25.0
Senegal (1988-91)	17.0

Source: Caprio and Klingebiel (1996).

Experience has validated that a sound banking system and macroeconomic stability go together. For this reason, the occurrence of major banking failures throughout the world has been a matter of great importance for anyone concerned with the stability and prosperity of the world economy (Fischer, 1998, September 10). The closure of deeply insolvent financial institutions was a prominent feature of the programmes in Korea, Indonesia and Thailand. The Thai authorities suspended 16 finance companies in June 1997 and a further 42 in August 1997. All but two of these were closed permanently in December 1997. In Indonesia, 17 small banks were closed in November 1997 and in April 1998 another 7 small banks were closed. In Korea, 14 merchant banks were closed between December 1997 and April 1998 (Jeeman & Won, 1997).

Economic and Social Distress

The crisis produced social distress and economic adversity in the suffering countries. Major banks was liquidated and consumers suffered from a price hike (Table-10).

Table-10: Indicators of Economic and Social Distress: Indonesia

Country	Unemployment	Business Conditions	Social Conditions
Indonesia	Doubles to 10% since 1996 Expected to rise from 8.5% to over 11 million this year	Government Liquidated 16 major banks throwing much of private sector into technical bankruptcy.	Rioting to protest food and medicines shortage Consumer prices up 30% for many years.
Korea	Projected to be 6.3% in 1998 Record of 1.2 million already jobless 12 of top 30 conglomerates wish to downsize by 20-50% (Chamber of Commerce and Industry Survey).	One third of merchant banks closed 15-12% of banks's loans non-performing. Small enterprise bankruptcies tripled in January.	Government forced to triple funds for unemployment and insurance. Inflation expected to be more than 10.5% in 1998.
Thailand	Increased by more than 700,000 since crisis began Expected to reach 5.6% a record two millions jobless by the end of year 300,000 Burmese have been deported to ease employment situation	56 finance companies with $20 billion in assets forced to close.	Consumer prices up 9.5% year-over year. Farmers demonstrated for more grant and aid.

Source: Steams, International Labour Organisation, International Monetary Fund, and Institute of International Finance (1998).

Impact on the Rest of the World

Today, global financial integration is universal and the East Asian countries have a significant share of world trade and production. For the first time, a financial crisis in the South has had a profound impact on

capital markets in the North. It is considered to cause a momentous drop in global growth. It badly rocked many South American countries, which now face the prospects of turmoil in stock markets and currency problems that could eventually be on the scale of Southeast Asia. On 30 October 1997, Brazil's stock market index plunged 9.8 per cent and the level fell 23 per cent over five days. The Brazil Central Bank spent over US$5 billion to defend its currency. Also affected are Argentina and Mexico, whose stock markets also dropped 9.1 and 3.4 per cent respectively on 30 October. It decreased by $260 billion in the European Union (3.25 per cent of GDP), $210 billion in Japan (5 per cent of GDP), and $40 billion in the U.S. (0.5 per cent of GDP) (International Monetary Fund, 1998).

The Asian crisis reduced the exports and imports flows to and from the U.S.A., Canada and Europe and the net loss exceeded $700 billion of which more than $30 billion was lost by U.S. investors (Johnson, Ellis and Stiff, 1998). European banks had the greatest exposure and their losses were projected at more than $20 billion. For example, Deutsche Bank took a charge of $773 million against 1997 earnings to cover its more than $5 billion in loans to East Asia (Stearns, 1998, April 14). The IMF (1998, April) estimated that world growth might be cut by 3 per cent in 1998 due to the Asian crisis.

Western industrial countries are expected to see only about a half per cent reduction in growth as a result of the ASEAN crisis (Roach, 1998, February). Two-fifths of all U.S. agricultural shipments go to Asian markets. Among the manufacturing sectors, the production and trade of computers, semiconductor equipment, industrial machines, power generating equipment, aircraft engines, and apparel will be most affected (U.S. Department of Commerce, 1998). One study suggests that 700,000 manufacturing jobs could be lost per $100 billion deterioration in the merchandise trade deficit (Scott & Rothstein, 1998).

The recent East Asian economic and banking crisis, which erupted in July 1997, has produced effects of varying proportions on the economies of several other countries including advanced industrial economies. It hurt investor sentiment towards growing market economies and led to large-scale currency depreciations in the countries of the region. It will dampen economic activity in the fastest growing region with significant implications for the employment situation, at least in the short run (Khan, 1998, pp.3-6). Due to that severe economic and banking crisis, there was an overall negative impact on the growth rates of all the others countries of the world. After the overwhelming crisis there was a huge withdrawal of international capital and severe credit tightening

which ultimately jeopardised all economic activities in the entire region. World output growth slowed to 2.5 per cent in 1998 mainly due to the ASEAN economic crisis (IMF, 1999, May).

Reforms in Banking and Financial Systems

Banking and financial reforms are indispensable in order to avoid the sudden and frequent phenomenon of a banking and financial crisis. They will restore the solvency and profitability of banks and financial institutions and hence ensure the survival of a nation. The reforms may improve the overall capacity of banking and economic systems to provide complete financial intermediation between savers and borrowers and ultimately restore public confidence (Dziobek & Pazarbasioglu, 1997). Experience has validated that a sound banking and economic system and macroeconomic stability go hand in hand. For this reason, the occurrence of major banking failures throughout the world has been a matter of great importance for anyone concerned with the stability and prosperity of the world economy. (Fischer, 1998, September 10).

Strategies and Reforms

- Grant of autonomy to the central bank as sole restructuring agency (Almost every affected country of East Asia gave full autonomy to their central banks).
- Liquidity support by central banks (Japan, China, and Korea).
- Closure of insolvent banks and unprofitable financial institutions (Thailand, Philippines, and Malaysia).
- Write down of shareholders' capital (Singapore, Indonesia).
- Establishment of agencies for restructuring and restoration of banks and other financial institutions.
- Improvement of supervisory and regulatory systems (Japan, Korea, Singapore, Philippines).
- Increasing the chances for foreign participation in domestic financial systems in a legalised manner with vigilant supervision and strict regulation.
- Merger of insolvent banks (Thailand, Singapore, and Japan).

- Privatisation (where applicable) in order to reduce undue deficit financing through external/internal debt (Thailand, Philippines, Indonesia, Malaysia).

- Enterprise restructuring to improve creditors (Japan, Korea, Philippines).

- Alliances with foreign banks in the cases of Indonesia, Malaysia, Philippines, and Thailand (Dewatripont & Tirole, 1994; Goldstein & Philip, 1996; Jeeman & Won, 1997; Kaminsky & Carmes, 1996; and Toole, 1999, March 17).

Table-12: Institutional Development: Thailand, Indonesia and Korea

Country	Year	Institutions	Functions
Thailand	1997	Financial Sector Restructuring Agency Asset Management Corporation	To manage and sell bad assets of the financial sector
Indonesia	1998	Indonesian Bank Restructuring Agency	To take over management of weak banks for disposal of non-performing assets of the banking system.
Korea	1997	Korean Asset Management Corporation	To buy impaired assets from banks.

The IMF injected about a $30 billion loan on long term basis into the economies of the region to implement the desired reforms in the financial and capital markets. This assistance was seemingly aimed at filling the gap emanating from reduced foreign private capital inflows in the Southeast Asian economies (Thomas, 1998). It is well documented that no economy has come out of the financial crisis induced slump without undergoing systemic bank restructuring. IMF research on Mexican and other universal banking crises shows that, on average, output growth takes about three years to return to the early trend and the average cumulative loss in output growth is 11.2 per cent points following a crisis (Surez & Weisbrod, 1993).

Rubin (1998, April 14) has urged that new multilateral arrangements are needed to foster three key objectives. The objectives include improving transparency through more extensive disclosure of financial and economic

liabilities and capital flows; strengthening the regulation of financial institutions in emerging economies; and developing the role of the private sector in bearing an appropriate share of the burden in times of crisis. Indeed, prompt remedial action is among the key ingredients of successful banking reform. The countries making substantial progress took actions within a year of the emergence of their banking problems. They also effectively diagnosed the nature and extent of the problems, identified the underlying causes, and designed a restructuring strategy to address them all systematically. Systemic problems had multiple causes. The chances for success of solutions were the greatest when the causes were diagnosed accurately, then addressed swiftly and comprehensively (IMF, 1998, June).

In order to avoid any further economic and banking damages there may be complete transformation of the banking and financial system. Measures may include renewed attention to overall corporate strategy; advanced operational and personnel management and accounting systems; improved credit assessment and approval techniques; and appropriate monetary and fiscal policies (Wall Street, 1998). Other measures are convenient exchange management, innovation in common and advanced banking practices along with government guaranties, terminating malpractice in the banking industry, especially embezzlement, corruption, money laundering and fraud. 256 banks and financial institutions were closed down on the orders of IMF on the charges of corruption and embezzlement (IMF, 1997). Efforts were made to strengthen the health and competitiveness of the banking system by recapitalisation and restructuring of nationalised and commercial banks, increasing their autonomy and accountability and improving prudential regulations and the supervision of all financial institutions.

Proper banking regulation and supervision are indispensable instruments to avoid any further banking and economic crisis. Sound macroeconomic and regulatory policies would enable the potentially involved countries to successfully overcome financial emergencies. Hausmann (1995) stresses the importance of financial market transparency and business ethics in order to avoid a crisis.

Economic recovery prospects of the ASEAN countries are shaped by developments in Japan, China and the Western industrial countries. Japan, as the biggest source of demand and capital for the East Asian region, could play a pivotal role in the recovery if it could put its own economic house in order. Stimulating the growth of Japan will increase the absorption of exports from its ASEAN neighbours (Hussain, 1998). The U.S. and Europe, along with Japan, are likely to continue to be the major sources of short and long-term foreign investment for the East Asian region. Macroeconomic and monetary

conditions within these countries substantially shape the strength of demand of exports from crisis countries. All economies in East Asia are now in the process of transition. The affected countries are taking decisive steps to tackle their banking difficulties (Payne, 1998). The countries with good growth rates are prone to sudden outside events, such as the collapse of export prices or higher world interest rates. In this regard, South Korea, Malaysia, Thailand, and Singapore are likely candidates for any banking and financial crisis.

Table-13: Future Economic Scenario of Selected ASEAN Economics

Country	Per Capita GDP Year – 1998	Per Capita GDP Year – 2010
South Korea	12,995	28,090
Malaysia	10,680	21,640
Thailand	6,285	12,405
Singapore	28,565	58,035

Source: (*Asia Week*, 1999, August 20-21, p. 93) and (*Far Eastern Economic Review*, June 4, 1998).

Table-14: GDP Growth Estimates

Country	Year-1998	Year-1999	Year-2000
South Korea	-5.8	6.5	5.5
Malaysia	-6.7	2.4	6.5
Thailand	-9.4	4.0	4.0
Singapore	0.3	4.5	5.0
China	7.8	6.6	6.0
Hong Kong	-5.1	1.2	3.6
Indonesia	-13.7	-0.8	2.6
Japan	-2.8	1.0	1.5
Philippine	-0.5	2.2	3.5
Taiwan	4.9	5.0	5.1

Source: (IMF, 1999, June).

Economic and Banking Crises in Sweden and Mexico

Sweden and Mexico suffered from economic and financial crises in the early 1990s. They were able to rescue their economies through a number of reforms and strategies.

Sweden

The banking crisis in Sweden started in late 1990. The main causes of the banking crisis were over-lending to the real estate sector. The loans were sunk due to the prevailing recession in the real estate industry. The government took quick action and stepped in with capital injections and loan guarantees. Many domestic banks were closed owing to their inability to handle and recover their non-performing loans. Sweden extended institutional support to rescue the suffering banks.

Table-15: Functions of Bank Support Authority: Sweden

Country	Year	Institutions	Functions
Sweden	1992	Bank Support Authority (BSA) the lead restructuring agency.	To charge with approving all bank requests for guarantees, and most banks set up workout subsidiaries to deal with their non-performing loans, freeing bank management to deal with core business.

Source: (World Bank, 1992).

In December 1992, the Swedish Parliament guaranteed that their banks' obligations would be met by the government and set up a new Bank Support Authority (BSA) as the leading restructuring agency. Firm standards were set to determine which banks could and could not be saved. The BSA was charged with approving all bank requests for guarantees. Most banks set up workout subsidiaries to deal with their non-performing loans, freeing bank management to deal with core business.

Sweden weathered a severe banking crisis in the early 1990s. The Swedish government successfully came out of the potentially disastrous banking crisis through numinous political commitment, managerial skills, entrepreneurship qualities, better financial and economic policies, closed and better regulation, supervision system which was transparent and accountability, and a set of comprehensive restructuring strategies. In order to save the interests of the common populace the Swedish government paid the

cost of the guarantees and supplied capital injections from the budget as needed. At its peak, the government's total banks, few in number, actually used government assistance (Dziobek & Pazarbasioglu, 1997). Ultimately, the cost to the budget reduced to 4.2 per cent of GDP, and is declining over time through loan recoveries and sales of appreciated shares of the now-profitable state-owned bank, Nord Banken. With no applications for support received in 1994-96, the guarantee programme was abandoned (IMF, 1991). Now economic conditions are stable and there is about $19 billion indirect foreign investment in Sweden (*The Economist*, 1999, October 2).

Strategies and Reforms

- Addressing the situation of bad loans and non-performing loans in order to sustain the element of profitability and solvency.
- Solving the immediate problems of weak and insolvent banks
- Eliminating shortcomings in the accounting, legal, and regulatory framework.
- Tightening lax supervision and compliance.
- Minimising the element of corruption along with comprehensive monetary and fiscal management implementation.
- Extending liquidity support to viable banks.
- Renewed attention to business strategy, improved management systems, and better credit assessment and approval techniques.
- Closed supervision and prudential regulations.
- Operational restructuring.
- Financial restructuring in attempting to restore solvency (World Bank, 1992; IMF, 1992).

Mexico

One of the worst economic crises emerged in December 1994 following the sharp peso devaluation and the subsequent decision by the Mexican authorities to let the peso float. As a result, foreign investment fled, international bond prices plummeted and the country experienced its worst financial crises in contemporary history (World Bank, 1995).

Michel Camadessus, the former Managing Director of the IMF, described the Mexican crisis in 1994-95 as the "the first financial crisis of

the twenty-first century," keeping in view the volume and velocity of capital flow involved, (Martinez, 1998), "with comprehensive and systemic efforts Mexico is on the road to recovery". Mexico, a market-based economy with large elements of state ownership, especially in energy and heavy industry, had major successes by the early 1990s after being hurt badly by the 1980s Latin American debt crisis. There was very high current accounts deficit before the crisis in Mexico as given in Table-16.

Table-16: Timeline of Current Deficit Accounts (Percent of GDP)

Country	1992 Current Accounts Deficit	1993 Current Account Deficit	1994 Current Accounts Deficit
Mexico	-6.7	-5.8	-7.0

Source: IMF and Bank of Mexico (1995).

The crisis caused currencies to depreciate, share prices to drop, and interest rates to soar in the country as shown in Table-17.

Table-17: Changes in Currency, Share Price Index and Interest Rate (December 2, 1994 to March 31, 1995)

Country	Depreciation of the Currency Vis-à-vis the Dollar (Percent)	Changes in the share price index (Basic Points)	Changes in the interest rates (Basic Points)
Mexico	98.12	-28.12	5,875

Source: Blooming Financial Services L.P. and Bank of Mexico (1995).

The IMF, US government and Mexican authorities worked together to deal with the crisis. A comprehensive set of strategies was adopted and it dramatically reduced inflation, restarted strong economic growth and made good reductions in its fiscal deficit. The IMF and the U.S. total package was $50.5 billion. As of February 1998, the Mexican government estimated the cost of all its bank rescue programmes to be 545.7 billion pesos (approximately $55 billion based on the exchange rate in December 1998 (Barney, 1994). Mexico received a total of US$12.1 billion as aid in 1997. The amount was a record high that signifies an increase of about 50 per cent in volume compared to that of 1996 (U.S. Embassy, 1993, April).

The fiscal cost of supporting the financial system is estimated at 14.4 per cent of GDP for 1997 and is amortised over 30 years during the life of the programmes. The measures adopted were certainly costly. However, the results have been encouraging. Although GDP declined by 6.2 per cent in 1995, it has recovered, with growth rates of 5.2 per cent in 1996 and 7 per cent in 1997, being the highest rate in 16 years. Inflation fell from 52 per cent in 1995 to 15.7 per cent in 1997 and it continues to decline (World Bank, 1994).

The current account deficit, which averaged 6.7 per cent of GDP in 1992-94, was reduced to an average of 1.5 per cent of GDP in 1995-97. The trade balance was 6.1 per cent in 1998-99 (*The Economist*, 1999, October 2). The floating exchange rate has functioned well. International reserves increased by more than $25 billion from January 1995 to January 1998. Total net public debt declined from 39 per cent of GDP in 1995 to 27 per cent in 1997 (*Financial Industry Issues*, 1998).

Causes

- The causes of Mexico's banking crisis were the result of interrelated deterioration of the banking and financial systems. The fragility of the Mexican banking system played a crucial role in the peso crisis of 1994-95.
- In many cases, inexperienced bank ownership and management and in some cases alleged fraud, coupled with the impact of the economic collapse on borrowers' repayment capacity, caused massive loan defaults in 1994-95.
- Inefficient operations or fraudulent activities in the banking sector.
- Negative role played by the multinational companies.
- Banking supervisory system, regulations, and accounting policies and procedures were inconsistence with international standards. Also transparency and accountability was not followed in cases of lending.
- Macroeconomic policies were not implemented on time in response to the wave of the overall crisis in Latin America.
- Poor financial disclosure and underdeveloped securities markets.
- Unproductive state-owned enterprises (Gavin & Ricardo, 1996; Surez & Weisbroad, 1994).

Strategies and Reforms

- Operational restructuring including reduction of the cost of banking operations and decreasing the number of staff.
- Supervision and compliance according to recognised international standards.
- Granting autonomy to the central bank to function independently.
- Solving the immediate problems of weak and insolvent banks and improving the entire deteriorating banking industry.
- Policy makers in Mexico first addressed the situation of bad loans and non-performing loans in order to sustain the element of profitability through various programmes of privatisation and foreign investment.
- Eliminating shortcomings in the accounting, legal and regulatory framework.
- Minimising the element of corruption along with comprehensive monetary and fiscal management implementation.
- Better business strategy, improved management systems, and better credit assessment and approval techniques.
- Prudential regulations.
- Restoration of profitability and solvency of the banks and financial institutions.
- Emphasising fiscal prudence and stabilised monetary policy.
- Intensifying efficient corporate governance practices in the banking system.
- Establishing the element of transparency practices in bank accounting, disclosure and self-regulation (U.S. Embassy, Mexico, 1993, April 3; World Bank, 1995-96).

Conclusion

While mankind is living in the realm of 'survival of the fittest,' individuals and communities must be fit in body and in mind. However, evolution processes have transformed the fitness of body and mind into the collective wisdom and performance of communities as reflected in their

soundness of policies and strategies, sophistication of production processes, core competencies of industries, and competitiveness of institutions.

In this world everything is connected with everything else. In this regard, economics, culture, environment, production systems, and financial institutions are connected with one another in a circular cause and effect relationship. Therefore, survival is also related to our ability to live in harmony with nature and other communities. Similarly, survival lies in producing environmentally safe products, creating sound alliances with international communities and institutions, promoting sustainable growth patterns, and following balanced trade pursuits.

Survival is in creating a whole greater than the sum of its parts, delivering value to others, devising new and improved ways to address the problems of human settlements, producing unity through diversity, and encouraging meaningful roles for the members of society beyond caste, colour and other ethnic divisions.

Survival is in the vitality of our culture and in the potency of our ideals of freedom, work, goodness, healthy living, equity, sovereignty, and respect for fellow human beings, air, water, soil, and even animals. Fitness is also in the adequacy of our emotions for pride and prejudice, cooperation and competition, war and peace, love and hatred, sorrow and joy, give and take, trust and deception, control and energy, sum and parts, time and space, and alienation and co-existence. The way of survival goes with the dynamism of waves, the freshness of a pure breeze, agility of new blood, domination of lively ideas, and force of action.

Banking and financial institutions and economic systems of Pakistan such as that of ASEAN and other crisis – hit countries, suffer from bad loans, political interference, corruption, declining exports, budget and trade deficits, internal and external debts, crashes of stock exchanges, currency mismanagement, and double digit inflation.

The crisis in East Asia was the inevitable consequence of an overvalued currency, massive bad bank loans, internal & external debts, unstable exchange rates, large current account deficits, and short-term capital inflows. Lack of regulatory and supervisory traditions, corruption, poor management, inappropriate role played by multinational companies, prevalence of speculative culture, and non-transparent financial systems also played their parts in promoting the crisis.

The crises in East Asia, Sweden and Mexico have highlighted the importance of sound macro and micro-economic management. The crises

have asserted the significance of integrated sets of policies and strategies for output, trade balance, interest rates, financial systems, appropriate exchange rate arrangements, prudent supervisory and regulatory practices, prevalence of accountability, and transparency along with banking and financial competitiveness and adaptability. Lessons of survival may include the following strategies and reforms:-

Macro Economic Strategies Reforms

- Political and economic stability
- Balanced policies of liberalisation, deregulation and privatisation
- Coherent monetary and fiscal policies integrated with external factors
- Only wise government intervention
- Abandoning import monopolies of certain families, groups, or communities
- Optimal allocation of budgetary resources
- Adequate legal structures
- Independence of central banks

Micro Economic Strategies and Reforms

- Sound corporate governance
- Equal opportunity for every member of the business community
- Proper utilisation of economic resources in productive channels such as industry and banking rather than real estate business and golf clubs
- Elimination of corruption

International Strategies and Reforms

- Careful allowance of feasible foreign direct and indirect investment
- Productive roles of multinationals companies
- Prudent lending and use of funds from the international monetary agencies such as the World Bank and IMF

Financial and Banking Strategies and Reforms

- Low debt-equity ratios

Adequate accounting standards

Effective system of credit valuation

Minimising credit management risks

Minimising the possibility of non-performing loans

Integration between national and international financial markets

Reducing vulnerability to reciprocating capital flows

Importance of banking and financial restructuring

Development of securities markets

Discouraging speculation in stock exchanges and assets investments

Sophisticated bankruptcy laws

The economic and banking crises across countries underline that banking institutions can play a special role for the consistent growth, maintenance of financial system and health of business enterprises. A prompt and comprehensive action package may prove an effective instrument in the restoration of delinquent banking and financial systems.

Invariably, every crisis is the product of poor policy-making, inattention to serious problems in banking operations, and carelessness in monitoring and regulating financial systems. Also, the confidence of people in the sagacity of economic policies and efficacy of financial systems is critical. In the countries of East Asia, Mexico and Sweden, a central factor triggering each crisis was the decision by private investors and lenders to suddenly withdraw their money, investments and loans, from these markets. The wave of the economic crisis travelled to other countries like a virus in human systems.

Appropriate measures may be adopted to reduce the risks that reciprocating capital flows can create. Macroeconomic variables may be carefully analysed with balanced monetary and fiscal policies integrated with foreign trade factors. It is very important to improve the standards of supervision, regulation, and transparency of financial systems in this connection, a central bank may be given a free hand through more autonomy. Consolidation of the credit markets, liberalisation of interest rates, application of prudential regulations, and sensible administration of privatisation policies may be useful in order to avoid a banking and financial crisis in Pakistan.

Everything in the world has a price and economic and banking reforms are no exception. Banking and economic reforms may be ineffective without cultural and social transformation. Personal interests and discretionary powers are to be replaced by national and organisational goals, sets of well defined laws and sound policies, and convenient procedures to efficiently process business transactions.

Countries may ensure the commitment of political leadership, soundness of financial systems, efficacy of economic policies, profitability of production channels, and feasibility of exchange rates in order to be fit for survival. Serious efforts may be made to resolve economic and financial anomalies at the national level and then integrate national economic interests with regional and global economies in order to increase the chances of survival.

The beneficiaries of the study include banking and finance experts, policy makers, management of multinational companies, and related researchers. Future study may attempt to develop generalised models for the survival of nations against economic and financial crises.

References

Allan, F. & Gale, D., 1997, Bubbles and Crisis. Cambridge Press.

American Chamber of Commerce, 1994, 'Charting the Economy'.

Asian Development Bank, 1999, 'Economic Outlook of Asia'.

Asia Week, 1998, May 26. Depreciation of Currencies.

Asian Development Bank, 1998, *Asian Development Outlook 1997-98*.

Aziz, S. 1998, May 27. Lessons of the Asian Crisis. *The Dawn*.

Barney, S.S., 1995, Mexican Banking System. Mexico Federal Banking Press.

Belchere, M., 1999, September 1. *The News*.

Bhagwati, J., 1998, March 25. 'The Capital Myth'. *Financial Times*.

Bermake, B., 1983, Non-Monetary Effects of the Financial Crisis in the Propagation of the Great Depression. *American Economic Review*. Vol. 73, pp. 257-276.

Baker, C.J., 1998, International Finance. Prentice Hall, Inc.

Blooming Financial Services L.P. and Bank of Mexico, 1995. 'The Crisis and Depreciation of Currency.'

Caprio, A., Gerad, S. and Klingebiel, N., 1996, 'Bank Insolvencies: Cross-Country Experience'. Policy Research Working Paper 1620. World Bank.

Caprio, A. & Gerard, M., 1997, Safe and Sound Banking in Developing Countries. *Research and Public Policy*. No. 9, pp. 79-97.

Choi, B.Y., 1998, On Financial Crises in Korea. *Korea Observer*. 39(3).

Dziobek, C. & Pazarbasioglu, C., 1997, 'Lessons from Systemic Bank Restructuring' UNCTAD Secretariat.

Davies, G., 1998, February 2. 'Causes, Cures and Consequences of the Asian Economic Crisis'. Economic Policy Institute.

Dewatripont, M. & Tirole, J., 1994, Banking Crisis and Regulation of the Banks. MIT Press

Demirguc, K. Asli, H. and Enrica, D., 1998, The Determinants of Banking Crises in Developing and Developed Countries. *International Monetary Fund Staff Papers*, 45(1): 81-109.

Far East Economic Review, 1998, June 4.

Feulner, J.E., 1998, 'The IMF Needs Real Reforms, Not More'. The IMF.

Fischer, S., 1998, September 10. Economic Crises and the Financial Sector. *Financial Industry Issues*. Fourth Quarter.

Gavin, M. & Ricardo, H., 1996, The Root of Banking Crisis. The macro economic Context. In Hausman and Rojas- Suarez (eds.). Banking Crisis in Latin America. Pp. 27-63.

Goldstein, M. & Philip, T., 1996, Banking Crisis in Emerging Economy: Origin and Policy Option. *BIS Economic Paper*. No. 46.

Gart, A., 1993, Regulation, Deregulation. John Wiley & Sons, Inc.

Hussain, S.M., 1998, May 4-10. Should Japan be allowed to crash? *The Dawn*.

Hudson, M. & Totten, B., 1998, Vulture speculators. *Our World* No. 197.

Haque, U.N., 1998, The Asian Crisis. *The Dawn*.

IMF, 1992, World Economic Outlook.

IMF, 1998, April. World Economic Outlook.

IMF, 1998, Asia crisis and depreciation of currencies.

IMF and Bank of Mexico, 1995, Economic Development and Current Accounts Deficits of the World.

IMF Report, 1998, June. Finance & Development of Asian Countries.

IMF Report, 1998, Economic Growth of the Asian Countries.

International Labour Organisation, 1998, April. The Social Impact of the Asian Financial Crisis.

Institute of International Finance, 1998, Asia and Growth Rates.

Johnson, S., Ellis, P. and Stiff, D., 1998, April. High-Tech Industries are Fueling U.S. Review of the U.S. Economy, No. 34.

Jeeman, J. & Won, J.L., 1997, Recent Financial Reforms in Korea: IMF.

Khan, A.A., 1998, East Asian Currency and Economic Crisis (Editorial). The Institute of Banker in Pakistan. 64(1). Pp. 3-6.

King, M., 1994, Debt Deflation: Theory and Evidence. *European Economic* Review. Vol. 38. Pp. 419-445.

Kiyotakei, N. & More, J., 1997, Credit Cycle. *Journal of Political Economy*. Vol. 105.

Kaminsky, G. & Carmes, R., 1996, The Twin Crisis: The Causes of Banking and Balance of Payment Problems. World Bank.

Latin American Weekly Report, 1996, July 25, p. 333).

Lissakers, K., 1998, October 8. The IMF and the Asia Crisis. P. 2. IMF.

Mehran, H., 1996, Monetary and exchange system reforms in China, IMF Occasional. Paper, No. 141.

Martinez, O.G., 1998, What Lessons Does the Mexican Crisis Hold for Recovery in Asia? Institute of Banker in Pakistan. 64(3).

McCall, C.H., 1998, Financial Support to East Asian Countries Since 1997. The World Bank Report.

Moegan, J.P., 1998, April 24. Asian Markets after the Crisis. *Asian Financial Markets Issues*.

Payne, I., 1998, The Asian Turmoil. Institute of Banker in Pakistan. 64(4).

Poon, P.J., 1998, October. The Asian Economic Crisis What Happened. Policy Paper Oxfam International.

Lyle, R., 1998, July 17. Financial Development and Economic Growth. *Journal of Economic Literature* 35(2): 688-726.

Roach, S.S., 1998, February. The Global Economy Turned Inside Out? Washington Modern Library.

Rubin, E.R., 1998, April. 'Strengthening the Architecture of the International Financial System' Brookings Institution.

Robert, W.m 1998, August 4. The Asian Debt-and-Development Crisis of 1997-98. Causes and Consequences. World Bank.

Salemm, F., 1998, January 12-18. What was Wrong in Southeast Asia? *The Dawn*.

Shirazi, K.J., 1998, 'The East Asian Crisis: Orgins, Policy Challenges, and Prospects'. The World Bank.

Shelby, K. & Davis, C., 1998, The Nature of the South Asian Countries. The Heritage Foundation.

Stearns, B., 1998, April 14. Global Development Finance. World Bank.

Scott, E.R. & Rothstein, J., 1998, American Jobs and the Asian Crisis: The Employment Impact of the Coming Rise in the U.S. Trade Deficit. Economic Policy Institute.

Stijn, C. & Thomas, G., 1997, Are Financial Sector Weaknesses Undermining the East Asian Miracle? World Bank.

Stiglitz, J., 1998, The East Asian Crisis and Its Implications. *Quarterly Journal of Economics 101 (May): 229-64*.

Stiglitz, J., 1998, February 4. Bad Private-Sector Decisions. *Wall Street Journal*.

Surez, R.L. & Weisbrod, S., 1994, Financial Fragility in Latin America in the 1980s and 1990s. BIS Basle.

Steams, B., International Labour Organisation, and International Monetary Fund, Institute of International Finance, 1998. *Press Reports*.

The South China Morning Post, 1997, November 3.

The New York Times, 1999, March 19.

The Financial Times, 1996, October 28. More Time and Money Needed. p.3.

Thomas, M.H., 1998, The International Community's Response to the Asian Financial Crisis. *Economic Review*. Second Quarter.

The New York Times, 1999, March 19. The Reverse Domino.

The Economist, 1999, January 30. A Survival Guide. Pp. 58-59.

The Economist, 1999, October 2. Hot Property. P. 94.

The Economist, 1999, October 2. Emerging Market Indicators. P. 124.

The Economist, 1999, October 2. Economic Indicators. P. 123.

Toole, K., 1999, March 17. Banking reforms in Asia beginning to take shape. World Bank.

The News week, 1998, June 22.

U.S. Department of Commerce, 1998, United States and Asian Crisis.

U.S. Embassy, Mexico, 1993, April 3. Mexico Economic and Financial Report. Pp. 211-248.

Wall Street Journal, 1998, April 15. Editorial.

World Bank, 1982, World Development Report.

World Bank, 1992, World Development Report.

World Bank, 1994, World Development Report.

World Bank, 1995, World Development Report.

World Bank, 1996, World Development Report.

World Bank, 1997, World Development Report.

World Bank, 1999, World Development Report.

Weisbrod, R.S., 1998, Liberalised financial markets can flourish. International Bank for Development.

Wijnholds, B.O., 1999, March 1. Maintaining an Indispensable Role. *Financial Times*.

Wolf, M., 1998, March 3. Flows and Blows. *Financial Times*.

An Assessment of Basic Education under the Social Action Plan in Pakistan[1]

Shahrukh Rafi Khan*

Abstract

Educational expenditure as a percentage of GDP has indeed been protected and over the first phase of SAP (1993-1996) has increased by about 0.2 per cent of GDP. However, despite SAP protection, it declined to the pre-SAP level for 1998-99. While there is evidence that, in some aspects, the gender and regional gaps have closed, the poorest continue to be excluded from schooling, the rural female income gap in schooling has widened and, if the poor do attend, they are the most likely to drop out. Also, net enrollment rates for boys and girls actually declined over the first SAP period.

I. Introduction

The justified fear of austerity imposed by structural adjustment is that the social sectors, including education, are likely to face the first and major budget cuts. This fear was based on experience in several developing countries and this led to an important critique by Cornia, Jolly and Stewart (1987) who urged, as implicit in the title of their book, *Adjustment With a Human Face*. An important finding of their analysis was that structural adjustment was associated with the neglect of the social sectors and the poor and thus their main recommendation was reversing this neglect.

In Pakistan, the Bank's effort to put a human face on structural adjustment has come in the form of the Social Action Programme (SAP). The bulk of SAP funding has been that of the Government (see below) and one stated concern is redressing the poor performance of the social sector relative to the economic sectors and relative to a reference group of South Asian countries.[2] Other stated objectives of SAP include improving efficiency, quality and closing the regional gender and income gaps in education access and attainment.[3]

---

* The author is the Executive Director, Sustainable Development Policy Institute (SDPI), Islamabad.

[1] This research was supported by a grant from The Asia Foundation. Many thanks are due to Sajid Kazmi for able research assistance.

[2] On both disparities see Banuri et.al. (1997, Chapter 3 and Chapter 6).

[3] For an official statement see Government of Pakistan, (1994, pp. 137-144) and (1998, pp. 16-17). For the Bank perspective see World Bank (1998).

The social services targeted by SAP include basic education, primary health, population and welfare, and rural water supply and sanitation.[4] Within the context of this programme, the first Social Action Programme Project (SAPP-I), with partial donor support, had a three-year duration from 1993-1996. The second project (SAPP-II, 1996-2000) is now being implemented.[5] SAP is now the major provider of rural primary schooling. Under the auspices of SAPP-I, between 1993-96, 15,487 new primary schools were planned and 13,356 actually built. In addition to these , 6,319 new classrooms were built and 5,794 buildings built for shelter-less schools. SAPP-II has been launched with an estimated expenditure of Rs. 270 billion (of which 65 per cent is allocated to basic schooling) compared to the Rs. 103.6 billion expenditure on SAPP-I. This represents a substantial increase in real terms.[6]

The main purpose of this paper is to review secondary data to ascertain the extent to which the Social Action Plan is attaining its objectives in the education sector. In the second section, we discuss SAP in a broader conceptual context and briefly describe the data, in the third section, we review educational expenditure patterns under SAP, in the forth section, we more directly review the attainment of various SAP objectives and we end with a concluding section.

II. Conceptual context and data

The World Bank clearly views SAP as part of a poverty strategy that has two planks. The first is to enhance growth and the second is to invest in human capital to enable people to respond as new opportunities emerge.[7] To elaborate, the two-pronged approach to poverty alleviation is first, to assure that there is economic growth, which is assumed to create jobs, and

---

[4] SAP is the overall Government initiated Social Action Programme while SAPP-I and SAPP-II are the first and second partially donor funded Social Action Programme Projects that interact with SAP.

[5] Government expenditure was about four-fifths of the total for the Social Action Programme Project (SAPP-I, 1993-96) and the rest was contributed by the World Bank, the Asian Development Bank, the Netherlands Government and DFID. The additional donors for SAPP-II are the European Union, Canadian International Development Agency (CIDA), Norwegian Aid Agency (NORAD) and the Japanese Overseas Economic Cooperation Fund (OECF). About 7 per cent of the total is to be contributed by the beneficiary communities. The Bank's pledge of $250 million is the largest and the Multi-Donor Support Unit is also housed in the World Bank compound. Sources for this information are SPDC,(1998, p. 44) and *The News International*, Friday, May 29, 1998, p. 13.

[6] Government of Pakistan, (1997).

[7] World Bank (1994, p. 2).

second, to ensure that the poor are contenders for these jobs, since human capital investments in them are designed to make them more productive.

Thus the SAP project is designed explicitly to reduce poverty and misery by improving human capital access for the poor. One could argue that investments in human capital, to ensure that the poor become better market players, is a long run hands off approach to poverty alleviation. First, it hopes to get rid of poverty among future generations and thus ignores the current poor. Second, even if poor households are reached by SAP like initiatives, given the high unemployment rates and various social and institutional distortions, there is no guarantee they will find jobs even if they are more productive.[8] Thus central to a sensible poverty strategy must be the creation of sustainable livelihoods.[9] Here it would be difficult to wean the Bank away from its ideological compulsions.

The Federal Bureau of Statistics, Pakistan (FBS) has started conducting annual surveys called the *Pakistan Integrated Household Surveys* (PIHS). The stated objective is to provide "household and community level data which can be used to monitor, evaluate and assess the impact of the Social Action Programme." The FBS presents reports based on the data collected from large national data sets. The *Round 2, 1996-97* (nd.) Report was prepared within an impressive two months of the completion of the data collection process of a survey of 12,622 respondents. Not only has the FBS demonstrated efficiency with regard to the regular data collection, it has also demonstrated a welcome analysis capacity as evident from the reports which contain a wealth of data in tabular form and some basic reporting.[10] All the relevant sampling and data collection information is carefully reported. For those wishing to probe further, the primary data are easily accessible on diskette. This paper is based on the tables reported in the PIHS 1996-97 and other secondary government data available in statistical reports.

III. Educational expenditure, patterns and outputs

One of the major fears of structural adjustment is that the austerity it imposes to contain the budget deficit results in cuts in social sector development and recurring expenditures. In Pakistan, as earlier indicated, the Social Action Programme (SAP) has been designed to protect the social

[8] The scarcity of jobs give rise to social institutions such as patronage jobs which in turn have a negative impact on incentives to acquire education.
[9] Amalric (1998).
[10] The FBS has also put out a much more sophisticated report [FBS (1998)] on education to which we also refer. This analyses demand and supply side determinants of schooling based on the 1995-96 *PIHS* data set.

sectors. It is, however, possible that while expenditures on elementary education increase, those to other levels of education decrease. In this case, SAP expenditures would not represent an "additionality" in educational expenditures but merely a re-structuring. We present the total allocations to the education sector as a percentage of GDP in Table-1 below.

Table-1: Expenditure on education as a percentage of GDP

Year/Expenditure	Education expenditure as a percentage of GDP
1988-89	2.4
1989-90	2.2
1990-91	2.1
1991-92	2.2
1992-93	2.2
1993-94	2.2
1994-95	2.4
1995-96	2.4
1996-97	2.5
1997-98	2.3
1998-99	2.2

Source: Government of Pakistan, *Economic Survey 1998-99*, Statistical Appendix, p.7.

Table-1 above reports information on educational expenditures from 1998-89 onwards, which could be considered the first fiscal year of the intensive phase of structural adjustment for Pakistan. The first fiscal year reflecting SAP expenditures is 1993-94. Between these two years, total educational expenditures as a percentage of GDP declined, but subsequently picked up and there is a 0.2 percent increase between the benchmark SAP year and the final year of SAPP-I. However educational expenditure has subsequently declined once again to the pre-SAP level despite SAP protection.

Aggregate numbers can mask many interesting details, and so it is useful to probe deeper to see how the numbers above translated into a change in facilities for basic education over the structural adjustment and

SAP years. Unfortunately, the data do not allow probing in much depth but, again at an aggregate level, it is possible to see the changes in the rural student-teacher and student-institution ratios over time by gender as reported in Table-2 below.

Table-2: Rural student teacher and student institution ratios by level, gender and time

Year	Primary				Middle			
	STRb	STRg	SIRb	SIRg	STRb	STRg	SIRb	SIRg
1988-89	36:1	39:1	81:1	113:1	34:1	28:1	341:1	243:1
1989-90	36:1	40:1	88:1	112:1	36:1	27:1	367:1	252:1
1990-91	39:1	40:1	86:1	118:1	38:1	26:1	372:1	244:1
1991-92	35:1	39:1	87:1	118:1	39:1	25:1	386:1	243:1
1992-93	40:1	48:1	88:1	121:1	51:1	31:1	303:1	197:1
1993-94	39:1	46:1	88:1	126:1	54:1	28:1	315:1	216:1
1994-95	39:1	49:1	88:1	134:1	51:1	35:1	352:1	242:1
1995-96	40:1	52:1	89:1	131:1	41:1	34:1	307:1	222:1
1996-97	41:1	56:1	89:1	135:1	41:1	36:1	289:1	217:1

Source: Government of Pakistan, 1996-97, Statistical Appendix (pp. 205-207).

Notes:
STRb: Student-teacher ratio (boy)
STRg: Student-teacher ratio (girl)
SIRb: Student-institution ratio (boy)
SIRg: Student institution ratio (girl)

One could view both ratios as very crude indicators of quality in so far as lower ratios indicate less crowding on an aggregate level. At the primary level, student-teacher ratios for both genders have increased since the on-set of structural adjustment, but much more sharply for girls. Such a rise accords with Bank research suggesting that ratios can be as high as 45:1 without impairing teaching efficiency.[11] While the average boy ratio of 41:1 in 1996 was below this threshold, the average girl ratio of 56:1 should be a cause of great concern. Again, student-institution ratios have been rising for

[11] Carnoy (1995, p. 662) and World Bank (1997, p. 18).

both boys and girls since 1988 and, once again, more sharply for girls than boys.

At the middle level (classes 5-8), the boy student-teacher ratio jumped to as high as 54:1 in 1993-94, but then subsequently declined to 41:1. The middle level girl student teacher ratio rose from the base of 28:1 in 1988-89 to 36:1 in 1996-97. The middle level students per institution fluctuated, but declined from the base year numbers of 341 and 243 to 289 and 217 respectively, in the terminal years (for boys and girls). Even with multiple sections, despite the improvements, these numbers appear to be extremely high for institutions covering three class years. The tables above indicate that more teachers for girl's primary schools and more institutions for both genders at the middle level are likely to be priorities in several areas. We revisit the quality and crowding issue in section IV.c, and turn now to a more direct review of the attainment of SAP objectives.

IV. Assessing the Social Action Programme objectives

A. Closing the age, gender and regional gaps

The data on population that has ever attended school by age shows that there is now a strong demand for schooling. Overall, 83 per cent of the boys and 60 per cent of the girls in the 10-14 age cohort have attended school at some point (90 per cent and 80 per cent respectively in urban areas). Thus the potential to raise educational attainment by providing quality schooling is high.

There was also a strong inverse association of school attendance by age and this association has become more prominent over time. Thus school attendance for the younger cohorts was much higher (72 per cent for the 10-14 age group compared to 20 per cent for the 60 plus age group). More important, the gender and regional gap was much smaller for the younger cohorts. The gender gap in urban and rural areas for the 10-14 age cohort was 11 per cent and 36 per cent compared to 76 per cent and 88 per cent respectively for the 60 plus age cohort. Similarly, the urban/rural differential among those ever attending school was 11 per cent and 36 per cent in the 10-14 age cohort and 51 per cent and 75 per cent among the 60 plus cohort. Thus, while in absolute terms the percentages need to be higher, the age differential and the closing of the gender and regional gaps are encouraging. These trends are also evident from data on primary school "completers".

The above analysis pertains to progress over a time period that begins much before but includes the SAP period. There is no discontinuity

as such observable in the data. There is however an interesting additional finding over the SAP period evident from juxtaposing the percentages in the youngest cohort that "ever attended school" with an older cohort which "completed the primary level" some years later. In 1991, 84 per cent boys and 53 per cent girls in the 10-14 age cohort had ever attended school. This is roughly the cohort that would be in the 15-19 age cohort in 1996-97. In the latter year, 70 per cent boys and 46 per cent girls were reported as completing the primary level in the 15-19 age cohort.

This finding is interesting for several reasons. First, it shows that the implied dropout rate was much lower than the mythical 50 per cent that is frequently cited in the press and even scholarly publications.[12] Second, the implied drop out rate seems to be lower for girls. It was possible to investigate this issue more directly by looking at data on primary school "completers" among the 10-18 age cohort for 1996-97. Non-completion among girls at 8 per cent was lower than 13 per cent non-completion for boys in the urban areas. However, in rural areas, the non-completion for girls at 25 per cent is higher than the 17 per cent non-completion for boys. However, it is still much less than the generally stated overall 50 per cent non-completion [13].

While there have been some SAP successes, there are also significant failures. Between 1991 and 1996-97, the net rural primary enrollment rate for boys declined from 50 per cent to 43 per cent and that for girls declined from 31 per cent to 30 per cent. Over the same period, urban boy and girl net primary enrollments declined from 61 per cent to 56 per cent and from 57 per cent to 55 per cent respectively.[14] Since improving rural enrollments

---

[12] Haq and Haq (1998, p 51) suggest that 50 per cent of children drop-out before completing the primary level and SPDC (1988, p. 50) similarly suggests the presence of a very high drop-out rate. This impression is probably based on earlier research. Khan, Siddiqui and Husain (1987, p. 9) showed very high cumulative drop out rates for 1978-79 / 1982-83 using provincial class level data and the cohort method to compute drop-out rates. For example, for rural girls and boys at the primary level, these ranged from 54 per cent to 80 per cent and 42 per cent to 75 per cent across the four provinces.

[13] The highest reported drop-out rate is 47 per cent for rural girls in class 6. This is roughly the time girls reach puberty and many parents still withdraw girls from school at this time in their lives.

[14] Gross enrollment rate is defined as the number of children attending the primary level (i.e. class 0-5) divided by the number of children in the 5-10 cohort, converted into a percentage. Net enrollment rate is defined as the number of children in the 5-10 age cohort attending the primary level divided by the number of children in the 5-10 age cohort converted into a percentage. Thus, while the World Bank (1998) claims success for SAP by concentrating on gross enrollments, net enrollment rates are a more precise indicator of educational success. Note that it is possible for total absolute enrollments and gross enrollment rates to rise while net enrollment rates are declining.

in general, and those of girls specifically, was identified as a major SAP objective, this is a glaring shortcoming. Also, the regional gap for boys became larger and net girl enrollment rate actually declined in the rural areas at the primary level. This failing is actually understated since the net rural enrollment rates reported do not include non-government schooling.

Table-3 below reports on the relative growth of absolute primary enrollments in government and non-government schools.

Table-3: Estimated enrollments and enrollments growth at the primary level by type of school and gender

(Millions)

	1991		1995-96		Percentage growth	
	Girls	**Boys**	**Girls**	**Boys**	**Girls**	**Boys**
Govt.	2.63	5.00	3.23	5.18	23.20	3.6
Non-Govt.	0.20	0.26	0.32	0.59	60.50	130.90

Source: Government of Pakistan (1998, p.23).

First, since is possible for absolute enrollments (numerator) growth to be positive while the net enrollment growth rate is negative (see footnote 14), the numbers in Table-3 do not contradict the numbers reported above indicating the decline in net enrollment rates. Second, non-government enrollments grew far more rapidly than government sector enrollments, particularly for boys. Third, while non-government enrollments at 11 per cent for boys and 10 per cent for girls in 1995-96 still represent a small fraction of total enrollments, the trend shows that non-government enrollments are growing rapidly. Finally, this rapid growth rate in non-government enrollments understates the poor growth performance of government sector net enrollment rates. Another significant SAP shortcoming pertains to the inability of the education system to reach the poorest. This issue is addressed in the sub-section below.[15]

B. Closing the income gap

Closing the income gap in educational attainment is another major SAP objective. In all provinces, gross and net primary enrollment rates vary

[15] We concentrate on broad impact indicators since that is the bottom line. SAP has instituted an elaborate monitoring and evaluation system, and third party validation (by the Auditor General's office) of input, process, output and impact. For details, see World Bank (1998, pp. 6-8).

positively with the level of income in both rural and urban areas for both genders and at both the primary and middle levels.[16] To give an example, the rural primary level net enrollment rate for the upper quintile in the Punjab, the most prosperous province, was 77 and 69 for boys and girls while it was 41 and 28 respectively for the lowest quintile.[17] Again, across the board, a much higher percentage of children belonging to households in the lowest quintile never attended school or dropped out if they did attend.

To get a sense of how educational attainment changed over the SAP years for the lowest income group, we looked at gross enrollment rates for girls across the five quintiles between 1991 and 1995-96 and these are reported below in Table-4.

Table-4: Gross primary enrollment rates for girls between 1991 and 1995-96

Quintile/Year	1991			1995-96		
	Urban	Rural	Overall	Urban	Rural	Overall
1st. Quintile	77	27	35	67	35	40
2nd. Quintile	78	39	53	82	49	56
3rd. Quintile	89	53	65	100	60	70
4th Quintile	101	70	80	107	63	84
5th Quintile	100	64	76	113	84	96
Overall	87	48	59	89	54	64

Source: Primary data analysis based on the PIHS 1991 and PIHS 1995-96.[18]

Again the table above shows gross enrollment rates for girls varying positively with income group. The only group for which gross enrollments dropped over the five-year period was urban girls from the lowest income category. While, one could argue that SAP had a positive impact on gross rural female girl enrollments in the lowest income group, the income gap in gross enrollment rates between the lowest and highest rural girls' quintile

[16] Government of Pakistan (1998, p. 42) clearly establishes the positive and significant association of income and school attendance for boys and girls in both urban and rural areas using multivariate analysis.

[17] Government of Pakistan (nd, p. 33). Quintiles were derived based on per capita household consumption in Appendix-C.

[18] The data analysis was done by Salman Zaidi and kindly made available by Shahnaz Kazi.

increased dramatically from 37 percentage points in 1991 to 49 percentage points in 1995-96 and from 31 percentage points to 46 percentage points for all girls during this period.

In mentioning reasons for why children had "never attended school" or "not completed primary school", the most frequent household response was that the schooling was too expensive. Thus for non-completion, 35 per cent of the parents mentioned this to be a reason for girls and 29 per cent mentioned it to be a reason for boys in urban areas. These percentages were 19 and 20 percent respectively for rural areas. The other important related reason cited was that the children were needed to help at home or at work. 10 per cent and 21 per cent of the parents for boys in urban and rural areas respectively and 9 per cent and 19 per cent respectively of the parents in the case of girls mentioned this.[19]

It is thus quite clear that if SAP wants to reach the poor and to improve the over all educational attainment, a pro-active approach would have to be used. At the moment, many poor children are either not attending or dropping out if they do attend. A more pro-active approach would include tuition wavers, free uniforms, books and other supplies for the poorest.[20] Identifying the poorest would have to be the task of the school management committees (SMCs) that only include teachers and parents of children currently in school.[21] Including local notables, as currently done, is meaningless since they have a very limited legitimate stake in the school and they can easily subvert expenditure targeting.[22]

C. Quality

Retention would also be more likely if the quality of public sector schooling improved. While expenditure on schooling is a very crude measure of quality, other things equal, it can provide some information. In 1996-97,

[19] Other less prominent reasons in explaining non-attendance and non-completion for girls were parental disapproval and distance from school. Among the important outliers was the mention of "education not being useful" for girls in rural Balochistan and for boys in rural Punjab.

[20] Follow-up research for investigating the impact on educational attainment of these incentives would be useful.

[21] For a comprehensive study of targeting, see eds. Van de Walle and Nead (1995). One lesson that emerges from this volume is that targeting is complex. In the opening piece of this volume, Sen (pp. 11-25) identifies several problems of targeting including corruption, stigma, exclusion, dependency, counter-acting behavioral changes, administrative cost and lack of political support. With regard to the targeting we propose, waiving all fees is more straight-forward than providing uniforms, books and supplies.

[22] Refer to Khan and Zafar (1999) for more details on community participation via SMCs in Pakistan.

excluding fees, expenditures on uniforms (which is roughly identical), books and supplies, private tuition, transport and other education related expenditure per pupil in private urban primary schools at Rs. 1,520 was almost double the per pupil expenditure of Rs. 851 in government urban primary schools. There was a similar differential is rural areas (Rs. 1,229 as opposed to Rs. 670).[23]

One could use the non-government sector as a benchmark to ascertain how the government sector was performing in 1996-97 on selected quality indicators.

Table-5: Selected quality indicators by type of school and region.

Regional	Urban		Rural	
Type of school	G	NG	G	NG
SIR	232	165	96	117
SCR	41	25	40	28
STR	24	18	29	24
% Teaching in classroom	77	97	55	82
% Schools that provide desks to students	56	92	17	70
% Schools with water supply	56	92	17	70
% Schools with electricity	76	98	27	88
Women teachers as % of total	46	85	36	71

Source: Government of Pakistan (1998, pp. 66-67).

Notes: The results are based on a survey of 1,227 government and 311 non-government primary schools conducted in 1995-96.
G: Government
NG: Non-Government
SIR: Student-institution ratio
SCR: Student-classroom ratio
STR: Student-teacher ratio

The sample data reported above reinforces the concern about congestion raised by the aggregate data reported in Table-2. The student-

[23] These aggregate numbers do not indicate the real duality of educational quality and social and economic opportunities these lead to when contrasting elite urban schools and cash strapped government schools; see SDPI (1995, pp. 211-213).

classroom ratio of 40 and 41 in government urban and rural primary schools is high. However, the student-teacher ratio of 24 and 29 respectively is more reasonable. If the non-government sector is used as a benchmark, the government sector does need to improve its supply side indicators. For example, only 55 per cent of rural government primary teaching occurs in a class room compared to 82 per cent for non-government schools; 17 per cent of government schools provide desks to students compared to 70 per cent of non-government schools; 17 percent of government schools have water supply compared to 71 per cent for non-government schools; 27 per cent of government schools have electricity compared to 88 percent for non-government schools. Educationists believe that women teachers are more effective at the primary level. Even in this regard, non-government schools dominate in provision since 71 per cent of their teachers are female compared to only 37 per cent for government schools.

Even so, there are signs of improvement in the public sector in the past three years (1993/94-1996/97) at the primary level. Twenty one per cent of girl schools and 28 per cent of boys schools had an increase in staff, 13 per cent of girls schools and 12 per cent of boys schools had an increase in the number of classrooms, 15 per cent of girls schools and 17 per cent of boys schools had an improvement in the maintenance of the building and 47 per cent of girls schools and 36 per cent of boys schools had an improvement in the availability of books.

Summary and conclusions

One of the major fears of the World Bank and IMF led structural adjustment is that austerity drives imposed to attain a fiscal balance result in massive cuts in the social sectors. Responding to critiques, the Bank has attempted to put a human face on the economic reforms it propagates and a central element of putting a human face to reform is protecting social sector expenditures. In Pakistan, the Bank led attempt at putting a human face to economic reforms has primarily taken the form of the Social Action Programme (SAP) which the Government of Pakistan has fully supported and for which it provides about four-fifths of the total funding. SAP's major goals are to protect social sector expenditures and to ensure that such expenditures result in the closing of the income, gender and regional gaps in access to social sector facilities. The first phase of SAP ran from 1993-1996 and the second phase of SAP (1996-2000) is now underway.

The evidence from the education sector shows that there have been some successes in the education sector during the SAP period, but that there have been dramatic failures and that a re-conceptualisation of SAP is urgently needed. Contrary to concerns that structural adjustment will result

in cuts in social sector expenditures, educational expenditure in Pakistan has been steadily, though not dramatically, rising. Education expenditure as a percentage of GDP has risen by 0.2 per cent between the benchmark year (1993-94) and last year (1996-97) of the first phase of SAP. However, by 1998-99 it had once again declined to the pre-SAP level (2.2 per cent of GNP) despite SAP protection.

Aggregate analysis suggests that these expenditures have not been adequate to reduce congestion for both boys and girls at the middle level. For example, the student teacher ratio for girls at the primary level for the last year of SAPP I was 56:1. Again, student-institution ratios for both boys and girls at the middle level were extremely high even though there has been considerable progress in this regard. Despite the crowding, Pakistan has made some progress in schooling. By 1996-97, 83 per cent of boys and 60 per cent of girls in the 10-14 age group attended school at some point. Also, since such attendance is much higher among the younger than the older cohorts, it is clear that the situation has been improving over time. Thus while overall school attendance for the 10-14 cohort was 72 per cent, it was 20 per cent in the 60 plus cohort. Also, evidence suggests that dropping-out is no longer as severe a problem as it used to be. Thus non-completion at the primary level was 13 per cent for males and 8 per cent for females in 1996-97. Evidence also shows that the gender and regional gap in schooling has closed over the SAP period. In addition to this, evidence shows that, over the last three years of SAPP-I (1993-1996), there have been improvements in various school characteristics including increases in staff and classrooms and improvement in the maintenance of the buildings and availability of books. Finally, there was a notable increase in gross enrollment rates of rural girls including of those belonging to the lowest income group.

Even so, there is still much to worry about. The net rural primary enrollment rate declined during the SAP years from 50 per cent to 43 per cent for boys and 31 per cent to 30 per cent for girls. This failing is actually more profound than it appears since it does not take into account the performance of non-government schools. Non-government enrollments grew by 61 per cent and 131 per cent for girls and boys compared to 23 per cent and 4 per cent respectively for government school enrollment growth rates. Also, government schools lag behind non-government schools in various respects. For example, only 55 per cent of rural government primary teaching occurs in a class room compared to 82 per cent for non-government schools; 17 per cent of government schools provide desks to students compared to 70 per cent of non-government schools; 17 per cent of government schools have water supply compared to 71 per cent for non-

government schools; 27 per cent of government schools have electricity compared to non-government schools.

The most serious failing of SAP has been its inability to address the problem of exclusion from schooling resulting from the low income of parents. In all provinces, gross and net enrollment rates are notably higher among the higher income group households. School being too expensive or children needed to help at home or at work are the most frequently cited subjective responses explaining why children are not in school. Again, the likelihood of dropping out increases as the income of the household declines. Finally, the income gap in enrollments for both rural and urban girls has dramatically increased over the SAPP-I period. Thus, in this regard, SAP has failed in one of the main stated goals of addressing the income gap in social sector provision. The programme needs to be re-conceptualised so that the excluded are targeted. Among other approaches, fee waivers, free uniforms or a no uniform policy, free books and supplies for the poorest, implemented by parent run school management committees, may be the most effective and least susceptible to subversion and leakage.

References

Amalric, F., 1998, 'The Sustainable Livelihoods Approach: General Approach of the Sustainable Livelihoods Project, 1995-1997,' mimeo, Society for International Development, Rome.

Banuri, T., S.R. Khan and M. Mahmood, 1997, Just Development, Karachi: Oxford University Press.

Carnoy, M., 1995, "Structural Adjustment and the Changing Face of Education," *International Labor Review*, Vol. 134, No. 6, pp. 653-673.

Cornia, G.A., R. Jolly and F. Stewart, 1987, Adjustment with a Human Face: Protecting the Vulnerable and Promoting Growth, Oxford: Clarendon Press.

Government of Pakistan, 1994, *Economic Survey 1992-93*, Federal Bureau of Statistics, Islamabad.

Government of Pakistan, 1999, *Economic Survey 1998-99*, Federal Bureau of Statistics, Islamabad.

Government of Pakistan, nd, 'Pakistan Household Integrated Survey, Round 2: 1996-97,' Federal Bureau of Statistics, Islamabad.

Government of Pakistan, 1998, 'Education Sector Performance in the 1990s: Analysis from the PIHS,' Federal Bureau of Statistics, Islamabad.

Government of Pakistan, 1997, 'Report on Social Action Programme for Pakistan Consortium 1997-98,' Planning Commission, Islamabad.

Haq, M and K. Haq, 1998, Human Development in South Asia, Karachi: Oxford University Press.

Khan, S. R., R. Siddiqui and F. Hussain, 1987, 'An Analysis of School Level Drop-Out Rates and Output in Pakistan,' *Pakistan Economic and Social Review*, Vol. XXV, No. 1, pp. 1-20.

Khan, S. R., and F. Zafar, 1999, 'Community Participation in Basic Education in Pakistan via Parent Teacher Associations,' unpublished paper, SDPI, Islamabad.

Social Policy and Development Center, 1998, *Social Development in Pakistan: Annual Review 1998* (Karachi: SDPC).

Sustainable Development Policy Institute, 1995, 'Nature, Power, People: Citizen's Report on Sustainable Development,' Islamabad: SDPI.

Van de Walle, D. and K. Nead, Eds., 1995, Public Spending and the Poor, Baltimore: Johns Hopkins University Press.

World Bank, 1998, 'Implementation Completion Report: Social Action Programme Project,' Poverty Reduction and Economic Management Division, South Asia, Washington, D.C.

World Bank, 1998a, 'Project Appraisal Document: Second Social Action Programme Project,' Education Sector Unit, South Asia Region, Report No. 17398-PAK, Washington, D.C.

World Bank, 1994, 'Staff Appraisal Report: Social Action Programme Project,' Population and Human Resources Division, South Asia Region, Report No. 12588-PAK, Washington, D.C.

World Bank, 1997, 'Towards a Strategy for Elementary Education,' Population and Human Resource Development Division, South Asia Region, Washington, D.C.

Management Development: a serious concern

Saeeda Shah*

In this age of globalisation, multiple pressures are intensifying for the under developed and developing countries. It is a struggle for economic survival, where the larger fish will eat up any small fish not clever enough to learn the rules of the game. In this market oriented competitive world, management development has increasingly become linked with economic output. Additionally, education is no more just an intellectual exercise. It is compulsively being recognised as a large sector of human and financial resources, requiring strategic management and a purposeful development of the concerned personnel for quality and effectiveness.

This paper is based on my Ph.D. study focusing on education management (Shah: 1998). It provides a discussion of the concept of management development and some concerned approaches. The relationship between 'management' and 'development' in the present day context of 'change' is highlighted to emphasise the need for serious and meaningful policy in the area. Issues faced in education management are analysed as indicative of lack of relevant expertise, and the significance of contextual factors is emphasised in educational planning and management for improved output.

Introduction

Management development is a contested area of theorising, and draws from relevant management concepts and organisational theory. The notion evolved from an industrial context where it was perceived as contributive to increased output. Stress on economic orientation and accountability in education emphasised the need for management development in education (Fullan:1993; Green:1994; Middlehurst:1995a; 1995b; Reeves:1995). The perception of educational institutions as organisations with specific aims, and "management development as an integral part of the process of orgnisational development" (Mullins: 1995:682) lent great stress to management development. It linked organisational development with management effectiveness and output, requiring development of management potential to achieve the intended aims.

* Dr. Saeeda Shah is Dean, University College of Home Economics, Mirpur, Azad Kashmir.

An Overview

In the developed world, the flux of literature concerning management development and training from the 1970s onwards was a response to the increasing complexity and diversity of educational institutions, and the economic, social and political elements leading to these developments. In Britain, "government sponsored research and policy initiatives provided a major impetus to educational management studies and training" (Preedy:1989:3). Development of BEMAS around the same time also points to the increasing demands and interest in the area. DES 3/83 and DES 1987 explicitly conveyed government policy regarding management development in educational institutions and linked it with economic development.

Research programmes focusing on needs analysis of educational managers highlighted the unpreparedness of personnel appointed as institutional managers. In a study of managers from ten universities and university colleges in Britain, Cuthbert *et al* reported confusion and lack of preparation for management mentioned by their respondents (1987:24). They perceived management development as "an attempt to improve management effectiveness through a planned and deliberate learning process ---- to improve educational practice by improving manager's performance" (Ibid:10). Educational progression to a considerable extent depends on the capabilities of the administrative heads to execute and support the developmental and implementation phases. In broad terms, management development implies improvement of management potential and effectiveness. Chambers *et al* define management potential as "the capacity to make intended and accepted things happen through the use of given resources" (1990:12) and explain 'development' as implying "improvement, becoming more accomplished, bettering oneself" (Ibid:14).

Management development is not necessarily linked with knowledge gained through formal education, or skills learned through specific training, although these can be contributory factors besides many others. It is often used as a blanket term inclusive of relevant experience, education and training. Middlehurst provides an interpretation of the three terms – management education, training, and development – given by Constable and McCormic (1987), who describe management education as formal qualifications, management training as formal learning activities, and management development as "broader still, job experience and learning from others" (Middlehurst:1995b:98,99). The meanings often vary in actual applications. Cuthbert *et al* observe that among senior management staff, training is "narrowly conceived as skills and task based; as being appropriate to career formations rather than senior positions. Development, on the

other hand, carries associations with experience and continuous learning" (:1987:239).

Ideally, management development in education should aim at improving performance and effectiveness: individual effectiveness and organisational improvement (Mullins: 1995:682); and also 'pupil performance' (Ballinger:1986:10). An increasing emphasis on the inter-relationship between management development and the institution's development and output (Brew:1995), and claims that the task of education will be compromised without effective management (Burnham:1994:25) indicate the direction of the argument. Middlehurst takes a very explicit stand:

> "poor management at the top .... directly effects the capacity and the motivation of individuals and groups to teach, research and to learn to their fullest potential" (1995b:106).

This requires a brief discussion of the phasing and processes of development.

Development Approaches

There is a high consensus on the need for training and development of institutional heads at the induction stage as a process of "orientation to new roles" (Middlehurst 1993:176). Many studies recommend development opportunities for managers to enhance their confidence in their ability to take on a new job (Lund:1990; Middlehurst:1995b; O'Neil:1995). However, the work context needs to be considered when planning approaches to training and development (Middlehurst:1995:98). Political and ideological approaches towards education greatly influence the nature of development policies and strategies. Accordingly, development activities can consist of very structured and specific programmes concentrating on learning a particular process or skill/s, or these may be intended to enhance resourcefulness and preparedness through increased understanding and insight, helping an individual to realise his/her full potential to manage in a way that allows for the individuality of the person and which enhances effectiveness within a particular context.

The management development model suggested by Bolam (1987) demonstrates that there are distinct development needs not only at induction but in relation to the whole career and also in terms of stages within a particular post:

the preparation stage (when they wish to apply for a new post)

the appointment stage (when they are selected or rejected)

the induction stage (e.g. first two years in a post)

the in-service stage (e.g. 3-5, 6-10, 11+ years in a post)

the transitional stage (i.e. promotion, re-deployment, retirement)

The emphasis is not just on preparing for the new job, but on continuous development and support programmes for effectiveness. Any perception of training and development "as a means of rectifying deficiencies" (Middlehurst: 1995b:109), or a help "to jump the ... hurdles" (Legotlo and Westhuizen: 1996:409) ignores the complex management contexts of educational institutions which require "sustained development rather than short-term patching up operations" (Brew: 1995:5). Middlehurst makes a very succinct statement:

> "given the breadth of these tasks, it is obvious that narrowly conceived and short-term training will not be sufficient to prepare individuals for senior roles or to support them when in a post, ... it is also clear that some preparation and continuing development will be required" (1995b:103).

Stressing continuing training and development for 'institutional managers', he strongly argues against the dangerous assumption that those who reach the pinnacle of their organisations – i.e. institutional heads, principals and others – no longer require further training or development. He proposes "an approach which embraces continuing and active participation in learning at all levels of organisation, including the top" (1995:98). In his opinion, lack of formal management education among university staff has strong 'implications for the design of management training and development opportunities' (Ibid:99). Middlehurst favours a 'holistic view of management learning', with an emphasis on 'renewal':

> "to remain intellectually stimulated and challenged, to maintain a breadth of vision and perspective, to achieve personal and professional refreshment (to stave off physical and psychological stress[1]), to sustain outside contacts or to overcome isolation and institutional introversion" (1990:114,5).

To achieve this ongoing development, Middlehurst considers three types of learning processes for institutional heads (1993:174).

---

[1] There is an abundance of recent literature on job stress; i.e. Farber:1991; Grady:1989; Ostell:1995; Quick:1990; Rogers:1996; for referencing see Shah:1998.

- informal managerial (in job experience);
- integrated managerial (through feed back on performance); and
- formal managerial (formal management development).

Learning through experience is in line with the famous Chinese proverb: I do and I understand. It has particular relevance for contexts like Pakistan with specific traditions and philosophy of education, and an absence of relevant management development programmes. In such situations, experience is often the only available mode of learning. Generally, learning through experience is perceived as a natural process but it has limitations, and as Bush maintains:

> "Disastrous errors of judgement can occur while experience is being gained. Mistakes are both costly in material and human terms"; and he further quotes Jennings (1977:vii) that "wise men do not have to learn of the existence of every brick wall by banging their nose into it" (Bush:1994:34).

Burgoyne argues that natural management processes take place in all organisations, can work in the start, but cannot work for all sorts of organisations and cannot be clung to beyond its time (1988). It relies on experience, and on how experience is perceived and used. Dewey's theory of experiential learning presents a cyclical process where experience and practice feed into each other. Discussing his theory, Osterman and Kottkamp (1993) argue that experience is a basis for learning but it requires reflection to serve as a learning process[2]. Boud *et al* also maintain that "while experience may be the foundation of learning, it does not necessarily lead to it: there needs to be active engagement with it" (1993:9). Learning from experience is not a linear process; it is learning and un-learning, and re-working: "Experience has to be arrested, examined, analysed, considered and negated in order to shift it to knowledge" (Criticos: 1993:161). Criticos stresses the significance of **reflection and reflexivity** by explaining the value of the intellectual growth that follows the process of reflecting on experience, emphasising that "effective learning does not follow from a positive experience but from effective reflection" (1993:162).

Schon defines reflective practice as "a dialogue of thinking and doing through which I become more skillful" (1987:34). This dialogue is simultaneous where:

---

[2] Elana Michelson highlights the distinction between 'experience' and 'reflection' in adult learning theory, which explains experience as the raw material for learning and reflection as a highly cognitive processing stage in which the learning actually takes place (1996).

> "The reflective practitioner assumes a dual stance, being on the one hand, the actor in a drama, and on the other hand, the critic who sits in the audience watching and analysing the entire performance" (Osterman and Kottkamp: 1993:19).

Management development programmes are generally linked with management theories (Bush:1994), and shape the training approaches. The notion of development is constructed by the ideological, political, social and economic factors on one level, and on another level, management concept, organisational ethos and learning approaches shape it in articulation with the specific contextual needs.

In view of the diversity and plurality of management situations, the emphasis on training needs of institutional heads[3] appears linked with a consideration of the specific ethos of educational institutions and the uniqueness of each management context (Gray:1980; 1982; Greenfield:1993; Hodgkinson:1991). Training people to replicate, or apply borrowed 'management techniques' (Gray: 1980:14) cannot be effective in education where each management situation is unique. Lund sees it as "a shift from a purely skill based approach to an emphasis on the personal development of the manager" (1990:41). Gray stresses and I agree that:

> "if we are to train people to manage, we must train them not to learn and remember what others have thought but to think and decide for themselves" (1982:8).

For the purposes of development, management skills can be defined as "both specific to organisations, applicable only on site, yet general enough to admit of technical training and preparation ..." (Hodgkinson: 1991:53). The areas emphasised might differ in different contexts or may have diverse priority levels, and the learning approaches deemed effective may vary but there is a high consensus in literature on the need for management development. Certainly there are barriers of time and resources for development (Cuthbert *et al*: 1987:239; Burnham: 1994:93), considering the size of the education sector, but the stress on the need is unanimous.

Management of Change

In today's context of economic constraints and global pressures, academic excellence cannot suffice to cope with the changing economic

[3] See Cardno and Piggot-Irvine:1996: Coombe Lodge:1994: Crawford *et al*:1997; Cuthbert *et al*:1987; Day:1991; 1993; Hughes:1982; Lund:1990; McNay:1988; Middlehurst:1993; 1995; O'Neil:1995; Thackwray:1994 and Watson:1988 for emphasis on training needs of institutional heads.

situations. It requires the development of relevant expertise. Besides, the process of change is pervasive and dynamic. The need to manage 'change and improvement with shrinking resources in turbulent times' (Busher and Smith: 1993:1) is emerging as a compelling theme in educational management. Vast literature on management of change bears evidence to the phenomenon. The snowball process of change has been increasingly gaining speed and size, demanding the strategic management of financial and physical resources (Fullan:1991; Green:1994; Leigh:1994; Reeves:1995; Weil:1994). Bush and West-Burnham admit that due to the rapid pace of change "college managers have to absorb and interpret externally imposed change while facilitating internal innovations" and to this purpose they need a 'fire fighting' approach accompanied by a 'vision' (1994:3). The Coombe Lodge Report (1994) conveys an awareness of rapid change with increasing demands on management, which not only requires a re-consideration of management theories and leadership styles but also necessitates the development of those responsible for management.

The manager is the new focus, and the shift of focus from teacher to the manager is indicative of the change where education is increasingly exposed to market forces and global effects. The emphasis on the institutional heads as the agents of change has been increasing (Fullan: 1991:152). Discussing different initiatives towards this end in the USA and Canada, Fullan emphasises that the need for professional development of leaders is more important than staff development because of its 'strategic importance' (Ibid:336-9). He perceives the "principals as gatekeepers or facilitators of change" (1993:11) who need to be prepared to manage it to the fullest of their abilities, in the best interest of organisational goals. The change can be initiated, or "imposed and unprecedented" (Newton and Tarrant: 1992:1), and in both cases requires sensitive management. It can be stressful (Ibid:205) if there is disparity between job and ability[4], leading to failure of implementing change as it did in the case of privatisation of selected institutions in Pakistan. Burnham claims that:

> "the reason why educational changes are often perceived as so problematic is not the nature of change itself but the nature of the knowledge, skills and attitudes of those involved and the way that these are exposed in action" (1994:93).

Management development is a coping strategy. Management development of those occupying key leadership positions in view of changes

[4] A definition of stress offered by Cox (1989) is that it is a "phenomenon arising from a comparison between the demand made on a person and ability to cope". The disparity is perceived as stressful.

in institutions and the educational sector gains importance in order to conduct change and development (Lyons: 1993:119; also 1982). Increasingly, the future education sector is "being forced by external pressure from a service to a business orientation which is having an impact upon management strategies and styles" (Elliott and Crossley: 1997:88; Elliot and Hal: 1994:5). The inability of the educational managers to manage in the new context cannot change the requirements but it may lead to the exploration of other options to satisfy the need. Back in 1988, Lewis C., Principal Swansea College, wondered prophetically "whether by 1995 the principal will have become a managing director"; and now there are advertisements in Europe for principals/vice-principals asking for a "generic management qualification such as the MBA" (Elliot and Hall: 1994:6). There is an ongoing debate in the area, maintaining that if principals do not have a background in education, quality of education and the special ethos of the educational institutions may suffer; and second, the practice may prove a barrier to teachers' promotions and affect teachers' motivation. This supports the argument to develop the management potential of the people from an educational background, 'who often lack in formal management education' (Middlehurst:1995b), to meet the ever increasing challenges of the time, and to maintain and improve the quality of education.

The requirements of change have emphasised interdependence between education and economic development, and demand that "education must be accountable and managed for the economic good" (Slatter:1994). In Pakistan, a changed orientation of educational aims is being constructed under global pressures asking for a new approach in management. The efforts to lead colleges towards financial autonomy marked the impact of change (Iqbal and Davies: 1994), and the doubts in managing financial autonomy pointed to the need for expertise in finance management. The predicament of concerned managers was equal to that of novice swimmers thrown against strong currents and flailing desperately for survival. In this case they had to be rescued by the government through retraction of the process (*Jang*: 1997). It shows that management of colleges has become a complex activity, which "cannot be left to chance, or to ambitious and enthusiastic individuals taking the initiative on their own behalf" (Bullock *et al*: 1995; 1994). It is an area of serious policy and application.

Another dimension of the issue is that change is not always welcome or necessarily developmental (Fullan:1991; Nisbet:1980; Schon:1971). Fullan argues that it can be stressful and problematic, involving anxiety, loss, and resistance from people, individuals and organisations, as it seemed in the case of Pakistan (Iqbal and Davies: 1994). Professional unpreparedness in such situations can be damaging for the managers, the managed and the

organisations. Greenfield rightly questions the tendency to ignore management development:

> "why do we merely throw people at these jobs, expecting them to do well with almost no experience of them, offering them no analysis of their experience" (1993:258).

It is increasingly viewed as a waste to leave "the resources and students in the hands of a person unprepared or untrained to handle" (Coulson:1990). Speaking from a developing country perspective, although from a school context, Legotlo and Westhuizen write:

> "Gone are the days of trial-and-error and swim-or-sink induction strategies. Without specific attention to the effective management development programmes for school principals, such as the well-planned comprehensive induction programmes for new principals, most of the attempts at improving the quality of education in developing countries will remain a pipedream" (1996:410).

In the higher education context, Middlehurst (1995b) stresses a necessary supporting framework for management and leadership development through courses, seminars and workshops. He maintains that although the new heads are not exactly without management experience of some sort, but for many individuals the entry to senior posts involves a transition from operational to strategic management levels (Middlehurst: 1995b:106). Therefore an assessment and provision of relevant 'competence' becomes essential to ensure optimum performance and effectiveness from this transition.

Pakistani Context

The education sector in Pakistan, according to my study, is conspicuous by virtue of the dearth of literature on management development, and also for lack of development facilities for educational managers in particular. A strong emphasis on this need has been voiced in government reports and by occasional educationists (Iqbal:1981; UNESCO: 1981; UNESCO: 1984) from as early as 1959 (Report of the National ... :1959), but it was virtually by the mid-seventies that the government began to realise the economic realities and the after-effects of quantitative expansion of 'higher education minus quality management'. In 1980, a UNESCO meeting of the educational administrators and key personnel from eleven South East Asian countries was held at Seoul to discuss "Innovations in Education". The major emphasis was on the preparation of principals, heads of schools, administrators, and key-personnel, who could introduce

and implement those innovations. This reflected an understanding of the fact that without developing the skills of the people immediately responsible for delivering education, improvements and quality could not be achieved. This meeting was a formal acceptance of the importance of institutional management and the need to develop it. In-depth discussions were undertaken to identify the issues and to prepare guidelines for the training of key-personnel (UNESCO Report:1981). The signals from the World Bank that "money is not and will not for a long time to come be available for everything" (Hulten: 1986:12) increased the demand for effective management. Hultin mentions the World Bank's education policy paper for 1980 which suggested along with other things that:

"the education system should try to achieve maximum internal efficiency through the management, allocation, and use of resources available for increasing the quantity, and improving the quality of education" (1986:2).

In spite of a large expansion of educational institutions, the situation in Pakistan in the 1980s was summed up as:

- an increase in unemployment, particularly among unemployed graduates;
- non-exploitation of national resources;
- a general decline in the quality of education;
- a large shortfall in the availability of scientific manpower; and
- absence of an integrated information system to co-ordinate higher education with national manpower requirements (Faraj:1988).

Such findings unveiled the disparities between policy-making and implementation. Criticism from within the country, and from the foreign funding bodies resulted in a shift in government policy, emphasising the role of education in developing manpower for different levels of the economy and the role of institutional managers in achieving these objectives. This directed focus on educational management which was further reinforced by the findings that inadequate management, lack of familiarity with the task and lack of trained management personnel (Hayes: 1987:78-97) were among the causes of deteriorating academic standards and the failure of educational reforms.

In Pakistan, policy making and planning work in a linear process, from top to bottom, and those planning at the top are mostly unaware of the realities of the actual educational situation, or of the implications

involved in the implementation of educational changes (Iqbal:1981; Hayes:1987). The recent trend towards institutional autonomy in several countries found its way in Pakistan as well, but only at the experimental level. Following a World Bank Report (1989) for Pakistan, "to consider the current circumstances and future development of education", which recommended that "some colleges should be accredited with full operational autonomy", four prestigious institutions, male and female, in the province of Punjab were declared to be 'autonomous institutions', mentioned above. A study carried out by Zafar Iqbal and Lynn Davies in 1992-3, to evaluate the early impact of these changes expressed the concerns of the teaching staff about the whole process (Iqbal and Davies: 1994). They also wrote that senior management and staff perceived no evidence of finances coming to the institution from any source, except government funding and feared financial difficulties as the major stumbling block to any progress towards real autonomy. Here, lack of relevant competence proved a stumbling block in the **management of change**.

The argument develops that if the senior management of these institutions had been trained and developed in view of the intended goals, this grant of autonomy might have worked better towards achieving improvement of the finances, and the quality of education, as is happening in the developed world. The practice of imposing a situation without working out all the details, and without preparing the key personnel responsible for managing it, meant that even the best plans could not attain the desired goals. Moreover, the world wide economic recession has imposed restraints on budgets. A country such as Pakistan can hardly afford to put huge amounts of money into education[5] as it was in the seventies, without some quality assurance and making education responsive to economic needs. This highlights the need for management of resources and change.

In addition to that, a major area of development in the present day context is **interpersonal relations**. "It is not only useful in policy-making, planning and conduct of activities but also develops political skills such as the ability to understand and develop power relationships or build coalitions" (Kotter:1988). It is a socio-political skill which enhances the support of those "above and below us". In Pakistan, political changes, power-play, and corruption, coupled with socio-cultural pressures[6] make

[5] The educational expenditure in Pakistan is a little above 2 per cent of the GNP (UNESCO Yearbook: 1995:1-5), which is very low as compared to other developing countries.

[6] Robert Kiltgard (1979) in a study carried out in Karachi, and Adele Jones (1991), in research conducted in Peshawar, Pakistan, refer to this corruption and power-play permeating through the educational context, although not in direct reference to institutional management.

management a hard task in itself. In the circumstances, it can be argued that professional competence and development of management skills in the relevant areas might improve the ability and effectiveness of the college heads, adding to their strength and confidence to manipulate interference in an effective way to achieve the target goals.

One more problem area is **finance management**. In my study, headship was perceived by the heads as finance-centred and control over money. Interestingly, even those college heads who opined that management was learned in the field insisted that training in finance must be provided prior to appointment:

"The department should arrange for training in finance. It is a skill. If you don't have it you incur a bad name ---- that you have swindled, that there is a fraud; even if you have been perfectly honest. It is a punishment for not knowing. Keeping a check is very demanding …." (PM2).

The emphasis on finance training seemed to arise from a shared belief that "as long as you do not know a job yourself you cannot make others do it for you properly. Your subordinate will work better if he knows that you know it" (PM5). Besides a 'broadening of vision' (Middlehurst: 1993; 1995; Greenfield: 1993), managers do need "a balance of technical, social and conceptual knowledge and skill, acquired through a blend of education and experience" Mullins: 1995:681. Lyons suggests three areas for management development:

1. substantive concerns—both theoretical and research;
2. socio political concerns—policy-making and resource allocation;
3. technical professional concerns—planning and conduct of activities.

An awareness of these issues is increasing in Pakistan, but still the development of educational administrators remains a neglected area. According to the institutional heads, coming to this job without being prepared for it reduces job-effectiveness, delays processes, and increases possibilities of errors and omissions. My research participants emphasised the need for comprehensive, pre-induction training. Learning-on-the-job was described as a hard and distressing experience:

"There should be training facilities. Although I never had any training, I think that there are certain things with the changing times, that we

> do not understand. Training can bring an awareness of new things and developments. .... It can make our job easier" (PF4).

However, development and training of institutional heads appeared to be a peripheral issue in the policy-making-politicians' domain, in spite of emphasised importance of the higher education sector and its admitted relationship with national development. Policy-making or absence of relevant policy making emerged as a political phenomenon[7]. According to the concerned managers:

> "Our resources are limited and also there are political compulsions. There is demand and need for staff development. It should be given priority. But when a politician (in power) says 'give a college to that area, or upgrade that inter college into degree or science college', our meagre resources are diverted towards that. ..... Politicians have their own priorities. Even officers in our positions, are not the real policy-makers; it is the politicians' domain" (PSM4).

And often this domain is mismanaged itself. Even when policies are formed in policy statements, these fail to materialise because of the issues of pragmatics, feasibility, practicality, implementation, etc. The requirement is that policy-making should be treated as a professionals' domain, and those who are to implement these policies – i.e. educational managers – should be prepared for this task. Ignoring management development in this large public sector will ultimately be a national disaster.

[7] For details please see Shah: 1998: chap 6.

References

Ballinger, Elizabeth: 1986: The Training and Management Needs of Managers: An Overview in Staff development in the secondary school: management perspectives, (eds) Chris Day and Roger Moore. London: Croom Helm; pp 9-31.

Bennett, N; Glatter, R and Levacie, R: 1994: Improving Educational Management Through Research and Consultancy. London: Paul Chapman and OUP.

Bolam, R 1997: 'Management Development for Headteachers: Retrospect and Prospect', in *Educational Management and Administration*: Vol 25, No. 3, 1997. Pp 265-284.

Boud, D; Cohen, R and Walker, D (eds): 1993: Using Experience for Learning. SRHE and OU Press.

Brew, A (ed): 1995: Directions in Staff Development. Buckingham Society for Research into Higher Education (SRHE) and OU Press.

Bullock, Kate: James, Chris and Jamieson, Ian: 1995: 'An Exploratory Study of Novices and Experts in Educational Management', in *Educational Management and Administration*: Vol 23, No. 3; pp 197-205.

Bullock, Kate: James, Chris and Jamieson, Ian: 1994: The Process of Educational Management Learning Paper presented to BEMAS Annual Conference, September 1994; pp 1-11.

Burgoyne, J: 1988: 'Management Development for the Individual and the Organisation', in *Personnel Management*; Vol 20, No. 6; pp 40-45.

Burnham, W.J: 1994: 'Management in educational organisations', in Bush, T and Burnham, W.J. (eds): 1994: The Principals of Educational Management. Longman: EMDU; pp 9-32.

Bush, T: 1994: 'Theory and Practice in Educational Management', in Bush T and Burnham, W.J. (eds): 1994; op cited; pp 33-53.

Busher, H and Smith, M (eds): 1993: Managing educational institutions: Reviewing Development and Learning. Sheffield Hallam University: BEMAS.

Cardno, C and Piggot-Irvine, E: 1996: 'Incorporating action research in school senior management training', in *International Journal of Educational Management*: Vol 10, 5.

Chambers, Charlotte: 1990: Develop your management potential: a self help guide / Charlotte Chambers, John Coopey and Adrian McLean. London: Kogan Page with Association for Management Education and Development.

Coombe Lodge Report: 1994: "Changing the Culture of a College', in Vol 24, No. 3.

Coulson, Alan: 'Primary school headship', in Saran, R and Trafford, V (eds): 1990: Research in Education Management and Policy. London: Falmer; pp 101-107.

Cox, T: 1989: Stress. Nottingham: Nottingham University Stress Research Unit. Nottingham.

Crawford, M; Kydd, Lesley and Riches, C (eds): 1997: Professional development for educational management. Buckingham: Open University Press.

Criticos, C: 1993: 'Experiential Learning ...', in Boud, D; Cohen, R and Walker, D (eds): 1993: Using Experience for Learning. SRHE and OUP: pp 157-168.

Cuthbert, R; Pike, J and Trafford, V: 1987: DIY: A Manual for Locally Based College management development. York: Longman for FEU Publications.

Day, C: 1991: 'Roles and Relationships in Qualitative Research on Teachers' Thinking: A Reconstruction', in *Teaching and Teacher Education*: Vol 7. No. 5/6; pp 537-547.

DES 3/83: The In-Service Teacher Training Grant Scheme. London, HMSO.

DES 1987: Maintained FE: Financing, governance and law; London: DES.

Elliott, G and Crossley, M: 1997: 'Contested Values in Further Education', in *Educational Management and Administration*: Vol 25, No. 1; pp 79-92.

Elliott, G; Hall, V: 1994: 'FE Inc. Business orientation in Further Education and the introduction of human resource management', in *School Organisation*: Vol 14, No. 1; pp 3-10.

Faraj, A.H: 1988: "Higher Education and Economic Development in South Asian Countries', in *Higher Education Review*: Vol. 21, No. 1; pp 9-28.

Fullan, Michael: 1993 Change forces: probing the depths of educational reform. London: Falmer Press.

Fullan, M with Stiegebauer, S: 1991: The New Meaning of Educational Change. London: Cassell.

Gray, H.L: 1980: Management in Education: Working Papers in the Social Philosophy of Educational Institutions. Driffield: Nefferton Books.

Gray, H.L: 'A Perspective on Organisation Theory' in Gray, H.L. (ed): 1982: The Management of Educational Institutions: Theory, Research and Consultancy Lewes: Falmer Press; pp 29-43.

Green, D. (ed): 1994: What is Quality in Higher Education? Buckingham: SRHE and OUP.

Greenfield, T and Ribbions, P (eds): 1993: Educational Administration: Towards A Humane Science. Routledge: London, New York.

Hayes, L.D: 1987: The Crisis of Education in Pakistan. Vanguard, Lahore: Pakistan.

Hodgkinson, C: 1993: Forward to Greenfield and Ribbins: 1993; op cited.

Hultin, M: 1986: 'The Role of Cross-National Research in World Bank Education Operations', in Postlethwaite T.N. (ed): 1986: International Educational Research. Oxford: Pergamon Press; pp 1-18.

Iqbal, M: 1981: Education in Pakistan. Aziz Publishers; Lahore: Pakistan.

Iqbal, Z and Davies, L: 1994: 'The Early Impact of the Grant of Autonomy to Educational Institutions in Pakistan', in *Journal of Education Policy*: Vol 9, No. 3; pp 197-210.

Jones, A.M: 1991: 'Community Participation in Frontier Education Planning', in *Educational Management and Planning*: Vol. 19, No. 3; pp 160-165.

Klitgaard, R.E: 1979: 'Merit and Admission Policy: Case Studies from Pakistan', in *Comparative Education Review*: Vol 23, No. 2; pp 271-282.

Kotter, J.P: 1988: The leadership factor. New York: Free Press.

Leigh, Andrew: 1994: 'Change and Leadership', in Bennett *et al* (eds): 1994, op cited; pp 11-26.

Legotlo, M and Westhuizen, P: 1996: 'Coming on Board: Problems Facing New Principals in Developing Countries', in Educational Management and Administration; Sage Publications: Vol 24(4) 401-410.

Lund, Graham: 1990: Educational management: research to identify the educational management development and training needs of primary headteachers and deputy headteachers. Thesis (M.Phil.) – University of Nottingham.

Lyons, G. and Webbs, P.C: 1982: 'The Nature of Managerial Activities in Education', in H.L. Gray (ed): 1982, op cited; pp 85-108.

Lyons, G: 1993: 'Human Resource Development', in Busher, H and Smith, M (eds): 1993, op cited; pp 118-133.

Michelson, Elana: 1996: 'Usual suspects: experience, reflection and the (en) gendering of knowledge', in *International Journal of Lifelong Education*: Vol 15, No. 6, pp 438-454.

McNay, Ian: 1988: Coping with Crisis: Management Development in FHE. London: Longman for FEU Publications.

Middlehurst, R: 1990: 'Leadership development in Universities', in Saran. R and Trafford, V (eds): 1990: Research in Education Management and Policy. London: Falmer; pp 115-121.

Middlehurst, R: 1993: Leading Academics. Buckingham. SRHE and OUP.

Middlehurst, R: 1995a: 'Leadership, Quality and Institutional Effectiveness', in *Higher Education Quarterly*: Vol 49, No. 3; pp 267-284.

Middlehurst, R: 199b: 'Top-Training: Development for Institutional Managers" in Brew A (ed): 1995, op cited: pp 98-117.

Mullins, L.J: 1995: Management and Organisational Behaviour. London: Pitman.

Newton, C and Tarrant, T: 1992: Managing Change in Schools. London: Routledge.

Nisbet, R: 1980: The History of the Idea of Progress. New York: Basic Books.

O'Neil, J: 1995: 'Whose job is it anyway: the team leader as catelyst for management development', in *Educational Management and Administration*: Vol 23, No. 1: pp 19-27.

Osterman, K and Kottkamp, R: 1993: Reflective Practice for Educators. Corwin Press.

Preedy, M (ed): 1989: Teachers Case Studies in Educational Management. London: Paul Chapman.

Reeves, F: 1995: The Modernity of Further Education: The Direction of Change in Further Education Colleges. Bilston: Bilston College in Association with Education NOW.

Report of the Commission on National Education: 1961: Government of Pakistan, Ministry of Education, Government of Pakistan Press, Karachi: Pakistan.

Schon, D.A: 1971: Beyond the Stable State. New York: Norton.

Schon, Donald A: 1987: Educating the reflective practitioner: [toward a new design for teaching and learning in the professions]. San Francisco: Jossey-Bass.

Shah: 1998: Educational Management .... : Ph.D. thesis at the University of Nothingham: England.

Thackwray, Bob: 1994: 'University Staff: A worthwhile Investment', in Knight, P.T. (ed): 1994, op cited; University-wide Change, Staff and Curriculum. Edgbaston: SEDA Publications; pp 71-77.

Jang (Urdu), London, April 18, 1997, p-2, a statement by The Chief Minister Punjab, Pakistan.

UNESCO Report: 1981: UNESCO Regional Office for Education in Asia and the Pacific. Bangkok, Thailand.

UNESCO Report: 1984: Diagnostic Studies in Educational Management: Country Pakistan, UNESCO Regional Office, Bangkok, Thailand.

Watson, K: 1988: 'Forty Years of Education and Development,' in *Educational Review*: Vol 40, No. 2; pp 137-174.

Weil, Susan (ed): 1994: Introducing change 'from the top' in universities and colleges: 10 personal accounts. London: Kogan Page.

From Samuelson to Marshall and Beyond

Jawwad Noor Butt

This paper is divided into three sections. The first section goes over the major developments in consumer choice theory[1] over time and contrasts the approaches of Marshall, Hicks and Samuelson. In the second section is an inquiry into the nature of utility and a hypothesis is developed in the Marshallian tradition. The hypothesis is built on the grounds that utility is not a homegenous concept as is conventionally believed. The last section is concerned with identifying some theoretical and philosophical implications of the hypothesis for economics.

The Theory of Consumer Choice and its Development

The development of consumer choice theory over the century has been in a very definitive direction, but this modern direction is certainly different from the direction in which the theory first started out. Utility theory finds its roots in the discovery of the notion of utility in 1738 by the Swiss mathematician Daniel Bernoulli and its introduction into the social sciences by Jeremy Bentham. Bentham in 'An Introduction to the Principles of Morals' (1789) talked about the 'principle of utility' which he defined as the 'property of an object… to produce pleasure, good or happiness or to prevent… pain, evil or unhappiness.' Then in the early/mid 1800s neoclassical economists such as William S. Jevons and later Alfred Marshall extended the notion of utility to consumer choice. Ever since, J. Hicks and Paul Samuelson have developed on the theory considerably, giving it is modern shape.

Marshall's exposition of consumer choice theory had a firm grounding in the description of the *nature of human wants*. Says he, 'There is an endless variety of wants, but there is a limit to each separate want. This familiar and fundamental tendency of human nature may be stated in the "law of satiable wants" or of the "diminishing utility" thus: The "total utility" of a thing to anyone (that is, the total pleasure or benefit it yields to him) increases with every increase in his stock of it, but not as fast as his stock increases. If his stock increases at a uniform rate the benefit derived from it increases at a diminishing rate…. That part of the thing which he is only just induced to purchase may be called his "marginal purchase", because he is on the margin of doubt whether it is worth his while to incur

[1] I shall be referring only to the theory of choice under certainty and hence am not including developments like the Neumann-Morgenstern Statistical theory, Armstrong's Marginal Preference theory, etc. in the paper.

the outlay required to obtain it. And the utility of his marginal purchase may be called the "marginal utility" of the thing to him. Or, if instead of buying it, he makes the thing himself, then its marginal utility is the utility of that part which he thinks is only just worth his while to make. And thus the law just given may be worded: The marginal utility of a thing to anyone diminishes with every increase in the amount of it he already has.[2] An important observation was made: 'If a person has a thing which he can put to several uses, he will distribute it among these uses in such a way that it has the same marginal utility in all. For if it had greater marginal utility in one use than another, he would gain by taking away some of it from the second use and applying it to the first.'[3] Hence the condition for consumer equilibrium came about, i.e. the ratio of marginal utility of each thing to its price must be equal for all things, or that the ratio of the marginal utilities of two goods must equal the ratio of the prices of the two goods.

As may be evident the above approach is concerned very closely with the individual and exactly what it is that goes on inside of him that eventually leads him to make a choice as a consumer. However, when Hicks came into the picture he had a different objective in mind. In his own words, 'My work on the subject began with the endeavour to supply a needed theoretical foundation for statistical demand studies; so that there is a definite relevance to that field. Other matters of fundamental methodological importance are thrown up as well.'[4] So Hicks had actually set out to derive the demand curve (as opposed to Marshall's aim to study the nature of choice-making behaviour) so that it may have significance for econometrics. His criticism of the Marshallian consumer choice theory is expressed in the following sentences: 'But now what is this "utility" which the consumer maximises? And what is the exact basis for the law of diminishing marginal utility? Marshall leaves one uncomfortable on these subjects.'[5] Rejecting the marginal utility theory on the basis that utility is unquantifiable, and that the law of diminishing marginal utility is nothing more than an unproven axiom, Hicks and Allan developed Pareto's indifference curve analysis into the theory of consumer choice as we know it today.

The principle of Occam's Razor was used to make redundant the Marshallian theory. The principle states that if two theories draw the same conclusion, then the theory with the less restrictive assumptions and the fewer axioms is superior to the other. And indeed, in the derivation of the demand curve the Hicksian indifference curve theory employs fewer

---

[2] A. Marshall, 'Principles', p 93.
[3] Ibid., pp 117-118.
[4] J.R. Hicks, 'Value and Capital', 2nd edition (Oxford: Clarendon Press, 1946), p 5.
[5] Ibid., p 12.

assumptions than the Marshallian theory. Indeed there is no need for unmeasurable concepts such as the concept of utility or of a utility function in the Hicksian approach. 'The quantitative concept of utility is not necessary in order to explain market phenomena. Therefore, on the principle of Occam's razor, it is better to do without it. For it is not, in practice, a matter of indifference if a theory contains unnecessary entities. Such quantities are irrelevant to the problem in hand, and their presence is likely to obscure the vision... We have... to undertake a purge, rejecting all concepts which are tainted by quantitative utility, and replacing them, so far as they need to be replaced, by concepts which have no such implication.'[6]

Arrow was to say that '...the proponents of measurable utility have been unable to produce any proposition of economic behaviour which could be explained by their hypothesis and not by those of the indifference curve theorist.'[7] Samuelson declared that 'the whole end and purpose'[8] of consumer choice theory was the derivation of demand functions in prices and income. It was a clean sweep.

Then Samuelson came up with the theory of Revealed Preference which employed even less restrictive assumptions than did the indifference curve theory and so made the Hicksian approach redundant in the same way that Hicks did the Marshallian approach. Samuelson did not require the consumer to go so far as to be able to write out a whole list of goods to identify all the bundles between which he was indifferent. Samuelson ruled out the possibility of this 'weak ordering' by postulating that choice reveals preference, and thus for him indifference was not an operationally significant concept. The consumer was required to do nothing but make a choice, and thereby reveal his preference of one bundle of goods over another. Hence, for Samuelson if one was able to consume any points of all points on a Hicksian indifference curve, the fact that he would eventually choose one particular bundle makes all other bundles inferior to the chosen one. The consumer has revealed his preference. There is no cardinal utility, no continuity of choices, no indifference curves, no nothing. Just choice.

An examination of the above-mentioned three theories shows that a certain pattern is developing. Marshall's emphasis was to explain consumer choice on the basis of the internal mechanisms involved in choice-making behaviour, Hicks' emphasis was gearing consumer choice theory towards deriving the law of demand, and Samuelson's emphasis was achieving the same through the discarding of a psychological explanation for choice

---

[6] Ibid., pp 18-19.
[7] Kenneth J. Arrow, 'Social Choice and Individual Values', 2nd edition (New Haven. Conn.: Yale University Press, 1963), p 9.
[8] Samuelson, 'Foundations', p 97.

altogether in favour of observed behaviour. This 'behaviourism' is a very stable ground to walk on because actual observation merges with the theoretical explanation, the latter trying to explain the former. Hence there is no going wrong. It is all safe play.

And certainly the changes in consumer choice theory to the present form can be seen as the development of the theory, as its evolution. But there is a point that needs to be made here. Exactly what have the later theories of consumer choice contributed to answering the question of ***why*** a consumer makes any choice? On the inquiry into the actual ***nature*** of choice, what have these theories added to our understanding?

It seems as if contemporary consumer choice theory jilted Marshall's concern of discovering the ***principles*** of choice in favour of what is, in my view, a possibly relatively less substantial and less philosophically meaningful question of theoretically proving the law of demand. Proving the observation of demand being inversely related with price by using observation itself does not explain why the demand curve is negatively sloped in the first place. All it says is that the demand curve ***is*** negatively sloped, not ***why*** it is so. What would be more meaningful is to come up with the precise mechanisms that work within the consumer, which determine his choice. It is only once greater insight is gained in this regard that one can actually, first, start answering the question as to why the demand curve is downward sloping and, secondly, make more precise predictions and estimations of demand. A true contribution would be an understanding of why a certain equilibrium arises in the first place, and for that we require a theory of the nature of consumer choice.

The above two paragraphs challenge the meaning of the term: 'the development of consumer choice theory'. As with everything else that exists, the meaning of the word 'development' is relative to what premise we employ when we speak of development. If we speak of development of a theory as being its simplification in terms of less assumptions and less axioms while the theory's conclusions/implications are the same, then the movement from Marshall to Samuelson has surely been development. But if the principle of Occam's razor was to be redefined so that it did not compromise on substance and insight, then there really has not been much development in the theory of consumer choice since Marshall.

Marshall still stands if we consider his purpose. To start off with, Marshall said nothing to the effect that utility was measurable. The terms 'cardinal' and 'ordinal' came after him. The maximum that he said in this regard was that the quoted price at which the consumer makes his purchase measures the marginal utility to him. Other than this he himself has said in

his 'Principles of Economics' that desires cannot be directly measured, that price may measure marginal utility but cannot measure utility in general, that the quantities of two benefits cannot be compared. His purpose was to describe choice and he rested on axioms that were capable of being tested physiologically, psychologically and of course through common observation and experience.

Hicksian indifference curve theory rests almost entirely on the grounds laid by Marshall. Every 'higher' indifference curve reflects greater utility, and thus if one wants to force the 'cardinal pill' down the throats of the indifference curve theorists one certainly can do so by simply arguing that every indifference curve can be assigned a number or a value. After all if we are talking about greater utility then we are talking about greater values of utility, are we not? And if it is argued that such an exercise is not necessary for the theory to operate then the fact is that such an exercise is not necessary for the Marshallian theory either. Further, the fact that indifference curves are convex to the origin is nothing other than the law of diminishing marginal utility itself. Just as the Hicksian consumer maximises utility, so does the Marshallian consumer. The principle is the same, and the indifference curve-budget line tangency is identical to MUx/MUy=Px/Py. It may be argued that the Hicksian theory is nothing more than a diagramatical exposition of the Marshallian theory.

When it comes to Samuelson, nothing new is added on the 'insight' front. His doing without indifference curves is ingenious, but at the end of the day if we are to use his theory to explain consumer choice then we get no answers. Actually Samuelson takes a step away from the consumer to simply observe his choices from a distance. The internal workings become immaterial in his analysis.

Arrow was quoted earlier saying that '...the proponents of measurable utility have been unable to produce any proposition of economic behaviour which could be explained by their hypothesis and not by those of the indifference curve theorists.' It would not be incorrect to say that the proponents of the indifference curve theorists have been unable to produce any proposition of economic behaviour which could be explained by their hypothesis and not by those of the proponents of Marshallian utility theory.

While Hicks and Samuelson were standing on similar ground, Marshall was standing on a ground different from theirs. His theory had a different function to perform and ***no improvements have been made on his theory on his own ground.*** His exile is not justified when we are on his premises. His theory belonged to a different plane, and we must look into what insights developments on his plane could give us. No doubt we would

be delving into pure theory which could be very difficult to substantiate. But the philosophical implications of such an inquiry into the internal functionings of the economic unit (which we call the consumer) could add some depth to our understanding of economics.

An Inquiry into the Nature of Consumer Choice

I shall now present a few thoughts developed in the Marshallian tradition of inquiring into the nature of choice. While these thoughts can be seen as serving the purpose of discovering knowledge for knowledge's sake, a few of its implications will be discussed in the next section.

The concept of utility is a reality the existence of which all of us can testify to. Indeed the mechanism governing the behaviour of all living things, from the simplest amoebae to man, can be easily identified in terms of two impulses – the pleasure impulse and the pain impulse. It is through this pleasure-pain mechanism that the brain governs the actual actions taken by any living organism. A stimulus received is interpreted by the brain as causing pain or pleasure, and the brain sends a response to the appropriate parts of the body to react to the stimulus. This system of impulses, of stimulus-response, of pleasure-pain is the basis of behaviour.

At best the above 'model' can only be called an 'intermediate' model of behaviour. The whole explanation of choice through the pleasure-pain mechanism, through the utility-disultility mechanism gives only the immediate explanation of behaviour. That is to say that it says nothing more than the fact that if a person buys a commodity then it is because he wants to, or because his preferences are such. But a complete model of behaviour would explain ***why*** his preferences are such, why one thing gives him more utility than the other, etc. For that one would probably have to look to the brain sciences to answer the questions that economists can not. But given that the state of knowledge is limited, then for our purposes an intermediate theory will have to suffice.

To Marshall's postulate that the consumer's equilibrium is at the level of consumption where the marginal utility of spending $ 1 on the good(s) equals the marginal utility of money (the opportunity cost of that $ 1) there is something that needs to be said. What Marshall has actually implied implicitly was that utility and disutility are directly comparable. That is to say that one can actually weigh a pleasure against a pain (in this case the pleasure of a marginal unit of consumption against the pain of losing the marginal utility of simply holding that money). It is only once one assumes direct comparability of the two that one can ever say that MUc = MUm (where MUc is the marginal utility of a dollar of consumption and MUm is the marginal utility of

money). To press the point further, the fact that it is postulated that MUc is ***equal*** to MUm means that both the pleasure and the pain have identical units. It is only when the units are identical that such a term as net utility can ever be used. But the common knowledge that Marshall used to substantiate his utility theory can actually go against him.

Common knowledge and common observation would reveal that no two pleasures, no two pains, and no single pleasure and pain are identical. The pleasure one gets from a good meal is different from the pleasure one gets from reading a good book. The pain of a pinprick is different from the pain of losing a beloved. The feeling one gets from losing a dollar of money is different from the feeling one gets from consuming an ice cream, which was bought with that same dollar. One can go on giving a huge range of examples from everyday life to substantiate the claim that pleasures and pains are not identical. Comparing pleasure with pain means comparing cows with pigs, and subtracting pain from pleasure means subtracting pigs from cows. Common experience tells us that ***we actually feel pains and pleasures simultaneously***. A person enjoys a drink of alcohol even though it tastes bitter. Hence pleasure and pain do not have identical units, and thus they do not cancel out or anything of the sort. Utility is heterogenous in nature, not homogenous.

Hence utility is not a term that can be used so lightly and so simply because the actual picture is a little more complicated than that. If one accepts the claim that pleasure and pain are not directly comparable then one cannot make the famous textbook diagram of a downward sloping marginal utility schedule intersecting the price line to reveal the single-good consumer equilibrium. If there is no direct comparability then the intersection is meaningless.

But to say that pleasure and pain are not comparable at all is certainly an absurd statement to make because we make choices everyday that involve both pleasures and pains, and making such a choice certainly means that the pleasure outweighed the pain. Hence a comparison has actually been made. The utility derived from the choice exceeds the utility derived from the money that is spent, although both have different units. Where does this lead us?

The fact is that there are two different feelings that one feels inside prior to making a choice and that both these feelings pull the choice-maker in opposite directions. Eventually one of these feelings 'wins' and the other 'loses'. They are not the same and yet at the end of the day a comparison is made. Such comparisons cannot be represented mathematically given the rules of mathematics, and yet every day every one of us makes such comparisons.

Hence what can be understood by all this is that although pain and pleasure are different feelings, they are indeed comparable, ***but only loosely so***.

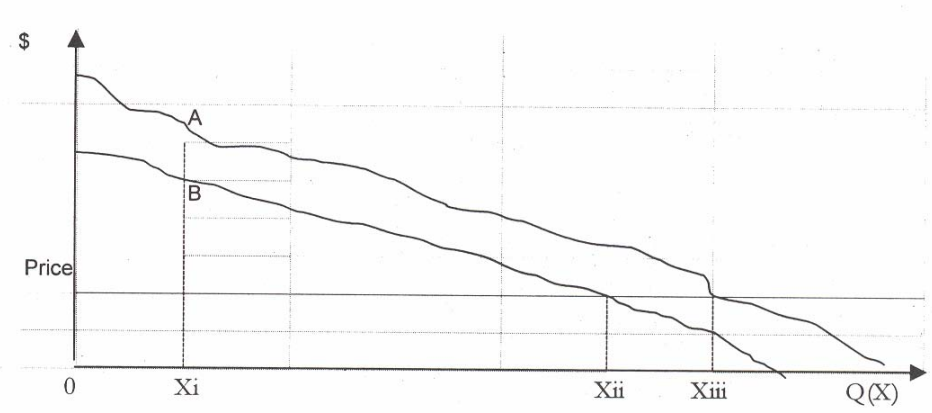
This hypothesis of weak comparability, if I may be allowed to coin the term, can be substantiated with a simple experiment. Assume that you are asked the question of how much money you would accept such that it compensates you for carrying out a 'painful' task, like swallowing a very bitter pill for no reason. $ 10, $ 30, $ 50? If you conduct this experiment you will actually be able to identify a ***range of values for which you would feel compensated, as opposed to a single value***. One will never be able to say, for instance, that $ 20.59 is the exact amount that will just compensate him for the act. Rather, one will be confused over a range of values (for example $17 to $25) where he is not certain whether he is just compensated or not. Weak comparability leads to a whole range of possible values of one kind of utility (or disutility) which seems to be equal to one unit of utility (or disutility) of another kind.

Going through the experiment will give rise to this 'gray area', a range of values for which one will not be sure if he/she is under-compensated, compensated, or more than compensated. The lower limit of this range would arise in the vicinity of those values of money for which he is certain that he is not compensated and those for which he is not so sure. The upper limit of this range is in the vicinity of those values of money for which he is not sure that he is compensated and those for which he is certain that he is more than compensated. The exact values of these limits are not definable with any kind of certainty whatsoever. If this result of the existence of such a range is difficult to absorb, the realisation of the actual difficulty of trying to evaluate this compensation level serves sufficiently to make the point. It becomes clear that comparison is not a simple addition/subtraction operation. It is not so clean a process, but rather a messy one.

The above experiment also demonstrates that the hypothesis of weak comparability assumes much greater significance when it comes to marginal analysis. It is much easier to say that a very large pleasure outweighs a very small pain or vice versa, but when it comes to comparisons at the margin, then the difference in the feelings of pleasure-plain makes comparability very hazy. This implies that economic theory is not simply a 'calculus of pleasure and pain' as Jevons believed. Behaviour, by its very nature, can not be as precise as that.

The figure below illustrates the hypothesis of weak comparability. The axes give the quantity of 'X' consumed on the x-axis and units of money ($) on the y-axis. Because only units of pleasure of a specific kind are meaningful, here we consider the utility from money to be our standard for

comparison. The curved lines give the range of values of $ the utility of which approximates (in the mind of the consumer) the marginal utility of the consumption of X. So the marginal utility of the consumption of the Xi'th unit of X is similar to the utility of $A to $B of money. The exact value between $A and $B cannot be determined by the consumer due to the nature of pleasure-pain. The final equilibrium, i.e. where the money valuation of the utility of the marginal purchase equals the marginal utility of money itself[9], is indeterminate between the range Xii and Xiii.



When the hypothesis of weak comparability is extended to Hicksian indifference curve analysis we find that indifference curves cease to be curves and turn into indifference areas, because bundles surrounding the indifference curves cannot be clearly classified as superior or inferior bundles (in terms of utility). No longer is it possible to define an indifference map. For areas that are sufficiently to the north-east of other areas on the x-y plane one can say that the former are superior to the latter, but for bundles and areas close to each other no such statement can be made because the consumer himself is unable to make such a statement. Hicksian theory, therefore, would fail in its objective of deriving the demand curve unless it employed sufficiently large changes in price.

Even Samuelson's Revealed Preference Hypothesis would find itself in a problem of ambiguity regarding choice even though all it is concerned with at the end of the day is the actual choice made, regardless of how it

[9] We assume that the marginal utility of money is constant, or that the range of the values of money that is involved is small enough for marginal utility of money to be practically constant.

was made. Samuelson's assumption of a positive income elasticity of demand would not yield the results it does unless, once again, a large enough price change was taken. Neither would he be able to use the concept of the 'superior zone' because the zone would not include points to the northeast of the original equilibrium bundle that are close to it.

When it comes to the demand curve itself the implication of the hypothesis of weak comparability would be demand areas rather than curves because at a given price the consumer would find himself choosing from a range of quantities which he is unable to establish as his single unique equilibrium level. The figure drawn above is also the consumer's demand curve (area) as it tells us how much (in terms of money) a consumer values the consumption of each marginal utility of X. Only large price falls would lead to an unambiguous rise in the quantity demanded. A small fall in price may lead him to leave his consumption level unaltered or it may encourage him to increase his consumption by a smaller or greater proportion than the fall in price. At a different time he may feel that he really does not value the product all that much and may end up decreasing his consumption of X. For narrow price ranges the demand curve may be elastic, inelastic or positively sloped between different time periods.

Perhaps the main significance of the above discussion is the fact that it brings to the fore an inescapable uncertainty regarding anything concerned with human behaviour, and that it identifies the exact reason for this. There is a certain minimum standard deviation that must exist in the calculation of all variables affected by the choices of human beings. The error term is no longer simply a nuisance. Part of it is a variable that involves the inability of humans to conform to the marginal analysis applied to their behaviur by economists. Perhaps a statistical inquiry into this minimum standard deviation could lead to findings that could be of significance to econometric analyses, as will be discussed in greater length in the next section.

In criticism and defense the following points can be made:

1. The practical importance of the above hypothesis of consumer choice cannot in any way be deemed significant unless the size of the standard deviation mentioned above is significant. This is something that can be subject to statistical testing. If a significant uniform standard deviation is found to exist then it can be used in calculations to determine the width of the possible range of outcomes of a certain policy, etc. If the standard deviation is insignificant then the whole discussion is insignificant for the purpose of applied research. The larger the standard deviation the greater the uncertainty that will be an inherent part of economic analysis.

On the issue of taking the expected value of such an error term as equalling zero the actual size of the standard deviation becomes important. The 'average' is an extremely useful device in throwing dispersions into the background where they lose importance. However the credibility of this average depends on the dispersion in the first place. Thus whether the expected value of the error terms can justifiably be taken to be equal to zero depends on the size of the standard deviation itself.

2. The hypothesis can be shot down if we define the development or superiority of a theory in a way so as to give practical applicability prime importance. The above may give insight into behaviour or may give us an idea of the limits we can hope to achieve in estimations of demand but it may be termed as unimportant because of the difficulty in the measuring of this standard deviation.

3. A further potential criticism that can be made is the fact that the hypothesis given above does not in any way explain the mechanisms that lead a consumer to actually choose out of the range of choices which he cannot decipher between in terms of superiority or inferiority utility-wise. It is silent on what happens between the identification of the range, and the final choice made. This can be seen as a factor making the hypothesis incomplete.

   But making this criticism could be seen as the result of missing the essence of the hypothesis because what one is trying to establish is that the indeterminism is a very real and unavoidable aspect of consumer choice and this indeterminism is indeterminism precisely because it cannot be determined or explained. It may be possible that an actual mechanism does indeed exist, but as mentioned in the beginning of this section the limits of the state of knowledge requires us to make the best out of such 'intermediate' modes of human behaviour.

4. The criticism of utility being unmeasurable can also be applied as it has been applied to utilitarianism, etc. However, as discussed in the previous section, no such measurement is required to achieve the results of the hypothesis, namely that at the margin a unique consumer equilibrium does not exist and hence there is ambiguity, and that the demand schedule can be shown to be downward sloping only for large changes in price.

The insight that the hypothesis provides is that economic analysis cannot be applied to small changes in variables. Large changes are necessary because even the most rational consumer will be unable to escape from a

minimum level of uncertainty regarding his choices, and this is something that can only be diminished by considering large changes in prices, incomes, etc. The demand curve has to include this unavoidable factor of indeterminism in consumer choice if it is to reflect reality.

A further insight that is provided by the hypothesis is an explanation of the concept of bounded rationality. It is no surprise that someone who is not clear in a marginal case will depend on any pieces of relevant information for support in the choice. A choice that he made in the past, or the choice that people normally make, helps a person make a choice whose accuracy and certainty is impossible for a human being. Bounded rationality is more human than pure rationality, and why this is so has been the point of this inquiry into the nature of choice.

Some Implications of the Hypothesis of Weak Comparability for Economics

The Expected Value of Choice

The homo-economicus is a man that conforms to all the theories of economics that explain and predict his behaviour. It is not very surprising that economists then are able to predict his behaviour with a greater amount of accuracy. But when it comes to actual human beings, economists have always found it most useful to assume that all consumers, or at least the vast majority, behave like the homo-economicus.

And such an assumption could be justified too. After all, everyone does try to maximise perceived utility, and it may be argued that perceived-utility maximistion can explain all choices as it allows for all errors in perception as well. One step and we reach the economist's ground: in the long run a person's choice is going to approximate the rational choice. Perceived utility approaches 'actual ex-post utility' over time. If nothing else, a person is much clearer about his preferences as time goes by. Hence it may be postulated that, in the long run, the consumer approximates the homo-economicus.

There is yet another possible justification that can be made for assuming such levels of rationality amongst all economic units. It can be argued that given that there is one and only one rational (utility maximising) choice in a certain situation, and given that all people are in search of maximum utility, then, for large numbers, the average choice must be the rational choice. That is to say that even if people, for some reason, are unable to identify that single unique utility maximising choice, everyone will indeed be attracted to it, and on average the people that make a choice Ci>Co (where Ci is the choice of the i'th individual and Co is the optimal choice) will

approximately equal the number of people that make the choice Ci<Co. Hence the actual market demand curve should be identical to the market demand curve that would result in a perfectly rational world. The expected value of the choice of each E(Ci)=Co, and thus for the aggregate ΣCi/n = Co. Because everyone *tends* towards this choice, hence the probability distribution of Ci around Co must be normal, or approximately normal, with many more individuals choosing Ci ≅ Co (i.e. Ci approximately equal to Co) than not. With this then, the assumption of rationality becomes justified.

But if we accept the weak comparability hypothesis then matters would be much different. The inability of human beings of comparing pleasures and pains at the margin leads to a range of possible choices. The individual is unable to pinpoint which choice in this range is superior or inferior to the other. This leads to an indeterminate solution at the end of the day. What does this say for E(Ci)? Quite a bit, actually.

It must be clear that the only reason we could assume that the probability distribution of Ci around Co was normal was because of the belief that *there is actually one* utility maximising choice Co. Given this, we very simply needed to take the average choice (ΣCi/n) and we could feel confident that this (observed) average must be the optimal choice. However weak comparability leads to a different result:

Weak comparability actually implies that the probability distribution of Ci is an even or uniform distribution, not a normal one. It is uniform because *each possible choice Ci in the range has an equal probability of becoming the eventual choice*. What this actually does is seriously dent the credibility of the average or mean of the distribution. In the case of a normal distribution the probability of Ci being approximately equal to Co is very high, actually the largest probability is that Ci ≅ Co. But in the case of an even distribution the probability of every single choice in th range is identical. For 'n' number of choices within the range, the probability of Ci=Co is identical to Ci being at either extreme of the range, i.e. probability of any and all choices equal 1/n. Hence the econometrician can no longer rest behind the thought that all deviations from Co will 'cancel' out or 'average' out. The probability that in any sample the number of people that choose from one extreme end of the range will equal the number that choose from the other is *identical* to the probability that all the people will choose from one end of the range. The value ΣCi/n loses its credibility in an indeterminate range.

To illustrate with the help of a simple example, imagine a market with 1000 identical consumers. This means that each consumer has the same indeterminate range of, say, the quantity of X demanded at $y. Say all

have a range of 10 to 20 units of X. The conventional approach would assume that on average everyone would choose 15X, and for every one consumer that chooses Ci less than 15X there will be a consumer that choose Ci higher than 15X by the same amount. Hence the market demand for X at price $y would be 15,000X. However if we assume an indeterminate range then no such thing can be said about market demand. The only credible thing that could be said would be that market demand for X at price $y is 10,000X to 20,000X. Hence the probability that one will find values around 15,000X to appear most of the time would be identical to the probability that, say, 19,999X would persist every time.

Just before leaving this point I would like to reiterate the fact that mathematically everything works out very well. Even for a uniform probability distribution $E(Ci) = \Sigma Ci/n$. But the 'average' can very conveniently sweep aside complications and the point of this discussion was to emphasise the fact that this average, mean, expected value, etc. may take us away from reality faster and more smoothly than may be evident. And indeed how close this average is to reality depends on the nature of pleasure-pain.

The Homo-Economicus is Human

The hypothesis of weak comparability can give us a new understanding of what the nature of the homo-economicus actually is. Conventionally the homo-economicus is assumed to be the epitome of rationality, and economics develops only after assuming that such rationality will be adhered to. He is the guinea pig on which rigorous economic models and theories are tested. Why? Because, as we have discussed before, it is believed that real economic agents can be justifiably approximated to him. However, the thesis reveals one thing. If the homo-economicus is a human (which at least the name suggests), then even his rationality is limited by a human inability to perform calculus when it comes to one's pleasure-pain.

Less has to be expected of the homo-economicus for he is human. His preferences cannot be complete because it is simply not possible for every bundle to be comparable to another for all the reasons presented in the previous section. His preferences can not be reflexive. To say that any bundle is at least as good itself, i.e. (Xo,Yo) is equal to or greater than (Xo,Yo) would require for a consumer to be dead sure about the utilities of each Xo and Yo and the comparison of these two (unidentical) utilities in terms of each other. Worse still his preferences cannot be transitive because for bundles close enough to each other if (X',X")>(Y',Y") and (Y',Y").(Z',Z") then it is as likely for (X',X")<(Z',Z") than (X',X")>(Y',Y"). Within certain ranges even the homo-economicus will give an unavoidably uncertain response.

Hence there can be no justification for building economics with purely rational building blocks because even the best custom-made guinea pigs used for their formulation do not support their predictions. The standards of rationality applied to economic agents have to be lowered, as these levels do not exist.

Indifference or Confusion?

The hypothesis can be used to argue for a re-definition of the concept of 'indifference' as it is applied in economics. Indeed if utility is homogenous in nature then utilities and disutilities can cancel each other out, leaving behind 'zero net utility'. If making a choice gives zero net utility then one is said to be indifferent between making the choice or not. In choosing between two bundles if one finds no difference in utility derived from consuming either bundle, then one is indifferent in one's choice between the two bundles. However, the hypothesis reveals that there is no such thing as zero net utility. If there is a pain and a pleasure associated with a choice, then, regardless of the magnitudes of the two, on making that choice one will feel ***both*** the pain and the pleasure. Whenever the pain and pleasure resulting from a choice has a magnitude, there is no such thing as one having 'no feeling' as a result of making the choice.

So what this means is that when one cannot decide between two bundles (because supposedly they give the same utility), it is not so much a state of indifference as it is a state of confusion. When one is stuck on a decision of whether to spend or save, it is not because he is indifferent between the two choices. Both choices give him pleasure (albeit of a different kind). It would be closer to the truth to see the situation as one of confusion that arises as a result of an inability to compare. Confusion would arise if one cannot determine whether the utility that one gains from the consumption of one bundle exceeds the utility from that of another. And the inability to compare comes from the heterogenous nature of utility.

Indifference means something different. Indifference would arise if the levels of pleasure and pain arising from a choice were too small to make the choice an important one. It is choosing between two choices that have larger pleasures and/or pains that leads to choices that have a significance to the individual. And the difficulty in choosing between two such significant choices means confusion, not indifference. If the two choices did not have large pleasures and/or pains attached with them, then the individual is in a state of indifference.

For this reason it may be correct to rename 'indifference curves/areas' as 'confusion curves/areas'!

Implications for the Theory of Value

The hypothesis of weak comparability could have some relevance to the theory of value. The theory of value tries to answer the question of what creates value within a commodity. There are two theories of value that have significance. On the one hand there is the Marxian theory of value which argues that the (exchange) value of a commodity is labour value. On the other there is what may be called the *laissez faire* theory of value, i.e. the value of a commodity is determined by the utility its consumers derive. We are back to Marshall then.

Now, let us study the quantitative relation given by the equation 2x=1y, where x and y are commodities. This means that 2 units of x are exchangeable for 1 unit of y. But what must be looked at closely is the equality sign between the two commodities. Equality means that the left-hand side and the right-hand side are identical. Thus, in 2x and 1y there must exist something that is common in both, and that too in equal quantities, such that it makes the two different commodities equal. Both x and y must be equal to some third 'thing'. And it is because the commodities contain this common 'something' that we are able to write the equation 2x=1y. Otherwise the equality sign would not hold.

We can never say that a horse and a cow are equal unless we are referring to something that is common to both of them. A certain many number of horses may be equal to one cow in weight, or in volume, but they will not be equal if we do not refer to some common 'thing' that exists in them. By similar argument, we must ask the question that if 2x=1y then what is it that is common to them that allows them to be equal. In other words, what is it that gives them both an equal value?

Here Marx argues that the 'thing' that is common to both sides of the equation is the fact that both commodities are the products of labour (and so the value of a commodity is created by the value of labour in it), whereas the *laissez faire* economists argue that 2x and 1y represent equal marginal utilities per unit of money. Leaving Marx aside, let us look at the *laissez faire* view.

If 2x and 1y both contain an equal amount of marginal utility (per unit of money), then utility being homogenous is a prerequisite. However the weak comparability hypothesis reveals that utility is not homogenous but is heterogenous. If the utility derived from x and the utility derived from y

are not identical in their natures, then MUx and MUy do not represent a 'thing' that is common to both x and y.

Contrary to what is commonly believed, the search, then, for a complete *laissez faire* theory of value is still on.

Implications for the Philosophy of Determinism

The concept of the homo-economicus reflects a certain theme that seems to run through the rest of economics. The homo-economicus is a rational animal whose choices work according to a certain mechanism. This mechanism is triggered off by a certain set of stimuli. Once the stimulus is applied, the mechanism is put to work, and man being the slave of the electrical impulses that drive his body acts accordingly. In this whole concept (which exists in contemporary economics) there is a very clear representation of the doctrine of Determinism[10]

For consumer choice to have any predictability whatsoever, Determinism is required. If the behaviour of an individual can not be found to be strongly correlated with conditions that could have caused it, then the scope of any sort of analysis of human behaviour becomes limited. The whole 'if this-then that' approach is crucial. Similarly it is required by the economist to be able to say that by taxing income from a rich person and redistributing the money to a poor man would lead to the greatest happiness of the greatest numbers. If a consumer's utility is not firmly correlated with the amount of money he has, then the utilitarian redistribution of money would run into serious problems. By hypothesising mechanisms and strong links, economics tells us that it believes in the doctrine of Determinism.

Determinism has its justifications. If a person makes a choice, then why does he do so? It is because his brain sent impulses to the relevant parts of his body to act so. But why did the brain do that? It is because the brain received a stimulus and hence gave the appropriate response. Hence his choice was determined by the impulse, and the impulse by the stimulus. And what about the role of the brain in this process? The brain just did its job by reacting to the stimulus. How? Through some kind of process that went on in the brain as a result of being triggered by the stimulus (and so even this process is being determined by something). Hence every thing is

[10] The doctrine of Determinism is the doctrine that all events are the inevitable result of antecedent conditions, and that the human being, in acts of apparent choice, is the mechanical expression of his heredity and his past and present environment. This is an anti-thesis of the doctrine of Free Will, i.e. the doctrine of the freedom of the individual, in acts of conscious choice, from the determining compulsion of heredity, environment, and circumstance.

determined by something, and in the same way even the stimulus was determined by something else. This is Determinism.

This certainly does not say much for Free Will because this apparent act of choice is actually the result of a series of antecedent events (starting from the stimulus all the way to the final response). Man might feel like it is he and only he who has made the choice and that he was never in any kind of compulsion to behave in that manner. But no. The only reason why he feels like that is because for him that choice was the most appropriate and the most pleasurable (utility maximising). Compulsion would have existed if he was forced to make a choice that he did not wish to make. But that does not say much about any freedom of his Will because this system of pleasure-pain is determining the very feeling of freedom of Will. If he is determined by nothing else, then he is certainly determined by the system of pleasure-pain. And it is precisely because this is what his choice is determined by that he feels confident saying that he chose what he wanted or felt like choosing (for he will not wish to choose anything other than what he wants or feels like choosing). To prove my point let us consider the argument that one would give in favour of his Will, i.e. that there was no compulsion because he did not make a choice that he did not wish to make. If there was some new 'pain' attached with the choice that he wanted to make, such that the second-best choice now becomes his best choice, then what will he do? Certainly he will make the choice of this option that he once did not wish to make. Thus the thing that makes him choose is not the choice itself, it is the pleasure-pain associated with the choice. Hence, if nothing else, the doctrine of Determinism exists in the system of pleasure-pain.

A very heavy argument against Free Will indeed. In my mind it actually proves to us that there is no such thing as Free Will as we understand it. Our Will is determined by pleasure-pain, so what Free Will can anyone talk about? But the hypothesis of weak comparability can actually contribute to a case I would like to present against Determinism.

I believe that a very important question is often forgotten to be asked whenever the Determinism-Free Will debate is underway: Whenever anyone uses the term 'my Will', then who exactly is 'I'? I believe that unless the 'I' is defined the debate is incomplete. The case I shall be presenting is a two-part case, and it runs thus:

The process of choice-making involves a chain that can be given by 'stimulus-brain-response'. In this chain, the brain refers to all the internal processes that go on inside of a person which eventually lead to his response, his choice. The brain is something that is still in the process of discovery and as I said earlier it is the Brain Sciences that will eventually tell us what exactly

the brain is. Nevertheless, given the present state of knowledge we know that the processes in the brain have to do with pleasure-pain.

Now, contemporary economics would have us believe that the processes in the brain involve a clear process of utility-disutility comparison. At least, on average the response will be the optimum choice. Hence this understanding actually binds the three elements of the process of choice making (stimulus-brain-response) very closely together. The hypothesis of weak comparability tells us something else. Weak comparability reveals that processes in the brain are in no way exact, in the sense that for any given stimulus or set of stimuli, the brain can not give us one single response. Rather its response is indeterminate within a range of possible responses. Uncertainty is an inherent characteristic, an idiosyncrasy of the brain. Hence, according to the hypothesis, the 'stimulus-brain-response' chain is not tightly bound.

This was the first part of the case. The second part concerns the question of who 'I' is. Now, the behaviourism of contemporary economics implies that 'I' am the sum-total of what I do, of my choices, of my observed final choices. 'I' am what my actions make me. This means that economics defines 'I' as being only the last part of the chain stimulus-brain-response. That is to say that 'I' am the response part of the choice-making process. Once this is clear then it is easy to see how Determinism finds its place in contemporary economic thought. If 'I' am just the response, then there is no doubt about the fact that 'I' am Determined. The chain says lucidly that the stimulus eventually determines the response. Whatever the brain processes may be or may not be, they do precede the response, and hence the brain processes do indeed determine the response. At the end of the day, all of us make choices, and all these choices are determined by at least a process that precedes it. Hence, 'I' am Determined.

However if we define 'I' to include the processes that go on inside us to determine your choices then a different story can arise. If 'I' am the 'brain-response' portion of the 'stimulus-brain-response' chain then matters change. But this is dependent on what we understand by the nature of the brain processes.

If we accept the tightly-bound view of the chain then Determinism can be shown to exist in the chain. The response is tightly bound to the brain processes, and brain processes to the stimulus. Hence the response is still tightly bound to the stimulus. The response is still determined by the stimulus and the brain acts like a medium that is simply transmitting. It just 'passes on' the stimulus, so to speak. However, the hypothesis of weak comparability gives us a different interpretation. *The fact that the brain*

produces indeterminate responses weakens the link between the stimulus and the response. And given that the brain processes are a part of 'I', ***'I' am thus not determined by the stimulus.***

It must be clarified that the above case is not in any way a case for the Free Will. It does nothing to show that in the choice-making process there is an element of control that 'I' has over 'I'. Hence, there is no support for Free Will, as we understand it. The case was basically one against Determinism and, at best, it can be used to support non-Determinism, i.e. that man is not Determined. This may imply either that Free Will might exist in a different way, or that choice is a result of a mix of Free Will and Determinism, or that choice is a result of a mix of uncertainty and Determinism, etc.

So if the economic agent cannot be subject to the doctrine of Determinism, then economics needs some revision. All economic theories involve the economic agent, the human beings, and if these theories are to explain reality then economics must work towards a more realistic model of man and his behaviour. After all, we are, at the end of the day, talking about real human beings.

References

Marshall, Alfred 1961, Principles of Economics, 1920 9th (variorum) Edition – London, Macmillan.

Hicks, J.R., 1946 Value and Capital, 2nd edition Oxford: Clarendon Press.

Arrow, Kenneth J., 1963 Social Choice and Individual Values, 2nd edition New Haven. Conn, Yale University Press.

Samuelson, Paul A., 1983 Foundations of Economic Analysis, Enlarged Edition, Cambridge, Mass., Harvard University Press.

Problems of Working Women in the Rural Informal Sector of Punjab (Pakistan)

Karamat Ali & Abdul Hamid*

I. Abstract

The informal sector plays a significant role in Pakistan's economy as well as in other developing countries. The role of the informal sector in solving the unemployment problem of Third World countries has become the focus of a conceptual and empirical debate in recent years. Most of the research takes a favourable view of this sector and suggests that it should be used as a policy instrument for the solution of the most pressing problems of developing countries, such as unemployment, poverty, income inequalities, etc. Before proceeding further, we will define the informal sector and differentiate it from the formal sector. There are various definitions, but the one given in an ILO report (1972) is generally considered the best. According to this report, informal sector activities are ways of doing things characterised by a heterogeneous array of economic activities with relative ease of entry, reliance on indigenous resources; temporary or variable structure and family ownership of enterprises, small scale of operation, labour intensive and adapted technology, skills acquired outside the formal school system, not depending on formal financial institutions for its credit needs; unregulated and unregistered units, and not observing fixed hours/days of operation.

The importance of the informal sector can be gauged by its contribution to national income and employment and its contribution to financial credit as compared to that of the formal sector. According to Moirs' study, "The contribution of informal sector to the income in Jakarta was about 30 per cent and the number of urban jobs provided by the informal sector were estimated to be between one quarter and two-thirds" {Hemmer and Mannel (1999)}. The share of the informal credit to total rural credit in many developing countries was estimated to be from 30 per cent to more than 80 per cent [Germidis, (1990)}.

The informal sector plays a vital role in Pakistan. The share of the informal sector in the urban employment of Pakistan was estimated to be about 69 per cent for the year 1972-73 by Guisinger and Irfan (1980). The World Bank (1989) also estimated the employment share of the informal sector in urban Punjab to be 78 per cent in 1984-85. Ahmad (1989) calculated the share

* The authors are Professor and Lecturer in the Department of Economics, Bahauddin Zakariya University, Multan, respectively.

of the informal sector in the total employment of Pakistan as 74.48 per cent for the year 1984-85. Despite the significance of the informal sector in Pakistan, there is limited attention paid to and research done in this sector and especially in the rural informal sector. Although women's role in the rural informal sector is very significant, it has been completely ignored. There is hardly any research on working women in the rural informal sector of the country.

The object of this paper is to analyse the role and contribution of the female labour force in the rural informal sector of Punjab and to highlight the problems of working women in this sector in the light of the survey results. The layout of the study is as follows: literature review is given in section II. Section III is a description of the survey. Survey results are discussed in section IV and finally policy implications and conclusions are given in section V.

II. Review of Literature

Very few studies are available on the informal sector of Pakistan and especially on the rural informal sector of the country. Guisigner and Irfan (1989) delineated the main features of Pakistan's informal sector, with the help of data from censuses and sample surveys for Rawalpindi. Their findings were that real wages in the informal sector have increased during the 60s and 70s and that this rise of wages in the informal sector could be accounted for by the rise of the real wages in both the agricultural and large scale manufacturing sectors of Pakistan. They found the share of the informal sector in urban employment of Pakistan to be as high as 69 per cent.

Germidis (1990) carried out a study on the financial share of the informal rural sector in developing countries and found that the financial contribution of the rural informal sector was very significant. He estimated that the share of informal credit to total rural credit in many developing countries was from 30 to more than 80 per cent.

Khan (1983) estimated the earnings functions for the informal sector of Lahore and his main finding was that education was the most important factor which affected the earnings of both male and female. The main conclusion of the study was that wages in the formal sector were higher than those in the informal sector for both males and females, irrespective of their educational qualification. Though Khan's results are good, his study suffers from certain limitations. She chooses a specialised definition to differentiate the formal sector from the informal sector. According to her definition, professionals, executives and government servants are included in the formal sector while the informal sector comprises skilled workers, petty businessmen, private employees, artisans, mechanics, and casual labourers. It

may be pointed out that production workers are also included in the informal sector. That is why her definition overestimates employment in the informal sector.

Khan (1990) found that the share of female employment in the informal sector has considerably increased. According to the study, this share has increased from 61.4 per cent in 1981 to 84.9 per cent in 1987-88. The increase was most pronounced in urban areas as it went up from 13.3 per cent to 45.8 per cent and in rural areas it increased from 76.9 per cent to 91.4 per cent during the same period. Ahmed (1989) also calculated the share of employment in the informal sector of Pakistan and according to him this share was 74.48 per cent for the year 1984-85. For the same period, the World Bank also estimated the share of the informal sector in employment in the urban Punjab as 78 per cent.

Fluitman (1987) on the basis of 17 enterprise level questionnaires and 48 questionnaires for individual participants for Lahore and Rawalpindi, found that the share of informal sector employment to total employment was 47 per cent. He further found that all the entrepreneurs in the informal sector were earning more than they would in the formal sector and this refuted the commonly held view that earnings were lower in the informal sector.

Hayat and Qamar (1987) did an analysis of employment opportunities in the rural informal sector and found that most of the activities in the informal sector are undertaken as an additional source of income. They conducted this study for four districts in the Sindh province.

Sattar and Kazi (1988) analysed the problem that working women face in the informal sector. They distinguished formal and informal sectors from each other by adopting a very *adhoc* definition. According to this criterion, workers residing in *Katchi Abadies* and other low income areas were included in the informal sector and the rest belonged to the formal sector. According to this study, most women working in the informal sector were poor, illiterate and in poor health. They were low-paid workers and had to work to fulfill the basic needs of their families. They faced many other problems as well.

Ali, K. (1990) worked on the problems of working women in the rural informal sector of Multan District. Based on survey data for 30 respondents in five villages of Multan, he found that most of these working women started working as children, most were illiterate, unskilled and in poor health. They were usually engaged in home-based work and services. Their income was found to be low and the majority of them were working to finance their large, dependent families. On the average, each family had

nine members. Survey results showed that about 83 per cent of the total respondents received wages lower than those paid at the market rates for the same quality and quantity of work. Based on the survey, he also suggested measures for the improvement of the conditions of these working women. According to his study, their conditions can be improved by providing reasonable wages and raw materials and by bringing markets within their reach for the sale of their products.

Ghayur, S. (1990) worked on the urban informal sector and the need for a labour market information system for this sector. According to him, exploitation can be eradicated and employment opportunities increased by developing a labour market information system for the informal sector of the country.

Ahmad, V. (1990) analysed the problems of the informal sector and suggested policy measures for their solution. He said that the informal sector of Pakistan is handicapped by stagnant technology, low productivity and substandard working conditions which limited the ability and performance of the informal sector to play its role effectively in the economy. He said that suitable public policies would assist the informal sector in meeting these challenges.

From the literature review, it is clear that very little research has been done on the role and problems of working women in the rural informal sector. In this paper an attempt has been made to analyse the role of working women and to highlight their main problems in the rural informal sector of Punjab (Pakistan).

III. Description of the Survey

About 70 per cent of the population in the Punjab province resides in villages and females constitute about half that population. The female labour force plays a significant role in the rural informal sector of the Punjab. In order to achieve the objectives of the research paper which were mentioned earlier, a survey was conducted for eight districts including Multan, Kasur, Bahawalpur, Layyah, Sargodha, Jhang, Attock and Sialkot. On average, five villages were surveyed in each district randomly. In each selected village one per cent of the households were selected randomly for the purpose of the survey. In each household, one female was interviewed. The sample is made up of 30 to 40 respondents from each village.

IV. Result of the Survey

Present age and age at which Women Started Working

Most female respondents were found to be young and were of age between 15 to 30 years. 34.15 per cent of the total respondents were between 15 to 20 years of age and 33 per cent were of the age between 21 to 30 years. The age at which these women started working indicates that about 53 per cent of the total respondents started working when they were less than 15 years of age. It means that they had started working as child labourers. The highest incidence i.e. 72 per cent of such child labour is in Attock and a minimum, i.e., 30 per cent is in Layyah.

Marital Status and Education

In all the districts, the married women constituted the largest single group among the working women in the rural informal sector. The unmarried women were less numerous in the sample. Married women make up 47.52 per cent and un-married 37.81 per cent of the sample. Among all the surveyed districts, Multan has the highest percentage (67 per cent) of the married women in the sample and Attock the lowest (28 per cent). The survey data also revealed that the majority of working females were either illiterate or only able to read the Holy Quran. On average 57 per cent of total respondents could read the Holy Quran, while 27 per cent were totally illiterate. Only 12 per cent women had had some form of formal education ranging from primary to secondary level. Only 2 per cent had done their matriculation.

Family Size and Income of Family

Large family size and low income levels of respondents were the two characteristics which all the districts had in common. On average, in all the districts, each family consisted of 7 members. Multan District had the highest figure for family size, i.e., 9 per family and Bahawalpur the lowest, i.e., 6.37 per family. On average, in each family three members work and earn something, and of these working family members, women make up 50 per cent, each of them earning 12 rupees per day on average. These details highlight the extremes of poverty and very low wages which are these women's lot. Women contribute about 34 per cent to the daily income of their families. This figure illustrates the significant role these women play in the rural informal sector of the Punjab.

Other Information

For each District, the information about working days in a month and working hours in a day was collected. For the respondents in all the District the average figure is 24 working days per month. The highest (26 days per month) is in Multan and Sialkot Districts while the lowest (18.6 days per month) is in Sargodha District. The average figures in all districts for working hours per days is 6, the highest being 9.96 per hours per day in Jhang and lowest being 4.66 hours per day in Sargodha. These figures indicate that the women in the informal sector work as much as the women in the formal sector. However these women are usually exploited and the wages of women working in the rural informal sector of the Punjab are much lower then those of the women working in the formal sector.

Reasons for Working

The survey also looked at the reasons that make women work in the rural informal sector. The survey reveals that about 55 per cent of the total respondents have been forced to work due to abject poverty, to fulfill their and their families' day to day needs such as clothing and shelter. If we include those respondents also who work to facilitate their domestic requirements, then this average will rise to 75 per cent in all the districts surveyed. Fulfillment of basic economic needs as a reason for working applies to the highest percentage of respondents in Bahawalpur District and to the lowest percentage of respondents in Layyah. To provide their children education, unemployment and death of the working male bread winner are the other reasons for working and account for 5.22 per cent. 4.49 per cent and 8.44 per cent of the respondents respectively. There are some other reasons for working for instance, to provide a dowry and to pass time etc. The percentage in this regard is 5.42.

Work-Related Problems

The major job related problems confronted by women were also looked into. The major problem is the disproportionately low wages paid to women for the work done by them. About 61 per cent of the women working in the informal sector are not paid what is their due according to market rates. Other problems are difficulties in buying raw materials, problems of selling commodities as markets are too far away and time taken up by domestic engagements, etc. However, the major problems are economic rather than social and cultural as appears from the survey data. These women have to deal with males outside their families, and their job related activities are frowned upon by their families and friends or neighbours. They make up only 5 per cent and 3 per cent of the respondents respectively.

Suggested Measures

The respondents were also asked to give suggestions which could facilitate their work. More than half the respondents (55.14) wanted steps to be taken that would lead to higher wages for their work. About 34 per cent had suggestions concerning better training and education facilities. 22 per cent were those who wanted something done about the availability of better raw materials. About 18 per cent of the total respondents required other facilities such as a financial system, banking system, roads and transport etc. The percentage of respondents who suggested better market facilities was 11.48.

V. Conclusions

Women play a significant role in the economy but unfortunately their work and contribution have been underestimated. They are accorded no recognition or respect. Most of their work and income are not even counted in the national income accounting. As is apparent from the surveyed data for the Punjab, women in rural areas of Pakistan not only work in the agricultural sector but also play a significant role in the rural informal sector of the country. They make up half of the labour force in the rural informal sector of the country. Women working are stretched to their endurance limit, devoting all their energy and time in unfriendly or often hostile conditions. They work as much as the women in the formal sector i.e., they work 26 days a month and 6 hours a day. But the wages they are paid are lower than the wages in the formal sector. The average daily income of such women is only rupees 12. They are usually poor, malnutritioned, sick, uneducated and unskilled. Inspite of this, they make up 50 per cent of the labour force and contribute about 34 per cent to the total family income. More than half of them started working as child labour. A major reason forcing them to work is to fulfill the basic needs of their large family. Major hinderances in the way of working are very low remuneration or wages, non-availability of adequate raw material and absence of markets for the sale and purchase of commodities. The analysis in the preceding paragraphs makes it very clear that working women in the rural areas are the most neglected segment in the population of Pakistan. Moreover, it is not the cultural and social obstacles which hinder women's participation in economic activities and the contribution they can make to the development of the country and to their own well-being. Rather, the economic factors are mostly responsible for the miserable plight and exploitation of working females in the economy and especially in the rural informal sector of the country. They are a great hurdle in the utilisation of their skill and time. There is an urgent need to remove these obstacles and to improve the living and working conditions of the women in the rural informal sector of the economy. They should be provided education and training, be paid wages

according to their work, and should be given access to better raw materials and markets and other facilities such as hospitals, educational institutions and training centers, banks, transportation, etc. so that they may work in a better environment and play their part for the prosperity and development of the country to the fullest extent possible.

References

Aftab, K. and E. Rahim, 1989, "Barriers to the Growth of Informal Sector Firms: A case study of Pakistan", *Journal of Development Studies, Vol. 25(4)*, pp 490-507.

Ahmad, E. Arshad, F. and Ahmed, A., 1990, "Learning and Earning Profiles in Pakistan's Informal Sector", A paper presented in the National Workshop on Informal Sector of Pakistan: Problems and Policies, Islamabad, September, 12-14.

Ahmed, N., 1989, "The Role of Informal Sector in Providing Urban Employment and Services in Pakistan", Paper presented in the International Workshop in Improving Urban Management Policies held at West Centre. Hawaii, Jan. 9-13.

Ahmed, N., 1990, "Women Home Based Piece-Rate Workers: A study", Paper presented in the National Workshop on Informal Sector of Pakistan: Problems and Policies, Islamabad.

Ahmed, V., 1990, "The Informal Sector: Need and Options for a Policy Framework", paper presented in the National Workshop on Informal Sector of Pakistan: Problems and Policies, Islamabad, September 12-14.

Ali, K., 1990, "Problems of Working Women in the Rural Informal Sector of Multan District", *Pakistan Economic and Social Review Vol. 27(2)*, pp 89-104.

Burki, A.A., 1990, "Returns to Human Capital in the Informal Sector: Some Evidence" paper presented in the National Workshop on the Informal Sector of Pakistan: Problems and Policies, Islamabad, September 12-14.

Chaudhry, H.R., 1990, "Self-employment in the Urban Informal Sector: A Socio-Economic Problem", Paper presented in the National Workshop on Informal Sector of Pakistan: Problems and Policies, Islamabad, September 12-14.

Fluitman, F., 1987, 'Training in the Urban Informal Sector of Developing Countries: Some Recent Findings of Local Observers' Geneva: ILO.

Germidis, D., 1990, "Interlinking the Formal and Informal Financial Sector in Developing Countries", *Savings and Development* Vol. 15(1), pp 5-22.

Ghayur, S., 1990, "Urban Informal Sector and Labour Market Information System: Consideration on Integrating the Both", paper presented in the National Workshop on Informal Sector of Pakistan: Problems and Policies, Islamabad, September 12-14.

Guisingers S. and M. Irfan, 1989, "Pakistan's Informal Sector", *Journal of Development Studies, Vol. 16(4)*, pp 412-426.

Hayat, K. and N. Qamar, 1987, "Employment and Income Generation Through Household crafts in Rural Areas of Sindh, in Synthesis Report of a workshop on: Employment Promotion organised jointly by Pakistan Manpower Institute, Islamabad and Friedrick Ebert Stifting, Germany, November 28-29.

Hemmer, H.R. and C. Mannel, 1989, "On the Economic Analysis of Urban Informal Sector", *World Development Vol. 17(10)*, pp 1543-1552.

ILO, 1972 Employment, Incomes and Equality: A Strategy for Increasing Productive Employment in Kenya, Geneva.

Khan, S., 1983, An Economic Analysis of Personal Earnings in Urban Formal and Informal Sector of Employment, *Pakistan Economic and Social Review 21:1&2*, pp 1-14.

Khan, S., 1990, "An Assessment of Changes in the Employment Situation of Pakistani Women in the Informal Sector", Paper presented in the National Workshop on Informal Sector of Pakistan: Problems and Policies, Islamabad, September, 12-14.

Kibria, G., 1990, "Engineering Industry in the Informal Sector", A paper presented in the National Workshop on Informal Sector of Pakistan: Problems and Policies, Islamabad, September 12-14.

Mahmood, Z., 1990, "The Informal Sector of Pakistan: Some Neglected Issues", National Workshop on the Informal Sector of Pakistan organised by Deptt. of Economics, QAU, Islamabad, Pakistan, September 12-14.

Mazumdar, D., 1976, "The Urban Informal Sector", *World Development, Vol. 4(8)*, pp 655-679.

Sathar, Z.A. and S.Kazi, 1988, "Production and Reproductive Choices of Metropolitan Woman: Report of a Survey in Karachi, Islamabad, Pakistan Institute of Development Economics (PIDE).

World Bank, 1989, 'Report on Pakistan --- Employment Issue in Pakistan', Washington, IBRD.

Empowering People: How?

Shahid Kardar*

Few would deny that there is increasing disillusionment with democracy as practised today in Pakistan. The experience with dictatorships has been equally disenchanting. Since both dictatorships and elected governments have failed, a common refrain these days is the need to empower people through democratisation, decentralisation and opening up of new avenues for participation in politics to enable them to change their own destinies.

Although the Constitution of Pakistan bestows a host of rights in all citizens, for the vast majority these rights exist only on paper. The common lament in this case is that creating rights is one thing, implementing them and enabling people to secure and exercise these rights is quite another. Used in this sense, the concept of empowerment seems to involve the building up of the economic, social and political capability of all segments of society, including, above all, the marginalised and less organised groups and social classes, since not only are there deep-rooted inequalities of income and wealth (with over one-third of the population living below the poverty line), inequalities are also built into the traditional structure of society based on gender, religion and ethnic background. In other words, the concept has become a catchall slogan that carries different meanings in different situations on who is to be empowered and how. What does the term mean? Have we sloganised a terminology that only manifests itself meaningfully when applied to Western societies and polities and gets devoid of its intrinsic character when applied to our social, political and economic structures? What forms can it acquire here to take on a character more in tune with our institutional framework and social and cultural values?

The above questions are relevant for a discussion on empowerment in our environment, since the accomplishment of social transformation, especially of the economically disadvantaged groups, as a way of empowering people, will require a rearrangement of the power structures. What would the new underlying relationships and power structures look like? How would the role of the State be redefined and re-configured? How do we build these new, but basic, institutions of good governance that ensure a fair deal for all, and particularly for the handicapped sections of society? Since rights are a product of social relations, will the entrenched groups in society meekly

* Director of Systems (Private) Ltd., currently, Minister of Finance, Government of Punjab.

accept demands for transforming the social order without putting up a fight? Can the existing systems and institutional structures of criminal justice and administration, which are not independent of the executive, ensure the protection of the various rights granted by the country's Constitution and supporting framework of legislation? All these questions require clear answers, since the manner in which the concept of empowerment has been expounded to-date seems to suggest that it is both a means to an end as well as an end in itself. And since the broad objectives associated with the concept include the enhancement of the civil, political, economic and social rights of the people, we need to see what ways have been devised domestically to first secure and then expand these rights. How successful have these efforts been? In which direction should we be moving in the future?

As indicated above, the need for elaborating on the concept has arisen from the huge gap, if not contradiction, between the procedural features of the democratic political system in the country, i.e., the formal aspects of political participation, on the one hand, and the extent of democratisation of the political culture, the society and the institutions of the state, i.e., the degree to which political participation is effective, on the other. It is not that there have been no improvements over time (described later below) but that these changes have been marginal in comparison with the expectations aroused in 1947, and are also the need of the hour. For instance, electoral voting, one of the processes for democratic participation has been in practice for some time and has had some successes to its credit, but the achievement has been far less than its promise and the expectations that were linked to it. For ordinary voters the attraction for participation has withered over time, since change in governments has not meaningfully altered their lives. It is not that the political and state structures have completely ignored these demands. They have accommodated some of these demands, with the different groups (in particular the different nationalities) articulating their grievances more stridently and vociferously, although these concessions were made reluctantly, haltingly and, in effective terms, inadequately and well below the quality and level of participation demanded in the decision-making processes and structures.

At one level these structures established and nurtured a system of quotas to empower disadvantaged groups, identified on the basis of their place of birth. Quotas are supposed to empower these groups (by selecting the most meritorious among them) by ensuring an equitable representation of the different nationalities in the decision-making structures and key institutions managed by government - the civil bureaucracy and public sector enterprises.

At the political level, the State structures gave representation to different nationalities (identified through their provincial/administrative links) in parliament – in the National Assembly on population basis and in the Senate in equal numbers. At yet another level, an institutional framework was set up, in which provinces were granted a measure of autonomy. To enable people at the local level, remote from the provincial capitals, to organise their lives, the provincial structures were further decentralised by creating a more basic representative unit of government, the local government.

However, as argued above, none of the Constitutional arrangements has come up to peoples' expectations. One reason for the nature and scale of the problem is the weak rooting of the concepts of civil, political and social rights in our social order. These concepts are relatively new for both society and politics. Within the prevailing social order individual freedoms have traditionally been subordinate to group or community rights. The building blocks of our social order have been groups as opposed to individuals as autonomous entities and agents and the relationship between the individual and society is largely mediated through the *biradari*, tribe, family or the community. Empowerment as an alternative, using modern symbols and institutional arrangements, will require a slow dismantling of these social structures before new ones can be firmly put in place. In industrialised societies, the middle class is the moving spirit of a democratic system, since it has a vested interest in it. In societies where such a middle class is still in its early stages of formation, what supposedly constitutes our "national polity" manifests itself in the form of the above referred ethnic, *biradari* and tribal loyalties.

The discussion above raises an obvious question. Should we create new institutions or can we place our hopes for the future on existing institutions, which can, supposedly, after some modifications and changes, ensure the development of participatory, transparent and accountable systems and structures of governance? If the presently inefficient existing institutions and systems can perform the new role being envisaged, how will they have to be reformed, since empowerment of people will work only if legislatures, policing and legal and judicial systems function properly? A functional legal system to enable and further such empowerment and a political system that allows the legal and judicial apparatus to function independently are part and parcel of what constitutes the essential ingredients for the successful empowerment of people. But if these institutions and procedures are to be reformed, is it more important to perform this task in a piecemeal fashion, or at the lowest level first or should the underlying issues be addressed at all levels of the hierarchy simultaneously?

Moreover, real empowerment of people can only be achieved if they are literate, healthy and capable of exploiting economic opportunities. So, what political, social and cultural structures, institutional arrangements, mechanisms and systems will enable us to educate our population, establish a rule-based political order and ensure the development of a neutral and independent police and an impartial and independent judiciary? Can an impartial system of policing and a just legal and judicial system be established without new reform criteria, in terms of qualifications, credentials and training for screening both new entrants and existing cadres of the police and the judiciary?

Some of the more vocal and articulate voices in civil society, with the support of donors, are also advocating other mechanisms and initiatives to empower people. The most important of these are provision of micro credit, poverty alleviation programmes and development and management of economic and social services through community participation. The government is also supporting some of these initiatives through SAP (Social Action Programme) and the newly established Poverty Alleviation Fund. But such governmental efforts to avowedly empower ordinary people contradict a host of other attempts to either centralise or weaken endeavours to decentralise, e.g. the 15th amendment, the strategy currently operational in Sindh, the attempt in the recent budget to impoverish local governments by abolishing Octroi and Zilla Tax, etc. How can such tendencies coexist? Empowerment of people can only be achieved if policies and strategies proceed in tandem and efforts are dovetailed to ensure that all initiatives are nudging society in the same direction. Which raises the question how to link these informal structures and mechanisms with the formal institutional framework and systems, to make the effort of civil society institutions to empower people meaningful and effective?

There is little doubt that in a country of Pakistan's dimensions and diversity ultimately only the government machinery can reach all sections of society. And there is no method for empowering the rural poor nationwide that can completely bypass the bureaucracy and the government. Hence, the need to improve the social composition of the membership in the strategic public sector institutions. However, this may be easier in some institutions compared to others. For instance, the different groups in society can be more easily accommodated in Parliament than in say PIA or the Atomic Energy Commission.

Although under the Constitution the rights of citizenship are vested in individuals, irrespective of sex, race, religion and creed, there is moral support for policies that grant precedence to the rights of some groups in the name of social justice. As mentioned earlier, our way of empowering

certain groups in the name of social justice has been through a system of quotas.

Part of the demand for quotas in public service stems from the mindset that expects the state to act as the employer of last resort, and sees expansion of government as the answer to unemployment. Although new opportunities have arisen, the attraction for government service has not diminished, largely in part because of lack of institutional mechanisms for ensuring the accountability of public servants. Moreover, since the middle class was essentially created by the state (through provision of employment in the public sector) and did not emerge from the dynamic process of growth it has, as yet, not come around to believing that it can advance without State patronage; thereby providing one of the explanations for the urge to acquire control over State institutions.

This empowerment of groups based on their place of birth through the system of quotas is in conflict with, and discriminates against, the Constitutional provision for equality of opportunity for all citizens; that the quota system as implemented, functioned poorly and did not address the issues which had led to its construction, is another matter. Also, merely bringing about a change in the social composition of an organ of the State or public sector may not be enough to bring about a transformation in the way in which power is exercised, and the manner in which authority is dispersed.

Instead of the system of quotas being phased out after 20 years, it has been extended for an additional 40 years in the interest of equality, social justice and greater representativeness of institutions. As a result, the rights of citizenship have been sacrificed in the interest of group rights symbolised by quotas on the basis of regional backgrounds/domiciles, with all the inherent implications for the efficiency of services provided by public sector agencies. However, this demand for quotas will get diluted over time as the role of the private sector in the economy is expanded, public sector enterprises are privatised, and the scope of provincial autonomy and decentralisation is extended, the latter through the administrative and financial strengthening of the lower tiers of government.

The legitimacy of the government and the effectiveness of parliament as an instrument in policy making and the manner in which the executive views this role, including the extent to which it is representative of the demographic and social structures (and the changes taking place in them over time), is important for creating the legitimacy of the political structures.

A political order can only be sustained over time if it acquires legitimacy through its wide acceptance as fair and equitable. In our case, the moral legitimacy of the system has been progressively undermined over time. There is a sense of helplessness that the political and social order cannot be transformed simply through holding elections regularly or by enacting good laws. Although the economics of the market is excluding the poor, the politics of democracy is including them. The rich and the professional middle classes, though small in number, play a more dominant role in the market. But the poor, large in number, now have a stronger voice in politics, and hence the mismatch. This has been partly responsible for the change in the social composition of the leadership in the political parties making it more accessible to the people. However, these developments have not led to any great enhancement in the political power of ordinary voters. Economic reforms that ignore the social and political dimensions are destined to fail. Consequently, the radical transformation in the political structures required for empowerment will involve changes in the social composition of the key institutions in society and, particularly, in the state structure and its institutions.

Will the change that people are looking for come from some other mechanisms, processes and institutional arrangements? Perhaps this realisation and the sense of resignation, especially with the evident failure of secular and liberal thought to provide an alternative, provides one possible explanation to the growing numbers of youth aligning themselves with the right wing parties. The social composition of the leadership of these parties appears to be less alien, more open and has seemingly demonstrated greater capacity to absorb the growing numbers of educated youth from middle income households, whose accommodation and upward mobility would be highly restricted in the formal and more well-established political parties where hereditary, filial and social class relations count for more.

Under the present structure, power is centralised either in Islamabad or at the provincial headquarters whereas people are located at the local level. The power that people can practically exercise at the local level cannot check the political power of those located at higher levels. Electoral reform and an active judiciary, can, at best, address the symptoms. The solution lies in changing the role of ordinary people from passive recipients of services to active participants in the conceptualisation, design and delivery of services, i.e., by empowering them. Which means that power will have to be brought down to them through minimum governance from Islamabad or the provincial capitals. This will have to be achieved through a restructuring government, requiring, as a pre-requisite, a reduction in the importance of Islamabad and the provincial capitals, such that the political, economic and service delivery systems become more responsive to citizens' demands.

The level of provincial autonomy and the limitations within which it is allowed to be exercised has further charged the environment already characterised by disgruntlement and a sense of alienation in the provinces. This has manifested itself in the growing stridency in the demand for greater devolution, especially owing to the ham-handed execution of a strategy under which representative government at all levels is somehow good for the Punjab but not for the other provinces. The political and State structures hold elected institutions in contempt. Only this can explain why it is easier to dismiss elected governments (at all levels) than a clerk in government service-where elaborate procedures come into play to protect even those patently corrupt.

Greater decentralisation is widely regarded as the panacea for these problems. If decentralisation is the answer to some of our major problems, what should decentralisation mean in the context of Pakistan? What form should it assume? Is the present political and administrative structure of local institutions sufficiently representative and adequately equipped to fulfill the functional obligations that they are being expected to perform? There is enough evidence of the growing criminalisation of our political structures, especially at the level of local governments. The dubious credentials of those who presently constitute the Pakistani class of local "notables" prompt many to express concern on the limits, and pace, of decentralisation, suggesting that the tasks of selecting the functions and powers to be decentralised and assigned to local governments and the phasing and sequencing of this mandate would require careful handling. To illustrate, there would be a great deal of apprehension in transferring law and order and policing functions- and the authority to control and exert force- to local governments controlled by shady characters protected by "local representatives".

If existing institutions, and those voted into them, are not adequately representative and do not articulate the dominant views within their constituencies, how do we improve their representativeness? If electoral reform is not the answer – which, based on similar experiences of so many other countries, it clearly is not- how do we get representative institutions to articulate the views of civil society? Since civil society institutions cannot substitute the State, how can inputs from such institutions find formal recognition in the institutional arrangements, i.e., how will the system internalise these inputs? Who will articulate these views? Even if they function essentially as watchdogs and resource centres, do civil society organisations have adequate capacities (in issue analysis, advocacy and outreach) to play their potential role in the formulation and implementation of public policy? Are there organised groups within civil society with the kind of integrity and credibility- both responsive and

accountable to the stakeholders- to stake a claim to some legitimacy to lobby and pilot these causes? Having raised more questions than provide answers for, this article will restrict itself to an examination of the issue of decentralisation focusing on the devolution of powers to local government institutions. Future articles will attempt to address the unanswered questions in detail.

Decentralisation-Part II

There is little doubt that the political and administrative machineries of the federal and provincial governments have become excessively flabby, that has resulted in the development of a situation in which we have one public servant for every 35 Pakistanis. They have over-burdened themselves with functions that fall naturally within the functional domain of local governments. Decentralisation in these circumstances can, therefore, be expected to reduce workload and congestion in the channels of administration and communication. Efficiency requires a centralised revenue collecting system but a decentralisation of expenditures on services; the latter because of the variations between the needs of different areas and because locals can best determine their own needs and priorities. It will also increase efficiency in the provision of services, particularly in the case of services which are not characterised by significant economies of scale and the coverage of which is essentially limited to small jurisdictions.

Moreover, in the 52 years after independence practical problems of administration, governance and development along with people's aspirations for power sharing and the growing demand for widening of space for people's organisations have underlined the need for decentralisation.

However, in Pakistan, the attempts to decentralise authority have at best been halting, few and far between, and generally in the form of administrative solutions rather than decentralisation of political power. Whereas there has been a legal transfer of power, in practical and administrative terms local governments are still controlled by the government, i.e., autonomy exists in form but not in reality. Both hierarchically and through institutional arrangements they are subject to political interference by higher levels of government. The regulatory mechanisms available to the provincial government include approval of projects, budgets and taxation proposals of local councils and appointments/ transfers of their key personnel. In addition, there are legislative provisions regarding the supervision and inspection of the councils to their dissolution by the provincial governments. In the rural areas in particular, the power structure is still within the control of the

district bureaucracy. This is partly because the administrative machinery does not report to a political authority at the local level. Different legal enactments have facilitated this. Checks and balances instead of being internal to local governments are being exercised through an external administrative agency – the bureaucracy.

The legislation cramps their style and restricts their functional freedoms in other ways as well. For instance, not only are there severe restrictions on their ability to borrow, Local Councils are also required to comply with long-winded cumbersome consultative mechanisms before they can revise tax rates. They have to invite public objections to proposals to revise tax rates, both before and after approval by the Council. This institutional arrangement is unique to Local Councils, since such a rule does not apply to other tiers of the system of representative government prevailing in the country, under which governments are accountable to the public through their representatives.

To enable local bodies to function as institutions of self-government a major redistribution of powers will be required in which certain prerequisites will have to be met. These will include clearly demarcated areas of jurisdiction, adequate administrative powers and human and financial resources commensurate with the functional responsibilities delegated to them and autonomy within this structure. All of these will have to be appropriately guaranteed by the Constitution. By devolving power to lower formations of government, decentralisation can become an engine of growth. The dynamics flowing from instituting such a structure can have a chain effect. In this sense, decentralisation is not being viewed from a territorial but an institutional perspective. This strengthening of local councils is also required to strengthen civil society and promote democratic decisions and norms.

Presently, there is major political and bureaucratic resistance- both overt and covert – to the shedding of political and administrative power to lower levels. There is resistance even to fiscal decentralisation. However, despite the several handicaps faced by local governments, the pressure for decentralisation is building up and future policies are more likely to be attuned to greater devolution of power and authority. Some of it is already reflected in the greater political authority and autonomy being exercised today by the provinces.

However, if there is to be a third tier of government, it raises an obvious question whether it should have the same structural features that local governments currently have. Should there be a uniform third tier along the lines of the district government, proposed by some, and should

the present separate arrangements for urban or rural areas be discontinued? Should the existing institutional arrangements be merely strengthened to improve service delivery or should this capability strengthening be complemented by other structures that improve the accountability of the service providers? The principles that make the functioning of the market and the providers of service more efficient and cost effective in delivering better quality service have somehow to be applied in the case of services provided by the government. Admittedly, this is easier said than done, but few would disagree that those paid from the public purse must be made more accountable to those receiving these services. However, if an alteration of the current arrangements is regarded necessary then, whatever the structure of government at the lowest level, it would have to tackle the following key questions:

a) Should there be a uniform structure for both rural and urban areas? If so, how will cities like Karachi (which currently has five districts) and Lahore and large municipal corporations like Gujranwala, Faisalabad, etc., be accommodated in this framework?

b) A third tier at the district level would be too remote for grass root interaction, a role which union councils in rural areas, because of their proximity to the local population, are better placed to play.

c) How will the employees of the provincial and federal government functioning at the local level be accountable/answerable to, say a district government responsible for providing services that have been transferred to it? The most effective way available to a political set-up to exercise control over the bureaucracy is to have powers to recruit, post, transfer and fire. This may require a conversion of the existing provincial cadre of employees to a district cadre. But this will be resented by different categories of civil servants – for fear of the likely impact on seniorities, career paths, future pay scales, pensions that have accrued to date, and perhaps even job security, etc.

d) Urgently, all functions pertaining to general hospitals, metropolitan transport, housing (sites and services) schemes, trunk water, sewerage and drainage systems, civil defence, etc., in the urban areas fall within the functional domain of the provincial government or its agencies. What will be the future of development authorities and water supply and sanitation agencies in the urban areas? Will they continue to exist or will they function under the third tier of government?

e) Some economic services because of their nature, such as irrigation (which are essentially integrated and inter-linked systems), will be difficult to dissect into separate systems that could be neatly divided amongst local governments for both development and operations and maintenance.

In the light of the discussion above, what functions and administrative responsibilities should form the mandate of the local governments? The economic case for decentralisation justifies the handling over to the lowest tier of government, services, which are based on relatively simple technology, are labour intensive and serve relatively small jurisdictions. Functions that best meet these criteria or guiding principles include primary education, curative health, water supply, drainage and sewerage, etc.

However, in view of the agreement that the Federal Government has signed with the IMF, octroi and export tax, the major sources of revenue for local governments has been abolished after the enhancement in the rate of GST from 12.5 per cent to 15 per cent and the eventual extension in the scope of GST to the services sector. This development will strike a deadly blow to the viability of strong local governments and the potential for empowering people through decentralisation. The local councils will be faced with a major predicament, a revenue setback, at least in the initial years, and will require financial assistance to tide over the adjustment period – which is likely to be much longer than is being envisaged at the moment, even if the income from a particular revenue stream or instrument were to be earmarked for distribution among local governments. The resource transfer arrangement that has been currently designed or likely to be designed in the foreseeable future to replace the revenue foregone by local governments will, by increasing the unpredictability of revenue receipts, enhance their dependence on the federal and provincial governments and compromise their autonomy, if not place them at the mercy of these governments. The mixed experience of local urban councils with respect to property tax transfers from the provincial government and that of the latter on transfers from the NFC divisible pool does not provide a comfortable basis for being complacent about the smooth functioning of such an arrangement. In particular, the operational experience of the NFC Award does not provide succour for establishing a similar framework at the provincial level for "statutory type" transfers to local governments. The arrangement on financial flows will be critical because it will take time to develop an adequate revenue base through a tax sharing or revenue transfer arrangement and additional resource mobilisation measures at the local level.

Ultimately, decentralisation is a political decision and its implementation is a reflection of the political structures and processes. Greater participation in development planning and management will result not only in a more efficient and effective utilisation of scarce resources but also promote national unity, by giving different groups in different regions of the country a greater ability to participate in planning and decision making and, thereby, a greater stake in maintaining political stability. A complete decentralisation of services will be difficult to attain in the short to medium term. The demands for resources to finance the recurrent and development budgets as well as the lack of institutional capacity will place limits on the scope of a decentralisation package.

Profit Loss Sharing System and Community Saving and Investment Scheme

Syed Tahir Hijazi*

Profit sharing refers to the splitting of profit between two or more business partners. It is a substitute to the interest system where one partner gets a fixed return irrespective of business performance. In the past two decades profit sharing has captured the attention of policy makers and researchers alike. This increased interest has been roused by factors including research interests in the West, practical supremacy of the system and commitment to Islam. Martin Wietzman (1984, 1987, 1990) carried out research work on profit sharing, which gave respectability to the concept. Japan, during its boom era, used profit sharing in a small segment of the labour market. The UK passed legislation to provide tax incentives to encourage the adoption of profit - related pay schemes and following Islamic principles, a few Muslim economies attempted to modify banking practices in line with Islamic principles.

In the existing banking system based on the interest rate, the lender gets a fixed percentage of the return against the loaned amount, irrespective of the performance of business. The borrower is thus bound to pay a fixed percentage as a charge for using the fund. If he makes a higher profit percentage than the interest rate, he benefits more than the bank. If his profit is the same as the interest rate, the borrower is even. If the borrower makes a profit percentage less than the interest rate, he loses and has to pay the difference from his own pocket. If he is unable to pay the interest rate he may reschedule the loan and capitalise on the outstanding interest payment as loan. Thus the total interest he has to pay increases making it more difficult to survive. If loss or low profit persists the business often opts for bankruptcy. In a situation like that, both the bank and the owner of the business lose.

In today's banking world, interest base is the dominant lending system. The system has major problems. Adam Smith, who is considered the father of economics, was the first to introduce the interest rate system. He said, 'interest is a proxy for profit earned'. He also added that if we could use profit itself, as the guide for charging an interest rate, it is better. Probably economics had not developed as a subject at that stage to enable the devising of a system based on profit sharing. But today it is much easier to explore the possibility in the light of numerous problems attached to the

* The author is Associate Dean, Muhammad Ali Jinnah University Karachi, Islamabad Campus.

interest rate. The interest based loaning system has several problems. Broadly these could be divided into problems at the macro and micro level.

Macro Level Problems

When the economy is booming, business expands faster than banks as the profit margins are higher than the interest rate. The income of depositors does not expand at the same rate as business because of the fixed rate of interest. Their purchasing power thus does not expand at the rate of economic expansion. Demand lags behind supply leading to recession. During a recession business is unable to pay the interest rate as the profit margin falls below the interest rate leading to excess production and inventory builds up culminating in recession. Alternatively during recession some businesses are unable to pay back interest and the principle, some of the banks focus on a number of defaulters and declare bankruptcy, and depositors lose their savings. Purchasing power further falls and recession is intensified.

Micro Level Problems

At the micro level, a fixed interest rate creates even greater damage. New businesses are the major affectees of the interest system. Smaller businesses in particular and medium and larger businesses in general are unable to make sizable profit margins in the beginning. If they are unable to pay interest they may have to pay a bigger interest rate in the following years over the capitalised interest or compounded interest rate. This increased financial cost often results in failure of the firm to survive. Problems at the macro and micro level necessitate a look into alternative systems of financing. Profit sharing provides that alternative.

Structure of Profit Sharing System

A profit sharing system requires an advance agreement between borrower and lender to share profit in the ratio of 50:50, 40:60 or in any other combination. If business makes a loss then both are supposed to share the loss. The theme of the system requires businesses to survive to their maximum and may not close due to unforeseen variation in the market. Monitoring of the profit sharing system is higher than interest based financing and it is as practicable as the interest based financing system.

Community Saving and Investment Needs

Micro businesses and cottage industry often provide a wide range of job opportunities, therefore economic planners are often more interested in developing this sector. But banks are often reluctant to extend micro credit because of the high operation cost of lending. Governments in general have

failed to run micro credit schemes both because of the high cost of operations and because of an inefficient monitoring system. Community and small investors are pushed away from the government and banks because of a number of problems, including the following:

- θ Too much paper work
- θ Lack of understanding of procedures
- θ Low literacy rate
- θ Shyness
- θ Higher interest rate to pay
- θ Limited access to banks

An alternative to this is community saving and investment scheme.

Community Saving and Investment Scheme (CSIS)

Objectives

The objective of CSIS is to increase the income of individuals in the community through micro-business schemes.

Methodology

In this model the community is organised into a group or organisation which collects savings from the community on a monthly basis. These are entered into a register with the name of the depositor and date of deposit. At regular monthly meetings the community organisation (CO) decides on the recipient of the loan in that month. CO assesses the potential of business and lends to small entrepreneurs on the basis of his/her profit potential. Initially, the size of a single loan is supposed to remain below Rs. 5,000/-.This may be increased depending on the availability of funds and the potential of the lender to utilise it profitably. As a rule of thumb no individual investment loan should increase above 5 per cent of the community's total saving.

Monitoring

Since the return on investment is to be determined on the basis of actual profit made, two representatives of the community are associated with each investor to monitor his performance. They will enter total cost incurred, the sale receipts and the calculated profit of the day. The register used for the purpose will be the total account of the month. The manager and monitors of funds are paid a monthly salary as a percentage of the total monthly profit of the community.

Profit Calculation

There are two types of profits to be calculated, first the amount to be charged to business and second, the amount which is available for distribution to the savers.

Charge to investor/borrower

The borrower is supposed to return the loan as well as a margin of the profit earned over his investment. If the profit loss sharing is fixed as 50:50 he has to pay half the profit or share losses with the community. So his monthly return to the community will be based on the following formula:

$$\text{Total Repayment} = \text{Installment} + \frac{\text{Total Profit/Loss}}{2} \times \frac{\text{Balance Payable}}{\text{Total Loan}}$$

Requirements of the Scheme

To calculate profit accurately the following costs must be included:

- labour charges of the lender
- rent of the place
- cost of all type of raw material
- Any cost incurred on sales promotion, advertisement etc.

Training needs;

The community needs to be trained in book keeping, profit measurement, profit calculation, monitoring and assessment of the potential of businesses. Furthermore the community is required to be properly organised.

Advantages of this Scheme over other Schemes

- There is flexibility of the amount to be invested

- Community is involved in the business activities of individual borrower, developing a community spirit and learning process for others.

- Declaration of profits makes every thing transparent. It reduces the risk of default and a source of expanding knowledge of the business.

- Since every one benefits in high profit schemes there will be a strong tendency to lend to a business that has higher expected profit margin over and above political influence.

Benefit to Savers

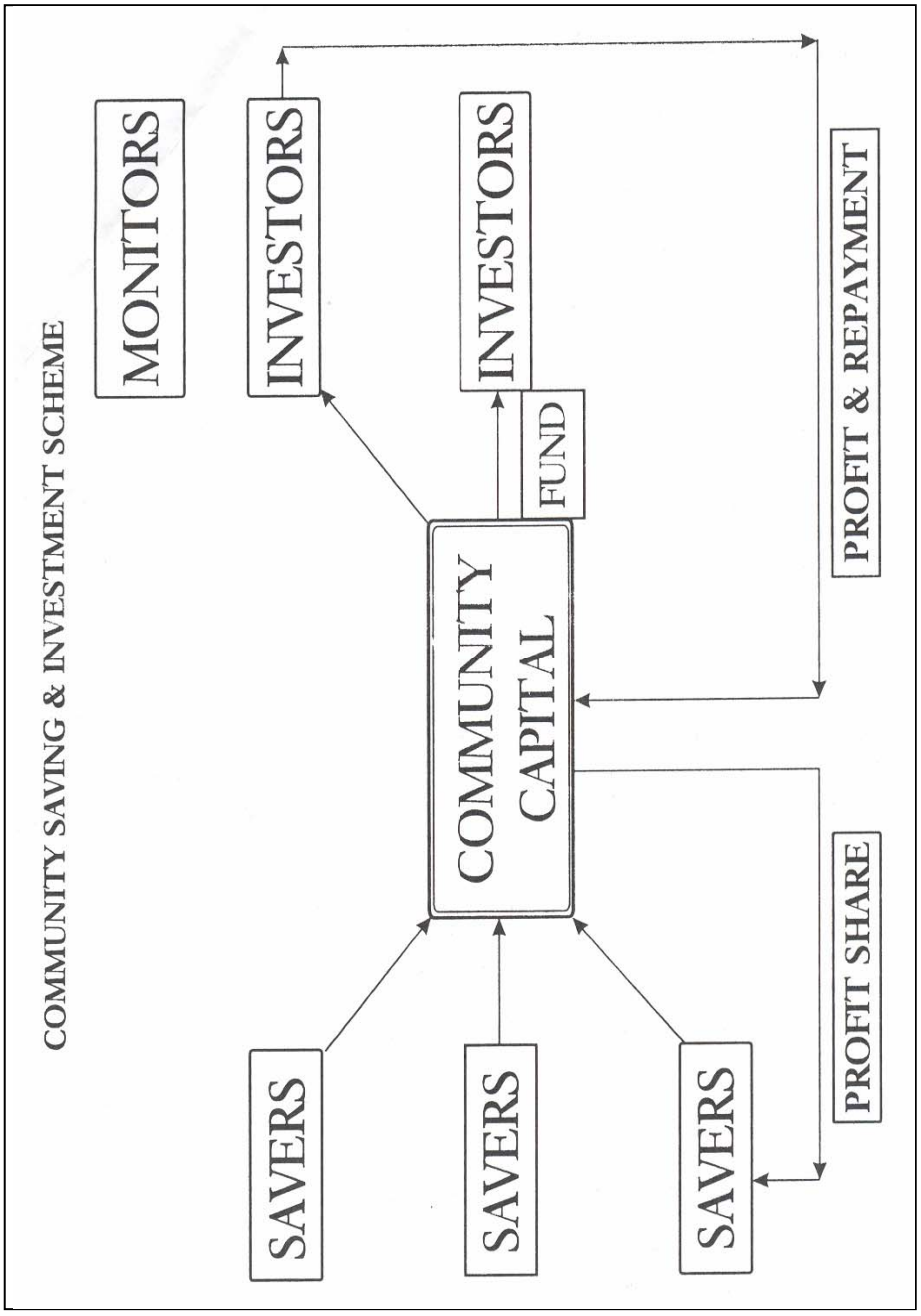
Savers are eligible to draw profits from the scheme. An individual contributing his fund will be able to draw profit from the scheme at almost the same level as the borrower/investor. The total profit calculated at the end of each month could be redistributed to the savers or is reinvested on behalf of the savers. What ever may be the situation the profit calculated will go to the accounts of each individual who has invested according to his share.

A widow, orphan and handicapped person who cannot start a business of his/her own, can invest their savings through the community. Savers and contributors of funds can draw profits every month or provide the permission to reinvest their profits as investment. The saver's share of profit to be calculated using the following formula:

Depositor's Profit = Saver's contribution X Total Profit / 2X Total Community saving

Administering Cost of Borrowing & Lending

The administrative cost of running CSIS needs to be deducted before the profit is distributed to savers (contributor) of funds. The cost should include stationary cost, photocopying cost and an honoraria for the funds manager and funds monitoring staff. Honoraria must be a percentage of the monthly profit of the community.


COMMUNITY SAVING & INVESTMENT SCHEME
MONITORS
INVESTORS
INVESTORS
FUND
COMMUNITY CAPITAL
PROFIT & REPAYMENT
PROFIT SHARE
SAVERS
SAVERS
SAVERS

Advantages of this Scheme over other Schemes

There is flexibility of the amount to be invested

Community is involved in the business activities of individual borrower, developing a community spirit and learning process for others.

Declaration of profit makes every thing transparent. It reduces the risk of default and is a source of expanding knowledge of the business.

Since every one benefits in high profit schemes there will be a strong tendency to lend to a business that has higher expected profit margin over and above political influence.

Benefit to Savers

Savers are eligible to draw profits from the scheme. An individual contributing his fund will be able to draw profit from the scheme at the same level as the borrower/investor. The total profit calculated at the end of each month could be redistributed to the savers or reinvested on behalf of savers. What ever may be the situation the profit calculated would go to the accounts of each individual who has invested according to his share.

A widow who can not start a business of her own can invest her savings through the community. Savers and contributors of funds could draw profit monthly or provide the permission to reinvest their profit as investment. The saver's share of profit to be calculated using the following formula:

Depositor's profit = Saver's contribution x Total Profit / 2 x Total Community saving.

Administering cost of Borrowing & Lending

The administrative cost of running CSIS needs to be deducted before the profit is distributed to savers (contributors) of funds. The cost should include stationary cost. Photocopy cost and honoraria for the one who is keeping the accounts and monitoring them. Honoraria must be a percentage of monthly profit of the community.

References

Hijazi S.T. and Amanullah M.K., 1997, "Profit Sharing" Melmillan Publishers Lahore.

Usmani. M. Taqi, 1988, "An Introduction to Islamic Finance" Idaratual Ma'arif, Karachi, Pakistan.

Bashir, Abdel-Hameed Mohammad, 1990, "Financial Contracts in Interest-Free Islamic Economics: Theory and Practice", The University of Wisconsin – Madison (0262), Ph.D. thesis, p 133.

Beason, Richard Derek, 1989, "Microfoundations of the Japanese Macroeconomy: An Empirical Study", The University of Michigan (0127), Ph.D. thesis, p 193.

Weitzman L. Martin, 1987, 'Steady State Unemployment Under Profit-Sharing', *Economic Journal* 97, pp 86-105.

Weitzman L. Martin, 1985, 'The Simple Macroeconomics of Profit-Sharing', *The American Economic Review*, Vol 75, pp 937-53.

Equal Opportunity and the Education System in Pakistan

Rukhsana Zia*

Introduction

The educational system in Pakistan is beset with multiple dilemmas and constraints. Some are underlying and deep-rooted, while others are rooted in immediate, superficial reasons. Understandably all are inter linked and each affects the other. One that pervades as an under current is the issue of lack of Equal Opportunity (EO) which takes myriad forms when translated into practice. This paper delineates the various forms the absence or imbalanced prevalence of EO takes within the context of the education system of the country, and primary education in particular.

Objectives of the Study

The paper aims to:

1. State the prevalent educational system of the country and analyse it vis-à-vis the issue of EOs;
2. Analyse the above and briefly state the determinants of the existing situation;
3. Relate the concept of EO and education to similar situations in other countries;
4. Recommend proposals to alleviate the existing status according to the above.

Limitations of the Study

This study focuses on the primary grades, essentially because of the easy availability of data, and places the issue of EO within this level of education in Pakistan. Higher levels of education are referred to where applicable.

This paper relies on documented data that is controversial in many cases and questioned for reliability (Zia 1998). In cases where recent data is not available, older information has been utilised.

---

* The author has a Ph.D. in education from the University of Wales and is an Associate Professor at the College of Home Economics, Lahore.

Educational sources as cited below, do not carry information on the private sector. It is accepted, though that non-government (NG) share accounts for 22 per cent of the primary sector. There is a very strong NG presence in the secondary and higher education levels, which has not been considered in the study, basically due to lack of documented data. (The researcher is aware that NG and private schools are more highly priced in general, and provide a better quality of education than the public sector. This means that children from the lower socio-economic strata lose their chance to quality education, and in later life this factor, even when considered as the sole variable, places them at a disadvantage when competing for jobs in later life).

Lack of information relating to in-school situation has meant limiting the study to enrolments and completion rates. This has meant more emphasis on out-of-school factors, rather than in-school factors.

EO concerning handicapped/exceptional children has not been discussed in the study.

Significance

Most social development studies state discrimination, bias, stereotyping, labeling, (UNICEF 1998, PIHS 1996-97) as issues that pervade various sections of the country. And yet to date, the concept of EO as a theme by itself is not mentioned in policy making or in policy implementation arenas. This study hopes to disseminate an awareness of the concept, and place the concept as a viable theme for educational settings in particular.

As a teacher in government colleges for the past 25 years, the issue of EOs has been evident in one way or the other. Involvement in social development programmes as an NGO worker has motivated the researcher to highlight the issue of EO for the social consciousness of the policy makers and planners.

Methodology of the Study

The study will rely on available published statistical data to describe the prevalent situation of the educational system. The researcher will use analytical and reflective skills to assess the situation and state possible causes for the EO situation as identified. The review of related literature will be used to identify ways of improving the above situation so that the concept of EO can be recommended as a policy for the educational system of the country.

Educational Data/Information

The following pages will identify and delineate data that is relevant to the educational system of the country. It will focus on the primary level.

Table-1: Gross Enrollment (Proportion of children 5-11 years. Presently enrolled in Primary schools)

Pakistan	70%
Urban	78%
Rural	63%
Gender	
Boys	74%
Girls	65%
Provinces	
Punjab	75%
Sindh	70%
NWFP	56%
Balochistan	70%

Source: UNICEF (1998 p 39)

The above table clearly shows the difference in the enrolment of the primary age group (100 per cent enrolment is the government requirement). It also shows the difference that exists among the provinces, the rural/urban and the male/female. The same is again obvious in the following table:

Table-2: School Entry Rate: Proportion of Children of School Entry Age who are Currently Attending Primary Schools

Pakistan	37%
Urban	44%
Rural	32%
Gender	
Male	38%
Females	36%
Provinces	
Punjab	42%
Sindh	36%
NWFP	27%
Balochistan	38%

Source: UNICEF (1998 p 40)

The gross enrolment rate (GER) shows the same pattern that is visible in the above tables. The highest rate were found in the Punjab, followed by Sindh and NWFP and then Balochistan. GERs were higher in urban areas compared to rural areas (87 and 63 per cent respectively) and for boys relative to girls (78 and 61 per cent respectively). The difference between GERs for girls and boys are considerably higher in rural areas compared to urban areas (PIHS 1998 p 25).

Literacy is the most important indicator in the education sector. It also shows the urban rates to be higher than those in rural area, with wide differences in the provinces as well. The gender bias is very evident as well (Table-3).

Table-3: Literacy Population 10 years and Older---By Region and Province

Region and Province	Percentage of Population 10 years and Older (1996-97 PIHS)		
	Male	Female	Both
Urban Areas	65	50	58
Punjab	64	51	57
Sindh	67	54	61
NWFP	58	34	46
Balochistan	61	27	45
Rural Areas	44	17	31
Punjab	45	21	32
Sindh	46	12	30
NWFP	43	13	27
Balochistan	41	5	24
Overall Pakistan	51	28	39
Punjab	51	30	40
Sindh	57	33	45
NWFP	46	17	30
Balochistan	44	9	27

Source: PIHS: Round 2: 1996-97, p 44.

The indicators in the above data are consistent. A wide difference is evident in the educational figures for the various provinces, urban and rural areas and for boys and girls. In the light of the above it is not wrong to assume that a bias exists in the educational system and that EO, as a practice, is not a viable force in the machinations of the education system of the country. Understandably, the bias compounds with the progression in the levels of education.

The determinants of poor education indicators are cited as quality of education, access and condition of schools, poor funding by government and poor management of the education system (UNICEF 1998 pp 41-43). It is also worth noting that PIHS data (1998 pp 34-35) tabulates data on 'Reasons for Never Attending School'. The stated responses were significant. The reason of "Parents did not allow" when considered as a first and second response, showed as 18 per cent of the reason for boys but in case of girls it accounted for 57 per cent of the responses. It is interesting to note that in the case of girls, 50 per cent of the cases stated demand related factors, and especially for rural girls, these factors are more important than for either boys and girls in urban areas. This establishes the fact that discrimination against females exists in the socio-cultural patterns of the country.

A positive relationship between household income and school attendance has been found in every province and region (PIHS 1996-97 pp 13-14). It can be safely assumed that the poorer the family, the less the chances for the young to attend school. This delineates the fact that socio-cultural biases are further compounded by poverty. This aggravates the discrimination and adds another dimension of 'haves' and 'have-nots' to this debate. (Due to the brevity of the report, this will not be discussed in detail).

PIHS (1998 pp 70-72) data show that 22 per cent of the primary age group children attend non-government schools. Figures state no difference in enrolments in terms of gender in this sector. But the data does show variations of greater NG enrolment in terms of urban rather than rural areas. Positive correlation was found in the income of the household and education of parents to the child attending a non-government school. Surprisingly, a high number of children from low-income groups attend NG schools and the reason is that NG schools often provide higher quality education than government schools. This provides reasonable proof that quality education is a requirement along with issues of equality and access. This is similar to conclusions reached in the West (Runnymede Trust 1993; Riley 1994).

The above data consistently show the same pattern. A wide difference is evident in the educational figures for the various provinces, urban and rural areas and then in figures for boys and girls. In the light of the above, it is not wrong to assume that a bias exists in the educational system and that EO, as a practice, does not exist for all the provinces, or the rural and urban areas or even for males and females. Provision of basic education is a state responsibility and a right of every citizen. Since it is established that lower income means higher rate of children not attending school, it becomes evident that the poor segment of the population stands

more at risk of not getting education and the myriad benefits that accompany it in terms of better quality of living. This establishes an increased responsibility on the public sector to provide education to all across the board so that income disparity does not effect the opportunities to a better quality of life, either at home or at work.

At higher grades, the situation becomes complex. Students who have been left out of primary education because of poverty or parent's attitudes (attitude has been found to be related to parent's education and socio-economic status (PHIS 1998 pp 40-41), or due to poor provision of infrastructure or facilities, give up their claim to higher levels of education anyway. This aggravates their claims to equality and access to equality in later life as well.

Related Literature

In the Western world EO is gaining momentum for reform, especially in the field of education. There is a call to recognise cultural diversity. Similarities rather than differences within the various cultures are being stressed. The multicultural approach is being increasingly encouraged in a wider context in general, and educational settings in particular (Antonouris and Wilson 1989 pp 5-6). The talk is about a "democratic pluralist society" (Swann Report 1995). Teaching-Learning environment is placed within the perspective of EO. Teachers are being increasingly entrusted with the task of creating awareness of the concept, thus helping undermine stereotyping, bias and discriminatory behaviour (Pratt *et al* 1984, Blackstone 1985 p xiii, Antonouris and Wilson 1989 pp 101-102, Orr 1995 p 11 and 18). Teaching materials reflect the same approach. This has led to the evolution of the concept of Education for All (EFA). The idea is to educate all with a focus on shared values and appreciation of the diversity of culture, religion, language, race, gender and so on. Most developed countries of the world anticipating the possible friction arising in their societies due to the vast diversity of their nationals have initiated the concept of EO in their curriculum, teaching objectives, classroom environment, instructional materials and teaching practice. Devising a curriculum that will reflect the above and focus on ideas, principles and generalisations for EO concepts in particular are the main test for an expert. Devising such a curriculum is the need of the time.

Conclusions and Recommendations

The EO concept in its totality is a recent development all over the world. Its major components, that is, bias, discrimination, inequality have long held negative connotations in general and for education in particular.

Being an Islamic ideological state, Pakistan has propounded "no difference on basis of class, creed, colour, race, social class and so on", and yet the state has to honour its commitment in practice in general, and education in particular.

The above literature clearly pinpoints the vast difference in perspectives of developed countries and Pakistan, an underdeveloped economy. Both are tackling the issue of EO, but at different levels. Where Pakistan has yet to initiate a socio-cultural attitudinal change in the populace, the West is tackling the issue within its classrooms. The West has the added advantage of 100 per cent enrolments in its schools, which is not so in the case of Pakistan.

Pakistan clearly needs to tackle the issue of EO at the community level. Its first challenge would be to fulfill the quantity requirements for education. This is not to say that quality issues cannot be tackled alongside. There is a need for initiative for EO practices both inside and outside the schools and both need to be addressed concurrently.

All educational policies, time and again have proposed equality. Most social development policies, such as the National Plan of Action for Women Development are tackling the issues of gender bias and discrimination. This study propounds that the whole range of issues encompassed in EO, of which gender bias is one, be dealt with on a common platform. This would mean a more effective and sustainable solution to the existing situation in the country where there is a lack of EO that is area-based, gender-based, social class based, to name a few.

References

Antonouris, G. and Wilson, J., 1989, Equal Opportunities in Schools: New Dimensions in Topic Work. New York: Cassell/Nichols Publishing.

Blackstone, T., 1985, Preface. Whyte *et al* (Eds.) Girl Friendly Schooling. London: Routledge.

Clements, P. and Spinks, T., 1994, The Equal Opportunities Guide: How to deal with issues of everyday unfairness. London: Kogan Page.

Orr, P., 1985, Sex bias in schools: national perspectives. Whyte *et al* (Eds.) Girl Friendly Schooling. London: Routledge.

Pakistan Integrated Household Survey. (n.d.). *PIHS. Round 2. 1996-97.* Islamabad: Federal Bureau of Statistics, Government of Pakistan.

Pakistan Integrated Household Survey, 1998, *PIHS. Education Sector Performance in the 1990s.* Islamabad: Federal Bureau of Statistics, Government of Pakistan.

Pratt, J.; Bloomfield, J. and Seale, C., 1984, Option Choice. A Question of Equal Opportunity. Slough: NFER-Nelson.

Pratt, J., 1985, The attitudes of teachers. Whyte *et al* (Eds.) Girl Friendly Schooling. London: Routledge.

Runnymede Trust, 1993, Education For All. London: HMSO.

UNICEF., 1998, 'The Situation Analysis of the Woman and Child in akistan', Islamabad: UNICEF.

Zia, R., 1998, Profile of the Rural Woman of Pakistan, In *The Lahore Journal of Economics,* 3,1, 47-79.

Pakistan's Textiles and Anti-Dumping Laws

Talat Yazdani*

Abstract

Textile is one of the most heavily protected sector in developed countries. This paper addresses the issue of anti-dumping measures, a new form of trade restriction. Protectionism is still common place in textiles, tariffs remain high and progress in eliminating import quotas has been slow. In fact, protectionism is on the rise in a new guise: anti-dumping cases against Asian countries are multiplying in the US, EU and around the world. Pakistani textiles (yarn, unbleached grey cotton fabric and bed-linen) exports are being increasingly subjected to the initiation of anti-dumping investigations, which creates uncertainty and depresses business sentiment. Investigation periods are quite lengthy and the legal costs of defending against these cases are enormous. These result in a great loss of time that could be better spent in a productive manner. This phenomenon is a matter of great concern because it has created a damaging impact on the normal growth of trade. In fact, by merely initiating an anti-dumping case against exporting country's manufacturers, or even just threatening to do so, developed countries producers can cause extensive disruption to the market for an extended period of time. At the end of the day, whether dumping and injury are proven may no longer matter for some Asian manufacturers, who could be driven out of the market simply as a result of the case being initiated.

I. Introduction

In textiles, protectionism is on the rise - but in a new form. Instead of raising import tariffs or cutting import quotas, developed countries are slapping anti-dumping duties (ADD) on imports from the developing countries. Anti-dumping is popular mainly because world trade rules allow it. WTO rules allow countries to impose anti-dumping duties on foreign goods that are being sold cheaper than at home, or below the cost of production, when domestic producers can show that they are being harmed.

Anti-dumping measures are not only legal, they are also very flexible. Only some firms in an industry need complain for an investigation to be

* The author is Associate Professor of Economics at Lahore College for Women, Lahore (Pakistan).

launched. It can be directed at specific firms and countries, and they can be hit with differing duties. The most important aspect about ADD is that these duties can be presented not as protection but as compensation against "unfair" competition. In theory, anti-dumping measures are intended to restore fairness to the market by ensuring that foreign-made goods are sold at a fair price. In practice, however, they can undermine all competition from a particular country, without regard to whether specific manufacturers are dumping their goods.

The Agreement on Textiles and Clothing (ATC), which currently governs the textile and apparel trade among WTO members, became effective on January 1, 1995. It is intended to gradually bring global trade in textiles and clothing into compliance with the principles of the WTO over a ten-year period. At the half-way mark, however, it already has become apparent that eliminating quotas will not end the obstacles for Asian suppliers to sell into the major importing markets, such as Europe and the United States. A number of anti-dumping actions have been brought in Europe, the most notable actions covering Pakistani fabric and bed-linen. And in the US, Malaysian and Indian manufacturers of elastic rubber tape - an essential component in swimwear and underwear - have been the subject of both anti-dumping and counter veiling duty investigations.

The likely replacement of quota with anti-dumping actions to protect US and EU textiles industries will have significant implications for Pakistani textile exporters and manufacturers. Anti-dumping actions means anti-dumping duties, which must be paid in addition to regular duties. Also, participating in a complex anti-dumping investigation is a considerably expensive and time-consuming undertaking. Pakistani textiles manufacturers and exporters whose products are being targeted have to collect and organise an enormous amount of data related to their domestic costs, sales and prepare for a complicated review process.

The paper proceeds as follows. In Part II a compact description of the complex WTO rules and procedures for levying ADD is given. Part II also reviews anti-dumping measures as competition inhibiting measures. Part III gives a detailed description of anti-dumping measures against different segments of the textile sector of Pakistan. Part IV includes the conclusion along with policy guidelines.

II. WTO Rules and Procedures for Levying ADD

America's dumping rules, copied by many countries - and the basis for the WTO code, Kennedy Round in the mid-sixties brought about a GATT Anti-Dumping Agreement, the European Union (EU) and

the US anti-dumping law implements Article IV[1] of the GATT agreement of April 1979 with the added elaboration of certain procedural rules. To incorporate measures agreed in the Uruguay Round, existing rules were replaced by the new Agreement on Anti-Dumping Practices (ADP). The WTO rules deal with two types of "unfair" trade practices which distort conditions of competition. First, the exported goods benefit from subsidies. Second, the exported goods are dumped in the foreign markets. The ADP allows members to levy Anti-Dumping Duties (ADD) on dumped imports. A product is considered to be dumped if the export price is less than the price charged for the like product in the exporting country. A product is also considered to be dumped if it is sold for less than its cost of production.

The dumping petition is typically filed by a domestic industry. Under the US law, the petition is actually filed with the two agencies: the US Department of Commerce (DOC) and the US International Trade Commission (ITC). The DOC determines whether goods are sold at "less than normal value".[2] The ITC, headed by a six person commission, is responsible for determining whether imports are injuring or threatening to injure a domestic industry producing like products to the imports at issue. These two agencies conduct independent, concurrent investigations, and if both make affirmative determination, the DOC will direct the US Customs Service to impose an anti-dumping duty. In EU, it is the European Commission (EC) which is responsible for investigating complaints and assessing whether they are justified. The Commission can also impose provisional measures, however, it is the Council of Ministers which imposes definitive ADD.

Injury to the domestic industry

The ADD should be levied only where it has been established on the basis of investigations that:

- There has been a significant increase in dumped imports; or
- The prices of such imports have undercut those of the like domestic product, have depressed, suppressed the price of the like product; and

[1] Article IV of the GATT sanctions special duties if an importer could prove that another country was dumping its exports, i.e. selling below cost of production or below home-market value.

[2] The normal value is based on the prices paid or payable, in the ordinary course of trade, by independent customers in the exporting country.

- As a result injury is caused to the domestic industry or there is a threat of injury to the domestic industry of the importing country.

The ADP specifies that for ADD to be levied, it must be clearly established that there is a causal link between dumped imports and injury to the industry. The causality indicator reflects the coincidence in time between increase of dumped imports and injury suffered by the domestic industry.

Procedural Rules

The application for the levy of ADD will contain evidence of dumping, injury and a causal link between the allegedly dumped imports and the alleged injury.

Once investigations have begun, exporters, importers of the alleged dumped products, and the governments of the exporting countries have adequate opportunity to tender oral and written evidence to rebut the claim made by the domestic industry and to defend their interests. In addition, industrial users and consumers of the product under investigation will be given an opportunity to express their views.

Methodological Rules

The methods used by the investigating authority to calculate the margin of dumping can greatly influence the level of ADD to be paid.

Price comparison. A product is considered dumped only if the foreign producer's export price[3] is lower than the price charged for home consumption in the country of export. The margin of dumping is determined primarily by comparing these two prices. Such comparison should be made at the same level of trade, normally at the ex-factory level, and in respect of sales made at as nearly as possible the same time. The average ex-factory price of sales can be calculated for the same product or a similar product in the home market during a specified period. Adjustments[4]

[3] The export price is the price actually paid or payable for the product concerned when sold in the importing country market.

[4] A fair comparison has to be made between the export price and the normal value. Due allowances have to be made in each case, on its merits, for differences which affect price comparability, including differences in physical differences, import charges and indirect taxes, discounts, rebates and quantities, level of trade, transport, insurance, handling, loading and ancillary costs, packing, credit, after-sales costs, commissions and currency conversions.

are made to calculate foreign market value. These adjustments include the following items:

- Removal of all movement expenses from the invoice price.
- Differences in direct selling expenses between the home and foreign markets.
- Any difference in packing between home market sales and those shipped to another country.
- In the case of similar products, the direct costs of physical differences between the product sold in the foreign market and its counterpart in the home market.

Cost of production. In making a price comparison, the question often arises of what benchmark to use in determining the price for home consumption when the producer is selling in the home market at prices below average production cost or at a loss. This evaluation is usually made only if the petitioner alleges sales below cost of production.[5] If such an allegation is accepted, then the actual full cost of production (COP) must be calculated for each product sold in the home market or third country market. The COP is the full cost of production including:

- Actual cost of manufacture;[6] and
- Allocation of selling, general and administrative and financial expenses (SGA&F) of the alleged company.

Constructed value. When the volume of domestic sales is "low" the consumption price in the exporting country may not provide a proper basis for price comparison. In such cases, for price comparison purposes, a constructed value[7] (CV) is used instead of the domestic consumption price. The constructed value is calculated on the basis of cost to the exporting industry of producing the product.

---

[5] Cost of production includes cost of manufacturing and selling, general and administrative expenses. Financing costs are part of the SG&A expenses.

[6] Cost of manufacturing consists of cost of materials, cost of direct labour and manufacturing overheads.

[7] Constructed value is calculated on the basis of the cost of production in the country of origin plus a reasonable amount for selling, general and administrative costs and for profits incurred on the domestic market of the country of origin.

Constructed value is essentially a cost-based calculation of what the home market price of a product would be if it were sold in that market at a normal or fair price. Constructed value is calculated based on the actual cost of manufacturing (COM) of the product, allocation of SGA&F expenses, and a profit factor. Although rules for calculating CV are very similar to those for COP; there are three major differences:

- Costs of inputs purchased from related parties are treated differently in CV;
- SGA&F expenses must be at least 10 percent of COM for the product; and
- Profit must be at least 8 percent of COM plus SGA&F expenses for the product.

De minimis Rule

The ADP Agreement provides that the application should be immediately rejected and the investigation terminated if:

- The margin of dumping is *de minimis*, i.e. less than 2 per cent, expressed as a percentage of the export price; or
- The volume of imports from a particular country is less than 3 per cent of all imports of like products into the importing country; or
- The injury is negligible.

Provisional/Definitive Measures

The ADP Agreement authorises provisional measures to be taken when the investigating authorities judge that such measures are "necessary to prevent injury being caused during the investigation". They must not exceed the *dumping margin* and have to be set at a lower level if that would be enough to remove the injury. Provisional duties are normally valid for six months and may be extended for a further three months. When they are imposed, importers must lodge security (in the form of cash deposit or bonds) for payment of the duties when importing the goods. For example, if the dumping margin is 15 per cent, and the value of imported steel covered by an anti-dumping order is $ 500/MT the importer would have to deposit $ 75/MT at the time of entry in order to continue to import steel.

Disclosure Prior to Final Determination

The Agreement stipulates that the investigations should be completed within a period of one year, and in no case more than 18 months after its initiation. If a definitive decision is made to levy duty, the investigating authorities are required to "disclose" to the interested parties (exporter or producers under investigation, their governments and importers) the essential facts on which the decision to apply the duty is made.

Sunset Clause

Definitive duties are valid for five years. They will then expire, unless a review of the case determines that, in the absence of such measures, dumping and injury will continue or recur. Reviews for this purpose must be initiated before the sunset date and should normally be concluded within one year.

Price Undertaking

Exporters can avoid ADD by undertaking to increase their export prices. However, no exporter shall be forced to enter into such undertakings. The Agreement permits such price undertaking only after the investigating authorities have made *preliminary affirmative determination* of injury to the domestic industry and of dumping. It is a definitive anti-dumping measure, if it is violated or withdrawn, definitive duties can be imposed immediately.

Dumping Margins

The dumping margin is the difference between the export price and the normal value, the price charged in the exporter's home market. The prices in the respective markets are adjusted to exclude selling expenses, physical differences, import charges, discounts, rebates, transport, insurance charges, packing and currency conversions, etc. in order to arrive at comparable ex-factory gate prices. The adjusted export price is then compared to the adjusted normal value to determine the margin of dumping.

The investigating authorities perform this calculation on a sale-specific basis, it calculates a weighted-average margin, based on the comparison of the weighted average normal value with weighted average export price.

ADD should be determined separately for each exporter or producer, the amounts of duties payable could therefore vary according to the dumping margin determined for each exporter. When the number of exporters or producers is so large as to make the calculation of an individual dumping margin impracticable, however, the investigating authorities may determine duties on the basis of *statistically valid* samples.

Anti-Dumping "Inhibiting Competition"

Anti-dumping measures may be justified if foreigners are guilty of predatory pricing and even if they are guilty, anti-dumping is the wrong response. In any case, consumers gain from lower prices, so do the importing companies and users who can buy their supply cheaply. Alan Greenspan, US Fed Reserve Board Chairman, recently pointed out: "While these forms of production have often been imposed under the label of promoting *fair trade,* often-times they are a simple guise of inhibiting competition."

Direct and Hidden Costs of Anti-Dumping

Dumping calculations are a sham. Foreigners are almost always found at fault. For example, the ITC rarely makes a negative finding in its preliminary determination - the standard is very low. And the short deadline means that there is little time available for exporters/producers and importers (of the product at issue) to assemble the information necessary to present a strong case. The figures can easily be manipulated to show dumping because it is so hard to make sensible comparisons across borders. To prove injury, it is enough for domestic firms merely to show that sales are being hit by rising imports. Between 1980 and 1997, 71 per cent of anti-dumping claims in the EU did indeed succeed, as did 80 per cent of those in America.

The anti-dumping procedure is quite expensive, both in direct cost and the lost sales, worse still are the hidden costs of anti-dumping. The most damaging aspect is the inconvenience imposed on the manufacturers. This results in a big loss of time that could be better spent in a productive manner, rather than responding to the complicated questionnaires sent by the investigating authorities which is quite burdensome and time-consuming.

There are huge indirect costs. Even unsuccessful dumping cases are a tax on trade. They typically engage firms for over a year and impose huge legal costs. In effect anti-dumping measures encourage domestic and foreign producers to collude to raise prices at consumers' expense. For

example, the textile industry in EU is simply not in a position to compete with cheaper imports from Asia. Europe has now reached a crossroads where it has to decide whether it wants to protect its consumer or its industry. As far as textiles are concerned, both cannot be protected. Pattrick Messerlin, a French economist, estimates that because of this pro-cartel effect, anti-dumping duties are generally twice as costly to the economy as equivalent import tariffs. According to Messerlin, only 3 per cent of anti-dumping cases in the EU and 4 per cent in the US might involve predatory pricing.

Anti-Dumping/Safeguard Measures

The WTO rules permit countries to take safeguard actions restricting imports for temporary periods when, as a result of a sudden and sharp increase in imports, serious injury is caused to the domestic industry of the importing country. Similar principles apply when countries take anti-dumping measures to restrict imports in order to assist a domestic industry. The standard of "injury" to the industry that must be established to justify safeguard actions is, however, much higher than that required for the levy of ADD. In the case of safeguard actions, injury to the industry must be "serious"; in the case of ADD, a lower standard of proof of material injury is adequate. That makes ADD more attractive to developed countries. The WTO rules allow countries to use "safeguard" measures for temporary protection against import surges, but the countries nearly always resort to anti-dumping instead, which suggests that their real aim is to bring back protection by the back door.

Forced Dumping

In one sense, "dumping" is common. Since firms often charge less in more competitive foreign markets than they do at home. It is fairly normal for businesses to sell below cost for some time to establish their position in a market that can initially be entered through fierce price competition. In the short run, there is incentive for the firms to keep production going if losses can be minimised in the hope that market conditions will improve. The actual duration of this short-run can vary depending upon the sector. Moreover, agro-based industries require special treatment as weather plays a central role in these industries. If the weather is bad, the cotton crop yield is low and the firms under these circumstances are forced to sell below cost of production for some time. Due allowance should be given to this fact.

Repeated Anti-Dumping Charges

Developing countries are worried about the repeated anti-dumping charges against the same product. It is noteworthy that new investigations are initiated against the same product almost immediately after the conclusion of an earlier investigation. Often new cases are filed as soon as old ones have been rejected - on the basis that eventually, one will succeed. In this context, anti-dumping rules need to be improved and made more rigorous, under which the burden of proof of dumping should be placed entirely on the country, initiating such charges.

III. Anti-Dumping Measures against Pakistan

In the 1990s, Pakistan's exports especially textiles and clothing have been subjected to ADD in a number of countries such as Japan and the European Union. This new wave of anti-dumping cases is particularly alarming for Pakistan because Pakistani textile products from yarn to grey fabric and made-ups have been subjected to ADD.

Yarn

In 1995, Japanese Spinners Association levied ADD on cotton yarn of 20/21 counts imported from Pakistan claiming that these imports were causing material injury to the spinning industry of Japan. Japan, the biggest market for Pakistan's cotton yarn, levied 9.9 per cent ADD on Pakistan's yarn in 1996. This was a big blow to Pakistan's textile industry as 24 per cent of total exports of yarn goes to Japan. About 70 per cent of the total requirements of Japan's towel industry have traditionally been met by Pakistan's yarn. The export of Pakistani cotton yarn to Japan has declined by $ 67 million over 1998-99.

Initially, the proposal was to collect samples of 21 companies instead of 188 companies against whom the notices were issued. Provisional ADD was imposed in April 1997. Table-1 displays the names of some of the targeted firms against their dumping margins.

The investigation process by the Japanese team was slow and lengthy. The response of both Pakistan's government and textiles industry was slow and erratic to Japan's anti-dumping initiation. It has been observed that Pakistan lacks expertise to defend dumping cases. The reason Pakistan could not defend Japanese allegation was the hiring of an unsuitable attorney from Australia.

Table-1: Anti-Dumping Duties on Yarn (Japan)

Firm	Provisional Duty
Ahmed Fine Tex Mills	9.9
Ellcot Spinning Mills	9.9
Eastern Spinning Mills	9.9
Gulistan Tex Mills	9.9
North Star Tex Mills	0.9
Muhammad Farooq Tex Mills	3.9
Umer Fabrics	9.9
Nageena Cotton Mills	9.9

Source: *Pakistan Textile Journal*, May 1997.

Another setback to cotton yarn export was erected by the United States. Unlike other importing countries instead of slapping ADD, the US gave a call for consultation in category 301 (Combed Cotton Yarn) in April 1997. Pakistan is the largest exporter of yarn to the USA excluding the NAFTA countries, Canada and Mexico.

The US government has imposed a restraint on the export of combined cotton yarn (Category 301) from Pakistan in March 1999, under safeguard clause of the Agreement of Textiles and Clothing (ATC). Pakistan appealed to the Textile Monitoring Body (TMB) against this US action. Though less protectionist than the EU, America is losing its way. TMB had recommended twice in favour of Pakistan, first in April and second in June 1999, but the US government has refused to comply with the TMB recommendation. Now Pakistan is considering contesting its case at the Dispute Settlement Board (DSB) of the WTO.

Bed-Linen

The European Commission (EC) has imposed definitive ADD on Pakistani bed-linen with effect from December 5, 1997. Pakistan, which is the largest exporter of bed-linen to the EU, will face lower duties of around 6.4 percent while Egypt will attract duties of around 13 percent and India would be subject to around 12 percent dumping duties. For non-cooperating companies, 24.7 per cent duties have been slapped on Indian firms and 6.7 per cent on Pakistani firms.

The ADD on Pakistan and its competitors were imposed on the charges of dumping cheap cotton fabrics and bed-linen onto the markets of the EU. The complaint was lodged by Eurocotton, an association of textile manufacturers in the EU. Eurocotton has demanded the imposition of very high ADD on bed-linen imported from Pakistan (32 per cent), India (27 per cent) and Egypt (38 per cent).

The period of investigation was from July 1, 1995 to June 30, 1996. The provisional ADD on bedwear were imposed by the EC in June 1997 (see Table-2).

Table-2: Anti-Dumping Duties on Bed-Linen

Firm	Initial Jun 1997	Provisional Oct 1997	Definitive Dec 1997
Farooq Textile Mills	6.6	2.9	1.8
Al-Karam Textile Mills	2.6	Nil	1.3
Al-Abid Textile Mills	8.2	8.2	6.7
Fateh Textile Mills	7.9	7.9	6.3
Gul Ahmed Textile Mills*	-	-	0.1
Excel Textile Mills	-	-	0.1

Source: *The News*, various issues.

*Gul Ahmed Textile Mills had been exempted as dumping charges on this firm could not be substantiated by the investigating team from the EC.

The scope of investigations covers bed-linen of cotton, pure or blended with man-made fibres, bleached, dyed or printed. Bed-linen comprises bed sheets, duvet covers and pillow cases, packaged for sale either separately or in sets. There are about 160 Pakistani exporters belonging to 5 different textile associations (see Table-3) which export bed-linen to the EU and fetch more than US $ 180 million per annum. The export of bed-linen falls under quota administration.

Table-3: Associations of Bed-Linen

Export of Bed-Linen to EU (1995)	
Association	**Percent Share**
APTMA	13.4
PBEA	24.3
APMUMA	26.7
PCMA	15.1
APCEA	20.5

Source: APTMA

EU says there has been injury to the domestic industry. Pakistan says there are already quota restraints then why were ADD imposed on bed-linen? The answer is fairly simple. French politicians promised further restraints on imports of grey fabrics to the French textile industry. And they made a prestige issue out of it. Though nine EU nations voted against the levy, the French were simply not willing to give up. Anti-dumping on bed-linen was perhaps offered to pacify the French. There has been sharp pressure from France and other countries such as Italy and Portugal for the imposition of the duties.

According to exporters of bed-linen, by accepting a second complaint from Eurocotton within two months after withdrawal of anti-dumping proceedings against the import of bed-linen from Pakistan, the EC gave the impression of cooperating with the complainant. The Pakistan delegation adhered to the following major points in order to challenge the validity of the complaint:

- Pakistani exports of bed-linen (Category 20) are subject to a quota restriction. Being a quota item, Pakistani manufacturers could not flood the EU market. There is also no incentive to lower prices as there is only a fixed amount of product allowed into the EU under the quota system.

- Eurocotton, which lodged the complaint, did not represent at least 25 percent of the trade.

- Pakistan catered to the lower end of the market, while the European producers served the upper end. Therefore, injury to community industry could not have occurred, as their products are not similar products - hence they cannot be compared.

- During the last few years the producers in the EU textiles industry have introduced automation which could have resulted in an increase in cost of production and possible workers layoff. For this the exporting countries such as Pakistan cannot be blamed.

Unbleached Cotton Fabrics

The exports of Unbleached Cotton Fabric (UCF) contributes significantly to the total exports of Pakistan, especially the EU. The value of UCF exported to the EU countries amounts to about $ 106 million per year and comprise 14 percent of the total textile quota of Pakistan. This product has been subjected to anti-dumping proceedings time and again during the period 1994 to 1998 by the EU.

Unbleached cotton fabric is a raw material for the textile finishing industry, which transforms it into bleached, dyed and printed fabrics used to make clothes and home furnishings. France, Italy, Spain and Portugal eager to protect the EU's own weaving industry were leading backers of the dumping duties. They wanted to block the relatively cheaper grey cloth from Asia, from entering their markets. It would appear to be clearly in the interest of certain community upstream industries, in particular yarn producers, to preserve the community weaving industry, which is an indispensable part of the European textiles sector. The existence of this sector is clearly threatened by the Asian countries that have a certain cost advantage over their counterparts in the European Union.

In January 1994, a complaint was lodged by the Cotton and Allied Textile Industries of the EC (Eurocotton) to initiate anti-dumping proceedings against imports of UCF originating in the People's Republic of China, Egypt, India, Indonesia, Pakistan and Turkey. The complaint was withdrawn by Eurocotton due to insufficient evidence, therefore the Commission decided to terminate the proceedings in January 1996.

On February 21, 1996, the Commission announced the initiation of an anti-dumping proceeding with regard to the imports into the community of UCF originating in China, India, Indonesia, Egypt, Pakistan and Turkey. The proceeding was initiated for the second time as a result of a complaint lodged on January 8, 1996, by Eurocotton, on behalf of the community industry.

European Commission's Investigation of UCF

Injury to the Community Industry

The findings of the Commission, based on a sample of community producers during the investigation period (1992 to 1995) were as follows:

- Total sales of domestically produced UCF fell by 11.8 per cent, while consumption of the product concerned rose by 12.9 per cent over the investigation period.
- Market share of the community producers fell by 14 per cent, while production of the product concerned decreased by 9.7 per cent.
- It was estimated that 88 plants manufacturing the product had been closed. This resulted in 8,625 job losses in the community industry.
- The investigation of the community producers showed as the main injury indicators:
  - Unsatisfactory development of sales prices.
  - Deterioration of profitability over the period 1992 to 1995.

It was established that at the same time the dumped imports were sold in the community at prices which significantly undercut the prices of the community producers. The results of the comparison showed margins of price undercutting for all the producers investigated in the exporting countries (see Table-4).

Table-4: Price Undercutting Margins Established by EC

Country	Margin
China	17.5%
Egypt	20.0%
India	34.5%
Indonesia	25.7%
Pakistan	24.7%
Turkey	30.4%

Source: *Official Journal of the European Communities* (November 18, 1996), Commission Regulation (EC) No. 2208/96.

Effects of Other Factors

Imports from third countries. It was alleged by certain exporters that imports from other third countries not included in this proceeding were the cause of any injury suffered by the community producers. The market share of these imports increased from 26.4 per cent in 1992 to 31.6

per cent in 1995. The market share of Russia, for example increased from 1.3 per cent to 3.1 per cent. The market share of imports from UAE rose from 0.2 per cent to 2.4 per cent. The Commission, however, has no indication that imports from Russia and the UAE are entering the community at dumped prices.

Increase in raw cotton prices. Average raw cotton rose worldwide from ECU 1.17/kg in 1992 to ECU 1.86/kg in 1995, a rise of 59 per cent. The Commission, however, concluded that it was not the rise in the raw cotton price in isolation that caused the material injury suffered by the community industry. The Commission considered the price suppression brought about by the price undercutting of the dumped import from the exporting countries, that prevented the community industry from reacting fully to the rising cotton prices.

Sampling

In view of the large number of exporters in the countries concerned, the Commission decided to apply sampling techniques, and divided the exporters into three categories: participants, cooperating companies and non-cooperating companies. In the case of Pakistan only four companies were selected in the sample, another 160 exporters cooperated with the investigation team. The four participant firms were:

- Lucky Textile Mills, Karachi
- Diamond Fabrics Limited, Sheikhupura
- Nishat Mills Limited, Faisalabad
- Kohinoor Raiwind Mills Limited, Lahore

Normal Value

Domestic sales were considered representative when the total domestic sales volume of each producing company was equal to at least 5 per cent of its total export sales volume to the community. Normal value was constructed by the Commission:

Manufacturing Cost + SG&A Expenses + Reasonable Profit

Export Price

In all cases where exports of grey cotton fabric were made to independent customers in the community, the export price was established. On the basis of export prices actually paid or payable, the Pakistani exporter

claimed that, in establishing the date of sale, the date of contract should be used rather than the date of the invoice. This was rejected on the grounds that it is in the Commission's normal practice to use the date of invoice as the date of sale.

Comparison

For the purpose of ensuring a fair comparison between the normal value and the export price, due allowance in the form of adjustments was made for differences affecting price comparability. Pakistan requested an allowance for import charges, which was rejected by the Commission as irrelevant considering that the duty was not included in the costs of raw material used for the calculation of constructed normal value.

Dumping Margins

The Commission established that a comparison between a weighted average normal value and a weighted average of the export prices of all the transactions to the community did not reflect the full degree of dumping being practised. Therefore, export prices had to be compared on a transaction-by-transaction basis to weighted average normal values.

The general rule regarding group companies was applied to calculate the dumping margin for Pakistani companies forming part of the same group. The comparison between normal value and export price showed the existence of dumping in respect of all the Pakistani companies in the sample. The provisional dumping margins expressed a percentage of the cif import price at the community border (see Table-5).

Table-5: Provisional ADD on Unbleached Cotton Fabrics

Company	Provisional
Diamond Fabrics	22.3%
Amer Fabrics Limited	22.3%
Kohinoor Raiwind Mills Limited	30.3%
Kohinoor Weaving Mills Limited	30.3%
Lucky Textile Mills	30.6%
Nishat Mills Limited	22.8%
Nishat Fabrics Limited	22.8%

Source: *Official Journal of European Communities*, Commission Regulation No. (EC) 2208/96 (November 1996).

Cooperating companies not in the sample were given the average dumping margin of the sample, weighted on the basis of export turnover to the community. Expressed as a percentage of the cif import price at the community border, the margin was 27.8 per cent.

For non-cooperating companies, the provisional dumping margin had to be assessed on the basis of the information available. Expressed as a percentage of the cif import price at the community border, the margin was 32.5 per cent.

In March 1997, the Commission proposed definitive dumping margins on imports of UCF from Pakistan (and five other countries) ranging from a minimum 9 per cent to a maximum 22.9 per cent (see Tables-6 and 7). In May 1997, six months after the imposition of provisional ADD (November 1996), the Council of European Union decided not to impose definitive ADD.

Table-6: Anti-Dumping Duties on Unbleached Cotton Fabrics

Company	Provisional	Proposed Definitive
Diamond	22.3	9.0
Amer	22.3	9.0
Kohinoor	30.3	22.9
Kohinoor	30.3	22.9
Lucky	30.6	16.9
Nishat	17.0	9.2
Nishat	17.0	9.2

Source: Morning Brief, March 1997.

For the third time in July 1997, Eurocotton again asked the Commission to extend the investigation in view of imposing ADD against imports of UCF, originating in the same six countries. One thing is clear that this matter is essentially a political issue. Therefore, improved presentations and strong arguments could achieve very little. Once again investigation started and provisional duties were imposed in April 1998 followed by proposed definitive ADD in July 1998.

Table-7: ADD Imposed on Cooperating and Non-Cooperating Companies

Company	Provisional	Proposed Definitive
Cooperating	27.9%	14.2%
Non-Cooperating	32.6%	22.9%

Source: Morning Brief, March 1997.

Exporters/producers of the targeted countries sent a rebuttal against the findings of the European Commission both orally and in writing. The Commission sent its recommendations to the Council of Ministers. The case was voted out in October 1998 by the Council of Ministers. The Council confirmed there was no majority in favour of the proposal for five-year ADD averaging 12 percent on UCF imports from China, India, Indonesia, Egypt and Pakistan. As a result the Commission finally had to withdraw its decision of imposing definitive ADD against these five countries.

IV. Conclusion and Policy Directions

Preventive Measures

The likelihood of developed countries imposing anti-dumping duties on Pakistan's exports in the future is quite high. Pakistan, therefore, should strengthen its technical, legal and institutional set-up to fully prepare for the prospective anti-dumping charges on Pakistan's exports. It is not too early to begin taking preventive measures to minimise the potential ADD, so waiting until an investigation is initiated would not be a wise policy to follow.

An understanding of the complex rules on the levy of ADD could enable exporting firms to take precautionary steps to avoid anti-dumping actions in foreign importing markets where there are increasing pressures from industrial and other vested interest groups for such actions. Since dumping margins are determined on the basis of the margins between the price charged in the domestic market and its export price.

While an exporting enterprise may continue to charge export prices that are lower than its domestic prices, it should avoid to do so in markets where anti-dumping actions are possible. In such markets anti-dumping measures can be avoided if the exporter does not allow the difference between its domestic price and export price to fall below a reasonable margin. If the margin is *de minimus* investigating authorities have to reject application for the levy of duties.

Database

Once the investigations begin, the exporters/producers of the exporting countries have to provide information on the cost of production and other matters on the basis of a questionnaire sent by the investigating authorities. It is essential for exporters to cooperate with these authorities and to give them the required information. To prepare beforehand, developing separate databases for importing countries' market and home market sales could be extremely helpful. Having an organised database that provides full information concerning the calculation of the export price, normal value and constructed normal value could also reduce the possibility that the investigating authorities will reject a company's data. Thus, producers/ exporters should identify (a) major costs of production, (b) important selling expenses and (c) significant adjustments for their product.

Anti-Dumping Law of Pakistan

After a series of anti-dumping charges on Pakistan's exports, the exporters have been demanding the introduction of an ADD law in Pakistan to neutralise the situation. Although Pakistan's legislation authorises anti-dumping or countervailing duties, no such measures have ever been imposed. In fact the ADD law in its present form is neither complete nor WTO consistent. The full implementation of the present tariff reform and trade liberalisation programme is likely to expose a number of domestic producers to external competition; this may bring an increased number of applications for anti-dumping. In our view, there is an immediate need to have an effective anti-dumping law in force and an equally competent machinery to enforce it. A draft of Anti-Dumping and Countervailing Duties Act, 1998, has been prepared by the National Tariff Commission and has been submitted to the National Assembly of the previous government.

To implement the law effectively both the businesses and the concerned officials must be thoroughly trained to make an anti-dumping case. The purpose of the law must not be tit for tat retaliation. The main purpose must be to use it to protect the local industry, once our markets are exposed to severe foreign competition.

Competition Policy

Competition policy may be on the agenda for the upcoming WTO meeting in Seattle, which could launch a new round of trade talks. In a study, the OECD has identified areas where competition policy supports or undermines trade policy and areas where trade policy supports or undermines competition policy. After the Singapore Ministerial, Japan

wanted talks on competition policy to include anti-dumping or special tariffs. As frequent practitioners of anti-dumping measures, however, the EU and US opposed the idea. A further improvement would be to write anti-trust rules into world trade law.

Role of Government

As the legal and other costs of participating in anti-dumping investigations are substantial, and are often beyond the resources of small and medium-sized enterprises, they rely on their governments to defend their interests. In the future, the Government of Pakistan should play a more dynamic role during anti-dumping investigations to help exporters and their associations. The Government of Pakistan should support the proposal submitted at the WTO which proposes modifications of rules, such that the dispute settlement panels follow the common rules provided by the Dispute Settlement Understanding. Currently, there exist special provisions in the agreement relating to settlement of disputes in the anti-dumping area.

The Agreement of ADP unfairly restricts the role of the dispute settlement panel. The ADP excludes anti-dumping cases from the normal dispute settlement panel. In dispute on all other subjects, the panels are empowered to determine whether the country has violated its obligations under the Agreement. This authority has been denied to the panels in anti-dumping cases. These selective methods and the discretion they provide to those initiating the anti-dumping cases need to be reformed. Without these reforms, WTO will fail to function independently as a neutral body in determining the veracity of anti-dumping claims.

The developing nations must bury their trade differences and thrash out a common stance on ADD ahead of the upcoming WTO meeting in Seattle. It is time for the world to dump anti-dumping, a huge impediment to future export growth in developing countries in general and Pakistan in particular.

References

APTMA News, 1997, Volume 1, No. 3 (April).

Asian Textile Journal, June 1997.

Bashar Amanullah, 1998, Provisional anti-dumping duty on unbleached cotton. *Pakistan & Gulf Economist* (April 20-26).

Brenda, A. Jacob, Powel, Goldstein, Frazer and Murphy, 1999, The end of textile quota: Will it bring higher duties? LLP, Washington D.C. Paper presented at an APTMA seminar (July 1999).

Business Guide to the Uruguay Round, 1995, International Trade Centre/UNCTAD/WTO/Commonwealth Secretariat.

Cai, Wenguo, Maria Isolda, P. Guevara and Coleen Hamilton, 1997, Pakistan and the Uruguay Round: Issues, implementation and impact. Centre for Trade Policy and Law, Carleton University, Canada.

Clotex India, 1997, July-August-September.

Edward, L. Farrell Jr., Seth T. Kaplan and Beril J. Lapson, 1993, Dumping and transfer pricing. In Robert Feinschreiber (ed.), Transfer Pricing Handbook.

European Commission, 1994, Anti-Dumping Questionnaire, Anti-Dumping Strategy, Dumping Aspects, Brussels.

European Commission, 1996, *Official Journal of the European Communities*, Commission Regulation (EC) No. 2208/96, Brussels.

European Commission, 1997, EC Seminar on Anti-Dumping. Coopers and Lybrand Consulting (April).

European Commission, 1998, Anti-Dumping Policy of the European Community. Information Day for Journalists of Pakistan and Bangladesh, Brussels (September 9).

Kazmi, Shabbir H., 1997, EU investigating the dumping of bed-linen. *Pakistan & Gulf Economist* (January 4-10).

Pakistan Textile Journal, 1997, February-March-May.

The Economist, 1998, November.

The News, various issues.

WTO, 1995, Trade Policy Review - Pakistan. Volume 1, Geneva.

WTO, 1998, WTO Ministerial Conference, Second Session (May 18-19), Geneva.

WTO, 1998, WTO-Related Business Issues for Discussion in Pakistan. ITC Geneva Pack (August).

WTO, 1999, Anti-Dumping: WTO-Related Pakistan Trade Policy Project, Consultant Note on Pakistan Trade Issues. Presented in Seminar, Ministry of Commerce/EPB/LCCI (October 4).

What use is the Neo-Classical Theory of International Trade?

Part II: International Trade without Comparative Advantages[1]

Sikander Rahim

A. Summary of Part I

The first part of this paper showed that the neo-classical theory of international trade leads to conclusions that contradict the facts or leads to no conclusions that can be verified. The version of the theory with two factors and the same production functions in different countries has some appeal because relative abundance of factors or intensities of their use have consistent meaning and make the theory plausible, but it results in the Leontief paradox and factor price equalisation. This appeal is lost when the number of factors is greater than two or production functions are not the same in different countries; relative abundance and intensity can not be consistently ranked or their connections to the pattern of trade is not the simple one of the Heckscher-Ohlin theory. Nor does the theory have much left to say; the kind of verifiable general prediction that was possible with two factors is not possible when the factors are more than two; such conclusions as can, in principle, be drawn are specific to the general equilibrium calculated for a given set of production functions and a given set of countries, with specified factor endowments and consumer preferences.

In practice, not even such specific conclusions can be drawn. No model appears to have been constructed that calculates general equilibrium for a group of countries while deriving incomes from factor prices and allowing for a sufficient number of different goods to be a plausible description of trade as it actually occurs. Trade models with more than two factors always assume that demand for goods is entirely determined by the prices of the goods and neglect the effects of income and, hence, of factor prices. Sometimes consumer preferences are assumed to be homothetic, which makes demand independent of income distribution but does not make the model more realistic.

In the real world countries exchange the same or similar goods. *Prima facie* this is not compatible with the notion of comparative

[1] For brevity the country China is referred to as consisting of three economies, China, Hong Kong and Taiwan, because, although they constitute one country, they are economies run along different lines.

advantages, according to which countries export the goods for which they have comparative advantages and import the ones for which they do not. One way of overcoming the incompatibility is to make the differentiation between goods so fine those countries only exchange goods that are different. Thus, two countries may export small cars to each other, but the differences in the designs of the cars make them different goods. The problem with this is that minor differences, like the shape of the hood, are supposed to be the consequences of the characteristics of each country, e.g. its factor endowments. Because of the absurdities that follow, economists have preferred to avoid this course. Besides, such differentiation ensures that the number of goods to be included in the model will be too great for any possibility of calculating a general equilibrium.

An alternative way proposed by Helpman and Krugman is to assume that the countries that exchange similar goods have the same factor prices, because that permits such trade. With the additional assumption of increasing returns to scale, specialisation occurs in different variants of the same type of goods. The explanation purports to apply to Europe, Japan and North America, but it requires that differences in real or nominal wages between, say, the UK, US and Sweden be negligible, which they are not. Nor does it explain why these economies were able to exchange similar goods in the 1950s, 1960s and 1970s, when Europe's and Japan's wage rates were lower compared to the US than now. And it fails to deal with the cars exported by Mexico and Brazil, the machine tools exported by Taiwan, the computer components exported by Korea, the aircraft exported by Brazil and so on. Finally, a model like this, presented in the abstract, with no attempt to test it or to show how it can be tested, does not qualify as a theory or an explanation.

The neo-classical theory also fails because the concept of a factor is not adequately determined. Firstly, the list of factors is left indeterminate, often as though it were a matter of choice, whereas in a verifiable theory the factors and their characteristics would be expected to be definite, meaning that economists would generally agree on what the factors are that determine international trade. Even the number of factors is treated as a matter of choice.

Secondly, the theory must assume that factors and products are separate, i.e. those factors are not products. If factors can be produced, if capital goods or their stock can be assumed to be factors of production, an inconsistency arises. For, in the standard general equilibrium of the neo-classical theory of international trade, prices are determined by endowments and consumer preferences and are, therefore, unrelated to the past costs of producing those factors. One way the inconsistency can be removed is by

going from one-period to inter-temporal equilibrium, with the addition of equations to make the earnings from capital goods consistent with the costs of producing them. Such models have been devised for the closed economy, though, in view of their assumptions regarding the foresight of economic agents and the prevalence of forward markets, few consider them to be descriptions of reality or guides to policy. No model of inter-temporal equilibrium with several countries and heterogeneous capital goods has yet been attempted. **Moreover, the chances are remote that such a model will be devised that is elaborate enough to be realistic and that passes empirical testing.** But if one were to be devised, it would yield a different pattern of trade to that of the present-day one-period models by allowing the trade in capital goods.

Alternatively, capital goods can be assumed to have properties that prevent the inconsistency from arising in the one-period equilibrium. In the neo-classical theory this is done by treating capital as one or several malleable substances whose quantities can be measured independently of factor prices and the place of production. By this means prices are determined by the usual marginal relations of production functions and consumer preferences of neo-classical economics, all of which can be satisfied in the one-period equilibrium. But, although presented as a heuristic device, as a parable, paradigm, pragmatic simplification of complex reality and so on, the assumption has to be taken literally. For, if the assumption is not literally true and countries do not have the same factor prices, the price of any capital good depends on where it is produced. Then, regardless of how the quantity of capital embodied in a capital good or set of capital goods is measured, the quantity of the capital goods differs from their value, and the inconsistency of the previous paragraph returns.

Haberler's representation of trade, in which an economy is represented simply as a convex production set, shows why the shortcomings of the neo-classical theory are inescapable. It assumes that both short term and long term rates of transformation are given by movements along the production frontier. But, if capital goods are not malleable, these two rates are not equal. Then the prices of capital goods depend on where they are produced and the production frontiers depend on prices. The problems of the Heckscher-Ohlin theory are, moreover, magnified in it. Being more general than the Heckscher-Ohlin theory, because it abstracts from the relations between the production of individual goods and the means of production, the Haberler representation has even less to say about trade; the only conclusion that can be drawn from it, without the addition of special assumptions, is that free trade is best: the general problem of neo-classical trade theory -- policy prescriptions from an unverifiable theory.

If the neo-classical theory of trade, whether the Heckscher-Ohlin theory or the Haberler representation, does not hold, the notion of comparative advantages, according to which the prices and allocations of factors in countries adjust to yield an equilibrium, can not hold either. For the only other form of comparative advantages is the theory of Ricardo, according to which costs and output are proportional to the inputs of labour, and this is not accepted theory.

B. Bensusan-Butt's Model

Trade theory has been so completely associated with comparative advantages since Ricardo first formulated the notion that it may seem impossible for it to be otherwise. Yet models and theories of trade without comparative advantages can be devised easily enough. This was done already in 1954 by Bensusan-Butt. The paper attracted much attention at the time, but was ignored after that and forgotten. Already Chipman's survey of trade theory, which appeared in 1965-66, makes no reference to it. Nor does Bhagwati's survey that appeared in 1968. None of the standard textbooks on international economics refers to it and their authors are most likely unaware of it.

In Bensusan-Butt's model the same techniques of production are available to all countries and each good can be produced by unassisted workers (manually) or by workers operating machines, which can also be produced in both these ways. The output per worker is higher with machines than without. Bensusan-Butt discusses what happens when two countries, A and B, have given workforces fully employed in manual production with the same wage rate and one country, A, begins to produce machines. Entrepreneurs in A first employ machines to produce the good that gives the highest return, and manual production of that good in A is progressively displaced by machines until none is left. At that point trade with B starts. There was no reason to trade before, but now B's manual production of that good is displaced in the same way as was A's. Once mechanisation is completed for that good, it proceeds to the good offering the next highest return on investment, which means the price of the first good falls to yield the same return. Employment remains full because of the rise in incomes and the demand for machines, while trade balances because B exports manually produced goods to meet A's growing demand for them and imports machine made goods.

Bensusan-Butt's model differs from comparative advantages in several respects; the nominal wage is given and trade occurs because of differences in mechanisation; trade does not occur if the two countries mechanise in step; the gains to workers occur as mechanisation progresses and prices fall;

entrepreneurs in one country benefit if the other country is behind in mechanisation, because they can increase the scale of their production, and, hence, the sum of their profits, by displacing manual production in the other country, but they lose as the rate of return falls. The whole is a process through time, not a one-period equilibrium. None of these differences is a consequence of 'rigidities' in the nature of capital in Bensusan-Butt's model; the model assumes that each machine can be used to produce any type of good and the model presented below in the present paper puts no limit to the number of techniques of production. The reason for the differences is the assumption in the neo-classical theory that capital can be treated as a quantity independently of prices, wages and rates of return, an assumption whose illegitimacy and consequences only began to become clear with the publication of Joan Robinson's paper 'The Production Function and the Theory of Capital' in 1954.

C. A Model of Trade and Development

The model of the present article follows that of Bensusan-Butt in assuming that nominal wages are given, that the same techniques of production are available to all countries and that goods can be produced by workers using machines, which are also produced goods. But it is intended to examine two questions that Bensusan-Butt did not discuss; what happens when one country is a developing country with a low wage and the other a developed country with a high wage, and what are the effects of trade barriers, in particular of tariffs?

When a country is developed, i.e. produces every type of manufactured good that it uses, the prices of all goods that are actually produced are given by the costs of production there, excepting those that are produced by the developing country and used entirely by it or which have no substitute in the developed country, e.g. a primary product only produced in the developing country. The developed country, denoted by A, is assumed to be the price setter and the developing country, B, the price taker. The people of A and B are assumed to consume the same types of goods.

Since A's nominal wage is assumed to be higher than B's and prices of goods are assumed to be the same in both countries when trade is free, once entrepreneurs in B start mechanising production, they obtain rates of return higher than that prevailing in A. This is true even if they choose an activity that occurs in A (produce the same good with the same type of machine), but they may be able to obtain a still higher rate of return if they use a different type of machine to take advantage of B's lower wage. The goods that are produced at lower cost in A than in B are those for which the higher rate of return in B more than offsets the lower wage. The highest rate of return

obtainable in B may come from producing a consumption good and importing the machines to make it, but it might equally come from producing a certain type of machine for export and importing the machines to make it, or from importing machines to make machines to make consumption goods. In the first case producing the consumption goods can be loosely said to be less capital intensive than producing capital goods, whereas in the second the capital goods are the less capital intensive to produce. In the last case the production of consumption goods in B with machines produced in B is less capital intensive than producing the consumption good in B with machines produced at A's costs.

Assuming that the highest rate of return in B is obtained by making a consumption good using imported machines, once B produces enough of that good to satisfy domestic demand at the given prices, it begins to export to A. Then, if A imposes tariffs, it lowers the price B obtains for its exports and, hence, the rate of return obtainable in B and, if the tariffs exceed a certain level, the rate of return from making consumption goods there falls below that obtained from making machines. For, if the rate of return is lowered to that of A, machines are cheaper to produce in B because of the lower wage. So above that rate there is a rate that exactly offsets B's lower wage so that machines cost the same to produce there as in A and, corresponding to it, is a tariff level. A higher tariff gives a lower rate of return in B and makes machines cheaper to make there. Consequently, a developing country facing trade restrictions may find it obtains a higher rate of return on investment by producing its own capital goods and that the capital or labour intensity of various branches of production depend on tariffs, wages and where the means of production are made. The belief that textile production, for instance, is labour intensive and hence suited to low wage countries ignores the effects on prices of the developed countries' trade restrictions.

The model that follows is intended to demonstrate the consistency of the reasoning of the two preceding paragraphs, but it also serves to bring to light some phenomena that are not obvious when the reasoning is purely verbal. To begin the model assumes two consumption goods and is confined to examining how and where these goods are produced and what effects tariffs may have. The extension to more consumption goods is straightforward and is discussed briefly.

D. A Model of Trade and Development

One technique of mechanised production

The argument made above verbally about the tariffs and the choice of sectors can be presented by a simple model. A homogeneous

consumption good, to be called cloth, is assumed to be produced by a machine, to be called a b-machine, one man operating one b-machine produces one unit of cloth per period. b-machines are produced by k-machines, one man operating one k-machine producing one b-machine per period. k-machines can also produce k-machines, one man operating one k-machine producing μ k-machines per period.

Denoting the nominal wage in country A by W and the rate of return by R and assuming that machines last forever:

$$W + R.B = P$$
$$W + R.K = B$$
$$W + R.K = \mu.K.$$

where P, B and K are the prices of cloth, b-machines and k-machines respectively.

In the case that the highest rate of return obtainable in country B is obtained from producing cloth with imported b-machines, denoting the nominal wage in country B by w and the rate of return by r, and assuming that, given the prices:

$$w + r.B = P$$
$$w + r.K > B$$
$$w + r.K > \mu.K.$$

In this case, denoting by r' the rate of return that country B would get if it imported k-machines, made b-machines and with these made cloth,

$$w + r'.(w + r'.K) = P. \quad r > r'.$$

Then:
$$w + r.(w + r.K) > P,$$

Which is to say that country B gets a lower rate of return if it makes its own machines.

If country A applies an *ad valorem* tariff, t, on imports of cloth, the price country B gets for cloth is P/(1+ t).

Then:
$$w + r.B = P/(1 + t)$$
$$w + r'.(w + r'.K) = P/(1 + t).$$

But, $w + R.K < W + R.K = B$. That is, since country B has a lower wage, b-machines are cheaper to produce there if the rate of return there is the same as in A. So, if A's tariff is raised so high that:

$$P/(1+t) = w + R.B, \quad \text{that is, such that } r = R,$$
$$\text{then} \quad w + R.(w + R.K) < P/(1+t).$$

At this tariff, $r' > R$. Then there is a $t' > 0$ such that, $r' > r$ if $t > t'$. This means that, if tariffs are raised high enough, country B obtains a higher return from producing its own machines for making cloth. Moreover, if country B makes its own k-machines, it is assured a positive rate of return, r'', given by:

$$w + r''.K = \mu.K$$

and this occurs for $t < P/w - 1$, that is at a level for country A's tariff that still allows a positive rate of return on country B's exports.

The conclusion, obvious to common sense, is that the greater the protection by developed countries, the more self-reliant developing countries ought to be.

Several techniques of mechanised production

The model can be elaborated to include choice of techniques and depreciation. The consumption good, cloth, remains the same, but b-machines are of various types, the type being denoted by a suffix. A b_y-machine is manned by one worker and has an output of α_y of units of cloth per period. The number of b_y-machines produced by a k_x-machine and a worker is β_{xy}. For simplicity, rather than having various types of k-machines make various types of k-machines, k-machines are assumed to be made by m-machines, of which there is only one type. An m-machine is manned by one worker and the number of k_x-machines it can produce per period is κ_x and the number of m-machines it can produce instead is μ.

At the start the developed country, A, makes cloth for its own consumption and that of B. It also produces all the machines it needs to make cloth and to replace machines as they wear out. B's labour is fully employed in the manual production of corn, which is also produced in A with the aid of machines. Further details of corn production are not needed, it simply represents the activity of the population of B before industrialisation begins, including the export that allows the import of cloth, and is convenient as a numeraire when one is needed.

The wage and rate of return in A are denoted, as before, by W and R. Cloth is made with b_t-machines, which are made by k_s-machines. Any other combination results either in a higher price of cloth relative to W or a lower R. Each machine is assumed to last T periods and then to collapse,

when it becomes valueless and is disposed of costlessly. The prices in A are given by the following equations:

$$
\begin{aligned}
W + (1 + R).M_1 &= \mu.M_1 + M_2,\\
W + (1 + R).M_p &= \mu.M_p + M_{p+1},\\
W + (1 + R).M_T &= \mu.M_{1,}
\end{aligned}
$$

$$
\begin{aligned}
W + (1 + R).M_1 &= \kappa_s.K_{s1} + M_2,\\
W + (1 + R).M_p &= \kappa_s.K_{s1} + M_{p+1}\\
W + (1 + R).M_T &= \kappa_s.K_{s1,}
\end{aligned}
$$

$$
\begin{aligned}
W + (1 + R).K_{s1} &= \beta_{st}.B_{t1} + K_{s2},\\
W + (1 + R).K_{sp} &= \beta_{st}.B_{t1} + K_{s2p+1},\\
W + (1 + R).K_{sT} &= \beta_{st}.B_{t1},
\end{aligned}
$$

$$
\begin{aligned}
W + (1 + R).B_{t1} &= \alpha_t.P + B_{t2},\\
W + (1 + R).B_{tp} &= \alpha_t.P + B_{tp+1},\\
W + (1 + R).B_{tT} &= \alpha_t.P.
\end{aligned}
$$

Here B_{tp}, K_{sp} and M_p denote the prices of the corresponding machines in their p^{th} periods and P is the price of cloth. These equations also imply that entrepreneurs are indifferent between using an m-machine of a given age for producing k-machines or m-machines.

Omitting the age suffix, the equations for new machines and cloth can be summarised as:

$$
\begin{aligned}
1.a \quad & \mu.M = W + h(R).M,\\
1.b \quad & \kappa_s.K_s = W + h(R).M,\\
2.a \quad & \beta_{st}.B_t = W + h(R).K_s,\\
2.b \quad & \alpha_t.P = W + h(R).B_t;
\end{aligned}
$$

where $h(R) = R.(1+R)^T/[(1+R)^T - 1]$, which is monotonically increasing if $R > 0$.

When entrepreneurs in B start to invest in machines they choose those that yield the highest return. For the present the prices are taken as given, the effects of B's investment and production on them are taken up later. This allows the main point to be stated without complications that obscure the argument and do not change the conclusions.

Several techniques of mechanised production: free trade.

Let the highest rate of return obtainable in B come from importing b_x-machines made in A with k_v-machines and producing cloth. Then:

$$\kappa_v.K_v = W + h(R).M$$

3.a $\beta_{vx}.B_x = W + h(R).K_v,$
3.b $\alpha_x.P = w + h(r).B_x.$

Since $w < W$, $r > R$.

By hypothesis, on the assumption that b_t-machines and b_x-machines are different, making b_t-machines in B or making them in A and operating them in B yield lower returns. For the same reason, b_x-machines are not operated in A. Then:

4.a $w + h(r).K_s > \beta_{st}.B_t$
4.b $w + h(r).B_t. > \alpha_t.P$

5.a $w + h(r).K_v > \beta_{vx}.B_x$
5.b $W + h(R).B_x. > \alpha_x.P$

From these follow: $B_x < B_t$, K_s, K_v, which is to say that, because its wage is lower, country B uses less capital per head than A.

If, instead, the highest rate of return obtainable in B were to come from importing k_y-machines and making and operating b_z-machines there, B_z and r would be defined by:

6.a $w + h(r).K_y = \beta_{yz}.B_z$
6.b $w + h(r).B_z = \alpha_z.P.$

3.a ceases to hold and 6.b has the same form as 3.b. By hypothesis, b_z-machines cost more to produce or to operate in A, so:

7.a $W + h(R).K_y > \beta_{yz}.B_{xz}$
7.b $W + h(R).B_z > \alpha_z.P.$

Then B_z, $K_y < B_t$, K_s and $\alpha_z < \alpha_t$. Again, B uses less capital per head and has a lower output per head than A.

At some moment entrepreneurs in B begin to invest and they choose the activity that gives the highest rate of return. In the following discussion of industrialisation in B the highest rate of return obtainable in B in free trade is assumed to be given by importing b_x- machines made in A with k_v-machines and producing cloth.

The effect of the growth of output on prices can be discussed in two ways. One is to assume that entrepreneurs and workers in both countries

act with perfect foresight and move freely from one activity to another. Then, as B's output of cloth increases, A's entrepreneurs withdraw from the production of cloth. If the growth of B's output is fast enough for some b_t-machines in A to be scrapped before they cease to be usable, they are amortised faster to yield the same rate of return. Similarly, k_s-machines will be scrapped early and amortised faster if they are not fully used for producing b_x- machines for export. Hence, A's entrepreneurs reduce their own production of cloth in such a manner as to allow prices to rise by enough to obtain the same rates of return as before on investments that last a shorter time. The price of cloth rises and perhaps so does the price of b_t-machines. The real wage falls.

In this equilibrium expectations are satisfied, but prices are complicated to calculate. They depend on the rate of investment in B and the relative sizes of A's and B's cloth producing sectors, and then the possibility arises that, because of the price movements, other types of machines become more profitable in either country. Explicit formulae for prices become unmanageably complicated, if not impossible. These complications can be avoided by assuming, as did Bensusan-Butt, that machines last forever and can be used at any time to produce any good and are only of one type. But the existence of amortisation, the dependence of the length of use of an investment on growth and the choice of techniques have effects worth discussing. Nor are explicit formulae needed, the prices and rates of return given by equations 1-4 are adequate reference points for the discussion that follows, and will, for the most part, be used as such.

The second way to discuss the growth of B's output of cloth is to assume that A's entrepreneurs try to compete to keep their markets for cloth and are forced to cut their production because they can always be undercut. The prices of cloth can vary anywhere between the level that just covers the wage cost in A and that, discussed above, given by perfect foresight, and the returns are accordingly below what those obtained with perfect foresight. The real wage may rise.

Perfect foresight and fulfilled expectations are not normally to be expected in the real world, but are interesting because they show, firstly, that full employment and balanced trade can be maintained and, secondly, how the likely behaviour of entrepreneurs can cause losses, unemployment and trade imbalances. In B workers move from producing corn to producing cloth; in A workers are displaced from the production of cloth and from the production of k_s-machines and b_t-machines for use in A to the production of k_v-machines, b_x-machines and corn. The number of m-machines and their use may also change. The reduction in B's imports of cloth is balanced by the reduction in its exports of corn, which is a change in its method of

obtaining cloth, and by its imports of machines, an act of saving. At this stage, since the assumption that the rate of return in A is unchanged implies that the price of cloth rises, the real wage falls in each country. An alternative, not taken up here, is to assume that, along with perfect foresight and fulfilled expectations, the rate of return declines uniformly in A, in which case entrepreneurs lose and workers gain.

Full employment and balanced trade remain possible when foresight is not perfect and expectations can be disappointed, but they are not assured. In A the lower cloth prices deter investment in cloth production and in k-machines by lowering rates of return in these activities, but B's demand for b-machines and the fall in its production of corn stimulate investment for their production in A. The net effects on investment, employment and the trade balance depend on how A's entrepreneurs respond to stimulus and deterrent, which depends on what each entrepreneur anticipates will be future investment in B and the reaction of other entrepreneurs. The effect of the stimulus can outweigh that of the deterrent and can cause demand for workers and machines to exceed supply, or can be insufficient and result in deficient demand and unemployment.

Other consumption goods can be assumed to exist and to be made with similar hierarchies of machines. Assuming that consumption goods offer higher rates of return to production in B than machines and assuming, also, full employment and balanced trade, B's entrepreneurs turn to producing the consumption good that offers the next highest rate of return when A's cloth production has been completely displaced, or when the price of cloth falls enough to make the return on producing the other consumption good higher. As B produces a succession of consumption goods in this manner, prices fall and the real wage rises in each country.

Trade and development with tariffs

In the real world countries restrict imports when domestic production is displaced too fast or too much. Why this happens was discussed in the first part of this article, though the emphasis was on developing countries. Of the several ways of restricting imports, the *ad valorem* tariff has been the most common and is the simplest to use in the present model. So A is assumed to impose an *ad valorem* tariff, t, on imports of cloth. Up to now A and B could be considered to constitute one market for cloth, both countries could have been exporting and importing cloth at the same time. But, with A's tariff, B's consumption of cloth must be met entirely from domestic production before exports to A begin.

If the price of cloth in country A is P, the price that country B receives for the cloth it exports to A is P/(1+t). Assuming that prices in A are given by equations 1.a to 2.b, the rate of return to producing cloth in B using b_x-machines is given by:

$$w + h(r).B_x = \alpha_x.P/(1+t).$$

If t is put so high that the price of cloth only covers the wage cost, $w = \alpha_x.P/(1+t)$, country B can only obtain a positive return from importing b-machines by choosing types of these machines which have higher outputs. The higher the tariff, the higher the output of country B's b-machines must be and, therefore, the more capital intensive its cloth production. But, if t is so high that B can not obtain a positive return using the same b-machines as A, $w = \alpha_t.P/(1+t)$, it can obtain a positive return by importing k_s-machines and making b_t-machines for export to A, because, if r is determined by

$$w + h(r).K_s = \beta_{st}.B_t = W + h(R).K_s,$$
$$w < W \text{ implies } r > R.$$

Then:
$$W + [h(R)/\beta_{st}].[w + h(r).K_s] = \alpha_t.P.$$

This value of r is assured given this level of t, but a higher value might be obtained by suitable choice of types of b-machines and k-machines, the highest value being given by:

$$8 \qquad Max_{mn} \{r \mid W + [h(R)/\beta_{mn}].[w + h(r).K_m] = \alpha_n.P\}$$

For some lower values of t, B may obtain its highest rate of return from importing k-machines and making b-machines and using these to make cloth domestically. For, if t is such that B's rate of return on using imported b_x-machines to make cloth is reduced to the same rate of return, R, as in A,

$$\alpha_x.P/(1+t) = w + h(R).B_x = w + [h(R)/\beta_{vx}].[W + h(R).K_v]$$
$$> w + [h(R)/\beta_{vx}].[w + h(R).K_v],$$

which says that if B, at the same return as in A, imports k_v-machines and makes b_x-machines and uses these to make cloth, its price will be below P/(1+t), i.e. it can obtain a higher return. Again this return is assured, but, by choosing the types of k-machines and b-machines suitably, it might get a higher rate:

$$9. \qquad Max_{yz} \{r \mid w + [h(r)/\beta_{yz}].[w + h(r).K_y] = \alpha_z.P/(1+t)\}$$

and $r > R$.

Since the expression 8 is not a function of t and since r in the expression 9 increases as t decreases, there are values t' and t'' such that the highest value of r obtainable is given by 8 for $t \geq t''$ and by 9 for $t'' \geq t \geq t'$. For $t \leq t'$, B's highest rate of return is obtained from importing b-machines and making cloth.

Then, if $t \geq t''$, B exports b-machines to A, displacing A's production of b-machines and the same sequence follows as was described for cloth under free trade and, in the same way, it either ends when A produces no more b-machines, whereupon B starts exporting some other good, or when A imposes a high enough tariff on imports of b-machines. In the latter case B obtains m-machines from A and exports k-machines and, if A puts a high enough tariff on imports of k-machines, B becomes autarkic.

And, if $t'' \geq t \geq t'$, B exports cloth to A, but imports k-machines and makes its own b-machines. As B's exports of cloth grow and continue to displace A's cloth production, A might raise t until $t \geq t''$, whereupon B starts exporting b-machines, as in the preceding paragraph.

E. LESSONS FROM THE MODEL

1. Absence of Capital Goods Industries

The model leads to the conclusion that a developing country whose exports are subject to high tariffs by importing developed countries obtain better rates of return by producing its own capital goods. Yet, in practice, developing countries have rarely reacted to trade barriers in this way and it must be explained why. Pakistan is an extreme example, it specialised in cotton and jute textiles in the 1960s and cotton yarn, cloth and apparel remain its main manufactured exports. These are probably the products that have long been subject to the severest trade restrictions by the developed countries, mostly in violation of the spirit and letter of the General Agreement on Tariffs and Trade. The developed countries restricted imports in the 1950s individually but imposed the restrictions as a group in the Short Term Arrangement of 1960, which, after repeated assurances that it was temporary, became the Long Term Arrangement, which, despite promises that it would be confined to cotton goods, became the Multi-Fibre Arrangement, which is now being gradually eliminated. Yet Pakistan has never developed a noteworthy capital goods industry.

Education and training

Several explanations can be given for why developing countries do not take the next step of producing their own capital goods. Part of any

cogent explanation is that these countries nearly always lack the engineering and scientific skills needed. Industrial plant and machinery normally require more engineering and scientific capabilities to manufacture than do producing most textiles, assembling apparel, soldering circuit boards and the many other simple activities in which low wage countries are supposed to have comparative advantages, and these capabilities are lacking because developing countries do not provide enough education and training. (Moreover, many of the ablest scientists and engineers they do produce emigrate to the developing countries.)

The production of these technical capabilities is an investment with a cost, just as the production of machines, except that it is embodied in people. These people are needed for the production of industrial plant and machinery, or any other goods, as much as the plant and machinery being used in that production. Economists sometimes recognise this by classifying such capabilities as a factor separate to labour, capital and land and one with which the developed countries are relatively well endowed. They thereby make the same mistake as with investment in machines, that of ignoring the cost of producing these capabilities. Even if developed countries are relatively well endowed with these skills, they have had to produce them at a cost (except for immigrants) and, by the same reasoning as for capital goods, the developing countries should be able to produce the same skills at lower costs or at least at higher rates of return.

Few developing countries have systematically attempted to produce the scientists and engineers they need and only a sketchy explanation can be offered here. Ultimately, the reason is the peculiarity of education and training as an investment, that it is embodied in people. Because of that, the state must supply the greater part, especially in a developing country, and support the private sector in supplying it as well. In Pakistan, more than in most countries, the wealthier segments of the population have, to the extent they deemed education desirable, had their offspring educated abroad and, at least at first, little of this education was in sciences or engineering. Because they could do this, the wealthy had little stake in the national education system, which has, therefore, been given insufficient attention.

In more recent years international organisations, such as the World Bank and the IMF, have emphasised primary and secondary education on the grounds that they reduce poverty, population growth and the disadvantages of women, and at the same time these organisations discourage emphasis on higher education on the grounds that it costs more per student. Obviously primary and secondary education should be given more emphasis than they have been in Pakistan, but so should higher education. Viewed simply as an investment, scientific and engineering education at universities and beyond,

if properly imparted and used, yield higher economic returns than they do in the developed countries (provided the recipients of the education do not emigrate). Analogously, the ability of primary and secondary education to relieve poverty depends in the long run on how fast national income grows, and so far no economy has developed that neglected higher education.

Infant industries

But the lack of scientific and engineering skills, though it must be part of any cogent explanation of why capital goods industries in developing countries are so small and backward, cannot be an explanation by itself. For, if entrepreneurs had wished to invest in capital goods industries, governments would normally have obliged them by providing or helping them provide the necessary higher education. If entrepreneurs have, instead, preferred to invest in technically simple consumer goods industries, it is because they were deterred from capital goods by considerations in addition to the lack of scientific and engineering skills.

The main explanation is that the more complex an industry is technically, the more it must be nurtured as an infant industry. A factory does not normally produce at maximum efficiency as soon as it is set up. If it is part of a larger enterprise which can supply it personnel of the required skill and experience, it can be expected to be close to efficient operation in a couple of years, after an investment has been made in the training of the workforce. Thus, when Toyota sets up a new factory in the UK, it invests the time of its own Japanese personnel in training the British workforce and in overcoming teething troubles. When a developing country starts a industry new to it, it usually does not have this kind of skilled and experienced personnel. The country may obtain it by attracting a foreign company with the necessary personnel to set up the industry, though this rarely happens in enough industries in a country to make a noticeable difference to the economy, or it may attract nationals working abroad who have the skills and experience, a course that helped Japan in the early stages of its industrialisation. But usually the country must acquire the skills and experience itself.

Hence, if an infant industry that is technically more complex than the simple consumer goods industries to which most developing countries, including Pakistan, are limited is to be nurtured so as to become efficient enough to compete with similar industries in developed countries, not only must the supply of scientific and engineering skills be adequate, but all the workforce (managers, scientists, engineers and shop-floor workers) must be able to acquire the specialised training and experience needed to operate the industrial plant with that level of efficiency. Entrepreneurs must be

willing and able to cope with the complexity of the industry, despite economic returns that may be low, even negative, for several years, and their financiers must be willing to see them through difficult times with a high risk of failure. Moreover, in the case of capital goods, there must be entrepreneurs or firms willing to use these capital goods when they install new or replace old productive capacity, which means they must not be put at so much of a disadvantage relative to their competitors who obtain better and cheaper capital goods from elsewhere that they can no longer compete.

Since economists and international organisations such as the World Bank, the IMF and the WTO never tire of pointing out that successful infant industries are rare in developing countries, especially Pakistan, what was said in the first part of this article must be repeated: the conclusion to be drawn is, not that infant industries should not be protected, but that making them succeed is difficult. The countries that do not try to make infant industries succeed can expect to remain where they are; the economies that have, since the Second World War, been successful with their infant industries, notably Japan, Korea, Taiwan and Singapore, are no longer counted as underdeveloped. Among the developing economies, that which seems to be developing consistently fastest is China, which is not an open economy and has spent decades developing it own infant industries.

As pointed out in the first part of this article, after its 'Industrial Revolution' had made England the leading industrial economy, every country that has industrialised has done so with the state providing some combination of protection, rewards, punishments and assistance of various kinds. The problem each developing country has to solve is how to design a combination suited to its specific circumstances, along with a set of institutions to administer it so that it does not end in corruption, inefficient enterprises or subservience to special interest. Much can be learnt from the few economies that have successfully industrialised over the last fifty years, notably Japan, Korea and Taiwan, but also from the industrial policies of Germany, the US and other western countries in the nineteenth century.

But designing such a combination has in many ways become harder with time. The successful East Asian economies just mentioned were able to use protection, several kinds of subsidies, state technical expertise, various export incentives and so on, and the western countries, which were their chief markets, tolerated these departures from what was deemed fair trade because these economies were considered to be threatened by communism. That threat has gone and the stake of the developed countries in the development of the developing countries is not the same. Consequently, the developed countries are quick to act against any appearance of infringement of the rules of fair trade as laid down by the WTO, or often by themselves.

Developing countries must, therefore, devise their own means of fostering their infant capital goods industries. There are no manuals or guidebooks, nor even reliable general analyses of the methods used by the successful economies just mentioned. On the contrary, orthodox economists and institutions, such as the World Bank and the IMF, insist that such methods should not be tried; they argue variously that the methods used by Japan, Korea and Taiwan did not work, that the success of these economies was the result of allowing markets to work, that market distortions were insignificant, that the various measure the authorities in these economies used to influence the behaviour of enterprises did not seriously affect the operation of markets and that the authorities were only deluding themselves when they thought that they did, that the economists of the Anglo-Saxon countries of the West in the 1990s can judge better what went on in Japan in the 1950s or 1960s than could Japanese officials at the time, that the present developing countries could not possibly do the same things and so on. Certainly, such arguments are easier than solving, country by country, the problems of institutions, laws and procedures, education and training, social structures and the like, all of which are complex, difficult and, yet, inseparable from development.

Unequal exchange

The consequence for Pakistan of the trade barriers the developed countries imposed on the cotton products it exported was that the income it received, the value added, was low. Estimates of the rates of return for cotton cloth for the early years of Pakistan's textile exports (1954, 1956 and 1959/60), taking only total direct and indirect foreign exchange costs of the current inputs and capital goods, i.e. putting the wage cost at zero and ignoring all non-foreign exchange costs, give 7.4 per cent to 14.8 per cent, depending on the year. If, instead of Pakistan's unit values of exports, UK unit values are used, the rate of return calculated the same way becomes 43.8 per cent. If wages are taken as greater than zero, the rates of return are correspondingly lower, which is to say that these rates of return ignoring wages can be regarded as a measure of the total gain to the economy.

Just taking the ratios of export unit value of textiles less the cost of tradable direct inputs (cotton, dyes, etc.) as a measure of value added and the cost of the tradable investment (e.g. ignoring local construction costs, land, etc.), the associated capital:output ratios range from 5 to 10. Economists usually consider capital:output ratios of 2-4 to be normal averages for developing economies. Of Kuznets' estimates of incremental capital:output ratios for whole economies, rather than just manufacturing, the highest for high wage countries in the 1950s was 7.4 for the UK. For

manufacturing in the US it was only 0.5. Textiles may have been labour intensive in the developed countries, but the effects of protection on prices made them capital intensive in Pakistan. These poor economic gains were not limited to Pakistan's early efforts to industrialise; the severest restrictions on textile exports came later. The subsequent political, economic and social difficulties are not surprising in the light of this.

When the price-setting country (A in the model) imposes a tariff, t, on the import of a good whose price is P, the income that the price-taking country (B in the model) gets per unit of that good is P/(1+t). For the same good, the price-taker receives less income than the price-setter, though both countries might even use the same investment and labour in producing the good; the price-taker pays P.t/(1+t) in tariffs per unit of cloth as a tax to the price-setter's government, but pays the price-setter's prices for the goods it imports. If the export good of the price-taker is made from a primary product that the country could have exported or had to import, as with textiles made from cotton, the tariff reduces the income of the exporter disproportionately because the tariff is proportionate to the price of the good including the raw material.[2] This, in brief, is the argument of unequal exchange.

The argument rests on the wage difference. Reverting to the model, A can lower the price B receives for its cloth because B's wage is lower. Were B's wage only a little below A's but the tariff high, B would not export; the greater the wage difference, the higher the tariff that A can impose without cutting off trade.

In the real world unequal exchange is a broader phenomenon, it also occurs when low wage countries export goods that high wage countries do not produce, i.e. certain primary products. Examples are coffee, tea, cocoa, bananas, jute and many spices and flavours. These goods would cost more to produce if the workers who produced them were to be paid the wages of the developed countries, even if the most mechanised techniques were used. The income the producer receives per unit of output is determined by the wage rate; because its wage rate is low the developing country receives less income per unit of output than it would if the wage rate were high.

The argument that developing countries receive less income per unit of output than do developed countries because they pay lower wages was

[2] Taking C as the cost of the cotton in the cloth (and neglecting other current inputs), the value added, hence the income, from producing cloth in the price-setting country is P-C, whereas the price-taker receives P/(1+t)-C. The price-setter need only raise t to (P-C)/C to eliminate the price-taker's income; for instance, if the value added is 20% of the price-setter's price of the good, with a tariff of 25%.

first put forward by Arghiri Emmanuel in 1969.[3] His formal reasoning rested on an unsound Marxist labour theory of value in international trade and has, therefore, been easy to dispute. For example, Krugman and Obstfeld purport to refute Emmanuel by presenting unequal exchange as meaning simply that the labour used directly in the production of exports of developing countries is greater than the labour used directly in the production of the goods they import in exchange from the developing countries. They state, "In asking whether trade is beneficial, you should not compare the domestic labour used to produce your exports with the foreign labour used to produce your imports. Rather, you should compare the labour used to produce your exports with the amount of labour it would have taken to produce your imports yourself. If another country can produce your imports with much less labour than would have been required in your country, good for them; this fact does not reduce your own benefit from trade."[4]

Nonetheless, Emmanuel's point is obvious; it is a point about income, not about the quantities of labour exchanged. And, once again, the neo-classical theory's manner of representing trade precludes a phenomenon that evidently must occur.

Unequal exchange can, in principle, be quantified for the goods that compete with the goods produced by the developed countries merely by finding the unit values and the volumes exported by the developing countries. If the sole cause of the difference between the price-setter's and price-taker's prices for a particular good is a tariff, as opposed to quotas and other trade barriers, an even simpler, direct measure is the developed countries' tariff revenues from the imports of that good. The effect of trade restrictions on the income Pakistan derived from its cotton textile exports in the 1960s was mentioned earlier. Since cotton textiles were Pakistan's principal exports at the time, along with jute products, which earned no better, the income Pakistan lost from unequal exchange must have been many times greater than the foreign aid it received. Since then developed countries have placed more reliance on import quotas and have allowed the developing countries some freedom in administering them themselves so as to reduce the extent to which their own exporters bid down their prices. But no terms of trade effect appears to have followed and, consequently, the same unequal exchange continues.

In a case like Pakistan's textiles, unequal exchange is a natural phenomenon; Pakistan is trying to sell a good the buying country can supply

[3] Originally published in French as 'L'Echange Inégal', François Maspero, Paris. 1969.
[4] Krugman and Obstfeld. p. 22

itself and, therefore, does not want to buy. The 'arrangements' by which the developed countries restricted textile imports merely reflect this. Reverting to the model of this article, country A does not gain from free trade if B's cloth is sold at A's price, but it loses if the price of the cloth is lower and rapid growth of import causes unemployment. By imposing a tariff and extracting revenue from B, A does gain from trade. When economists advise countries whose exports are hampered by trade barriers of the importing countries to try harder, they ignore the elementary rule that a seller whose wares are not wanted gets a bad price.

When a primary product of a low wage country does not compete with a product of a high wage country, the constraint on raising the price (assuming that the producers co-operate) is that demand may be elastic. Developing countries often have to accept lower prices to increase their foreign exchange earnings. Here, the obvious remedy is to move into activities that offer more income, preferably into manufacturing goods that can be sold at the prices of the developed countries. To the extent that the new activities are subject to the trade barriers of the developed countries, they continue to suffer unequal exchange. But, to the extent that low wage countries can supply each other with capital and consumer goods at their own prices, unequal exchange can be avoided.

World prices

According to orthodox economic theory, free competitive international trade ensures that the price of any tradable good will be the same in all markets. The theory concludes from this that all tradable goods that are produced have world prices. For most developing countries this means that, since they can not influence world prices, the 'small country assumption', they reach an optimal allocation of resources by adopting them. But any traveller knows that prices differ from country to country, even among developed countries, and, as discussed in the first part of the present article, the studies carried out by economists confirm what the traveller knew already.

Even if prices of goods were the same in all countries, it would not follow that all tradable goods that are produced have world prices. An example of such an exception occurs in the model when the highest rate of return that the low wage country, B, obtains in free trade comes from importing k_y-machines, using them to make b_z-machines and using these to make cloth. (See section D, equations 6 and 7.) In this case a b_z-machine has no world price because it can not be trade. It can not be exported to the high wage country, A, because its output is too low to be competitive at A's high wage and it costs more to make in A than in B. Yet, this b_z-

machine is produced, because it yields the highest rates of return to B, and is tradable. It is not traded at the prevailing prices, but might be if prices were different. A proof that this is possible is easily provided by a diagram.

But the differences in the prices of the same goods in different countries probably imply that the failure of orthodox international trade theory is greater than argued so far in the present article. For it shows that the larger economies, at least, have their own price structures and that trade does not lead to equalisation of prices. A rough illustration can be given by taking two fully integrated developed economies in isolation. Production in the one is represented by a simple input:output matrix, S, and in the other by a similar matrix, T. The nominal wage in the first is W_1 and in the second W_2, and R_1 and R_2 are the rates of profit. Then the prices are given by:

$$P_1 = W_1 + S.P_1 \quad \text{and} \quad P_2 = W_2 + S.P_2.$$

According to orthodox theory, free trade will ensure that one country does not produce certain goods and the other country does not produce certain others. Behind this conclusion is the standard argument that competition will prevent the same good from being sold at different prices in the two countries. In reality, what seems to happen is that the countries keep their prices and their production structures largely intact, i.e. P_1 and P_2 do not change with trade, but the exporting industries in each country accept that prices and rates of return they get from exporting will be different to those they get at home, and that the relationship between the export price and the rate of return is determined by the exchange rate. (It may be absurd to compare two countries before and after trade is opened, but, since it is the standard method for expounding orthodox theory and concluding that there are gains from trade, it can be allowed for the rough explanation given here.)

References

Baldwin, Robert, 1971, "Determinants of the Commodity Structure of U.S. Trade." *American Economic Review*.

Becker, Gary. "Human Capital and the Personal Distribution of Income" W.S. Woytinski Lecture No.1. University of Michigan.

Chipman, John S. "A Survey of the Theory of International Trade: Part 3, The Modern Theory." *Econometrica*. 1966.

Dornbusch, Rudiger. "Purchasing Power Parity" National Bureau of Economic Research No. 1591. 1985.

Haberler, Gottfried v., 1937, The Theory of International Trade with its Applications to Commercial Policy Translated from the German. MacMillan. New York.

Helpman, Elhanan, and Paul R. Krugman. "Market Structure and Foreign Trade. Increasing Returns, Imperfect Competition, and the International Economy." MIT. 1985.

Isard, Peter. "How Far Can We Push the Law of One Price?" *American Economic Review*, 1977.

Isard, Peter. (2) 1995,Exchange Rate Economics Cambridge University Press.

Krugman, Paul R., and Maurice Obstfeld, 1994, International Economics: Theory and Policy. Harper Collins, New York. Third edition.

Krugman, Paul. "Pricing to Market when the Exchange Rate Changes" National Bureau of Economic Research No. 1926, 1986.

Krugman, Paul. (2), 1989, Exchange Rate Instability MIT Press.

Leontief, Wassily. "Domestic Production and Foreign Trade: The American Capital Position re-examined." Proceedings of the American Philosophical Society 97. 1953.

Marston, R. "Pricing to Market in Japanese Manufacturing" *Journal of International Economics*, 1990.

Meade, James Edward, 1955, The Theory of International Economic Policy. Vol. II. Trade and Welfare. Oxford University Press.

Rodrik, Dani. "What Does the Political Economy Literature on trade Policy (not) Tell us that we ought to know?" National Bureau of Economic Research Paper No. 4870. U.S. Centre for Economic Policy Research Discussion Paper No. 1039, U.K. 1994.

Samuelson, Paul A. "International Trade and the Equalisation of Factor Prices" *Economic Journal*, 1948.

Serven, Luis, and Solimano, Andres "Adjustment Policies and Investment Performance in Developing Countries: Theory, Country Experience, and Policy Implications" Working Paper No. 606. Policy, Research, and External Affairs. Country Economics Department. World Bank, 1991.

Vanek, Jaroslav, 1968, "The Factor Proportions Theory: the N-Factor Case" *Kyklos*.

Yang, Jiawan. "Pricing-to-Market in US Imports and Exports: a Time Series and Cross-Section Study" *The Quarterly Journal of Economics and Finance*, 1988.

Book Review

Karmakar, *Rural Credit and Self-Help Groups: Micro-Finance needs and Concepts in India New Delhi;* Sage Publications, 1999. Pages: 374. Price: Rs. 465/- (India).

Micro-finance is an idea which occurred to developing countries considerably late in the day. When during the colonial era, the modern sector and its peculiar institutional framework emerged in the South Asian continent, the system catered to the needs of the modern sector i.e. trade and industry. Agriculture did not receive the kind of attention that it deserved although colonial rule was responsible for destroying the viability of this vital sector. A compensatory effort to provide finance for the rural sector would have been in order. However, this task was left to the co-operatives and informal sources of credit. The governments in the colonial system only undertook "distress lending" in the form of Taccavi loans on a somewhat limited scale.

In recent decades, however, the need for micro-finance has been discussed largely in the context of poverty alleviation, more so since the late 1970's when the Grameen Bank came into existence as a micro-financing institution and gained worldwide fame.

Dr. K.G. Karmakar, a senior official at the National Bank for Agriculture and Rural Development in India, in the book under review, has focused on the rural credit scene in his country and the role of self-help groups in providing micro-credit. As a banker he has a deep insight not only into the conceptual side of micro-finance and its role, but also its management, delivery system and problems. Being a "no nonsense" kind of professional that he seems to be, he shatters a number of myths about rural credit and also micro-finance.

In a world dominated by bureaucracies, and hence inevitably short of ideas and originality, problem solving is bound to revolve around worn-out phrases and cliches. Dr. Karmakar's analysis of rural credit issues is a bit of fresh air.

Cheap credit, the author underlines, cannot offset the misallocation caused by price and yield distortions. This sentence deserves to be displayed prominently in all places in The Third World where economic policies are articulated. He also criticises the belief common among the Finance bureaucracies that a government-owned bank can defy laws of 'financial gravity' and yet remain viable.

He stresses the principles of "repayment ethics" and "recycling of credit" as crucial for any credit delivery system. Simple truth. But how many policies are based on such simple truths?

The author's review of credit policies for specific groups like rural non-farm sector, rural women and micro-enterprises is also highly instructive, based as it is on the experiences from India. But the most interesting part of the book is his critical assessment of micro-financing and self-help groups in India, Bangladesh and Thailand. He highly praise for the Grameen Bank in Bangladesh but also points out (i) The small number of its female borrowers, (ii) repeat loanees' repayment record being not as good as that of the first-time loanees, (iii) high cost of supervision, (iv) too many compulsory contributions, (v) the bank being both a co-operative venture and a commercial bank at the same time, and (vi) the bank's heavy reliance on cheap foreign credit at very low interest rates and favourable repayment terms while it charges commercial interest rates for the loanees.

Pakistan, however, finds a negligible mention only with reference to the Mobile Credit Officers' scheme. The author fails to look at micro financing in Pakistan by many NGO's active in both rural and urban areas. Such financing, outside the control of the government machinery and a good example of purely private initiative, is perhaps the final answer to the credit needs of the poor.

Lahore School of Economics
Lahore

Viqar Ahmed

Notes For Authors

1. Manuscripts of research articles, research notes, review articles, comments, rejoinders and book reviews - in English only - should be sent in duplicate together with floppy in MS - Word to the Editor, The Lahore Journal of Economics, 105, C-2, Gulberg-III, Lahore-54660. Each request for a book review in the journal must be accompanied by one copy of the book concerned.

2. Manuscripts will be accepted for consideration on the understanding that they are original contributions to the existing knowledge in the fields of Economics, Banking, Current Affairs, Finance, Sociology, and Economic History.

3. Each manuscript should be typed and should carry a margin of an inch and a half on the left-hand side of the typed page.

4. The first page of the manuscript should contain the title of the paper, the name(s) of author(s) and a footnote giving the current affiliation of the author(s) and any acknowledgments.

5. Detailed derivations of any main mathematical results reported in the text should be submitted separately along with the articles.

6. Tables for the main text and each of its appendices should be numbered serially and separately. The title of each table should be clearly expressive of the contents. The source of the table should be given in a footnote immediately below the line at the bottom of the table.

7. Footnotes should be numbered consecutively.

8. All references used in the text should be listed in alphabetical order of the authors' surnames at the end of the text. References in the text should include the name(s) of author(s) with the year of publication in parentheses. Attempt should be made to conform to the style of the Journal. Further information on questions of style may be obtained from the Co-Editor, The Lahore Journal of Economics, Pakistan.

9. Each author will receive three copies of The Lahore Journal of Economics with the compliments of the LJE.

10. Book Reviews should give a description of the contents of the volume and a critical evaluation of the book. It should not exceed 5 or 6 typewritten pages.

THE LAHORE JOURNAL OF ECONOMICS

Lahore School of Economics

105-C-2, GULBERG III LAHORE, PAKISTAN. TEL: 874385 FAX: 5714936

SUBSCRIPTION FOR PUBLICATIONS

1. **Kindly enter a subscription for the following publications of the Lahore School of Economics:**

	Publications	Yearly subscription (within Pakistan)	Yearly subscription (outside Pakistan)	Period (No. of years)	Total Payment
1.	Occasional Paper Series	Rs. 1200.00	US $ 200	.....	.....
2.	Lahore Journal of Economics	Rs. 600.00	US $ 100	.....	.....

2. **The subscription is to be in the following name and address:**

Name: ----------

Address: ----------

---

3. **A crossed cheque/demand draft for the sum of Pakistan Rupees/US $_____ is enclosed made out in the name of The Lahore School of Economics to cover the above subscription.**

4. **Please address your order to: Nina Gera, Publications, Lahore School of Economics, 105-C-2, Gulberg III, Lahore 54660, Pakistan.**

Signature:----------

Name:----------

Date:----------

The Lahore School of Economics

The Lahore School of Economics (established 1993) is one of Pakistan's leading centres of learning for teaching and research in economics, finance and business administration. The Lahore School of Economics' objectives include: (i). The training of young Pakistanis as professional economists, finance managers, accountants, financial analysts, bankers and business executives, and (ii). Undertaking research in economics, management, finance and banking to further deepen understanding of major economic facts, issues and policies.

The Lahore School was granted a Charter in January, 1997 by an Act of the Provincial Assembly of the Punjab: The Lahore School of Economics Act 1997 (Act II of 1997). The Charter vests the powers of an independent degree granting institution to The Lahore School.

The Lahore School has both undergraduate and graduate programmes in economics, business and finance. Its postgraduate programme leading to the MPhil degree is administered through the Lahore School's Centre for Advanced Research in Economics and Business (CAREB). The student body and faculty comprise both national and expatriate Pakistanis and The Lahore School encourages expatriate Pakistanis to join as students or as faculty.

The Lahore School's publication programme comprises The Lahore Journal of Economics (a bi-annual publication), a Seminar Paper Series and a Text Book Series. The Programme encourages both in-house and external contributors.

For further information, please call (Pakistan 92-42-) 5714936 or 874385 or E Mail: les@brain.net.pk