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## IS FOREIGN AID NECESSARY FOR THE ECONOMIC DEVELOPMENT OF LESS DEVELOPED COUNTRIES WITH SPECIAL REFERENCE TO PAKISTAN?

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### Introduction

Foreign aid is the transfer of resources from developed countries to under-developed countries, either through bilateral donors or multilateral donors. Many countries in the world accept foreign assistance and get different benefits along with a few adverse results. The implication of foreign assistance has made it a debatable issue. There are different schools of thought on foreign assistance, i.e. Extensionist School (ES) and Non-Extensionist School (NES). The Extensionist point of view is held by most of the developed countries, which claim that they give foreign aid to developing countries for their socio-economic and political development at individual as well as societal level. In the case of foreign assistance for Pakistan, a group of economists lead by Hollis Chenery and Arthur MacEwan and followed by Pakistani economists, express the need for foreign assistance to Pakistan for accelerated growth. Non-Extensionist School of thought comprising Griffen and Enos (1970), Weisskopf (1972), Ridell (1987) and White (1992), followed by Pakistani economist Shahrukh Rafi Khan, point to the existence of a negative relationship between assistance and growth. Foreign aid is normally subject to certain limitations, which reflect the motives of the donors as to how much they are sincere to the development and welfare of the developing countries, or pursue their own overt and covert interests. Both the parties have progressive designs for optimization of their respective utilities. The underlying motive is not retarding or the ruthless exploitation of any of the parties; rather both the parties have the same direction of development of their local as well as international status. It is in fact a form of generalized reciprocity between two states (the donor and recipient), which leads to transaction of money, goods, and services in lieu of implementation of policies of the donors by the recipient state. However, the unit of exchange for transaction varies from time to time and is highly influenced by the

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international geo-political scenario and global economic trends. Similarly, the endogenous factors such as internal political stability, economic strength and public support to government policies also affect the bargaining power of a recipient country. The more stable a state is, the higher bargaining power it possesses. Then the frequency of foreign aid transaction decreases with the increasing stability of the Least Developed Country (LDC) and vice versa. It is an important fact that large-scale flow of funds/foreign assistance is taking place from multilateral and bilateral donors. Hence we will have to analyze different issues pertaining to actual foreign assistance, such as how much is the flow of and what role it plays in the overall development of a country? Whether to accept foreign assistance or not? Which type of foreign aid should be accepted?

This paper highlights the theoretical aspects of foreign assistance, different types of foreign aid, the objectives of donors and the applied aspect of foreign aid. What is the impact of foreign aid, which type of foreign aid should be accepted and how foreign aid can optimally be utilized? To analyze the issue we have divided this paper into a number of sections.

Section I explains the meaning of foreign aid. Section II deals with the various forms of foreign aid, which are determined by the conditions of the donors. Section III explains the motives of donors, while section IV tells why developing countries accept aid. Section V discusses the most important aspect of foreign aid, that is the role of foreign aid in the economic development of the developing countries. This section is divided into two sub-sections. In the first sub-section the arguments in favour of foreign aid are discussed and we see what positive role it plays in the economic development of developing countries. While in the second sub-section the discussion relates to the harmful impact of the foreign aid, which shows how it hampers the economic development of developing countries.

After considering the positive and negative roles of foreign aid in the economic development of developing countries, the concluding remarks give the guidelines as to what type of aid should be accepted and how optimally it be utilized.

### **Meaning of Foreign Aid**

Foreign aid has been given different meanings by different schools of thought with respect to its structure, its factors such as interest rate determination, repayment period and other modalities.

Foreign aid takes place when a recipient country receives additional resources in foreign currency over and above the capacity to import generated by exports. Foreign aid means those additional resources, which are used to raise the performance of the recipient country above the existing level.

Foreign aid can be defined as the debt that is given by a country to another country on the concessional rates (Saeed 1995).

The concessional elements may be:

- i. Rates of interest lower than the prevailing rates of interest in the international commercial money market.
- ii. Longer period for repayment.
- iii. Grant, which does not entail the payment of the principal or interest i.e. a free gift.

Strictly speaking the concessional element of a foreign aid loan is the difference between the amount of the loan and the present discounted value of the repayment. If the capital market rates enter the present value calculations as discount rates and if they in fact exceed the interest ratio charged by the lender, then the present value of the stream of repayments is less than the amount of the loan. The lender has made a concession to the borrower.

These concessional elements in foreign aid can involve at least three of the terms of the loans. The present value of the repayment is zero and hence the concessional element is 100% of the grant amount.

The concessional element for a loan depends on:

- i. The interest rate;
- ii. Length of period for repayment;
- iii. Grace period.

#### *Foreign Aid in terms of Official Data*

All kinds of resources inflow that are publicly granted and are made either from government to government or from financial institutions to a government, only economic aid is included while military aid is excluded (Saeed 1995). The main points of this definition are:

- a. Resource inflow
- b. Publicly granted
- c. From government to government i.e. bilateral aid
- d. From financial agencies to government i.e. multi-lateral aid
- e. Economic aid, the aid that is used for economic purposes and for dams, projects, industries etc.

Table 1 shows the disbursement of Official Development Assistance (ODA) by principal donors both in total amount and as percentage of GNP in 1996 and 2001. Although the United States (along with Japan) remains the largest donor in absolute terms, relative to others it provides lower percentage of GNP—0.12% in 1996, compared to an average of 0.25% for all industrial countries.

Table 1

**Official Development Assistance Disbursements from Major Donor Countries  
1996 and 2001**

Donor Country	1996		2001	
	Millions of US Dollars	Percentage of GNP	Millions of US Dollars	Percentage of GNP
Canada	1795	0.32	1533	0.22
Denmark	1772	1.04	1634	1.03
France	7451	0.48	4198	0.32
Germany	7601	0.32	4990	0.27
Italy	2416	0.20	1627	0.15
Japan	9439	0.20	9847	0.23
Netherlands	3246	0.81	3172	0.82
Sweden	1999	0.84	1666	0.81
Switzerland	1026	0.34	908	0.34
United Kingdom	3199	0.27	4579	0.32
United States	9377	0.12	11429	0.11
Total (21 countries)	55622	0.25	52336	0.22

Source: World Bank, World Debt Tables, 2002-03, tab. 6.9; World Bank 2003 *World Development Indicators* (Washington, D.C.: World Bank, 2003), tab. 6.9 and 6.10.

#### *Economics and Foreign Aid*

Economics suggests that foreign aid should meet two criteria.

- i. The objective should be non-commercial from the point of view of the donor.
- ii. It should be characterized by concessional terms in respect of interest rate and repayment period of borrowed capital; and these terms should be softer than commercial terms.

It is the flow of resources and technical assistance to developing nations directly from the government of developed countries or from international organizations such as the World Bank.

Foreign aid is defined by the authors of this paper as the flow of funds to a country having lower per capita income from a country with higher per capita income and transaction of services/ commodities by a country having comparative advantage to another country with less comparative advantage.

## **Types of Foreign Aid**

Foreign aid is the transfer of resources from a rich country to a poor country. It is subject to certain limitations, which generate various forms of foreign aid.

### *Financial Aid*

The simplest form of capital inflow is the provision of convertible foreign exchange but very little foreign capital indeed comes to the under-developed world so conveniently. If any divergence from this form is described by saying that “strings are attached” then almost all foreign public capital has strings. Financial aid is divided into different sub-forms i.e.

### *Tied Aid*

Tied aid is of two types. One is nation tied and the other is project tied.

- i. Nation Tied:  
Nation tied aid is given to a recipient country on the condition that it will spend it in the donor country to solve the BOP problems of that country and to stimulate exports. For example, if Pakistan is given aid by US and is asked to import raw material and machinery from US only, then it is nation tied or resource tied aid.
- ii. Project Tied:  
Project tied aid is given only for specific projects and the recipient country cannot shift it to another project.
- iii. Double Tied:  
When nation tied or resources tied and project tied are combined then it is called double tied aid.

### *Untied Aid*

Foreign aid, which is not tied to any project or nation, is called untied aid. It is in all respects, better than the tied aid because it offers more efficient use of foreign resources.

Untied aid is much desired because the recipient country is not bound to spend foreign resources on specific projects in the donor country.

### *Loans*

It is borrowing of foreign exchange by a poor country from a rich country to finance short term or long term projects. These are sub-divided into two types subject to this criterion:

- i. Hard loans
- ii. Hard loans are given in order to finance industrial imports and are given usually for a period of five years or less. It contains no concessional elements but interest rate is usually lower than the

prevailing rate in international market. The grace period is very much limited, penalty is paid after expiry of stipulated time period.

iii. Soft Loans

Soft loans are normally given for 10-30 years. Interest on these loans is less than hard loans and often these loans involve a grace period. Concessional elements are comparatively greater.

### *Grants*

A grant is that form of foreign aid, which does not entail either payment of the principal or interest. It is a free gift from one government to another or from an institution to a government. It is much desired because it increases internal expenditure and generates income. It is given on a humanitarian basis, especially in times of emergencies, earthquakes, floods, wars or other special purposes.

During 1956-65, the grant component of foreign aid to Pakistan was 73%, which has been reduced to only 0.2% in recent years.

### *Commodity Aid*

It is another type of tied aid, which relates to commodities such as agricultural products, raw materials and consumer goods. It helps in controlling famine and maintaining the tempo of industries by providing raw materials to the industrial sector. It would be more helpful if it is provided in cash form because a country can then buy more commodities from cheaper sources. Commodity aid some times has a depressing effect on agriculture prices in a recipient country, so it serves as a disincentive for the agriculture sector. The donor country may have much political influence on a recipient country.

A spend type of commodity aid is a food grain loan, which is given in the form of food grains. For example, US gives food grains to a poor country under Public Law (PL 480) and the funds obtained from it are used on American companies and agencies working in the recipient countries. The rest of the aid is granted.

### *Technical Aid*

Technical aid is tied aid and is useful for a recipient country as it increases the pace of economic development by using modern technology in some specific sectors of the economy. Under this aid programme, training facilities are provided by the donor country, which bears all the expenditures involved in the training of advisory technocrats.

Technical assistance from donor's point of view has two main forms. First, people are recruited in the donor country for service overseas partly, often largely, at the expense of the donor government. Secondly, scholarships and training facilities are provided in the donor country. A recipient



government might equally well be given more financial assistance and left to decide for itself what fraction of the aid should be spent on the services of foreign experts and on education and training overseas.

A further useful attribute of technical assistance in educational and training facilities in donor countries is that the donor and recipient governments have a role in choosing the courses and selection of candidates. The types of training offered could be closely geared to the need of the recipient's economy.

Whatever be the apprehensions of foreign influence, developing countries must import foreign skills and education if they are to achieve economic progress. Even isolation like the Russian or Japanese models would not be a feasible policy for any of the developing countries at this stage because they do not yet possess a sufficient number of trained and skilled people, or the determination to introduce technical change, which the Russians and Japanese possessed in the late nineteenth century.

Foreign advisors favour modern technologies whether these are appropriate for a recipient country or not so they prefer projects involving modern technology.

#### *Foreign Direct Investment*

Foreign Direct Investment (FDI) is also included in the category of foreign aid. In Pakistan, the examples of FDI are Lever Brothers, Reckitt and Colman, Bata, and Philips etc.

It is sometimes argued that foreign direct investment is much cheaper for a recipient country because it entails no payment of principal or interest. But it is also argued that the profit outflow may exceed the amount of repayment. FDI brings technical know how to developing countries. But technical know how can be purchased at cheaper rates on commercial basis if possible. So the FDI may have positive as well as negative effect for developing countries.

#### *Military Aid*

Although the defence of a country plays an important role in its development and business activities, a school of thought based on an economic viewpoint often excludes it from foreign aid because it does not create an immediate and direct effect on the economic activities of the country.

**Sources of Foreign Aid:** There is no unique source of foreign aid. It may be from a single country or from a group of countries. On the basis of the kind of donor we may divide foreign aid in two types:

- i. **Bilateral Aid**

Aid that is given from the government of one donor country to a recipient country is called bilateral aid. It is basically a one to one

relationship of two states. It depends upon the political and economic relationships of the two countries coupled with the will of the donor country.

ii. Multilateral Aid

Multilateral aid is given by certain international financial institutions, agencies or organizations to the governments of developing countries. It is distributed in a fair manner in order to raise the pace of economic development.

### **Motives of Donors**

Donor countries give aid primarily according to their policies pertaining to their political, strategic, or economic interests. Some development assistance may be motivated by moral and humanitarian consideration of a less fortunate country hit by famine, earthquake, flood etc. But in normal circumstances there is no historical evidence to support that over lengthy periods of time, donor nations assist others without expecting some corresponding benefits (political, economic, military etc.) in return. Donors' motives are explained below.

#### *Political Motivations*

Political motivations have been a most important factor for aid-granting nations, especially for a major donor country like the United States. Aid flows to further the donor's interests. The flow of funds tends to vary in accordance with the donor's political assessment of changing international scenario rather than the relative need of potential recipients.

The experience of other major donor countries like Japan, Great Britain and France has been similar to that of the United States. Most socialist aid, especially from the former Soviet Union, emanated from the same political and strategic motivations, but its form, contents and modalities were somewhat different.

With the end of the cold war and the demise of the Soviet Union (and, indeed the whole second world) these political motivations are not persistent, rather intermittently show existence. For example, the Persian Gulf War of 1991 saw aid flows directed to friendly allied governments like Egypt and Turkey. Moreover, in the 1990s, both bilateral and multilateral aid was being conditioned according to a recipient country's willingness to promote free markets, open its economy and transform its politico-economic system according to the donor's capitalistic and democratic principles.

#### *Economic Motivations*

In a broader political and strategic perspective, foreign aid programmes of the developed nations have a strong economic rationale. For instance Japan

intends its aid to neighbouring Asian countries to promote substantial private investments and trade expansion.

*Economic Motivations and Self-interest*

The increasing tendency is for loans instead of outright grants [interest-bearing loans now constitute over 80% of all aid, compared to less than 40% in earlier periods (1960s)] and toward tying aid to the exports of donor countries, which has saddled many LDCs with substantial debt repayment burdens. It has also increased their import costs by as much as 40%. These extra import costs rise because aid tied to donor-country exports limits the receiving nation's freedom to shop around for low-cost and suitable capital and intermediate goods. Tied aid in this sense is clearly a second-best option to untied aid and perhaps also to freer trade through a reduction of developed-country import barriers.

A former US aid official candidly puts it:

“The biggest single misconception about the foreign aid programme is that we send money abroad. We don't. Foreign aid consists of American equipment, raw materials, expert services, and food—all provided for specific development projects, which we ourselves review and approve. Ninety-three percent of Agency for International Development (AID) funds are spent directly in the United States to pay for these things. Just last year [1967] some 4,000 American firms in 50 states received \$1.3 billion in AID funds for products supplied as part of the foreign aid programme.”

The allocation of foreign aid is rarely determined by the relative needs of developing countries. Most bilateral aid seems unrelated to development priorities, being based largely on political and military considerations and the unpredictable whims and ad hoc judgments of donor decision makers. Multilateral aid (e.g., from the World Bank and various UN agencies) is somewhat more economically rational, although here too the rich seem to attract more resources than the poor.

**Table 2**

**Official Development Assistance (ODA) by Region, 2001**

<b>Region</b>	<b>United States</b>	<b>Japan</b>	<b>France</b>	<b>Germany</b>	<b>United Kingdom</b>
Middle East and North Africa	920.6	352.4	623.8	422.9	48.8
Sub-Saharan Africa	1374.8	849.0	978.8	684.2	1185.6
Latin America and Caribbean	1473.3	738.2	111.9	334.3	190.1

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East Asia and Pacific	535.2	2987.6	214.8	355.6	134.6
South Asia	863.7	1156.8	27.9	221.8	409.7

Source: World Bank, 1998 World Development Indicators (Washington, D.C.: World Bank, 1998), tables 1.1 and 6.11.

### **Why Developing Countries Accept Aid**

The reasons why developing nations, at least until recently, have been eager to accept aid, even in its most stringent and restrictive forms have been given much less attention than the reasons why donors provide aid. We can identify three reasons:

#### *Economic Reasons*

The major reason is clearly economic. Developing countries have often tended to accept uncritically the proposition that aid is a crucial and essential ingredient in the development process. It supplements scarce domestic resources; helps transform the economy structurally and contributes to the achievement of LDC take-offs into self-sustaining economic growth. Thus the economic rationale for aid in LDCs is based largely on their acceptance of the donor's perceptions of what the poor countries require to promote their economic development.

Conflicts, therefore, generally rise not out of any disagreement about the role of aid but over its amount and conditions. Naturally, LDCs would like to have more aid in the form of outright grants or long-term low-cost loans with minimum strings attached. This means not tying aid to donor exports and granting greater latitude to recipient countries to decide for themselves what is in their best long-run development interests.

#### *Political Reasons*

In some countries aid is conceived by both donor and recipient as providing greater political leverage to the existing leadership to suppress opposition and maintain itself in power. South Vietnam provided the most dramatic illustration of this aid phenomenon in the 1960s, as perhaps Iran did in the 1970s and Central America in the 1980s, many other third world nations have a similar political motivation. The problem is that once aid is accepted, the ability of recipient governments to extricate themselves from implied political or economic obligations to donors and prevent donor governments from interfering in their internal affairs can be greatly diminished.

#### *Moral Motivation*

Whether on grounds of basic humanitarian responsibilities of the rich toward the welfare of the poor or because of a belief that the rich nations owe the

poor nations conscience money for past exploitations, many proponents of foreign aid in both developed and developing countries believe that rich nations have an obligation to support the economic and social development of the third world. They then go on to link this moral obligation with the need for greater LDC autonomy with respect to the allocation and use of aid funds. The most recent example of this phenomenon was at the 1992 Earth Summit (UNICED) held in Rio de Janeiro. Here developing nations pressed for substantial increase in foreign aid to permit them to pursue environmentally sustainable development programmes. Implicit was the notion that industrialized countries were the major polluters of the world and they had no business telling LDCs to slow their growth to save the planet.

If we examine the relationship between aid allocation and poverty, we find even stranger results. For example, only 31% of aid goes to the 10 LDCs with 66% of the world's poorest people (see Table 3). Moreover, the richest 40% of the Third World's people receives more than twice as much per capita aid as the poorest 40%.

**Table 3**

**Foreign Aid Allocations and the Poor, 1992**

<b>Ten Developing Countries with Greatest Number of Poor People</b>	<b>Number of Poor (millions)</b>	<b>Poor as a percentage of Total World Poor</b>	<b>Official Development Assistance (ODA) per Poor Person (U.S. \$)</b>	<b>ODA as a Percentage of Total ODA</b>
India	350.0	26.9	7	5.2
China	105.0	8.1	28	6.5
Bangladesh	93.2	7.2	19	3.8
Brazil	72.4	5.6	3	0.5
Indonesia	47.8	3.7	44	4.6
Nigeria	46.4	3.6	7	0.5
Vietnam	37.6	2.9	16	1.3
Philippines	35.2	2.7	49	3.8
Pakistan	35.0	2.7	49	3.8
Ethiopia	31.9	2.5	41	2.9
Total	854.5	65.9	17	31.7

Source: United Nations Development Programme, Human Development Report, 1994 (New York: Oxford University Press, 1994), tab 4.2.

This ratio has risen substantially since 1970. Finally, if we compare ODA allocation to LDCs with large and small military expenditures, we find that countries that spend more on their military (greater than 4% of GNP) receive twice as much aid per capita as countries that spend much less.

As donor and recipient countries see foreign aid differently, hence we analyze the giving and receiving process from these two often-contradictory viewpoints.

### **Role of Foreign Aid**

The issue of the economic effect of foreign aid like the effect of private foreign investment is fraught with disagreements. On one side are the “Foreign Assistance Extensionists” who argue that aid has indeed helped to promote growth and structural transformation in many LDCs. On the other side, are the Non-Extensionists who argue that aid does not promote faster growth but may in fact retard it by substituting for, rather than supplementing, domestic savings and investments. Also by exacerbating LDC balance of payments deficits as a result of rising debt repayment obligations and the linking of aid to donor country exports. These arguments are given below in detail:

### **Foreign Assistance Extensionist School of Thought**

This school of thought is lead by Hollis Chenery who has developed a firm basis of foreign aid in the form of Two Gap Model briefly given below:

Hollis Chenery and other writers have put forth the “two Gap” approach to economic development for the case of development as to how much foreign aid is required in future. It is the most explicit and well-set model for the attainment of self-sustained growth with the help of foreign aid.

### **The Two Gaps**

The idea is that the savings gap and foreign exchange gap are two separate and independent constraints on the attainment of a target rate of growth in LDCs. Chenery sees foreign aid as a way of filling these two gaps in order to achieve the target growth rate of the economy.

#### *Investment and Savings Gap or IS Gap*

A savings gap increases when the domestic savings rate is less than the investment required to achieve the targets. For example, if the growth target of national real income is 6% per annum, and the capital output ratio is 3.1 then, the economy must save 18% of its national income to achieve this target of growth. If only 12% of savings can be mobilized domestically, the savings gap is 6% of national income.

The economy can achieve the target growth rate by filling this savings gap with foreign aid.

### Foreign Exchange Gap

Similarly, a fixed relationship is postulated between targeted foreign exchange requirements and net export earnings. If net export earnings fall short of foreign exchange requirements a foreign exchange gap appears which can be filled by foreign aid.

The two gaps are explained in terms of the national income accounting identities:

$$E - Y = I - S = M - X = F$$

Where E is national expenditure, Y is national output and income, I is investment, S is saving, M represents imports, X represents exports and F is net capital inflow.

$I-S$ , is the domestic savings gap and  $(M-X)$  is the foreign exchange gap. Like the basic national income accounting identities, the two gaps are always equal Exchange Rate-post in any given accounting period. But they now differ Exchange Rate-ante because in the long run those who make decisions about savings investment exports and imports are different people.

In the initial stage the imports are greater than that of exports output in the country is low. The foreign exchange gap is the amount by which the imports required for a given rate of output exceed the exports likely to be associated with that output.

Chenery justifies existence of two gaps and their gradual development leading to higher growth rate in three stages.

#### *Three Stages*

Simplifying their argument, we can say that the country passes through three stages on its way to self-sustained growth.

#### *Lack of Absorptive Capacity*

In the first stage the dominant constraint is that of absorptive capacity i.e. the economy is so primitive and backward that it cannot invest beneficially the minimum amount necessary to achieve the required rate of growth of say 5-6%. The purpose of foreign aid at this stage is to increase the absorptive capacity of the country by providing technical assistance training, education, managerial ability entrepreneur talent and so on.

When a backward economy starts development in the initial stages by using capital, it cannot bring changes in the structure of the economy overnight.

### *Internal Gap*

Once the absorptive capacity of the economy has increased sufficiently, the constraint on growth is that of domestic savings. A country with a low level of income and a large proportion of its population at subsistence level can hardly be expected to save 19-20% of its national income. The suggested way out is that foreign aid may be used to supplement domestic savings and fill the gap between domestic savings and the investment required for a reasonable level of growth. At the same time there may be a deficit on the balance of payments but for a while the savings gap will be greater than the trade gap and during this stage the savings gap is said to be dominant. However, as the economy grows, more and more inputs are required in the form of capital goods, industrial raw materials etc. Exports cannot keep pace with increasing imports and the resultant difference between the two becomes larger and larger until it exceeds the difference between domestic savings and the required savings. At this stage the trade gap is said to be dominant and the foreign aid is required to bridge this gap and in so doing the savings gap is also more than filled.

### *Foreign/External Gap ( $M > X$ )*

It is then argued that as the economy develops, the further rising level of income results in an increase in savings as a proportion of national income until the required level is attained and the savings gap is closed. Also as development proceeds, first import substitution of consumer goods, then the exports and imports substitution of capital goods takes place with the result that exports grow faster than the imports and ultimately catch up with them and hence the trade gap is also closed.

With the closing of this the need for foreign aid is also ended.

### *Phases of Development*

#### *First Phase of Development*

In a backward economy the savings level is very low and investment, which is required, is very high so foreign aid is required to fill this gap. As a result due to an increase in investment the income or output will increase which will lead to increased savings. There will come a stage when savings will become equal to investment.

S-I i.e. the whole project will be financed by domestic savings. When equality between savings and investment will hold, phase one will be completed.

#### *Second Phase*

In the second phase imports will be greater than exports i.e.

$M > X$  but there will be a little difference between imports and exports. Now foreign aid is only required for the gap of export and import.



### Third Phase

In third phase of development there will be a situation in the economy when

$$I < S \quad \text{and}$$

$$M < X$$

and the country will be in a position to repay debt aid and loans.

Critics say that these gaps are not equal due to dependence of different variables (imports and exports) on different other variables.

### **How Aid helps in Development**

Many economists in Pakistan such as AR Kamal (2001), Parvez Hasan (1999) Pervez Tahir (1998), Rehana Siddiqui (2001) highlighted non-optimal utilization of foreign assistance for Pakistan and interpreted it as a sustainable and prospective factor for higher growth, if macro and micro level efforts are made for optimal utilization of foreign assistance.

Different debt indicators have been highlighted by Nadeem A. Burney (1988) who says that:

- (i) Debt: GNP ratio,
- (ii) Amortization: Disbursement ratio,
- (iii) Net Resource-transfer: GDP ratio,
- (iv) Debt-service: Export-receipt ratio
- (v) Interest-Payment; Export-receipt ratio and
- (vi) Foreign-exchange Reserve: Debt ratio, are examined to analyze the external indebtedness of Pakistan during 1959-60 to 1986-87. Nadeem A. Burney is optimistic about the improvement in debt sustainability conditional to overall improvements and careful expansion.

AR Kamal (2001) says that the analysis shows that even though debt burden as a percentage of GDP of Pakistan exceeds that of all the South Asian countries, it still is not so high as to qualify for a debt write-off. This implies that Pakistan has the capacity to service its debt. In this context, long term rescheduling (to avoid illiquidity) through re-profiling of debt assumes great significance. However, we must ensure that the short run gain is converted into long run gain as well and not into a long run liability. Accordingly, the following ten major elements, outlined by Ahmed and Summers (1992), must be kept in view:

- Systematic thinking is crucial to avoid bad lending decisions.
- There should be close monitoring of how loan proceeds are spent.
- Those opting out of the international financial system generally do worse.

- Good national policies are necessary for economic revival and access.
- Economic adjustments take time and sustainability of reforms should be taken into consideration.
- There is a compelling need for official action to overcome the free-rider's problem through concerted lending and/or debt reduction.
- Without official action, debt problems fester with unfortunate consequence for both debtors and the creditors.
- Debt reduction is sometimes necessary but never sufficient to restore external viability.
- Building risk-sharing contingencies into financial contracts is much less costly than renegotiating contracts when things go wrong.

External finance for investment that comes to low-income countries must come from official resources.

The positive role of foreign aid can be expressed as following:

- i. To avoid Starvation and Malnutrition:  
Foreign aid is useful to avoid starvation and malnutrition resulting from drought and natural disasters in the poorest developing countries. Although this use of foreign aid does not directly speed up development process, it is important on humanitarian grounds. Foreign aid permits the recipient developing nations to invest more than it is able to save domestically and to import more than it can finance through its exports. Foreign aid is most effective when it acts as a catalyst to greater domestic development effort by overcoming bottlenecks.
- ii. To Invest More than Savings  
In developing countries the savings level is very low as compared to their required investment level. Foreign aid makes them able to fulfill this gap and undertake new projects for their development and prosperity. In this way foreign aid makes it possible to invest more than savings.
- iii. Import More than the Exports  
In developing economies the export volume is low and consists of raw material and agricultural products whose prices are low in international markets, which is why normally developing economies have low export earnings. Whereas they have to import a lot of goods and services, such as machineries, new technologies, experts' services, medicines etc. for their development. Foreign aid makes it possible for them to import

more than their export earning and accelerates their economic development.

iv. Capital Formation and Vicious Circle of Poverty

Foreign aid is essential for capital formation and to break the vicious circle of poverty. In LDCs, the income level is very low due to which the savings are almost nil. People hardly fulfill their basic needs. Thus when there is none or lack of savings, there will be low capital formation in the country. That is why it is very difficult for LDCs to break the vicious circle of poverty.

Foreign aid solves this problem, and it gives rise to capital formation and the vicious circle of poverty can be broken.

v. Cheaper Funds

It is very difficult for LDCs to raise their funds in short run for the development of the economy. Foreign aid provides cheaper funds for the completion of different projects of the economy. It is in this way that foreign aid helps to complete the projects of economic development.

vi. Technological Progress

In a developing country like Pakistan production techniques are backward and less efficient. As a result the cost of production per unit is relatively high. Because of low skills of manpower and low quality of capital goods, productivity of labour and capital is also quite low. Foreign aid not only helps to overcome the deficiency of capital but it also helps to overcome the technological backwardness. Foreign aid, besides transferring physical and financial capital to developing countries, also brings in the technical know-how, highly qualified persons with administrative experience and advanced techniques of production. It provides opportunities for local labour to be trained in new skills. Thus foreign aid helps to accelerate the rate of economic growth in the aid-recipient country.

Provision of Overhead Capital and Building of Basic Infrastructure:

In countries like Pakistan foreign aid can help to build overhead capital and basic infrastructure. Overhead capital like railways, highways, roads, canals, power stations, can provide basic infrastructure for economic growth in the country. As overhead capital requires huge amounts of investment so over-head capital projects have long gestation period i.e. they take a long time to fruitify and generate income. Therefore, a developing country like Pakistan cannot easily provide required huge financial resources for building such capital through domestic means. But, such overhead capital can be built through foreign aid and thus a

sound foundation for economic growth of the country can be laid through foreign aid.

vii. Establishment of Basic Heavy Industries

A developing country like Pakistan cannot establish basic heavy industries from its own resources because these industries require huge amounts of financial capital along with state of the art modern machinery. Foreign aid can help to acquire financial resources required for the establishment of such industries and with its help the required complicated modern machinery can be imported from other countries. Thus foreign aid can help a developing country like Pakistan to establish steel, machine tools, heavy mechanical, heavy chemicals and other key industries. With the establishment of heavy industries, the external economies emerge and the costs of production of other industries decline, which help in their expansion. Thus foreign aid can play a key role in the industrialization of the economy of a developing country.

viii. Establishment of Risky Ventures

Pakistan's investors are hesitant to invest in risky ventures. They also do not want to make investment for the utilization of idle natural resources. Moreover, they do not want to invest in industries for which they lack adequate experience because such investment may involve risk of huge loss. With the help of foreign aid such risky businesses can be established. Foreign aid besides providing opportunities for economic growth by opening up inaccessible regions for development and by utilizing idle natural resources, can also help to remedy the regional imbalances in the country.

ix. Increase in Employment Opportunities

Foreign aid increases employment opportunities by helping build overhead capital; establish new industries, by utilization of idle natural or other resources and by opening up inaccessible regions. Usually import of capital goods made possible by foreign aid, help to increase employment opportunities in urban areas. As a result surplus labour from rural areas moves in search of jobs to urban areas and thus it helps to reduce the disguised unemployment and helps to lessen the burden of population on agricultural lands. In this way foreign aid is also a source of some social benefits.

### **Non-Extensionist School of Thought**

This school of thought mainly expresses views against foreign assistance due to its negative relationship with growth due to different factors. The

economists like Griffen and Enos (1970) and Weisskopf (1972) and Ridell (1987) and While (1992) express a negative relationship of aid with growth. Fry (1992) showed that the debt/GDP ratio in excess of 50% has a negative impact on economic growth due to flight of capital and a decline in the quantity and deficiency of investment. Shahrukh Rafi Khan (1997) says that the harsher terms on which Pakistan gets aid makes the debt trap more formidable as does the economics of aid growth nexus.

### **How foreign Aid Hampers Development**

The negative role of foreign aid in the development of developing countries is given below:

i. Debt Servicing

There is a burden of debt service (repayment of principal and interest) for development loans. There has been a progressive rise in the ratio of debt to the GDP of developing countries from approximately 20 percent in the early 1970s to over 40 percent in 1990. Over the time Rs/ local currency depreciates against the \$/ foreign currency and after 20-25 years loans turn into more hard at the time of repayment.

ii. Source Tied Aid is Expensive

Nation-tied aid imposes an economic cost on the recipient if prices in the donor nation are higher and the technology embodying into capital imports is too advanced and thus inappropriate for a developing nation in economic terms.

Aid is expensive if the donor does not pay money rather conditions purchase of commodities, the objective of the donor seems not to give loan but to promote its export.

For example, if Pakistan takes loans from United States and United States imposes a condition that Pakistan will have to purchase F-16s at any price. Similarly prices are given to Pakistan for purchase of accessories also.

iii. Project Tied Aid and Misallocation of Resources

Project-tied aid may lead the recipient's development effort into less productive direction.

If there are two projects in a country, one is construction of a road and the other is environment related. The project of the road construction is more important for the country than environment project. But the donor offers to finance 30% of the environmental project or any reasonable percentage of the construction. Then the recipient country in many cases undertakes the project of environment, which seems to be

cheaper for the country. In this way the resources of the country will be mismatched with the efficient development strategy.

iv. Huge Projects Call for Huge Recurring Expenses

A grant to finance construction of huge projects in fact is piling up of recipient country's liabilities after project completion with a form of recurring costs. If a huge project is completed with a grant, then after the completion of the project, a heavy amount of money will be required to run such a huge project and to maintain the machineries. There is a possibility that it may not be affordable for the country. For example, Pakistan Steel.

v. Bilateral Aid is Politically Motivated

There is a problem that once aid is accepted, the ability of recipient governments to extricate themselves from implied political and economic obligations of donors and prevent donor governments from interfering in their internal affairs can be greatly diminished.

Foreign Aid and Disastrous Policies by Government

Foreign aid is sometimes followed by disastrous policies by government. Some times IMF or World Bank imposed condition on recipients to increase utility prices, taxes, so that the recipient would be able to repay principal and interest to these institutions. Which may in turn hamper local developmental activities and social welfare level of the society.

vi. Unsuitable Models of Development are Imported

With foreign aid sometimes unsuitable exotic models of development are imported. Moreover, many a time the developed countries train manpower of LDCs according to circumstances of developed countries, which cannot perform an active role in their own countries.

Along with this the developed countries have advanced in technology according to their own needs. But, when such technology is imported by developing countries, it becomes difficult to fully utilize the technology.

The recipient country comes under the heavy influence of donor country, which cannot be avoided in any circumstances.

vii. Social and Political Tensions

Foreign aid has immensely influenced the socio-political life of developing countries. It has helped the rulers to extend their tentacles to prolong their rule and to suppress opposition. In this way foreign aid promotes social and political tensions and eventually it could result in halting economic development of a developing country. This undue increasing trend of the donor

country interfering in the political and economic affairs of the recipient country may put its sovereignty and self-reliance at stake.

viii. Too Much Dependence on Aid

Because of foreign aid, a recipient country's dependence on donor countries increases excessively. Foreign aid renders a recipient country vulnerable to interference by donor countries. Aid is usually tied to the donor country's exports and recipient countries are forced to import these goods from donor countries. Later on spare parts and replacement machinery are required to be imported from the same donor country. Recipient countries have to fulfill conditions imposed by donor countries. In this way by accepting foreign aid, a recipient country becomes heavily dependent on donor countries.

ix. Reduction in Savings

According to statistical investigations made by Griffin and Enos<sup>1</sup> for 32 aid recipient countries, 25 percent of foreign aid results in increasing investment and imports and 75 percent of foreign aid is spent on consumer goods. In this way foreign aid results in decreasing domestic savings as it is used as a substitute for domestic savings. Some critics doubt their findings. However, they claim that a part of foreign aid instead of being used for investment is used for consumption.

### **Structural Adjustment Programme/Facility**

As the process of aid extension for Pakistan continues and the donors are giving aid, they obviously are concerned about timely return of their debts with higher expectation of better growth and development of the indebted country. They frequently extended their guidance to the recipient states for effective utilization of the assistance so that they may be able to return the debt. In the late 1980s the multilateral donors launched a comprehensive structural adjustment programme in order to enhance capacity of the country through restructuring and capacity building. This structural adjustment programme formulated on generalizations was imposed on Pakistan to be followed in letter and spirit. This programme might have left a long term positive impact on the states but it also brought many problems with it. Economists like Arshad Zaman (2001), Shahrukh Rafi Khan (1997), AR Kamal (2001) expressed negative impact of adjustment programme.

Sabir Ghayur (2001) has highlighted gradual change in policy of the multilateral donors and ultimate implications on indebted countries like Pakistan.

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<sup>1</sup> Kieth Griffin and John Enos, "Foreign Assistance: Objectives and consequences", *Economic Development and Cultural Change*, (18 April, 1970) pp. 313-327.

The evolution and expansion of the Fund's assistance from stand-by arrangements and extended fund facility to structural adjustment facility and enhanced structural facility, encompassing a wide variety of economic and financial activities and the Bank following suit adds similar dimensions, should have been welcomed. The problems, however, were the accompanying conditionalities covering almost any decision making process of significance of the recipient countries. The performance criteria, performance reviews, structural benchmarks, prior actions, post programme monitoring etc and the speed as well as sequencing have been raising concerns. It is important to point out that it all happened without adequate preparation and building the twin "C" capability and capacity. Such an evolution and expansion in the nature and extent of conditionality is certainly characterized as stretching too far and overstepping mandate that also puts into question the very realism of designed programmes.

Moreover, whatever has been prescribed by IFIs and even accepted by the authorities, the package largely lacked political support and the ownership has been conspicuous by its absence. The effectiveness of the programmes has been yet another area of concern, being aggravated further by the noticeable absence of the stakeholders in the IFIs interactions with the policy makers.

#### *Main Features of the IFIs Prescriptions*

- Lowering tariff and non-tariff measures eliminating significant domestic manufacturing/production.
- Removal of public policy preferences in the form of reservations for the public sector, small and medium enterprises sector etc.
- Withdrawal of restriction entry of foreign capital and regulation of foreign exchange leading to more stock market manipulation and dollarisation.
- Structural reforms in manufacturing and service sectors.
- Downsizing.
- Raising of utility charges and at times at cost of money.
- Drastic reduction in subsidies even their withdrawal from food items and essential agricultural inputs.
- The withdrawal of subsidies on agricultural inputs followed by the imposition of GST.
- Reducing fiscal deficits through government expenditure, thus reducing the development component of the national budgets/public sector expenditure.
- Privatization, corporation and sale of state owned enterprises (SOEs).



*Some Instances*

This thrust of IFIs thus has been in the direction of spending cuts, restructuring, institutional reforms, enterprise closures, corporate governance, privatization and reforming the banking and financial sector. In the environment of a liquidity crunch quite oftenly confronting the counties approaching IFIs, such an emphasis is uncalled for. Moreover, the overall policies prescribed, lacked a balance between a consideration on economic stabilization and social development.

**Conclusion**

Keeping in view the above facts and points of view of different schools of thoughts, it is inferred that from basic economic axioms of local non-satiation and preference maximization of utility, the optimal foreign assistance strategy should be based on the principal of maximum achievement in the current time period and minimum liabilities in the future time period. The strategy should be a blend of macro and micro-policies on a case to case basis for selection of different types of aid, selection of donor on the basis of their policies, nature of aid pertaining to time period, its repayment schedule, interest rates, grace period and quantum of conditionalities and trickle down effect of the conditionalities on the socio-cultural and politico-economic system of the recipient country. The government's priority for soft loans, with less interest rate, lesser service charges, long repayment schedule and big pause of grace period can better be pursued while separately negotiating with them.

A close monitoring and examination of different indicators, determinants of debt problem and its debt servicing capacity, calculation of present value should also be carried out during the process of receiving any foreign assistance and negotiations with the donors.

In addition to above there are many micro-level issues pertaining to acceptance and utilization of foreign assistance. Non-consideration of the issues increases debt stacks. Delay in project completion causes payment of 1% commitment charges and additional service charges, similarly the donors may be asked to equally redress the government of Pakistan when the former either senses delay or withholds or withdraws its assistance (loan) unilaterally. Many of the projects near loan closing date ask for extension in closing date in order to complete book formalities, audit, accounts and other certification, which causes loss to the government. The donors may be asked to make prior provision in Loan Agreement for a three-month period for clearance of documentation, audit, accounts, certification and pending liabilities due to litigation etc.

The neglected sector of mineral development, oil and gas, water resources need special attention of donors, which being an important natural resource of Pakistan has been neglected and could not be properly exploited.

Concentrated efforts can be made for formulation of project proposals and searching of donors. Proper homework should be done for utilization of expected saving from devaluation of currency.

A comprehensive exercise is required to persuade the donor for untied aid, especially in procurement and consultancy, by obtaining data of already tied projects where extra expenditures incurred by the project and government means that tied aid is in contravention with the project objectives. Generally the donors ask for appointment of foreign consultants for different projects. The donors may be persuaded to accept qualification/ experience and merit as criteria instead of origin and nationality of the consultants. The consultancy may be kept open for consultants of a specified qualification irrespective of their nationality. This may enable Pakistani consultants to compete with the foreign consultants. The payments to be made to foreign consultants in foreign currency may be replaced with local currency to the local consultants. The procedural complications in submission of withdrawal applications, reimbursement of expenditure, contract policies and opening of imprest account may be reviewed with donors to control delay.

The conditional releases of foreign assistance with mostly fluctuating counterpart funds slow down projects' implementation activities. The release/utilization of a donor's assistance may be counted on yearly instead of quarterly basis. Special efforts are required to persuade the donors to avoid erratic funding/releases to different projects where government of Pakistan counterpart fund, and human resource are already available but cannot optimally be used without donor's funds.

Commodity aid and food aid should be accepted if the country's agricultural production level is below its requirement. Technical aid in form of technology transfer from the donor or training services may be hired to train local manpower in specific areas. It will help remove technical inefficiencies of the production units.

A major portion of foreign aid is utilized for defence purpose, which is no doubt imperative for national security. However, the utilization mechanism of defence aid needs micro-level analysis and screening of items to be imported. An ordering list reflecting priority, intensity and lack of indigenous substitutes of imported items may be prepared and then a revised decision to import foreign goods for the purpose made. By detailed working we may increase overall quantum of transfer of highly sophisticated technology to the country and replacing routine expenditure out of foreign aid on vehicles, ordinary equipments etc with locally manufactured vehicles/ items etc.

In addition to the above, optimal utilization of foreign assistance is very important to contribute to national development and raising of benchmark to repayment and subsequently further foreign assistance

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absorption capacity also increases and brings a stronger bargaining position and flexible foreign aid.■

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## THE REFORMS AGENDA IN IRAN

Maqsudul Hasan Nuri\*

### General

**I**n Iran the confrontation between conservatives (Islamic right/radicals) and reformists (Islamic left/reformists) has been going on for the last six years. The two contending elements represent the current political scenario of the Islamic Republic of Iran, which was established after the successful 1979 Revolution. It was a unique event in Iran's long politico-religious history and a major watershed of late 20<sup>th</sup> century.

In this paper, an attempt is made to, first, trace the genesis of reform movement in Iran; secondly, highlight its main agenda; thirdly, list some of the problems encountered by the reform movement, and, finally, speculate on the future prospects of the reforms.

### Context

The reforms in Iran cannot be properly understood without understanding the leading role played at the apex by Iran's Supreme Leader Ayotallah Rouhollah Khamenei. The system is conducted on the basis of a unique theoretical formulation of *Velayat-e-Faqih*, the Guardianship of the jurisconsult.<sup>1</sup> In other words, the Supreme Leader's power flows from God, not from the people, and he has the final say on all matters. In many ways, it is likened to the Roman Catholic Papacy of olden times.<sup>2</sup>

Imam Khomenei, the founder and leader of Islamic Revolution, held the exalted status of *Ayatallah al Uzma* and *Marja-e-Taqlid* (Source of Emulation) until his demise in 1989. After him the Assembly of Experts—a body of eighty clerics elected directly by the people after eight years—selected President Ali Khamanei as the next Supreme Leader. In other words, divine powers were transferred to the new *Rehbar* (leader), but not the exalted status of the founder. Today, he leads hard-line and conservative clerics, who control positions of authority, namely in judiciary, armed forces and internal security.

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<sup>1</sup> The first draft of the Iranian Constitution did not carry the notion of *Vilayat-e-Faqih*; however, Rouhollah Khomeini formulated this idea in a separate meeting. It has become quite controversial in the last decade or so and has been the source of conflict between the conservatives and the so-called moderates.

<sup>2</sup> On this see M. Athar Javed, "The Future of reform in Iran", the Carsten Niebuhr Institute of Near Eastern Studies, University of Copenhagen, Denmark, p. 2.

As the Supreme leader, he wields immense powers. For example, under Article 110 of Iranian Constitution, he has the power to dismiss the president of the republic after the Supreme Court holds him guilty of violation of his constitutional duties or after the vote of Majlis that testifies to his incompetence on the basis of Article 89 of the Constitution.

The reform process lately suffered a setback when in February 2004 many conservatives were elected after mass disqualification of moderates/reformers.

### **Beginnings of Reform Movement**

The origins of factionalism started soon after the 1979 Islamic Revolution. There were two major variants: “radical Islam” espoused by Ali Shariati and the “militant Islam” expounded by Ayatollah Khomeini. Both attempted imaginative and bold innovations in the interpretations of Shia doctrines, especially their application to religion and politics. While both supported the use of violence in creating an Islamic utopia, it was Shariati who wanted enlightened thinkers and not the ulema to undertake reforms. Khomeini, however, wanted the ulema as representatives of the hidden Imam. The audiences of the two schools were different: For Shariati it were young students and intellectuals while for Khomeini it were the clergy and bazaar merchants. The third variant was that of liberal Islam who favoured political accommodation and a liberal interpretation of Islam. Modern bourgeoisie, merchants, modern middle class and teachers embraced this school of thought and this was symbolized by Mehdi Bazargan, Iran’s first prime minister’s Iran Freedom Movement.<sup>3</sup> For the latter, it was socio-cultural revolution as opposed to theocratic clergy.

The reform movement started picking up after the prolonged 1980-88 Iran-Iraq war. Later, the demise of the Spiritual Leader Ayatollah Rouhollah Khomeini took away a commanding and charismatic personality from the scene. Mehdi Bazargan founded the Iran Freedom Movement and the reformist circle around the university teacher Abdul Karim Saroush sowed the seeds of initial reformism. On the other hand, the Second Khomeini Front after President Khatami’s elections comprised twenty organizations with disparate interests and orientations, including the Association of Combatant Clerics of which Khatami is a member. On the leftist side, the president’s brother led the Islamic Iran Participant Front and the Islamic Revolution Mujahideen Organization declared the irreversibility of reform process.

He was followed by the ascension of Hashemi Rafsanjani to the Presidency. Subsequent efforts by the latter’s faction and the rightist elements were led by the new Supreme Leader, Ayatollah Ali Khamenei, who wanted to

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<sup>3</sup> See Ali Banuazizi, “Islamic state and Civil society in Iran,”  
<<http://www.dayan.org/mel/banuazizi.htm>>

marginalize the reformist/ liberal elements in the Islamic Republic. These internal divisions climaxed in the April 1992 elections to the Fourth *Majlis* (National Assembly). In this election, the Council of Guardians, a non-elected but powerful religious watchdog organization, prevented the majority of Islamic left candidates, including such prominent figures such as Bahzad Nabavi and al Akbar Mohtashmai-Pour from contesting for the President's office on the plea that their "revolutionary" bona fides were suspect.

It is little realized that the reform movement in Iran is less an outgrowth of public disenchantment rather than a reconfiguration of factional politics. The Islamic leftists are prominent members of the Islamic Revolution; however, generally overlooked is the fact that most of them belong to or are in some ways associated with security and intelligence services of the country.

Hajjarian, a reformist leader is credited with sparking off the reformist agenda and initiating a political and intellectual discourse. Coming from a poor neighbourhood of southern Tehran, he participated actively in the Islamic Revolution. When the Ministry of Intelligence and National Security (NEVAK) was formed in 1984, he was appointed to the nascent organization. However, after a stint, he left it in 1989 and joined a reputed Tehran-based think tank, the Centre for Strategic Studies (CSS) linked to the Research Department of Foreign Affairs and sub-committee of the Supreme National Council. His thinking inspired other former intelligence corps officers, including Akbar Ganji of the Islamic Revolutionary Guard Corps (IRGC) and Hamid Reza Jaliapur, former IRGC officer, Mohsen Amin, a former IRGC Commander based in Lebanon, Mohsen Sazegaran, a former senior commander of IRGC ground forces and Ali Mohamad Mahaavi, a former IRGC intelligence officer.<sup>4</sup> Other revolutionaries with indirect ties were Abbas Abdi, Ebrahim Asghar-Zadeh—members of the student groups who had seized the American embassy in Tehran after the 1979 revolution.

A publication named *Kian* attracted radical Islamists of the left, including Mashallah Shamsolvaezin and Ali Rabi. The contacts developed in *Kian* proved instrumental in galvanizing the group; the process got a fillip after the 1997 elections. By the time President Rafsanjani had left office, reform movement had sufficiently developed the requisite skills, connections and appeal amongst the Iranian press and some intellectual circles.

To its good luck, the surprising election of Khatami as President in May 1997 acted as a turning point and gave a boost to the reform movement. Earlier, Khatami had been forced out of the Ministry of Culture and Islamic Guidance in 1992 and was living a life of obscurity in the National Library.

As a fledgling reform movement, its intellectual foundations came from the Islamic left *Majma-e-Roohanaeeye Mobarez* (Forum of Militant Clergy),

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<sup>4</sup> On their background see Mahan Abedin, "The origins of Iran's Reformist elite," *Middle East Intelligence Bulletin*, Vol. 5, No. 45, April 2003, p. 7.



*Sazmane Mojahiden-e-Engheleba Eslami* (Organisation of the Mojahidin of the Islamic Revolution (OMIR) and the *Daftar Takhbeema Vahadat* (Office for Fostering Unity), a student representative body. The intention was to force reform and renovation in Iran from outside the review of public scrutiny. Further, they wanted both intellectual and political reforms to proceed incrementally. In their formulation, after the first decade the Islamic Revolution had lost its moorings and veered off from its right ideological course. Besides, the leadership had not been able to deliver on their promises. Among other things, they argued, it had led to lesser egalitarianism, wide income disparity, secularization of society and creeping anti-Revolution tendencies and vices. Hence, there was a dire need to launch a simultaneous politico-social assault on the Islamic republic's failing institutions.

As state control was strong in the first half of the 1990s, they worked behind the scenes in CSS, which served as a front organization. Then they published *Kian* in 1989. Albeit loyal to the Islamic revolution it had sown seeds of reformism and rectification.

Following the landslide victory of President Khatami in May 1997 elections as the fifth president, the reform movement gathered momentum. Khatami was earlier removed from the Ministry of Culture and Islamic Guidance but had contacts and sympathies with the CSS group. However his impeccable religious and revolutionary credentials made him acceptable to run for the presidency.

After his elections, the reformists were in top gear attacking government institutions. The emergence of the daily *Jame'e* in February 1998 edited by Shamsolazin started the beginning of reformist press assault. Over the next three years there was a spurt of dailies, weeklies and monthlies. The hard-line judiciary came down strongly on these publications and many of these reformist publications were either closed or put under pressure. However, new outfits came up under changed names. The term, *degarbash* (alternative life style) by Akbar Ganjo for cultural diversity while his neologism *tavabi-saazi* (manufacturing repentants) was meant to highlight the highhandedness and illegal judicial and security practices of the clerical regime. He blamed some rogue elements in the clerical set up that were responsible for the "serial murders" taking place of intellectuals critical of the government. He also attacked Rafsanjani for his election campaign for speakership in February 2000, his family for alleged corruption and indirect role in serial murders.

President Khatami's brother, Mohammad Reza Khatami and others joined the Islamic Iran Participation Front (IIPF) to mature it into a conventional party. Hajarian talked about diminishing the importance of the institution of *Vilayat-e-Faqih* (Guardian of the Land), the supreme symbol of religious hegemony and champion of the democratic nature of the Revolution.

Although not against theocracy he believed in the taxonomy of “theo-autocracy, theo-aristocracy and theo-democracy.”<sup>5</sup>

The Islamic revolution’s religious basis remains a bureaucratic bottleneck. Ideology in Iran lacks religious, historical, institutional and ideological legitimacy. It has interpretive diversity and amorphous ecclesiastical structure. By August 2000 there was clamping down hard on the reform movement with the intervention of Ayotallah Khomeini to end a parliamentary debate over pass reforms, which undermined the process. It continued to attack the metaphysical foundations of the clerical regime yet not attacking the Revolution. In a country where paternalistic influence has been much in vogue that distanced the elite from the people, this debate was a major achievement. The reformists also bolstered the Islamic republic by undermining the “illegal” and specially the armed opposition.

It was e.g., Hajarian who coined the famous slogan: “our aim is to turn enemies of the system into critics and critics into supporters.” The demonstrations of bodies like the Islamic Society of Students and Graduates (ISSG) and OFU were too small to effect any changes. Many conservatives think that reformists would be able to channel peoples’ frustrations away from radical solutions to evolutionary activism that is within the purview of the constitution; therefore, they do not deem it as a potent threat to the regime.

### **Islamic Right Vs Left**

Since the 1979 Islamic Revolution the Iranians have gone to polls in large numbers. While the lowest turnout in parliamentary contest to First Majlis in 1980 was 52 per cent, those in the parliamentary elections of 2000 were almost 70 per cent.

The Presidential elections of May 1997 brought large sections of people to vote for change and in favour of liberal reforms. Pitted against Natiq Nuri, then Speaker of the Majlis, supported by the religious establishment, Khatami obtained 70 per cent of votes against Nuri’s 25 per cent. The average election turnout was about 88 percent.<sup>6</sup> Khatami was reelected in June 2001 with a landslide majority, garnering 21.7 million out of 28.2 million votes cast whereas his nearest rival Ahmad Tawakkoli received only 4.4 million votes despite support of the conservative establishment.<sup>7</sup> Iran possesses one of the youngest population in the world with nearly two-third under 30 and one of the lowest voting age of 15 for both men and women. In fact, the elections of 2000 for the 6<sup>th</sup> Majlis had signified a total victory for the reformers/ religious Left. However the February 20, 2004 parliamentary

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<sup>5</sup> Ibid., p. 4.

<sup>6</sup> Onder Ozar, “The Reform Process in the Islamic Republic,” *Turkish Review of Middle East Studies*, Annual, Istanbul, 2003, No. 14, p.114.

<sup>7</sup> Ibid.

elections (7<sup>th</sup> Majlis) resulted in the overwhelming victory of the religious right/ conservatives.

Some observers have termed it as “sham elections” which represented not only a temporary setback for the reformers but also a decisive defeat for the reform movement that had emerged nearly seven years ago.

In the February 20 elections only 29 per cent people cast ballots in Tehran that showed the voter’s apathy; the nationwide average was 50 per cent—a sharp drop from 67 per cent in parliamentary elections of 2000. Some say that the figure could be even lower than this.

While the reformers have attributed their defeat to a low turnout, there are some other reasons for their electoral debacle. They are summarized as follows:

#### *Increased Obstacles*

The reformers in the last four years have faced a number of heavy impediments e.g., the conservative Iranian judiciary had shut down over one hundred reformist periodicals and jailed hundreds of political activists, progressive/ liberal writers, artists, reformers, journalists and students. Harsh repressive measures followed the students’ uprisings in July 1999 and lately in June 2003. Death sentence to dissident writers like Hasham Aghajari was given. Murders of some intellectuals and activist by “rogue elements” were carried out.

The non-elected Guardians Council vetoed some reform legislation by the parliament. Defeat of reformists came about because of mass disqualification of 3,533 out of 8,144 prospective candidates by the powerful Council of Guardians.

Although some disqualifications were later reversed, most prominent reformist candidates, including 80 incumbent *Majlis* deputies were debarred from participating in the elections. This step was unprecedented—even surpassing the purge of Islamic left candidates prior to the 1992 parliamentary elections.

However, reformers were expecting the action by the Guardians Council action even before the disqualification move. They had already suffered a total defeat in February 2003 municipal council elections despite being allowed to contest.

Should the Majlis and the Council of Guardians not be able to decide the case, it will then be passed on to the Expediency Council for a final decision. Its members are composed of Islamic clerics and lawyers. Six of its members are clerics who are selected by the Supreme Leader, who also serves as Iran’s Head of state. The other six members are lawyers proposed by Iran’s judicial branch (selected in turn by the Supreme Leader) and voted in the Majlis. The members are selected for six years on a phased basis so that half the membership changes every three years.

All candidates of parliamentary or presidential elections as well as candidates for the Assembly of Experts have to be qualified by the Guardians Council in order to run for the elections. Based on controversial interpretation of the Constitution, it has led to numerous bitter debates in Iran.

The Guardians Council has a right to veto any legislation or debar any contestant from participating in elections. Article 98 of the Constitution says: “the authority of the interpretation of the Constitution is vested with the Guardians Council which is to be done with the consent of three fourth of its members.” Hence barred from open contest, the hardliners won all five seats from Isfahan—once a stronghold of reformers. This move was criticized by outside circles, including the EU and the US. The Council barred nearly 2000 reformist candidates from contesting elections on grounds of “ideological legitimacy.”

Why did the reformists act this way in 2004? Perhaps this had to do with perceived threat from the US to change the regime as result of Iraq invasion. So, faced with internal reform pressures in the last four years together with US rhetoric and threats they decided to come down harder on domestic opposition and reforms. By retaking control of the *Majlis* they tried to squelch the domestic pressures for reform that could have regime change implications. The student riots of 1999 and 2003 had set off an alarm.

#### *Non-Performance by Religious Left*

There was general disillusionment and apathy in voting public due to non-performance of reformists and President Khatami’s manifesto of civil rights, accountability and good governance. On the other hand, the religious right had skillfully and effectively campaigned on a platform that sought to improve the socio-economic conditions of Iranian masses rather than merely promotion of religious ideology. The broad conservative coalition of *Abadgarane Iran-e-Islami* (Developers of Islamic Iran) drew strong support from the conservative business interests.

#### *Election Ploys*

An effective election ploy employed by the conservatives was taking the cue from some Western electoral winning strategies by fielding celebrities such as wrestler champion Amir Reza Khadem and popular film maker Saeed Abu Taleb.

#### *Factional Conflicts*

In the 2000 parliamentary elections a vast majority of seats were captured by the reformists, then led by President Khatami. In 2001 Presidential elections, he got nearly 78 per cent of the votes. But instead of mobilizing the masses, the reformist circles indulged in factional conflicts and against the hardliners—thus sapping their energies. Comprising 18 political groups and factions, they

lacked a unified strategy. In the view of some observers, hamstrung by the Guardian Council and other conservative groups they could gain higher moral ground by resigning *en masse*, thereby improving their image amongst the populace.

Some analysts think that reform outside the government cannot work in Iranian context. Original ideologues of reform were a group of security and intelligence people of the Islamic left who recruited reformists into their ranks. There were no organised reform circles outside the government. Student organizations were also badly divided from within.

#### *Lack of Interest*

The Reformists were less interested in public welfare than promoting their own vision of the Islamic Republic. Saeed Hajjarian had observed that the reformists' strategies and primary focus was "to turn the enemies of the system into critics and critics into supporters." While the people desired some radical changes and reforms the reformists were averse to any risk taking and were concerned not to violate the politico-cultural norms of Iranian society. In fact, the conservatives' offensive after their electoral defeat in 2000 parliamentary elections showed that they chose not to confront the hardliners—a tendency that disillusioned the public.

#### *The Guardian Council*

The reformists contend that if wholesale vetting and disqualification exercise were not done the people would have gone out to vote in a major way.

Here it is germane to mention the role of the all-powerful Guardian Council. The 12-member strong Council of Guardians is the strongest non-elected body. Acting like a Constitutional Court appointed from above, it has the authority to interpret the Constitution and to determine if the laws passed by the *Majlis* are valid or not. Although not a legislative body, it exercises veto power over the *Majlis*. For example, it can drop a law based on two counts: anti-Islamic in spirit or repugnant to the Constitution. While all members vote on the laws compatible with the Constitution, only six clerics vote on them being compatible with Islam. If any law is rejected, it will be sent back to the *Majlis* for reconsideration.

#### *Voter's Apathy*

Whether Iranian voters' apathy was a cause or consequence of the liberal agenda is a moot point. After 1997 there were high hopes from President Khatami. According to his detractors, he was not assertive enough to speak and defend his reformist agenda, made compromises, had earlier served in the Ministry of Culture (1982-92) and had displayed a very conservative outlook. His and the Supreme leader were, therefore, engaged in a "choreographed

dance” to win diplomatic and domestic space for the ideologues.<sup>8</sup> He made attempts to amend the Constitution but did not make any pledge to revise it during his electoral campaign nor thereafter. He avoided confrontation to establish rule of law, enforce liberties and democratic rules that would improve Iran’s foreign image. His aim has been not to challenge and disrupt the system but to safeguard it through possible reformation.

This is, however, not to downgrade his opening to the West, rapprochement with Arab countries and Dialogue of Civilizations as positive measures. As a result of this, an end to “export of revolution” and rescinding of *fatwa* against Salman Rushdie came about. His period broke the isolation of Iran with the outside world except the US. For this, he cannot be entirely faulted as anti-US feelings form the very bedrock of the Iranian revolution. Frustrated with the reforms efforts he even threatened to resign at one stage.

### *Guardian Council*

The Guardian Council is often blamed for the reformist’s poor performance. This may be an exaggeration. The February 2003 Union elections, described as the “freest ever” were marked by a low turnout. So, if the voters abstained or stayed away when vetting by the Guardians Council was minimum, the conservatives naturally felt emboldened. They felt that that if candidates were blocked from competition, the reform movement could be dealt a grievous blow. Hence, the en masse disqualification exercise was undertaken to block the latter’s chances, if any. This worked as a major factor against them, who in any case, were putting up a lacklustre performance. However, if the reformists had resisted these moves, the conservatives could not have staged such an easy walkover.

### **Future of Reforms**

The February 2004 parliamentary elections in Iran do not represent a major departure from the factional politics of Islamic Republic of Iran. The problems of grafting Islamic ideology with the institutions of modern democratic state remain endemic. All Iranian elections since the last 25 years were on the theme of “Islamic democracy.” To be fair, albeit Iran’s brand of democracy is unique in the Middle East, it has much more participation than most of the neighbouring Arab monarchical /autocratic systems; yet the power structure remains dominated and concentrated in a handful of clerics. Combination of *Vilayat-e-Faqih* with absolute divine powers and the democratic components of direct elections for the Presidency, *Majlis* and Assembly of Experts are indeed a hybrid and an unprecedented model.

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<sup>8</sup> Rubin, op. cit.

The stronghold of the Guardians Council over all institutions is a standing testimony. They will decide the candidate president to stand for the 2005 presidential elections.

Another institution, Iran's Revolutionary Guards, the *Pasdaran* as a pillar of support of the Islamic Republic, is currently playing an independent role in the political life of the country. Added to this are *Basij* (volunteer paramilitaries), religious security forces, (vigilantes) revolutionary committees and pro-conservative media. With unintended consequences for the reform movement and major changes in foreign policy, the Revolutionary Guards are separate from the armed forces. They were created to safeguard and defend the Revolution from both internal and external foes. Before his death, the revolutionary founder-leader Imam Khomeini had forbidden the military from getting involved in politics, which was being involved in factional fighting. In addition, the Iranian Constitution prohibits members of the armed forces from direct engagement in politics.

However, recent developments have forced the clerical elite to get a stronger grip on power and rely on the Revolutionary Guards to bolster control. The recent developments impinging on Iran's national security and threats to nuclear programme have stirred national sentiment. Moreover, the looming presence of the US troops in the immediate neighbourhood (Iraq, Afghanistan, Pakistan, the Gulf, Central Asia and Turkey) has enhanced their standing in national life. Any talk of outright "military invasion" by the US or its surrogate, Israel, or "regime change" will be stoutly resisted by the Iranian people.

Besides assuming a political role, the Revolutionary Guards are engaged in a number of financial and economic ventures. Perhaps they are emulating the examples of their counterparts in Pakistan and Turkey whose militaries have come to have a major stake in financial investments and in national security. In the new *Majlis* at least 12 candidates are under the effective control of the Revolutionary Guards—notable for the first time in Islamic Republic's 25 years of parliamentary life.<sup>9</sup>

The Revolutionary Guard's clout can be gauged from the fact that they abruptly ended the Turkish engineering company TAV's tender of \$15 million for Tehran airport construction whose contender was a company having close ties to the Guards.<sup>10</sup> A major contract with Turkcell to run Iran's second private mobile phone license worth more than \$3 billion was also scrapped on alleged Turkish-Israeli contacts.<sup>11</sup>

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<sup>9</sup> Kamal Nazer, "Iran's Revolutionary Guards Making a bid for Increased power," *Eurasian Insight*, 19 March 2004.

<<http://www.eurasianet.org/departemnts/insight/articles/eav051904a.shtml>>

<sup>10</sup> Ibid.

<sup>11</sup> See "Iranian reforms attacked by hardliners", *Daily Times*, Islamabad,

The conservatives and religious hardliners could win the presidential elections in 2005 and continue to hold Iran under a tight clerical grip. However, Iran is not a static society but is in transition. The seeds of liberalisation and reform have been planted in its body politic.

Despite curbs, restrictions and tight ideological controls, nearly 68 million people of Iran—nearly two third below 30—are chafing under the retrogressive grip of the clerical regime. Unemployment, weak economy and international isolation have taken their toll. But the system has been designed in a way that safety valves like parliament and controlled degree of freedom are allowed with institutions like Guardians Council as a final check. Limited freedom and betterment in the lives of people has led to the survival of regime.

The student riots of July 1999 and June 2003 reflect the pent up frustrations of the youth. The student organizations remain as potent as they were in late 1970s against the Shah revolution.

Iran's bid to join the WTO has been repeatedly vetoed by Washington, which accuses Tehran of manufacturing nuclear weapons and supporting terrorism. The IMF has advised the country with an economy of 6.7 per cent growth rate duly fuelled by the oil sector, to end subsidies that lower its oil price to only 10 cents per litre at the petrol pumps.

Informal worker organizations and student unions have sprouted and thousands of non-governmental groups have been established to tackle domestic problems on issues ranging from pollution to drug addiction. Street rallies and strikes are becoming more common than before.

Globalization, democratization and the communication revolution (electronic and media) can no longer insulate the Iranian people who are still enamoured with the West, especially the US. In fact an unofficial poll estimates that nearly 70 per cent of the population is desirous of normalizing relations with the US. Interestingly at the time of the Shah, the population of 37 million had a literacy rate of about 50 per cent whereas now with a population of about 70 million it is more than 80 per cent.<sup>12</sup> Iran's contribution in cultural fields like film industry is notable; at the same time in armament especially the advances being made on missile and nuclear front cannot be ignored.

Another important thing is that unlike other revolutions in the Arab ME the Iranian revolution was not inspired from the top through military officers coups but from the grass root level. It was, in other words, a people's revolution against the monarchy and the "most democratic dictatorship" as well as the "most dictatorial democracy." Some of the failures of the

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<[http://www.Dailytimes.com.pk/default.asp?page\\_3-8-2004\\_pg4\\_25](http://www.Dailytimes.com.pk/default.asp?page_3-8-2004_pg4_25)>

<sup>12</sup> See Dr. Soli Shahvar's statement in "MERIA: IRAN, 25 years Later," *Middle East Review of International Affairs*, Vol. 8, No. 2 (June 2004).



revolution are in improving the lot of common people, export of the revolution and in attracting massive support. Besides, its model could not be successfully exported to other Shia societies in Iraq, Lebanon or Afghanistan.

On the foreign policy front, Iran has tacitly welcomed the US interventions in removing the Taliban and Saddam regimes in Afghanistan and Iraq. Moreover, it has desired cooperating with the US and others in reconstruction of the two countries.

The dichotomy of the liberals versus reformists is an over generalization by the US. There are various shades between the 180,000 clerics: ultra right conservatives, moderate right, pragmatic right, left conservative, moderate left and pragmatic conservatives. The present Supreme Leader could be appropriately described as “pragmatic/ cultural conservative” while President Khatami could be seen as a “moderate left.”

Although the reforms process has indeed suffered a setback, the process of evolution within Islamic framework will most likely continue. The conservatives will have to tackle the multifarious domestic and international challenges of the Iranian nation. There is no doubt that cynicism pervades and that “regime change” from within by emergence of a “strong leader is a wish for many Iranians.” There, is for instance, nostalgia about Reza Shah, the first Pahlavi king (1925-41) that haunts many circles, for he symbolized a modernizing autocrat.<sup>13</sup> Strangely enough, even the son of the architect of the Iranian Revolution, Ayotallah Khomeini has spoken positively of “American liberation of Iraq” and asked when the Americans could liberate Iran.<sup>14</sup>

Regardless of whether reformists or conservatives are ascendant in the parliament or presidency, activists, labour and student unions in Iran are a force to be reckoned with. They nurse high expectations about reforms, freedom and economic betterment in their existential living. Nearly 800,000 individuals are seeking jobs every year and the GNP of the country has slid to one-third of its pre-revolutionary levels due to cumulative effects of US-led sanctions, domestic corruption, mismanagement and insufficient infrastructure.<sup>15</sup>

But on the positive side, Iran’s vast hydrocarbon resources (the largest producer in OPEC with 10 per cent of world’s oil and second largest gas reserves after Russia), reservoir of scientific talent and expertise, a strong diaspora, robust Iranian nationalism after having survived a 10-year war with Iraq, prospects of EU and Russian cooperation and now nuclear energy /weapons—qualify it as a regional power and raise hopes. The victory of

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<sup>13</sup> Afshin Molavi, “Iran’s ‘Crisis of Legitimacy’ could Prompt Authoritarian Political Alternative”, *Eurasia Insight*, 29 August 2003.

<<http://www.Eurasianet.org/departments/insight/articles/eav082903.shtml>>

<sup>14</sup> Ibid.

<sup>15</sup> Mahdy Farhadian, “Beyond Khatami’s Reform Era: Economic Talibanisation or Liberalization?” *Iran Analysis*, Quarterly, Vol. 1, No. 3, Winter 2004.

conservatives in recent elections, therefore, does not mean the end or demise of the reforms process. These will have to follow an incremental course otherwise they might collapse.<sup>16</sup>

## Conclusion

In the near future, an interplay of internal reforms and foreign policy measures with neighbours and major powers, especially Europe and the US will determine the future of conservatives' success in ensuring Iran's security and stability. The re-election of President Bush in the November 2004 presidential elections may not drastically change the US policies towards Iran. In fact, the defeated candidate John Kerry was equally an advocate of strong US policy towards Iran.

While the Islamic character of Iran's Revolution marks the general parameters there are differences over democracy. Some writers affirm that Iran's nuclear programme is crucial together with support to Palestine cause and animosity towards Israel.

While this may seem true, the other side of the picture is that no society is at a standstill and can ill-afford to remain aloof or defiant in an increasingly interdependent world.<sup>17</sup> In other words, no country is an island unto itself: the costs are too heavy to bear in terms of international isolation, sanctions, loss of trade and investment. Besides, incurring the ire of big powers, which have unabashedly adopted the credo of prevention and preemption is a constant threat.

In recent times, the Chinese revolution is a vivid example of how a millennial ideology, aspiring for world defiance and domination through dethronement of other political systems, had to turn pragmatic—make peace with neighbours and adopt a paradigm of rapid, peaceful economic modernization. Mao's famous dictum of power flowing from the barrel of a gun has been turned on its head by peace flowing from "chimney stacks of factories." Many East European states have embraced capitalism after the demise of communism and end of Cold war. Vietnam, Yemen and Libya, in the developing world, are some other notable examples. Neighbouring Pakistan, e.g., once a staunch supporter of Taliban, has reoriented its policies by cracking down hard on Islamic radicals/extremists under President Musharraf's new policy of "enlightened moderation". Afghanistan, far from being stable and peaceful has completed its first general elections in its known history and Iraq has followed suit.

<sup>16</sup> Mrs. Elaheh Koolai, member of Foreign Affairs and National Security Committee, Iran, interview by Safa Haeri, *IPS* Editor, "Reforms are not dead, but the road is long and bumpy: Kolai," 20 June 2004.

<sup>17</sup> Robin Wright, "Iran Now a hotbed of Islamic Reforms", *Islam For Today*, 29 December 2000. <<http://www.islamfortoday.com/iran.htm>>

However there is no gainsaying that Islamic democracy in Iran will remain grounded in Islamic foundations that cannot be easily taken away. Secularism is a *sine qua non* of Western type of democracies and alien to religious and conservative societies like Iran. The attempt of the Pahlavis at secularization did not work and created a violent backlash. Iran's two democratic movements of short duration in the last century were: the 1905 revolution that led to the democratic constitution of 1906 and the government of Iran national front under the leadership of Prime Minister Mossadegh (April 51-August 53).

It seems that the present stalemate of muddling through in the absence of a charismatic leader may continue. The desire for opening up i.e. freedom of press, cultural liberalism, relaxation of dress code, human rights, accountability of the organs of state, credibility in international relations is palpable, but, in view of disagreements within liberal sections, there is no final consensus. There is need to organize the civil society under different political parties, non-governmental and civic groups.

The idea of "civil society" was introduced in the lexicon of political scientists in the 1990s with the demise of the Soviet Union and the rise of democratic movements in Eastern Europe. President Khatami's "rule of law" comes closer to this formulation. After two decades of the establishment of the Iranian republic, Islamism seems to have run its course: a political doctrine that makes political sovereignty subservient to the divine law or Sharia as interpreted and enforced by the Islamic government is being challenged by majority of the population, including the youth, urban middle class and women.

Even some high-ranking clergies warn about the dangers of religious involvement in politics. This has pushed the youth away from religion and given it a negative connotation. The more the religious clerics hold on to power the greater will they soil their reputation and get tainted with corruption. Besides, the cultural suffocation is making them increasingly unpopular.<sup>18</sup>

However, it is pertinent to point out here that the conservatives' use of the term "liberalism" has acquired a negative connotation—reminiscent of Stalinist Russia. Not surprisingly it was the Iranian Communist Party (Tudeh) that flayed Mehdi Bazargan and those around as him as "liberals" and "stooges" of the West who would sell out to them. The clergy has appropriated the same term and liberalism has become a negative label.

The fourth type was "tradionalist Islam" which appealed to the clergy and bazaris. It was a literal interpretation of Islam. After the clerical leadership liquidated the liberal and secular leftist groups the four strains coalesced into two major ideological camps: conservatives and radicals. While these

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<sup>18</sup> Banuazizi, op. cit.

categories appeared, various factions merged on foreign policy, culture and economics by being liberal and conservative on different aspects. Denounced Iran's cultural heritage includes some secular and pre-Islamic values like e.g. *nauroze* (spring) *mehregan* (autumn) *shabe yalda* (longest night celebration).

Iran at peace with itself and the outside world will be a factor of stability in the region. A lot will depend on regional developments, especially in neighbouring Iraq and the configuration of emerging internal forces after the January 2005 elections. Iran is faced with a peculiar dilemma: it does not want any precipitate US withdrawal from the region while at the same time it wants the US to leave the region as it feels its presence threatening to Iran's national security. Perhaps to its great relief, it would prefer the US getting bogged down in the Iraqi quagmire so that it cannot threaten Iran any more. Further, emergence of any pro-Sunni regime will be perceived as a threat while a pro-Shia regime will be welcome.

There is a direct linkage between internal reforms and foreign relations: adherence to the former could result in better domestic policies. Some commentators hold the view that it is the US policies that are responsible for strengthening the radical conservatives in Iran and responsible for slowing down of reforms.<sup>19</sup>

While the road to reforms is indeed bumpy and could entail fits and starts, it seems irreversible in the long run. The Iranian Revolution, a momentous event in late twentieth century, overthrew a corrupt monarchy through a populist, charismatic religious leader. However, revolutions in human history have a life span of their own and have to make adjustments in consonance with demands of their times. Unlike the French revolution, the Iranian evolution could not be "exported", nor was it a role model for its neighbours. More importantly, it has lately come under pressure of internal reformists as well as a hostile superpower. While the US may not exercise overt military option of attacking, there is no doubt that Iran is facing physical encirclement by the US. This is weakening the economy, scaring away foreign investment and adding to its general economic distress. Hence, the Iranian revolution may have to turn a corner—giving way to a Thermidor reaction. ■

<sup>19</sup> Kamal Nazer Yasin, "US Hard-Line policies Helped Bring about Reformists Demise in Iran- expert," *Eurasia Insight*, 3 August 2004.

<<http://www.eurasianet.org/departments/insight/articles/eav030804.shtml>>

## CHINA'S KASHMIR POLICY: BACK TO NEUTRALITY

Ghulam Ali\*

A number of factors establish China's relevance with the Kashmir issue: The old historical links between the two people; geographical proximity; China's control over a part of Kashmir, Aksai Chin, which is, at least, disputed between Beijing and New Delhi<sup>1</sup> and the provisional settlement of the territory between China and Pakistan through their Border Agreement in 1963. Despite this significance, little literature is available that deals with China's Kashmir policy. Only India and Pakistan are kept in the limelight while debating this issue. This paper is an attempt to fill this gap by examining the genesis, growth and existing status of China's Kashmir policy. A deep look into the history essentially helps in understanding Beijing's Kashmir policy in its totality. An attempt is also made to identify the factors behind the changes in Beijing's stance on this issue over different periods of time to make this study more comprehensive.

Links are found between the peoples of the two sides a long way back in history. In 2 BC, a central authority appeared under the Han dynasty in unified China that established trade links with present day South Asia and Jiban (Kashmir). Rock carvings reveal the travels of Chinese envoys to Kashmir about 2000 years ago. The Han rulers gave the impression that areas in Kashmir, Assam and Upper Burma formed part of the "celestial empire" of China.<sup>2</sup> These old historical links further enhance Beijing's relevance to the dispute.

The Kashmir issue had engulfed sub-continental politics even before the establishment of the People's Republic of China (PRC) in 1949. Pakistan and India had fought a war over this issue in 1948. Earlier in 1945, the UN had recognized the Nationalists as the representatives of the Chinese people and granted them not only UN membership but also the prestigious permanent seat on the Security Council. This enabled the Nationalists to take

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<sup>1</sup> Aksai China, controlled by China, is 20 percent of total Kashmir. India claims that China seized about 38,000 square kilometers (14,670 sq miles) of its territory in Aksai Chin as well as another 5180 sq km (2000 sq miles) of northern Kashmir that Pakistan later ceded to Beijing under a 1963 pact. This area is disputed between Beijing and New Delhi.  
<<http://edition.cnn.com/2002/WORLDasia/pcf/east/05/24/aksi.chin>> (24 May 2003).

<sup>2</sup> Maqbool Ahmad Bhatti, *Great Powers and South Asia: Post Cold War Trends* (Islamabad: Institute of Regional Studies, 1996), p. 142.

part in the discussions in the UN on Kashmir until their expulsion from the world body in 1971. In one such discussion, their delegate, Mr. Tingfu F. Tsiang, stated, "It is obvious that the key to the problem lies in the plebiscite. If the principle of a free impartial plebiscite for deciding the all-important question of the accession of Kashmir to India or Pakistan should be accepted much of the incentive to invoke the use of force would be removed."<sup>3</sup> This statement revealed that the government of the Nationalists wanted an early resolution of the issue. Moreover, their stance was closer to Pakistan's position that the Kashmiri people should be given the right of self-determination.

Kashmir's strategic position was clearly evident to both Pakistan and India. Its possession by Pakistan, in its entirety, could further distance India from the Soviet Union. While leaving some territorial issues aside, its possession by India could leave Pakistan with no common border with China. In this context, the emergence of the PRC as the sovereign authority over mainland China was a significant development to be taken into consideration by India and Pakistan. Pakistan realized that India would soon recognize the new Communist government in mainland China. It was also expected that the Communist government would occupy the Chinese seat in the United Nations replacing the Nationalists, which would enable them to take part in the Security Council discussion on Kashmir. Therefore, it was not in Pakistan's interest to be left too far behind.<sup>4</sup> Motivated by these arguments, Pakistan extended recognition to China, following India. John W. Garver, commented on this decision: "If, as then seemed likely, the PRC was going to assume China's seat on the Security Council, Pakistan did not want that to happen with Beijing more favourably inclined towards India than towards Pakistan."<sup>5</sup> Pakistan recognized the PRC on 4 January 1950 and established diplomatic relations on 21 May 1951.

The long civil war, which ended with the establishment of the PRC in 1949, had badly damaged the infrastructure. Reconstruction was necessary to develop the country and put it on the path to progress. Tangled with its own problems, China was least concerned with the Indo-Pakistan conflict over Kashmir. Thus in the early period, hardly any reference was available that showed Chinese concern on the issue. Beijing's somewhat sketchy understanding of the issue developed from its close interaction with Moscow. Therefore, China and the Soviet Union had an almost identical perception of the Kashmir dispute in the early 1950s. S. M. Burke, a noted writer on Pakistan's foreign policy stated on this shared perception. "China agreed with

<sup>3</sup> K. Sarwar Hassan, *Pakistan and the United Nations* (New York: Manhattan Publishing Company, 1960), p. 125.

<sup>4</sup> S. M. Burke and Lawrence Ziring, *Pakistan's Foreign Policy: An Historical Analysis* (Karachi: Oxford, 1990), p. 102.

<sup>5</sup> John W. Garver, *Protracted Contest: Sino-Indian Rivalry in the Twentieth Century* (Seattle: University of Washington Press, 2001), p. 190.

the Soviet Union that the division of India (subcontinent) into Pakistan and India was an imperialist trick. About Kashmir too, China believed that the United States, through its manipulation of the Security Council, wishes to send its own troops to turn that principality into a military base.”<sup>6</sup> However, in the subsequent period, China developed its independent understanding of the issue, which recognized Kashmir as an unresolved issue, left over by history. China adopted a neutral stance favouring neither Indian nor Pakistani positions. Instead it stressed upon them to solve it through bilateral means. Beijing was not in favour of the UN and US involvement in the dispute. According to China, the United Nations, during its five years of holding the matter had only aggravated the situation and merely worked as an instrument of the United States that wanted convert Kashmir into a “colony and military.” China stated that only the people of Jammu and Kashmir had the right to determine their fate and future. Thus it defended Nehru’s decision regarding the ouster and subsequent arrest of Sheikh Abdullah on the ground that he was “a tool of the American agents.”<sup>7</sup> Beijing’s reiteration to stave off the UN and the US from the settlement of the Kashmir dispute was understandable. Beijing had not been admitted to the UN and the nature of its relations with the US was based on hostility during that period.

With this spirit China welcomed the 1953 Bogra-Nehru agreement to have talks on holding Kashmir plebiscite. The mouthpiece of the Chinese communists, *People’s Daily*, in one of its commentaries, emphasized upon the bilateral resolution of the dispute and endorsed the right of the people of Kashmir to determine their future.<sup>8</sup> During that time India had not yet retracted its commitment to let the people of Kashmir exercise their right of self-determination.<sup>9</sup>

Throughout the 1950s, China stuck to its neutral stance, which originated from its desire for the unity of the Afro-Asian nations. China continued this policy even when Pakistan moved closer to the West.<sup>10</sup> Chinese Premier Zhou En-Lai, during his visit to Pakistan in December 1956, deliberately avoided focusing on Pakistan joining the Western pacts (SEATO and CENTO), though China had deep concern over these accords.<sup>11</sup>

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<sup>6</sup> Burke, op. cit., p. 104.

<sup>7</sup> Syed, *China Pakistan Entente*, p. 70.

<sup>8</sup> Ibid.

<sup>9</sup> Hassan Askari Rizvi, “China on Kashmir”, in K. F. Yusaf, ed. *Perspectives on Kashmir: Pakistan Forum series No. 4* (Islamabad: Pakistan Forum, 1994), p. 215.

<sup>10</sup> Pervaiz Iqbal Cheema, “The China Threat: A View from Pakistan”, in Herbert Yee and Ian Storey, eds., *The China Threat: Perceptions, Myth and Reality* (London: Routledge Curzon, 2002), p. 303.

<sup>11</sup> China termed SEATO an “illegal” organization as well as a tool of American “aggression” and imperialism. It stated that this Treaty along with some other agreements wanted to militarily encircle around the Soviet Union, China and other

Commenting on Indo-Pakistan tension, Zhou En-Lai stated that like other disputes among Afro-Asian nations, the Kashmir issue between India and Pakistan should also be settled amicably and that the “colonialists” who had originally created this problem should be kept out of it.

In the latter part of the 1950s, Pakistan’s pro-US policy soured its relations with China. Pakistan became close to the US policy to oppose China’s entry into the UN. On certain occasions, its officials issued some ambiguous statements regarding the status of Taiwan, which were in sharp contrast to its earlier stance that endorsed China’s claim over Taiwan.<sup>12</sup> This unfriendly China policy was clearly manifested during Prime Minister Suhrawardy’s visit to the US in July 1956. Suhrawardy adopted a pro-American posture and endorsed US Secretary of State John Foster Dulles denunciation of “Communist colonialism.”<sup>13</sup> These remarks created distrust between the two countries. An analysis of the situation at that time found the following possibilities behind the change in Pakistan’s attitude. First, in a recent debate in the UN Security Council on the Kashmir issue, Pakistan received strong “moral support” from the Nationalists. Perhaps Suhrawardy felt obliged to reciprocate this gesture by saying something nasty about their foes. Second, Pakistan had greater dependence upon the United States for military and economic assistance that required it to be in line with the US on this issue.<sup>14</sup> Third, the Communists approach to address the Kashmir issue contradicted Pakistan’s point of view, which had been stressing upon UN-based solution with the active support of the US.

Next year again, China demonstrated a neutral stance and slated the US involvement in the role of the UN in further complicating the issue. Furthermore, Zhou En-Lai during his visit to Sri Lanka, discussed the Kashmir issue with his counterpart Bandaranaike. The two leaders, in a joint statement, appealed to India and Pakistan to settle the dispute through peaceful means. This was followed by Zhou En-Lai’s statement, which again opposed the proposal of sending UN troops to Kashmir.<sup>15</sup> Pakistan immediately reacted at Zhou En-Lai’s statement and termed it a “Communist and neutralist line.” However, Suhrawardy agreed with the observation made

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people’s democracies, in Syed Anwar Hussain *China & Pakistan: Diplomacy an Entente Cordiale* (Massachusetts: University of Massachusetts Press, 1974), p. 56.

<sup>12</sup> Taiwan was as important to China as Kashmir was to Pakistan. While establishing relations with China in 1951, Pakistan not only endorsed the Chinese claim that Taiwan was the part of mainland China but also severed diplomatic relations with the nationalist government ruling in Taiwan, in K. Arif, ed., *China Pakistan Relations: Documents 1947-1980* (Lahore: Vanguard, 1985), pp. 3-4.

<sup>13</sup> Khalid Mahmud, “Sino-Pakistan Relations: All-weather Friendship”, *Regional Studies* (Islamabad), vol. XIX, no. 3 (Summer 2001), p. 5.

<sup>14</sup> Syed, op. cit, p. 72.

<sup>15</sup> *Dawn* (Karachi), 16 February 1957.



by a correspondent while passing these remarks that unlike Nehru, the Chinese Prime Minister and his Sri Lankan counterpart had at least accepted the disputed status of Kashmir.<sup>16</sup>

China soon realized Pakistan's sensitivity towards the issue. Some time after these remarks, Chairman Mao Zedong stated that his country was going to be neutral in the matter of Kashmir, and that, in his opinion; other Communist countries should also be neutral. Pakistan welcomed this change in China's stance on Kashmir and stated that until now the statements issued by Zhou En-Lai had always been to the effect that India and Pakistan must decide the issue among themselves which means no decision, which means India get away with the territory it had forcibly occupied through aggression by its army. It demanded a similar balanced policy from the Soviet Union.<sup>17</sup>

Against the low profile of Sino-Pakistan relations in October 1959, Islamabad took up the issue of demarcation of the northern frontier border, whose status was hitherto undefined with Beijing. In the beginning, Beijing responded coldly to this offer<sup>18</sup> primarily because of Pakistan's pro-West policy that contained anti-China elements and secondly because Beijing disliked alienating India by settling the border issue quickly as it viewed Kashmir as a disputed territory.<sup>19</sup> Pakistan further elaborated to China that it was asking for the identification of the line of demarcation. The areas on the north of the demarcated line would be Chinese and the status of the area on the south of the line "did not have to be determined." The defence of this area, Pakistan maintained, would be its responsibility.<sup>20</sup> India contended with China over these negotiations and stated that Pakistan had no right to negotiate for that part of Kashmir, which though under Pakistan's control, was a part of the territory of the State of Jammu and Kashmir and legally a part of India. New Delhi claimed that only India was the sovereign authority to negotiate a settlement of the boundary in question.<sup>21</sup> In support of this contention, India tried to muster the assistance of the Soviet Union and some other powers. However, despite Indian demarches, negotiations between China and Pakistan made satisfactory progress. The Sino-Indian conflict added fresh impetus to them. Most Indian analysts term the Sino-Indian border war a

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<sup>16</sup> Premier Suhrawardy's comments on China-Ceylon joint statement on 15 February 1957 in Arif, *China Pakistan Documents*, p. 14.

<sup>17</sup> Ibid. p. 15.

<sup>18</sup> Rizvi, "China on Kashmir", p. 216.

<sup>19</sup> Mohammad Ahsen Chaudhri, *Pakistan and the Great Powers*, (Karachi: Council for Pakistan Study 1970), p. 87.

<sup>20</sup> Muhammad Ayub Khan, *Friends Not Masters: A Political Autobiography* (Islamabad: Mr. Books, 2001), p. 163.

<sup>21</sup> Zulfikar Ali Bhutto, *Foreign Policy of Pakistan: A Compendium of speeches made in the National Assembly of Pakistan 1962-64* (Karachi: Pakistan Institute of International Affairs, 1964), p. 79.

turning point in China's Kashmir policy from a neutral stance to support for Pakistan's official position.<sup>22</sup>

Sino-Pakistan border agreement was finally signed in March 1963. The agreement, however, did not provide a durable solution. Article 6 of the agreement provided that after the final settlement of the Kashmir dispute, it would be re-negotiated by China and the concerned sovereign authority.<sup>23</sup> Significant to note is that the signing of the agreement was the first occasion when China showed cautious sympathy for Pakistan on the Kashmir dispute. In the joint communiqué signed between the two countries, China expressed its appreciation at the attitude of Pakistan in seeking peaceful solution of the dispute and was of the belief that the expeditious settlement of the question would be conducive to peace in Asia and in the world.<sup>24</sup> In response, Pakistan's Minister of External Affairs, reiterated that his country had worked and would continue to strive for an equitable and honourable settlement of the dispute and upheld the belief that expeditious settlement of the dispute would be conducive to peace in Asia and the whole world.<sup>25</sup> However, Zhou En-Lai asserted an overall position of neutrality on Kashmir in an interview with the *Associated Press of Pakistan (APP)*, later in the same month.<sup>26</sup> China had started retreating from a neutral stance on the Kashmir dispute towards a pro-Pakistan position. A further change appeared in China's stance during Premier Zhou En-Lai's visit to Pakistan in February 1964. In the joint communiqué issued at the end of the visit the two countries expressed the hope that the Kashmir dispute would be resolved in accordance with the wishes of the Kashmiri people as pledged to them by India and Pakistan.<sup>27</sup>

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<sup>22</sup> For example, Swaran Singh called it the "most critical milestone in the evolution of China's South Asian policy in general and its policy towards Kashmir in particular." See Swaran Singh, *China-South Asia: Issues, Equations, Policies* (New Delhi: Lancer's Books, 2003), p. 78.

<sup>23</sup> The Article VI of the Boundary Agreement between China and Pakistan signed on 2 March 1963 reads: "The two parties have agreed that after the settlement of the Kashmir dispute between Pakistan and India, the sovereign authorities concerned will reopen negotiations with the Government of the People's Republic of China on the boundary, as described in Article II of the present Agreement so as to sign a formal boundary treaty to replace the present Agreement, provided that, in the event of that sovereign authority being Pakistan, the provisions of the present Agreement and of the aforesaid protocol shall be maintained in the formal boundary treaty to be signed between the People's Republic of China and Pakistan." In Arif, *China Pakistan Relations*, p. 37.

<sup>24</sup> Ibid, p. 39.

<sup>25</sup> Ibid.

<sup>26</sup> Hassan-Askari Rizvi, *Pakistan and the Geo-strategic Environment: A Study of Foreign Policy* (New York: St. Martin's Press, 1993), pp. 153-4.

<sup>27</sup> Arif, *China Pakistan Documents*, p. 64.

New Delhi was perturbed at the forging of the Sino-Pakistan entente. In May 1965, Indian Ministry of Foreign Affairs issued a statement that commented on this cooperation in the following words:

The Chinese and Pakistan Governments, entertain a common hatred and a common hostility against India. Both have committed aggression against India in Kashmir; both have laid claims against Indian territory and grabbed a portion of it illegally and both have constantly applied military, political and propaganda pressure against India in order to make India submit to their aggressive demand.

This is a demonstration of the aggressive partnership between the Chinese and Pakistani Governments against India. The Chinese statement contains a threat against India when it says that if armed conflict is widened 'the Indian Government would definitely come to no end.' This is nothing but open incitement to Pakistan to persist in its aggressive occupation of Indian territory in the Rann of Kutch under the umbrella of China's collusion with Pakistan against India.<sup>28</sup>

During the Indo-Pakistan war in 1965, China proved its commitment of friendship with Pakistan and rendered political, economic and military support to Pakistan. The PRC sent a protest note to India, popularly called the 'Chinese ultimatum', which charged New Delhi with a "succession of serious violations of China's territory." China demanded that India should immediately dismantle all the aggressive military structures it had built beyond or astride the China-Sikkim border. In addition to this, Beijing accused New Delhi of carrying out "armed aggression against the people in Kashmir and unleashing and expanding its armed aggression against Pakistan."<sup>29</sup> Chinese Foreign Minister Chen Yi stopped over at Karachi on his way to Mali and addressed a press conference in which he condemned Indian provocative violations of ceasefire line in Kashmir. He stated that the oppressive Indian rule in Kashmir had produced the current struggle of the freedom fighters there. He stressed that the wishes of the Kashmiri people should be duly considered in the final settlement of the dispute.<sup>30</sup> In the subsequent period, China left its neutral path and started rendering unqualified support to Pakistan on the Kashmir issue. An analyst commented that a complete identity of views on the Kashmir question proved to be the hallmark of the emerging convergence of Sino-Pakistan relations.<sup>31</sup> China started supporting the right of self-determination of the Kashmiri people at almost all high level exchanges with Pakistan. In the post-1965 war period, the PRC became more vocal and talked repeatedly of the two issues in an inter-related manner: support for

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<sup>28</sup> Statement by the spokesman of the Ministry of External Affairs of India on 7 May 1965, in Arif, *China Pakistan Documents*, p. 65.

<sup>29</sup> Mahmud, op. cit., p. 9.

<sup>30</sup> *Dawn* (Karachi), 5 September 1965.

<sup>31</sup> Mahmud, op. cit., p. 10.

Pakistan's "national independence, state sovereignty and territorial integrity" and peaceful settlement of the Kashmir problem through the exercise of the right of self-determination by the people of Kashmir.<sup>32</sup>

Support to Pakistan on the Kashmir issue and other South Asia countries in their fight against Indian hegemony became part of China's policy. Li Hsien Nien, Vice Premier, during his visit to Pakistan expressed that his country would stand by the people of South Asia against their just struggle against hegemonism and expansionism (of India). In this regard, he especially reiterated Beijing's support to Pakistan's proposal for a nuclear free zone in South Asia; the struggle of the Kashmiri people for the right of self-determination, the resistance of the people of Sikkim against the naked annexation by India, to the just struggle of the King of Nepal in declaring Nepal a zone of peace and the proposal of the Sri Lankan Government for making the Indian Ocean a zone of peace.<sup>33</sup>

### Deng's Reforms and China's Foreign Policy

Mao's successor Deng Xiaoping (1978) initiated China's first major diplomatic transformation by launching the "reforms and the opening up policy." The magnitude of the reforms was so high that it gave a new outlook to foreign policy. Beijing began to emerge from the Mao-era, which was characterized by isolation expanded its international profile by significantly increasing its participation in global politics.<sup>34</sup> These epochal shifts along with other far-reaching implications, added an additional rationale for China to cultivate better relations with India. Since then Sino-Indian relations are on the path of normalization.<sup>35</sup> In February 1979, China hosted the visit of the then Indian Foreign Minister, Atal Behari Vajpayee. During the visit, Vajpayee complained to the Chinese authorities about their pro-Pakistan attitude regarding Kashmir that had created "additional and unnecessary complication to the prospects of Sino-Indian relations".<sup>36</sup> Subsequently, China started retreating from its support for the right of self-determination to the Kashmiri people by taking a neutral stance on the issue. Though on some occasions, as a result of Pakistan's persistent efforts, Beijing did mention and referred to the relevant UN resolutions.

Seemingly to be in response to Vajpayee's plea in June 1980, Deng Xiaoping stated that the Kashmir issue was a bilateral issue between India and

<sup>32</sup> Rizvi, "China on Kashmir", p. 219.

<sup>33</sup> Vice Premier Li Hsien Nien's speech on 20 April 1975, in *Foreign Affairs Pakistan*, vol. II, no. 4 (1975), p. 26.

<sup>34</sup> Evan S. Medeiros and M. Taylor Fravel, *Foreign Affairs* (November/December 2004).

<sup>35</sup> Garver, *Sino-Indian Rivalry*, pp. 216-17.

<sup>36</sup> *Keessing's Contemporary Archives*, 1981, p. 31153.

Pakistan, which should be solved peacefully.<sup>37</sup> After a long period, it was the first statement by any Chinese official that called for a bilateral settlement of the dispute. China's improving relations with India and changing stance on the Kashmir dispute was uncomfortable development for Pakistan. Officials in Islamabad took serious notice of Beijing's reduced support on the issue and started diplomatic efforts to convince Beijing to reconsider its stance. Foreign Minister Agha Shahi was deputed to China for this purpose. At Pakistan's persistence, China slightly moderated its stance and Foreign Minister Huang Hua, stated on the occasion that China appreciated Pakistan's efforts to seek a just settlement of the Kashmir dispute in the spirit of the Simla Agreement and in accordance with the relevant UN resolutions.<sup>38</sup> However, there was no reference to the right of self-determination and the Simla Agreement referred to a bilateral solution. It was a clear message that Beijing had made up its mind to disassociate itself from the Kashmir imbroglio.

In July 1989, a series of anti-Indian bombings in Srinagar again drew world attention to the Kashmir dispute. Clashes soon erupted between demonstrators and the occupying Indian forces. The Indian government attempted to repress the movement by massive application of police force that caused an unending cycle of escalating repression and resistance. China's stance on the Kashmir issue underwent further evolution. Premier Li Peng made initial statements during his visit to Pakistan in November 1989, and the Foreign Ministry spokesman issued other statements on 4 and 19 April 1990. In these statements, there was no mention of the UN resolutions but a solution through bilateral talks. This omission reflected China's desire for a strictly neutral line, thus avoiding antagonizing India.<sup>39</sup> Pakistan, however, was dissatisfied with Beijing's new formulation since failure to mention the United Nations resolutions contributed to the worldwide impression, which India assiduously attempted to foster that the UN resolutions were obsolete and had been superseded by the Simla Agreement. Pakistan conveyed its displeasure to China and got some positive response. Chinese officials Li Peng and Qian Qichen made appropriate statements, which mentioned the United Nations resolutions with reference to the Kashmir issue.<sup>40</sup> However, it was not possible for Pakistan to keep pressing China on this issue. The Emerging Sino-Indian rapprochement had become a reality, that Islamabad had to accept. Since the signing of the Sino-Indian agreement of 1993 on maintenance of peace on the LoC, both Beijing and New Delhi actively adjusted their policies towards each

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<sup>37</sup> Garver, op. cit., p. 228.

<sup>38</sup> Naveed Ahmad, "Sino-Pakistan Relations 1971-1981", *Pakistan Horizon* (Karachi), 34, no. 3 (1981), p. 73.

<sup>39</sup> Garver, op. cit., p. 228.

<sup>40</sup> Ibid. pp. 228-29.

other and their relationships improved at a faster pace than expected.<sup>41</sup> The agreement further consolidated China's neutral stance on Kashmir.

Chinese Premier Jiang Zemin visited South Asia in 1996. The visit was very important to understand China's latest view with regards to the issue. In a speech before the Pakistan Senate, Jiang suggested that Islamabad should put Kashmir dispute on backburner and instead pursue economic development. Since then, Beijing appears to have drawn a line against support for freedom fighters in Kashmir.<sup>42</sup>

### China on Indo-Pakistan Conflicts

China adopted a neutral stance not only on the Kashmir issue but also on other conflicts between India and Pakistan: Beijing did not stand by Pakistan on the Kargil crisis or the Indo-Pakistan military standoff in 2001/2002. On Kargil, the first serious encounter after nuclear explosions by India and Pakistan in May 1998, China maintained absolute neutrality. Both Beijing and Islamabad had divergent views on these skirmishes. Some observers had even stated that China had clear differences over Pakistan's Kargil policy. However, these were not expressed publicly due to their long-prevailing bilateral relations. Beijing neither helped nor joined Pakistan in calling for an international settlement of the dispute. It emphasized upon a bilateral resolution of the issue through dialogues.<sup>43</sup> As Chinese stated, "China has a clear position on this. The Kashmir dispute is a question left over by history. We hope that the relevant parties would find a fair and reasonable solution to this question. We sincerely hope that the two sides could take peace and stability of the region as the priority, exercise restraint and solve the dispute peacefully through negotiations and dialogue."<sup>44</sup> An Indian analyst termed China's stance a "pronounced and extraordinary neutral position" and stated that this view was closer to India than Pakistan. "All indications are that China regards India as a major power and a potentially important player in a putative multi-polar world." However, the analyst observed, it remained to be seen if China's neutrality on the Kargil crisis signaled a major shift away from its historic support for Pakistan.<sup>45</sup>

Shortly after the Kargil episode, by the end of 2001, Indo-Pakistan tension again escalated bringing the two nuclear rivals to the brink of war.

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<sup>41</sup> Turkaya Alaov, *Kashmir and Neighbours: Tale, Terror, Truce* (Aldershot: Ashgate, 2001), p. 160.

<sup>42</sup> Mark W. Frazier, "China-India Relations Since Pokhran II: Assessing Sources of Conflict and Cooperation", 16-22 September 2000  
<<http://www.nbr.org/publications/review/vol3no2/essay.html>> (16 July 2003).

<sup>43</sup> Ibid.

<sup>44</sup> "China calls for fair solution of Kashmir issue-2002-05-27" <<http://www.Kashmir-hr.net/mainfile.php/news200205/114>> (9 January 2003).

<sup>45</sup> Frazier, op. cit.

China stressed upon both Pakistan and India to resolve their dispute through peaceful means. "It is our hope that both sides exercise maximum restraint and try their best to de-escalate the tension. We have been watching each and every development in the situation and the relations between Pakistan and India. We have been giving close attention to the least development involved. We have our normal channels of contact and communication and these contacts are carried out in normal communications."<sup>46</sup> Beijing adopted multi-channel diplomacy to defuse the tension and stressed the need for the international community to take a more balanced and unbiased approach to the problem. A spokesperson of the Chinese Foreign Ministry, Kuong Qihuan, stated: "This question must be settled through a direct dialogue between India and Pakistan" and declared that "China and Pakistan have friendly relations and China and India have friendly relations too." He added that, "China has always called on these countries to assert restraint and solve their conflict through peaceful means."<sup>47</sup> China's unambiguous role in this crisis was a testimony to its neutral stance towards South Asia. It had left its traditional way of tilting towards Pakistan. An analyst rightly observed that Beijing had taken the stand that the dispute between India and Pakistan must be settled bilaterally and had indicated that in case of any war it would not side with any party.<sup>48</sup> It has become clear that China has uncoupled its relations with Pakistan from its relations with India. There is continuation in the traditional relationships between China and Pakistan parallel to evolving a greater degree of understanding between Beijing and New Delhi. This parallelism has become a hallmark of China's South Asian policy.

Chinese Premier Zhu Rongji came to Pakistan in May 2001 to commemorate the 50<sup>th</sup> anniversary of diplomatic relations between the two countries. During his stay, he expressed his country's position on the Kashmir issue. Speaking at a joint press conference with Chief Executive of Pakistan, General Pervaiz Musharraf, Zhu termed the Kashmir dispute, "a leftover of history" and stated "China supports and agrees with the Pakistani position for a peaceful settlement of the Kashmir issue."<sup>49</sup> The statement cannot be taken as more than China's usual neutral position. This brief reference invited different interpretations from scholars. A part of the Indian press painted it a pro-Pakistan position. A noted Indian daily, *The Hindu*, commented: "The endorsement of the Pakistani position by the Chinese government is bound to catch India by surprise and could perhaps be attributed to the perceived closeness between India and the United States on several issues including the

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<sup>46</sup> "China urges restraint", *Dawn* (Islamabad), 30 December 2001.

<sup>47</sup> *Dawn* (Islamabad), 4 January 2003.

<sup>48</sup> S. Sethuraman, "India-China Relations: On the Slow Burn"

<<http://www.thehindubusinessline.com/bline/2003/05/13stories/2003051300040800.htm>>

<sup>49</sup> "China supports Pakistan stand on Kashmir", *Dawn* (Islamabad), 14 July 2001.

controversial proposal unveiled by President George W. Bush on National Missile Defence (NMD).” The paper further stated that the position was bound to make India unhappy.<sup>50</sup> In no way were these remarks different from China’s usual neutral position.

### **The Impact of 9/11**

The terrorist attacks in the US on 11 September 2001 had profound impact on international politics. Besides others, these attacks changed the perception of the international community towards freedom struggles. Since then, independence movements are sought to be labeled as terrorist activities. India, which had failed to subdue the long struggle of the Kashmiri people even applying brutal use of force, swiftly came to exploit the post 9/11 situation by branding it a terrorist movement.<sup>51</sup> China too condemned the September 2001 attacks and expressed its sympathies with the American people. However, it did not endorse India’s new approach to address the Kashmir issue. China stuck to its pre-9/11 stance that Kashmir was an unresolved issue, which should be addressed through peaceful means.

In an interview with an Indian newspaper, a Chinese official Wang Yi put the Kashmir question in perspective; he condemned the killing of innocent people in the valley, which he said fell “squarely within the scope of terrorism.” However, he went on to point out that the problem in Kashmir could not be reduced simply to one of terrorism or counter-terrorism. It was “left over from history, from the aftermath of British colonialism” and involved “very complicated territorial and religious issues.”<sup>52</sup> Maintaining this policy was worth mentioning particularly when China had been facing separatist movements in its own territory. Under the thick shadow of the war on terror, when Pakistan was under considerable pressure due to its links with the Taliban government in Afghanistan, China remained sympathetic to Pakistan. It rejected the charges that some training camps were being run in Pakistan, which assisted the East Turkistan terrorist organizations. Contrary to these charges, the spokesperson for the Chinese Foreign Policy later in September 2003 expressed his government’s appreciation for a series of measures, which the Pakistan government had taken in fight against religious extremism. The spokesperson also acknowledged a lot of help and assistance

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<sup>50</sup> “China backs Pak. Position on Kashmir”, *The Hindu* (New Delhi), 12 May 2001.

<sup>51</sup> In the post-9/11 situation India launched an aggressive campaign to label the Kashmiri freedom movement as terrorist by establishing its links with Al-Qaeda. The subsequent statements have been expressing such remarks. For instance see, “War against Terrorism: Official Statements [by Indian leaders]”  
<<http://meadev.nic.in/ind-ter/offl-stm.htm>>

<sup>52</sup> “China’s sane advice”, *Dawn* (Islamabad), 9 October 2002.



from Pakistan in fighting the ‘three forces’ and safeguarding the integrity and sovereignty of the country.<sup>53</sup>

During 2003, leaders from both Pakistan and India visited China and held discussions with Chinese leaders. During these visits, Beijing adhered to its neutral stance on the Kashmir dispute. A careful study of the statements and declaration issued during these visits showed no particular reference to Kashmir.

The first of these visits was conducted by Pakistani Prime Minister Mir Zafarullah Khan Jamali in March 2003. During the visit, leaders from the two sides further explored the prospects of their mutual cooperation and exchanged views on regional and international issues. The only reference to the Kashmir dispute was made by Jamali who, while talking to journalists after holding talks with his Chinese counterpart, Wen Jiabao, valued China’s continued support on Kashmir. He stated that the Chinese leadership had appreciated Pakistan’s stance to resolve all outstanding issues with India through peaceful means.<sup>54</sup> There was no further explanation of this statement. From this short reference, it is assumed that during their meeting, in response to Jamali’s briefing about Pakistan’s efforts for a peaceful solution of the Kashmir dispute, the Chinese Premier may have nodded, thereby expressing his appreciation of Pakistan’s policy. Had China had more interest in the issue, it could have stated its position in an explicit way.

Beijing followed a similar policy during President Pervez Musharraf’s visit to China later in November. At the end of the visit, the two countries signed a joint declaration, which addressed a wide range of issues. Again, there was no direct reference to the Kashmir dispute in the declaration.<sup>55</sup> Clause 8 of the declaration expressed China’s “appreciation” and support of Pakistan’s efforts for a peaceful resolution of all outstanding issues with its neighbour, without mentioning the Kashmir dispute. China’s silence over Kashmir at such high-level occasion indicates its commitment to non-involvement in Indo-Pakistan conflicts. It is difficult to assume that Islamabad had not tried to get Beijing’s support.

Between the two visits by Pakistani leaders to China, Indian Prime Minister A. B. Vajpayee also toured China in June 2003 and held talks with top Chinese leaders, including President Wen Jiabao, Premier Hu Jintao, Chairman Jiang Zemin of the Central Military Commission, Chairman Wu Bangguo of the Standing Committee of the National People’s Congress and Vice President Zeng Qinghong. According to press reports, these talks were held in a sincere and friendly atmosphere. The two countries discussed matters of bilateral

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<sup>53</sup> <<http://www.china-un.ch/eng/56332.html>>

<sup>54</sup> “Pak-China shares identical views”, *Dawn* (Islamabad), 25 March 2003.

<sup>55</sup> Document no. 12, “China-Pakistan Joint Declaration”, *IPRI Journal* vol. IV, no. 1 (Winter 2004), pp. 174-8.

cooperation, expansion of trade and agreed to continue dialogues on the boundary issue.<sup>56</sup> The most significant developments of the visits were that India formally recognized the Tibetan Autonomous Region as part of China and assured its restraint from all anti-China activities from its soil.<sup>57</sup> In return, China agreed to start trade through the northeast Indian state of Sikkim—a move that implied China’s tacit recognition to Indian claim over that area.<sup>58</sup> It is necessary to mention that until recently China has refused to accept the Indian claim over Sikkim. The Chinese official website continuously mentioned Sikkim as a sovereign state, which is now deleted.<sup>59</sup> On the Kashmir issue, both sides remained silent during Vajpayee’s visit. Neither India complained about pro-Pakistan Kashmir policy nor China expressed its desire for an expeditious settlement of the dispute. This mutual understanding further helped the overall success of the visit.

### Rationale of Neutrality

To determine whether China’s stance falls within the parameter of the definition of “neutrality”, let us first define the term neutrality with some standard references. *A Dictionary of Modern Politics* explains, “If a state wishes to assume a position of neutrality between countries who are at war with each other, it has an obligation under international law to refrain from aiding either party, or from allowing either to use its territory for any war-like purpose at all.”<sup>60</sup> *The Greenwood Encyclopedia of International Relations* defines the term neutrality as:

The legal status of any state not involved in a given war, granting that state neutral rights and duties such as freedom to trade and freedom from hostile military action, but carrying with it obligations to be impartial toward all belligerents and to restrain one’s own nationals from taking direct part in hostile acts.<sup>61</sup>

<sup>56</sup> Declaration on the Principles for Relations and Cooperation Between the Republic of India and the People’s Republic of China on 3 June 2003, in *IPRI Factfile*, vol. V, no. 7 (July 2003), p. 85.

<sup>57</sup> Declaration on the Principles for Relations and Cooperation Between the Republic of India and the People’s Republic of China <<http://www.meadev.nic.in/ind-chn-decla.htm>>

<sup>58</sup> “India and China agree over Tibet”, <[http://news.bbc.co.uk/go/pr/-/2/hi/south\\_asia/3015840.stm](http://news.bbc.co.uk/go/pr/-/2/hi/south_asia/3015840.stm)>

<sup>59</sup> Ghulam Ali, “Sino-Indian Relations: Looking Forward”, *Asia Pacific: The Research Journal of Far East & South East Asia*, vol. 21-22 (2003-2004), p. 159.

<sup>60</sup> David Robertson, *A Dictionary of Modern Politics* (London: Europa Publications, 2002), p. 343.

<sup>61</sup> Cathal J. Nolan, *The Greenwood Encyclopedia for International Relations*, vol. III M-R (London: Greenwood publishing, 2002), p. 1145.

A careful study of these definitions leads to the conclusion that China's Kashmir policy fits the definitions of neutrality. Beijing has adopted a neutral posture towards Indo-Pakistan conflicts as well as restraining its nationals from involvement with either of the parties. At the same time, it has been expanding the level of trade and other contacts with them independent of each other. This level of contact is likely to expand in the future.

This part of the paper explains the rationale behind the changes in China's Kashmir policy. There were a number of factors that led China to take a neutral stance on the Kashmir issue. The most significant have been explained here.

- States pursue their national interests, which keep on changing in accordance with the changes in geo-political landscape of the regional and international politics. It was not China whose policy shifted on Kashmir, the two main parties, India and Pakistan, have also gone through some changes in their established positions: India, for a long time kept on stating that Kashmir was its integral part and showed no flexibility for talks. However, quite recently, New Delhi has shown flexibility in its stance. Pakistan, on the other hand, has also come out of its traditional stance that Kashmir was its "jugular vein" and its reiteration for a solution through plebiscite based on the UN resolutions. President Musharraf, with a view to finding a solution, has expressed that his government may go beyond UN resolutions.<sup>62</sup> Thus certain changes have been taking place in the respective viewpoints of all concerned parties.
- Another important factor was Deng Xiaoping's coming into power (1978) in China. He introduced drastic reforms giving a new outlook to Chinese foreign policy that also affected China's Kashmir policy. Under these reforms, Beijing found reasons to cultivate better relations with New Delhi. In fact China needed peace and stability around its periphery to achieve economic targets. In addition to this India offered a big market for Chinese products. For this purpose, Beijing had to address its issues with New Delhi. This rapprochement resulted in increased mutual trade. Sino-Indian trade has jumped from less than \$ 1 billion at

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<sup>62</sup> Zhang Li, "China and Kashmir", a paper presented at the International Seminar on "The Kashmir Imbroglio: Looking Towards the Future" in Islamabad 15-16 March 2005. The Seminar was organized by Islamabad Policy Research Institute (IPRI) and the papers presented in the seminar are being published in the form of a book.

the end of the 20<sup>th</sup> century to around \$ 14 billion in 2004.<sup>63</sup> An analyst rightly observed that a critical factor in drawing the two countries (China and India) together has been their growing economies.<sup>64</sup> For such high economic gains, China cannot irritate India by supporting Pakistan on Kashmir.

- To achieve the results of Deng's reforms, China had to reduce its support for revolutionary movements, which was considerably high during the Mao-period. Thus, it was not merely on the Kashmir issue where this change took place, Beijing applied this policy in other parts of the world where revolutionary movements were going on. To cite another example in South Asia where China had terminated its support to revolutionaries is the Communist Party of Myanmar.<sup>65</sup>
- Beijing values relations with New Delhi to achieve its long-term objectives. China is rapidly gaining the status of a world power, which invariably invites the ire of the US. The US plans to counter China by propping up India, drawing cleavages between China and Russia, and exploiting international Chinese contradictions concerning human right issues and the rights of religious minorities. To counter the US, China requires improved relations with India. In fact the two countries have been developing their understanding rapidly.<sup>66</sup>
- There has been a fundamental change in the international system brought about by the September 2001 terrorist attacks on the United States. For better or worse, this event transformed the outlook of the international community towards freedom movements, particularly when they involve Muslim populations.<sup>67</sup> That event brought further changes in China's perception on Kashmir.
- The population of Muslims in China is around 16 million. Half of it is in the turbulent Xinjiang province. Beijing has been facing a separatist movement in this province for a long time. In the wake

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<sup>63</sup> Rollie Lal, China's Economic and Political Impact on South Asia, Testimony presented to the Commission on US-China Economic and Security Review on December 2004. RAND.

<<http://www.rand.org/publications/CT/CT214?CT214.pdf>>

<sup>64</sup> Rahimullah Yusufzai, "All weather friendship", *The News* (Rawalpindi), 10 May 2001.

<sup>65</sup> Ghulam Ali, "Sino-Pakistan Relations: The Indian Factor", *IPRI Journal*, vol. V, no. 2 (Summer 2003), p. 118.

<sup>66</sup> Ibid.

<sup>67</sup> Graham E. Fuller and S. Frederick Starr, *Xinjiang Province*, Central Asia-Caucasus Institute, Johns Hopkins University.

<[http://www.cornellcaspien.com/pub2/Xinjiang\\_final.pdf](http://www.cornellcaspien.com/pub2/Xinjiang_final.pdf)>

of 9/11 events, when the US attention shifted from the human rights issues in China towards the war against international terrorism, China availed this opportunity and launched its operation against the Xianjing separatists. In this context, it would be a stark contradiction if China supports the struggle of the Kashmiris on the one hand and takes stern measures against separatists in its own country on the other. Therefore, it is unlikely that China extends any diplomatic or other support to the freedom movement of the Kashmiri people, irrespective of the legitimacy of the movement or of the fact that it had previously rendered such support.<sup>68</sup>

- The basic principles of China's foreign policy are to safeguard the independence, sovereignty and territorial integrity of the country, to create a long-standing and favourable international environment, to safeguard world peace and promote common development.<sup>69</sup> To achieve these objectives, it is in China's interests to adopt a neutral posture on the issue. On other international issues as well, China maintains that "disputes concerning borders, territory and territorial waters left over by history, be settled through dialogues and talks so as to seek fair and reasonable solutions. If a dispute cannot be solved right away, it may be put aside for the time being, and common ground sought while reserving difference."<sup>70</sup> This is China's official viewpoint towards unresolved disputes and reflects its Kashmir policy.

## Summary and Conclusion

Over a long period of time, China's Kashmir policy has passed through different phases. It swung between the neutral stance, and support for the right of self-determination, and has once again reverted to neutrality. Broadly, Beijing's Kashmir policy can be divided into three phases. The first phase started with the establishment of the PRC in 1949 and ended by the early 1960s. During this period, China under the guidelines of its policy of friendship with Afro-Asian nations, avoided siding with either India or Pakistan. Instead, it favoured a resolution of the issue through bilateral means and warned both parties to avoid involving the US and the UN in the final settlement of the dispute. China opposed the role of the US and the UN since its relations with them were based on hostility. This phase ended with the beginning of the Sino-Indian rivalry.

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<sup>68</sup> Fuller, *op. cit.*

<sup>69</sup> Chinese Foreign Policy. <<http://www.china.org.cn/english/features/38193.htm>>

<sup>70</sup> Ibid.

The second phase started from the early 1960s and lasted till late 1970s. This period ensued in the Sino-Indian border war in 1962, which caused hostility between Beijing and New Delhi on the one hand and brought new opportunities for China and Pakistan to come closer to each other on the other. Resultantly, China stood by Pakistan on the Kashmir issue with firm support for the right of self-determination. Sino-Pakistan entente became a significant development in regional politics. China became a major supporter of Pakistan on a number of occasions. Its support to Pakistan in the Indo-Pakistan wars of 1965 and 1971 elicited mass popularity in Pakistan. In the subsequent period, their relations touched new heights.

The third phase started with the change of leadership in China. In the late 1970s, Deng Xiaoping came into power in China and ushered in an era of reforms in both internal and external spheres. China found it essential to stop its support to revolutionary movements in different parts of the world. In the same manner, Beijing started shifting its stance on the Kashmir dispute, though it took a long time to adopt a completely neutral stance. One of the reasons behind this shift was China's deep interest in cultivating better relations with India, relations that were critically important for its long-term interests. It was not in China's interests to continue to support the Kashmiri struggle at the cost of its relations with India, irrespective of the fact that it had firmly rendered such support in past. In fact, China has adopted a complete neutral posture on Indo-Pakistan conflicts. This was reflected during the Kargil crisis and Indo-Pakistan military standoff in 2001/2002.

Presently, China urges both India and Pakistan to find a solution through bilateral talks. This was differently interpreted by both India and Pakistan. Analysts closer to the Indian point of view see it as favouring their side. They state that China's emphasis on a solution through bilateral means reflects China's aversion to internationalization of the dispute. On the other hand, the Pakistani side believes that though China has shifted its stance over a period of time, yet it fully recognizes the disputed status of Kashmir. Beijing's repeated appreciation for Pakistan's efforts for resolving this issue endorses Pakistan's stance. Such appreciations are quite regular during the meetings of high officials of the two sides.

Two other factors also establish China's direct relevance to the Kashmir dispute. First, Beijing's control over, Aksai China, which is a part of Kashmir. Second, the Sino-Pakistan Border Agreement of 1963 was not a permanent settlement of that part of Kashmir. Once this dispute is settled, Beijing would reopen negotiations on this area with the then sovereign authorities, most probably Pakistan or India. However, China and India have been developing a greater degree of understanding on Aksai Chin and Sikkim. China has tacitly recognized Indian control over Sikkim. Their trade agreement through Sikkim is termed a step in this direction. In return, it is expected that New Delhi would agree to China's control over Aksai Chin. The progress on

this would greatly depend on the outcome of their border negotiations and the Indian response.

Presently China avoids taking sides with either of the parties. It emphasizes upon the incumbents to solve the issue through peaceful means. This is the identical position that China adopted during the 1950s with a view to maintaining good neighbourly relations with both India and Pakistan. However, Beijing recognizes the disputed status of Kashmir and sincerely wants a durable solution of the dispute since a stable South Asia would greatly serve its long-term interests. ■

## WORLD TRADE ORGANIZATION: APPREHENSIONS OF THE DEVELOPING COUNTRIES

Nuzhat Khanum\*

### Introduction

During the 1920's and 1930's the world faced a great depression mainly due to the protectionist trade policies of the developed world. This required promotion of free competition and liberalization of trade, which, it was thought, could ultimately result in the betterment of humanity. However, there is no consensus that free trade would lead to more equality. Liberalization of trade was achieved through negotiating as well as implementing a series of multilateral trade agreements. After the end of the Cold War, the situation soon began to change and a need was felt to liberalize trade. Various important trade negotiation rounds were conducted and the final outcome was the establishment of an international multilateral trading regime, i.e. the World Trade Organization (WTO) that replaced the General Agreement on Tariffs and Trade (GATT) in 1995. The WTO is an international trading regime and its charter contains a set of rules for trade, which has several implications for trading nations and covers issues such as trade in services, investment, goods and intellectual property rights.

These issues have affected the developing countries and require them to make drastic changes in their legislation for trade and commerce. Although these countries are also partners in this inter-dependent world, they have certain apprehensions about WTO regime, regardless of how minor they may be. These apprehensions/problems need to be addressed for the betterment of the world economy and humanity, so that the uncertainty about trade rules does not thwart the implementation and smooth functioning of the WTO. Pakistan, as a developing country, is thus affected by the WTO and its rules and regulations.

This paper analyses the apprehensions of the developing countries with regard to the WTO and its various clauses. It makes an effort to answer various questions, why does the WTO create fear among the developing countries? Would it provide a set of rules for global trade as well as dispute settlement mechanisms? What are the reservations of the developing world with regard to WTO? These are the questions that this paper will try to answer. The issue is quite significant as Pakistan, as a developing country, shares most of the apprehensions about the WTO regime. However, its main

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concerns are in the sectors of textiles and agriculture, which would be mainly affected.

### **Theoretical Framework**

The International Regime Theory would be used as a theoretical framework for explaining the theme of the paper. International regime formation is a new phenomenon, which had its origin and culmination in the formation of the League of Nations. Hitherto, matters were settled between states at the bilateral level (i.e., treaties and agreements were concluded between the states to regulate trade and settlement of disputes). The Cold War era was marked by security concerns in a bipolar world between the two superpowers. In the late 1970's and 1980's, security dimensions began to change. Bilateral trade agreements were replaced by multilateral trade agreements. The underlying principle of this new development was that in an interdependent world, the same rules of the game should be applied to all member states. With the formation of the United Nations Organization (UNO), there appeared a massive increase in the number of such institutions and regimes. These range from security regimes to economic and environmental regimes. The most important example is that of the WTO, which replaced GATT in 1995. In today's world, there are greater chances of international co-operation in trade and commerce; and the most important form of such co-operation was achieved through regime formation. These regimes cover areas of human trading activities. There is a need to understand this phenomenon. Though more and more literature has appeared on this subject matter.<sup>1</sup>

Theories of international regime help us understand the motivations behind regime formation and regime change and the factors that contribute to regime stability as well as regime formation in international politics. Three schools of thought co-exist in the study of international regimes. Each of these schools focuses on a specific variable, which helps to define its identity.<sup>2</sup>

These schools of thought are marked by three paradigmatic traditions i.e., realism, neo-liberalism and cognitivism. Instead of discussing different writers in each paradigm, we will focus only on the schools of thought and on contributions rather than contributors.<sup>3</sup> These schools of thought are named differently by different writers, however, we would classify them as 1) power based, 2) interest based and 3) knowledge based approaches. The underlying assumption in power-based school of thought is that "power and considerations of relative power positions affect the content and circumscribe

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<sup>1</sup> Jayantha Dhampala, "The State of Regime", in Joseph Cirincione ed., *Repairing the Regime* (London: Routledge, 2000), p. 19.

<sup>2</sup> Andreas, Hasenclever, Peter Mayer and Volker Rittberger, *Theories of International Regimes* (Cambridge: Cambridge University Press, 1997), p. 211.

<sup>3</sup> Ibid, p.6.

the effectiveness and robustness of international regimes.”<sup>4</sup> The underlying assumption of interest-based school of thought is that “interest acts as a motive for co-operation among states and for creation and implementation of international regimes.” Knowledge based school of thought points out that “both the perception of interests and the meaning of power capabilities is dependent on actors causal and social knowledge.”<sup>5</sup>

Neo-liberal paradigm or interest based theories of international regimes represent the mainstream approach in understanding international regimes<sup>6</sup> “We pay special attention to the points of disagreement with neo-liberalism as the leading school of thought in regime analysis.”<sup>7</sup> Thus the most influential paradigmatic tradition or school of thought that best explains regime formation is neo-liberalism or interest based school of thought.

International regimes are defined as “principles, norms, rules and decision making procedures, around which actors’ expectations converge in a given issue area.”<sup>8</sup> A good regime requires (a) verification (b) enforcement (c) transparency (d) reciprocity. Maximalist “interpretation of sovereignty” will hinder achievement of all of these qualities of a stable and effective regime and would lead to a setback to the regime.<sup>9</sup> There is a need to find out which is a better approach towards understanding the regime stability. A synthesis has been attempted by many theorists in respect of this school of thought.<sup>10</sup> “International regimes help provide the political framework within which international economic processes occur.”<sup>11</sup> Joseph Nye, Hellen Miller, Krasner and Keohane are among the influential scholars who have written on regimes.<sup>12</sup>

### *Three Schools of Thought*

Some important questions include, “what accounts for the emergence of instances of rule-based co-operation in the international system? How do international institutions (such as regimes) affect the behaviour of state and non-state actors in the issue area, for which they have been created?”<sup>13</sup> Various theories have been formulated to address these questions.

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<sup>4</sup> Ibid, p. 211.

<sup>5</sup> Ibid.

<sup>6</sup> Ibid, p.7.

<sup>7</sup> Ibid.

<sup>8</sup> Stephen D. Krasner ed., *International Regimes* (Ithaca: Cornell University Press, 1983), p. 1.

<sup>9</sup> Dhamapala, “The State of the Regime”, p. 21.

<sup>10</sup> Hasenclever, *Theories*, p. 7.

<sup>11</sup> Joseph Nye and Robert O. Keohane, *Power and Interdependence* (Boston: Little Brown and Company, 1977), p. 38.

<sup>12</sup> Hasenclever, *Theories*, op.cit., p. 6.

<sup>13</sup> Ibid. p. 1.

All theories of international regimes emphasize the importance of regimes but they differ on the “degree of institutionalism” because of variation in their “behavioural models” upon which they base their analysis, i.e., “the assumption they make about the nature of state actors and their motivation.” Power based theorists assume that “states care for absolute as well as relative gains” and give little importance to international regimes. However, “regime based inter-state co-operation” is still a “puzzle” to the realist research programme. But the realists say that distribution of power and resources among actors determine the nature of the regime whereas considerations of relative power forced upon states by the anarchical environment, create obstacles for international co-operation.<sup>14</sup>

Neo-liberals emphasize on the role of regimes in helping states realize common interests. “States care for their own absolute gains.” Neo-liberals “have drawn heavily from economic theories of institutions focusing on information and transaction cost.” In this respect, game theoretical models have been applied to characterize the constellation of interests that underline different types of regimes and also affect the likelihood of a regime being created in the first place.” Both realists and cognitivists criticize neo-liberals. However, cognitivists criticize interest-based theory not because it has ‘misconstrued’ the realist assumption about the anarchical world but the three realist “heritages” still present in the interest-based school of thought. Hence it still has the influence of the realist school of thought.<sup>15</sup>

Cognitivists say that “an institutionalism that is informed by a ‘sociological’ rather than a rational choice perspective is appropriate for the international system as well.” Thus, a ‘strong cognitivist’ has pointed out that “interest based theories have provided a truncated picture of the sources of regime robustness by failing to take adequate account of the repercussions of institutionalized practices on the identities of international actors.” It further says “states are better understood as role-players than as utility maximizers.” Hence we would say “knowledge based theories of regimes tend to embrace an institutionalism that is much more pronounced than that we find in either neo-liberalism or realism. It attributes a lot of significance to institutionalism.”<sup>16</sup>

A study of literature across these paradigms would help us enhance our understanding of regimes and in particular the regime under discussion i.e., the WTO. The interest-based school of thought (or neo-liberalism) is the most influential school of thought, which states that the “constellation of interests” plays an important role in the formation of economic regimes.

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<sup>14</sup> Ibid, p. 2.

<sup>15</sup> Ibid.

<sup>16</sup> Ibid, pp. 5-6.

A developing country's interests in the WTO include an access to the markets of the developed countries and to acquire benefits from multilateral rule-based dispute settlement mechanism. But a developed country lays its focus on investment and competition. It is being articulated that a developed country fears the migration of workforce from a developing country, which already faces unemployment and sluggish growth. The developed country's interest is to explore new markets in the developing countries. The negotiations at the WTO reflect an effort to increase and protect interests of both developing and developed countries. The WTO regime might act as a variable between the events and the desired outcomes, to liberalize trade and to achieve free competition. Once interests are safeguarded, the regime will function smoothly. Hence, the interest-based school of thought successfully explains the formation of international regimes such as the WTO mainly due to a constellation of interests.

### **WTO: Historical Perspective**

Before discussing the evolution of the WTO, it is important to note that today it is a world of knowledge, innovation and technology and not of territorial conquest. It can be best explained in these words: "We have moved from a world where the key to wealth is how you seize, hold and exploit territory to a world in which the key to wealth is how your country or company amasses, shares and harvests knowledge."<sup>17</sup> Hence, the need for the liberalization of trade and the importance of overcoming trade related obstacles are self-evident.

In order to liberalize world trade, GATT was established in 1946 initially among 23 countries, which resulted in over 45,000 tariff concessions. Trade was further liberalized through other rounds of talks. With regard to the establishment of the WTO, two trade rounds had special importance, i.e., the Tokyo Round (1973-1979) and the Uruguay Round (1986-1994). The Tokyo Round reduced non-tariff barriers on trade. These barriers included technical barriers to trade. Due to these rounds of talks, the average tariff in developed industrial countries decreased to 4.7%.<sup>18</sup>

The decision to establish the WTO was taken in the ministerial meeting of GATT held in Geneva in 1982. Uruguay Round (1986-94) led to the establishment of the WTO, which replaced GATT in 1995.<sup>19</sup> The

<sup>17</sup> Ahsan Iqbal, "Challenges of Globalization: Some Imperatives", *Dawn* (Islamabad), 3 April 2001.

<sup>18</sup> "WTO: Opportunities and Threats",  
<[http://www.imt.edu.pk/Frcevents/achieve/events03/WTO\\_t&t/world%20Trade%20organization%20Agriculture.doc](http://www.imt.edu.pk/Frcevents/achieve/events03/WTO_t&t/world%20Trade%20organization%20Agriculture.doc)>

<sup>19</sup> Haroon Mughid, "The Future of Trade Liberalization",  
<<http://www.pakistaneconomist.com/issue2001/issue30/etc4.htm>>

Marrakesh Accord in April 1994 implemented the eight years old Uruguay Round of GATT. The GATT was then subsumed into the WTO as a trade agreement.

Liberal internationalists regarded the WTO as the third pillar of the Bretton Woods System for trade as the International Monetary Fund (IMF) worked in the field of finance and the World Bank worked for economic reconstruction.<sup>20</sup> The WTO regime covers areas such as goods, services, investment and intellectual property rights. The WTO regime has trade policy reviews and dispute settlement mechanism. These negotiations are of unprecedented nature in the history of trade talks. Implementing and negotiating a series of multilateral trade agreements achieved the liberalization of trade.<sup>21</sup>

### The WTO's Structure

The WTO headquarters are in Geneva, Switzerland. The Director General heads the Secretariat. Mr. Supachai Panitchpakdi is the outgoing Director General of the WTO, whereas Pascal Lamy, a Frenchman and European Union Trade Commissioner, has been elected as the fifth Director General of WTO and would assume office on 1 September 2005. WTO had 148 countries as its members as on 16 February 2005 and 33 countries as observers. It has a staff of 630 and a budget of 168,703,400 Swiss francs for the year 2005.<sup>22</sup>

A biennial Ministerial Conference heads the organization, comprising all its members. According to Article IV:1 of the Agreement, the Ministerial Conference has the power to “carry out the functions of the WTO and take actions necessary to this affect” and the conference has “the authority to take decisions on all matters under any of the Multilateral Trade Agreements.”<sup>23</sup> Important Ministerial Conferences were held in Singapore in 1996, Geneva in 1998, Seattle in 1999, Doha in 2001 and Cancun in 2003.<sup>24</sup>

<sup>20</sup> Walden Bello, “The Iron Cage: The WTO, the Bretton Woods Institutions and the South”, <<http://www.tni.org/archives/bello/ironcage.html>>

<sup>21</sup> Haroon Mujahid, “The Future of Trade liberalization”, <<http://www.pakisatneconomist.com/issue2001/issue30/etc4.html>>  
Also see: <[www.ipripak.org/factfiles/ff15.shtm](http://www.ipripak.org/factfiles/ff15.shtm)>

<sup>22</sup> See <[www.wto.org/english/thewto\\_e/thewto\\_e.htm](http://www.wto.org/english/thewto_e/thewto_e.htm)>  
“WTO Chooses Lamy as 5<sup>th</sup> Director-General”,  
<<http://allafrica.com/stories/200506010064.html>>  
See, “Members and Observers”,  
<[http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/org6\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm)>  
See, “WTO Secretariat Budget for 2005”,  
<[http://www.wto.org/english/thewto\\_e/secre\\_e/budget05\\_e.htm](http://www.wto.org/english/thewto_e/secre_e/budget05_e.htm)>

<sup>23</sup> “Agreement Establishing the WTO”,  
<[http://www.wto.org/english/res\\_e/booksp\\_e/agrmntseries1\\_wto\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/agrmntseries1_wto_e.pdf)>

<sup>24</sup> Haroon Mujahid, “The Future of Trade Liberalization”,  
<<http://www.pakistaneeconomist.com/issue2001/issue30/etc4.htm>>

The General Council comprises all members of the WTO and is responsible for the management of the organization between sessions of the Ministerial Conference. The General Council usually convenes half a dozen meetings in a year. It also acts as a dispute settlement body (DSB) and as a Trade Policy Review Body and is concerned with the whole range of issues under the WTO. The DSB deals with trade related disputes of the member countries and the trade policy review body deals with the trade policy reviews of the member countries. The DSB meets about once a month whereas the trade policy review body convenes a session more often. All these bodies report to the Ministerial Conference. Besides the General Council, the WTO has established different “subsidiary bodies” or councils, i.e., Council for Trade in Goods, Council for Trade in Services and Council for trade related aspects of Intellectual Property Rights. These councils that report to the General Council, deal with issues such as those covered in the agreements on trade in goods, services and ideas. There are also a number of committees that are answerable to the General Council i.e., Committees on Trade and Development, Balance of Payment Restrictions, Budget, Finance and Administration etc.<sup>25</sup> The legal framework or structure can be described as follows: “The conceptual structure is reflected in the way the legal texts are organized. The Marrakesh Agreement establishing the WTO set up the legal and institutional foundations.” It contains the following Annexure. The agreements (included in Annex-1) of the WTO are referred to as the ‘Multilateral Trade Agreements’ as they “comprise substantive trade policy obligations which all the members of the WTO have accepted.”

Annex 1A contains the revised GATT, which deals with trade in goods. These also include schedules or lists of commitments made by individual countries.

Annex 1B is on Trade in Services. It also includes the schedule of commitments and exemptions of Most Favoured Nation (MFN) clause in some types of services where the individual countries are not applying MFN principle of non-discrimination.

Annex 1C deals with the Agreement on Trade Related Intellectual Property Rights in some specific areas, e.g., geographical indications (GI's), trade marks etc. Other details come from conventions outside the WTO.

Annex 2 contains a set of rules for dispute settlement; Annex 3 provides for trade policy reviews, Annex 4 covers ‘plurilateral’ agreements on civil aircraft and government procurement. Finally, the Marrakesh text includes a number of decisions and declarations on a variety of issues. Different councils are established to work in the above areas. The focus of

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<sup>25</sup> “Agreement Establishing the WTO”,  
 <[http://www.wto.org/english/res\\_e/booksp\\_e/agrmntseries1\\_wto\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/agrmntseries1_wto_e.pdf)>

negotiations after the Uruguay Round was basically on market access commitments, financial services, basic telecommunications and maritime transportation under General Trade Agreement in Services (GATS) and information technology equipment under GATT. However, there is a need to improve the system. These agreements, councils and committees, thus established, outline the basic structure of the WTO as discussed above.<sup>26</sup>

### **Apprehensions of the Developing Countries**

The WTO has both opportunities and challenges for the developing countries. Many of the WTO challenges for the developing countries include the issue of implementation of the existing agreements, review of the existing agreements, formulating a unified position for the ministerial conferences and negotiations and taking advantage of the 'gains' of the liberalization stemming from the Uruguay Round of talks.<sup>27</sup>

#### *The 'Most Favoured Nation' Clause and The Issue of Non-Discrimination*

The principal requirements of the WTO charter are reduction of tariffs on imports, Most Favoured Nation Clause (MFN) and national treatment.<sup>28</sup> The developing countries' main apprehensions stem from these clauses.

The issue of non-discrimination relates to MFN clause and national treatment. According to the MFN clause, trade concessions granted to one country by another country must be granted to all member countries of the WTO, whereas according to the principle of national treatment, when goods cross the borders of a country, these should not be treated less favourably than domestic goods<sup>29</sup>. Trade distortion such as dumping and export oriented subsidies are also checked. However, these basic principles are detrimental to the interest of developing countries. Implementation of these principles is not only costly; it reduces the revenues of the government and increases competition for the domestic industry.

#### *Burden of Membership*

One apprehension and obstacle is that each country has to contribute or pay a proportion of the WTO budget. There is a minimum requirement of 0.03 percent contribution of the budget. These contributions are proportionate to the value of a country's exports and imports in the total trade among the WTO members. It is important to note that under the GATT, only trade in

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<sup>26</sup> Ibid.

<sup>27</sup> Nagesh Kumar, "Emerging WTO Issues and Challenges: Imperatives for South Asia", *South Asia Economic Journal* vol. 1, no. 1(March 2000), pp. 9-12.

<sup>28</sup> Mushtaq Ahmed, "Making Sense of Economy", *The News* (Islamabad), 17 October 2000.

<sup>29</sup> "WTO: An Unfair Game Against Poor Countries"

<[www.ipripak.org/factfile/ff15.shtml](http://www.ipripak.org/factfile/ff15.shtml)>

goods was included. However, under the WTO, both trade in goods and services are included. Hence the developing countries and Least Developed Countries (LDCs) have to bear the burden of membership.<sup>30</sup> It constitutes an important apprehension of the developing countries, which already suffer from debt and sluggish economies.

#### *Loss of Sovereignty*

Developing countries fear loss of national sovereignty under the WTO. It is apprehended that the WTO is in reality dictating a world economic constitution. Both individuals and states fear that the WTO will erode their sovereignty. Such fears were once associated with the UNO. However, the UNO is not as intrusive in the internal affairs of the nations as the WTO is. This is an important concern of the developing countries, as the multinational corporations would then have an important say in policy choices. Hence, in this regard, the WTO must try not to acquire further intrusive powers and must address these concerns.<sup>31</sup>

#### *Regionalism—Friends or Rivals*

The WTO policy regarding regionalism is weak. It recognizes the importance of geopolitical bilateral and multilateral agreements between countries. However, it is more concerned with those regional groupings that involve reduction of barriers of trade within a bloc. Groups such as North American Free Trade Agreement (NAFTA), European Union (EU), and Asia-Pacific Economic Cooperation (APEC) forum contain regulations that conflict with WTO regulations. Hence, the WTO must adopt procedures and provisions that would make sure that it doesn't affect the interests of the members of the WTO. In this regard, it can conclude an 'inter-union treaty' with these blocs to amicably solve such conflicts.<sup>32</sup>

#### *Less Representation and Multitude of Committees*

Majority of developing and LDC's do not have permanent representation at Geneva, mainly due to financial constraints; hence they are less represented in the negotiations. The complex procedures as well as a multitude of committees further distort the position of developing countries. Transnational corporations also have an influence on the negotiations. Developed countries

<sup>30</sup> "Agreement Establishing the WTO",

<[http://www.wto.org/english/res\\_e/booksp\\_e/agrmnseries1\\_wto\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/agrmnseries1_wto_e.pdf)>

<sup>31</sup> [www.wto.org](http://www.wto.org). The World Trade Organization: History, Structure, and Analysis. Also See Dr. Kenny D. Anthony, "The WTO: Friend or Foe?" 4 August 2004, <[http://www.stlucia.gov.lc/primeminister/statements/2003/the\\_wto\\_friend\\_or\\_foe\\_august\\_3\\_2003.htm](http://www.stlucia.gov.lc/primeminister/statements/2003/the_wto_friend_or_foe_august_3_2003.htm)>

<sup>32</sup> Haroon Mujahid, "The Future of Trade Liberalization", 23-29 July 2001,

<<http://www.pakistaneconomist.com/issue2001/issue30/etc4.htm>>



that are contributing a big chunk of the WTO budget are exercising more influence on the trade negotiations. It is important to check this influence. There are several recommendations in this regard. There must be an effort to achieve fairness. This constitutes an important objection and apprehension of the developing countries.<sup>33</sup>

#### *Lack of Focus*

The WTO should focus more on matters related to international trade and investment rather than focusing on social issues and labour standards. In such a case, it would lose focus and clarity. Developing countries have serious reservations about these issues. Focus on such issues might cause divisiveness within the WTO. At the Singapore Ministerial Conference, such an effect was averted because of the efforts of the APEC Group and of several developing countries. It is important to note that the workforce in developing countries is cheap, which would be an extra advantage to the multinational corporations investing in these developing countries.<sup>34</sup>

#### *Cost of Judicial and Administrative Review*

The implementation of WTO regulations needs judicial and administrative review, which would cost a lot of expenditure. This expenditure would be an added burden on the meagre economies of the developing countries. This would require legal experts and lawyers, whereas many developing countries lack such legal experts. Acquiring such legal experts from developed countries would cost a lot. Hence this comes out to be one of the important apprehensions of the developing countries.<sup>35</sup>

#### *Lack of Awareness, Loss of Jobs and Cost Effective Industries*

Developing countries also suffer from a lack of awareness about the WTO. The business community is not very active and is not in a position to brief its government on different policy issues. Competing in this era requires installation of cost effective industrial plants, which require further expenditure. It might result in loss of jobs because only workforce with high expertise, skills and knowledge of management would get jobs. In this way, an unskilled workforce might lose jobs. Hence, unemployment in the developing

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<sup>33</sup> "WTO: An Unfair Game Against Poor Countries",  
<[www.ipripak.org/factfile/If15.shtm](http://www.ipripak.org/factfile/If15.shtm)>

<sup>34</sup> Martin Khor, "South wants Ministerial to focus on Implementation",  
<<http://www.twinside.org.sg/title/want-cn.htm>>

<sup>35</sup> Ananda P. Srestha, *WTO: Globalization and Nepal* (Kathmandu: Nepal Foundation for Advanced Studies, 2001), p. 62.

countries would increase. This might cause social discontent in these countries, which makes it a matter of concern for the developing countries.<sup>36</sup>

#### *Corporate Paranoia*

There is an apprehension in the developing countries that the WTO suffers from 'Corporate Paranoia' and hence it is felt that these deliberations and regulations be made more transparent. The WTO must follow the principle of 'transparency'.<sup>37</sup>

#### *Lack of Technical and Safety Standards*

The developing countries cannot compete with the developed countries because of a lack of technical and safety standards. To compete in the world market, companies would require International Standards Organization (ISO) certification. To meet these requirements would be expensive and would be a hurdle for the developing countries.<sup>38</sup>

#### *Trade and Environment*

One of the important apprehensions of the developing countries is in environment related trade disputes. There is also a trend towards 'judicial activism', taking a decision that does not necessarily reflect the discussions in the "Committee on Trade and Environment" (CTE). However, due to slow progress at the CTE, there is a likelihood that this tendency would continue. There is opposition from the developing countries in the 'Asbestos case' of the Appellate body decision to publish procedures for non-governmental organizations to apply for amicus briefs. Efforts to solve some of the trade related environmental conflicts, for example, the issue of extra-territorial applicability, has failed. There are suspicions about increasing the scope of trade related environmental issues coming within the ambit of the WTO. There is also a feeling in the developing countries that most "trade related environmental measures are actually disguised protectionist measures." However, there is a growing realization of the developing countries' concerns in the developed world especially their human health concerns, for example, on Genetically Modified Food (GM). GM food can cause health hazards and also unknown diseases and mutations. Even if they implement these regulations, developing countries cannot find markets for GM food in the developed countries as the public is much more aware of these health hazards.

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<sup>36</sup> See website: <<http://www.wto.org>> Also See "Workshop on Globalization, WTO and Pakistan", 6 January 2005, <<http://www.ips.org.pk/seminars/ListOfPrograms/WTO&Globalization.htm>>

<sup>37</sup> Srestha, Globalization and Nepal, op.cit., p. 62.

<sup>38</sup> "WTO: An Unfair Game Against Poor Countries", <[www.ipripak.org/factfile/ff15.shtm](http://www.ipripak.org/factfile/ff15.shtm)>

However, if developing countries participate in these negotiations, they would be able to make a difference.<sup>39</sup>

#### *Local Content and Trade Balancing Requirements*

Trade balancing requires that the “value of a foreign investor’s imports of raw materials and components be proportionate to the value of his or her exports of the finished commodity” whereas the “local content” requires that “a certain percentage of the components that went into the making of a product be sourced locally.” In Malaysia, the strategic use of local content policy enabled it to build a car in co-operation with Mitsubishi. Mitsubishi is a Japanese multinational company. It has 80 percent local content. Under Trade Related Investment Measures (TRIMS), these mechanisms used are no more legal. Hence, TRIMS are highly criticized by the developing countries. Import substitution, as a route to industrialization would not be there any more.<sup>40</sup>

#### *Marginalization of Cultures*

There is an apprehension in the developing countries that due to globalization, there would be marginalization of cultures, especially in the remote areas of the world. The youth would then be more exposed to the effects of globalization. One language might supersede other native languages. More people would be inclined to learn English, which is the language of trade and commerce, in order to compete and to move up the social ladder. Therefore, native languages might get marginalized or perish.<sup>41</sup>

#### *Fewer Subsidies*

Developed countries are more concerned with competition and investment related measures than the issue of subsidies. Developing countries cannot give heavy subsidies to their farmers and they cannot compete effectively with imported goods. It constitutes an important apprehension of the developing countries.<sup>42</sup>

#### *Lack of Capital, Market Information and Reliable Infrastructure*

In order to compete in the free trade area, countries need access to capital and market information, and a reliable infrastructure. The developing countries already lose \$ 700 billion due to trade barriers. The GNP product of all 48 very

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<sup>39</sup> “Emerging Jurisprudence in Trade and Environment Disputes at the WTO: Issues for Developing Countries”, <[www.cseindia.org/html/geg/cancun-jairaj.htm](http://www.cseindia.org/html/geg/cancun-jairaj.htm)>

<sup>40</sup> Walden Bells, “The Iron Cage: The WTO, the Bretton Woods Institutions and the South”, <<http://www.tni.org/archives/bello/ironcage.htm>>

<sup>41</sup> Srestha, *WTO: Globalization and Nepal*, op.cit., p. 17.

<sup>42</sup> “WTO: An Unfair Game Against Poor Countries”, <[www.ipripak.org/factfiles/ff15.shtm](http://www.ipripak.org/factfiles/ff15.shtm)>

poor countries in 1992 was \$ 8 billion as estimated by UNDP. This constitutes only 0.34 percent of the total GNP of \$23,100 billion of the whole world. It leads us to another question: why is the situation so abysmal?

The poor countries depend on minerals, tropical produce and commodities, whose prices are determined by markets elsewhere in the developed countries. Their market place is also small and has less purchasing power. Their economies suffer from a huge debt; there is political instability and widespread corruption. The infrastructure is also insufficient. There is a need to initiate different programmes for the uplift of the economies of poor countries. Therefore, lack of access to capital, lack of market information and insufficient infrastructure are the main obstacles to acquiring the benefits of free trade, especially for the poorest of the developing countries.<sup>43</sup>

*Inequality Gap Widens. Flawed Mantra of Globalization*

With globalization, WTO and free trade, it was thought that there would be more opportunities for poverty alleviation, living standards would improve and inequality gap would lessen. However, the gap between the rich and poor nations has increased instead. Though the advent of globalization was highly celebrated, today it is viewed with skepticism. Doctrines of social progress and benefits of free market have come under scrutiny. For example, Margaret Jane Radin in 'Contested Commodities' writes that the international community must not put so much faith in the market. C. Fred Bergsten, Director of the USA Institute for International Economics warned of a 'globalization backlash'. It is important to note that the combined wealth of the world's 447 billionaires is greater than the income of all poor countries.<sup>44</sup> Countries in Latin America and Africa have instead experienced a decline in gross domestic product. Globalization has increased differences among the developing countries. There were strikes in South Korea and riots in Indonesia and many other countries due to socio-economic inequalities and to uneven distribution of economic gains. It can be said that globalization *per se* is not bad but the way market reforms are implemented certainly has flaws. "Transforming the market into a theology would be dangerous. Everything that falls in line with market forces cannot be good and every political decision meant to regulate economic forces cannot be bad."

Professor Aldo Ferrer is also of the opinion that "markets do not solve problems spontaneously and left to them they only worsen the social imbalances and tensions." Modern economy must rather be something like an 'economic society'. It is also important to note that all countries cannot fit into the same developmental model. The effects of the market and globalization

<sup>43</sup> Pradeep S. Mehta, "The Poor Need Action, not Meetings", *The Economic Times*, 12 May 1997.

<sup>44</sup> Ash Narain Roy, "Flawed Mantra of Market", *The Hindustan Times*, 28 March 1997.

are not even. Many are left out and marginalized by globalization. Therefore, the inequality gap has increased between rich and poor and globalization has proved to be more of the nature of a 'flawed *mantra* of globalization' being chanted.<sup>45</sup>

#### *Anti-Dumping Regulations*

These are important regulations meant to check dumping. Dumping can be defined as follows: "If a company exports a product at a price lower than the price it normally charges on its home market, it is said to be dumping the product." Hence, extra import duty can be charged on a product in order to bring its price closer to its normal value. It can be said that 'it disciplines antidumping actions'. It does not pass judgment whether it is unfair competition or not? However, there is an apprehension in the developing countries that such regulations can be used against them. In this regard, it contains more detailed rules and particular standards for dispute settlement panels that can be applied in antidumping disputes.<sup>46</sup>

#### *Trade-Related Intellectual Property Rights*

Trade-Related Intellectual Property Rights (TRIPS) are one of the most controversial regulations of the WTO and are highly debated. The TRIPS agreement covers the following areas i.e., copyright and related rights, trademarks, including service marks, geographical indications, industrial designs, patents, layout designs of integrated circuits and undisclosed information including trade secrets. These agreements also cover such basic issues as, for example, how the basic principles of TRIPS can be applied, settle disputes relating to TRIPS and give adequate protection to TRIPS rules and the special transitional arrangements until the new system is applied?<sup>47</sup> There are always two sides of a coin: under TRIPS, "broad-based technological diffusion" is a 'piracy', which would harm the 'industrialization efforts' of the developing countries. It is being said that countries like the USA and Japan industrialized because they had access to technology. The WTO provisions would then restrict developing countries' access to new scientific and technological knowledge. Developing countries feel that such provisions are in sharp contrast to the principle of free trade. Paying royalties for the technologies would increase the price of products and there would be no

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<sup>45</sup> Ibid

<sup>46</sup> Haroon Mujahid, "The Future of Trade Liberalization", 23-29 July 2001, <[www.pakistaneconomist.com/issue2001/issue30/etc4.htm](http://www.pakistaneconomist.com/issue2001/issue30/etc4.htm)>

<sup>47</sup> Haroon Mujahid. "The Future of Trade liberalization", 23-29 July 2001, <[www.pakisatneconomist.com/issue2001/issue30/etc4.htm](http://www.pakisatneconomist.com/issue2001/issue30/etc4.htm)>

incentive for investment in the developing countries.<sup>48</sup> However, there is another perspective on the issue or the other side of the coin: when innovations are protected through TRIPS, investors and companies would be more inclined to invest in the developing countries. However, there are both adequate supporters and opponents of the benefits of the provisions of TRIPS.

Important issues in TRIPS are with regard to patents, medicines, anti-malaria drugs, GPs, traditional knowledge, farmers' rights etc. When drugs would be patented, the prices of medicines would escalate.<sup>49</sup> The cost of agricultural products would soar, as the patented seeds would not be permitted for reuse in production. Therefore, TRIPS regulations have been highly criticized. However, there is a need for a careful "clarificatory interpretation" rather than re-negotiating all the provisions, "so that the objectives and principles as contained in Articles 7 and 8 of the TRIPS are better reflected when the entire agreement is implemented by the developing countries." One apprehension of the developing countries is that instead of focusing on concerns of public health and the need to transfer technology to developing countries (as embodied in Article 7 and 8), the focus is more on protecting the rights of patent holders. It is important to note that, "at the WTO and outside, in rich and poor countries the connection between patents and the price of medicines has come under close scrutiny pushing those demanders of tough and universal patents on the defensive." With universal level of patent protection a universal level of price is not possible.

There is also a need for "differential prices" of medicines. There is a movement to keep the prices of life saving drugs low. Even if developing countries implement TRIPS patent regulations, 'drug conglomerates' would not be interested in the development of such products for which they cannot charge high prices in the developing countries, for example anti-malaria drugs, HIV and life saving drugs. Developing countries urge, "balancing the provisions of the agreement." A tax credit for Research and Development (R&D) in such medicines can be introduced outside the WTO.<sup>50</sup> Easy access to life saving drugs, drugs for diseases such as cancer, Aids, and malaria to the people of the developing countries is a 'Universal Human Right'. The governments of developed countries have a duty to ensure the availability of such medicine; and prices must be kept affordable. "The TRIPS Agreement should thus enable every member country to take a broad range of measures for protecting and promoting health care. The noble objective of 'Health for

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<sup>48</sup> Walden Bello, "The Iron Cage: The WTO, the Bretton Woods Institutions and the South", <<http://www.tni.org/archives/bello/ironcage.htm>>

<sup>49</sup> C. Rammanohar Reddy, "TRIPs Under Scrutiny at WTO", *The Hindu*, 18 October 2000.

<sup>50</sup> Ibid.

All' is too important to be left either to chance or to future WTO jurisprudence." The flexibility in the TRIPS regulations must be utilized for the betterment of humanity."<sup>51</sup>

The genetic, biological resources and traditional knowledge of developing countries must be protected. The patent application should reveal the country of origin. "It is necessary, therefore, to mandate that patent applications should reveal the country of origin, biological and genetic resources and traditional knowledge used or process for which intellectual property right is sought"<sup>52</sup>

To protect the original qualities associated with a geographical area the country of origin must be indicated on the product. The aim is to prevent 'copy' of such products in rich countries e.g. Basmati rice and Darjeeling tea. Developing countries are asking for protection of such products with GI's. At present it is only wines and spirits (champagne and Scotch whisky), which are protected under GI's. Whether it is a question of patents for medicine or for intellectual property rights for GI's, TRIP'S council can only conduct debates, whereas a change in regulations can come out only through other rounds of talks. Other important contentious issues are protection of traditional knowledge and farmers' rights on seeds. One would see greater participation by developing countries in the fresh round of talks in the WTO.<sup>53</sup> Under TRIPS, geographical indications will become more important. One important implication would be, for instance, that Pakistani carpet exporters would not be able to sell Bokhara, Isphahani or Shirazi, carpets under these names.<sup>54</sup>

#### *Dispute Settlement Mechanism*

A non-discriminatory dispute settlement mechanism would ensure a better world trade environment. Developing countries point out that the system must be improved. In case of violation of trade regulations the matter would be referred to the dispute settlement body instead of taking unilateral actions.<sup>55</sup>

The dispute settlement body is the most important pillar of the WTO. However the way trade disputes are resolved at the WTO level has come under scrutiny. It was one of the incentives that led developing countries accede to the WTO. "Panels/Appellate Bodies are transgressing into areas which should rightly be the jurisdiction of various other organs of the WTO."

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<sup>51</sup> "PM's Address at International Conference on Concerns of Developing Nations in the WTO Regime", <<http://commerce.nic.in/wtoaug01.htm>>

<sup>52</sup> Ibid.

<sup>53</sup> Reddy, Scrutiny at WTO.

<sup>54</sup> "WTO: Opportunities and Threats", <<http://www.imt.edu.pk/Ircevents/archieve/events03/wtot&t/world%20Trade%20organization%20Agriculture.doc>>

<sup>55</sup> Haroon Mujahid, "The Future of Trade Liberalization." 23-29 July 2001, <<http://www.pakistaneconomist.com/issue2001/issue30/etc4.htm>>

The Chief Editor of *South North Development Monitor* (SUNS), Chakravarthi Raghavan, believes that the panels' recommendations are tilting the balance against the developing countries through "substantive interpretations" of rights and obligations, where it only enhances obligations of the developing countries and further increases rights of developed countries.<sup>56</sup> The panels and appellate bodies have even adjudicated between the two conflicting provisions of an agreement in different trade disputes. In the Indonesia car subsidy case, it ruled that though "granting facilities for use of domestic products" was permissible under the Agreement on Subsidies, it violated the agreement on TRIMS. The U.S.S. 301 case was between the European Community and the U.S. on the US Trade Act in which the panel suggested no corrective action because the US Administration submitted an "undertaking not to use this conflicting provision as against WTO obligations." In the Korea US Government procurement dispute panel ruled that government procurement must be transparent. However, there are apprehensions and doubts whether panels can give a decision on the "error in treaty negotiations and transparency in the negotiating process." One important factor that puts developing countries at a disadvantage is that developing countries cannot afford to hire expensive legal experts. The relief system is usually delayed as it may take 30 months from the time proceedings were initiated. Upon winning a case, retaliatory sanctions are available but a developing country would not take such retaliatory measures because of the economic and political costs involved. An inability to take retaliatory actions could increase a shift towards regionalism.<sup>57</sup> Developing countries must work to remove such deficiencies in the system.

Some of the suggestions to improve the system include: (a) Developing countries must train legal experts; (b) Where there is a conflict between two provisions of the agreement, the panel should refer the case to the General Council for an interpretation; (c) If the panel found that harm has been caused to a developing country, it should give compensation from the time the offending action was initiated; (d) There should be a mechanism for joint retaliation by all the members; (e) Instead of a standing appellate body, there could be other panels, which could give their findings. Hence, the findings by a standing panel might have the risk of setting a precedent with a particular orientation. The developing countries must come forward and reverse this trend of "substantive interpretation" by the panels and appellate

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<sup>56</sup> B.L.Das , "WTO's Defective Dispute Settlement Process", *The Hindu*, 6 July 2000.  
Also see, Martin Khor, " WTO Dispute System: Tilting Balance Against South",  
<<http://www.twinside.org.sg/title/tilt.htm>>

<sup>57</sup> Ibid.



body. The apprehensions of the developing countries must be addressed to make the system more efficient.<sup>58</sup>

### *The Agriculture Sector*

Agriculture is an important sector of the economies of the developing countries. The provisions of the Agriculture Agreement have generated rigorous debate in developing countries including Pakistan. Important agreements that affect agriculture include: Agreement on Agriculture, Agreement on Sanitary and Phyto Sanitary Measures, technical barriers to trade and trade related aspects of Intellectual Property Rights (IPRs). There is a need to take into account the implications of these agricultural reforms on developing and food importing countries. As Pakistan is both a net importer of food and an exporter of agricultural products, it supports high prices of agricultural products as an exporter; but does not support high prices as a net food importing country. The Agreement on Agriculture requires the Organization for Economic Co-operation and Development (OECD) countries to reduce their agricultural export subsidies, which would in turn improve the income of the developing countries. However, the benefits should reach the grassroots i.e., the farmers in the developing countries. The agreement provides space for the developing countries to support their agricultural products and tariff reductions, but does not apply to products considered “strategic” by the developing countries.<sup>59</sup>

The Sanitary and Phyto Sanitary Agreement deals with measures necessary to protect animal or plant life. Food safety is an important concern of the agreement. The rules of the international trading partners must be collected and disseminated to the business community. Developing countries require technical assistance in the areas of processing technologies, research and establishing national regulatory bodies. The agreement on technical barriers to trade is related to the use of technical regulations and standards including packaging, marking and labeling requirements and provisions assessing conformity with the rules. The developing countries including Pakistan should modernize their laws, regulations and standards to promote their agricultural products. Pakistan can promote new agricultural products such as fruits and vegetables in raw and processed forms. The extension of TRIPS to agriculture has created further problems e.g. the right of farmers on new varieties of plants, issues relating to rules of origin and traditional

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<sup>58</sup> Ibid.

<sup>59</sup> Hashim Abro, “WTO Challenges and Agriculture Sector”,  
<<http://www.pakissan.com/english/issues/wto/wto.challenges.and.agriculture.sector.shtml>>

knowledge. Developing countries need to formulate policies not only on TRIPS but also on multilateral and regional basis.<sup>60</sup>

Pakistan can overcome the challenges of the WTO by enhancing technical capability. It can decrease the cost of production of the agricultural products with the use of the latest technology. Pakistan needs a comprehensive strategy to revitalize the agricultural sector. Pakistan should improve its infrastructure and its manufacturing sector.<sup>61</sup>

### *The Textile Sector*

The WTO would provide massive opportunities in the textile sector. The post quota era would lead to lower prices for textile products that would increase global demand for textiles. It would, however, increase competition in the textile trade. It is estimated that, as per international studies, the values of global textiles would go up to \$250 billion by the year 2008 and developing countries such as China, India and Pakistan would benefit or would be the front-runners. However, developing countries can face anti-dumping, countervailing duties, environmental laws and product standards. Hence, these countries require a “sea change” approach in their economic policies to compete in the textile trade. Pakistan, in this regard, lacks quality control management, marketing and time-to-market technology. Pakistan textiles have been subjected to normal custom tariffs from 1 January 2005. It got exemptions under Generalized System of Preferences (GSP) in the EU countries. This implementation would affect the big textile exporters because of high tariffs and existing anti-dumping duties.<sup>62</sup>

Pakistan should reduce the multiplicity of taxes and electricity tariffs. These steps would not only block the threat of unemployment but would create more jobs in the sector. The World Bank advocates human resource development in the sector.<sup>63</sup> According to the WTO conditions, the US and EU can extend quota on China till 2008. This would provide, by default, ‘breathing space’ or advantage for the developing countries to explore new markets.<sup>64</sup> New opportunities and threats would emerge in the post quota era. However, an active business community can gain from the opportunities

<sup>60</sup> Hashim Abro, Ibid.

<sup>61</sup> “WTO challenges can be met by enhancing technical capability”, *Business Recorder*, <<http://www.pakissan.com/english/news/2003/jan/wto.challenges.shtml>>

<sup>62</sup> “WTO to provide massive opportunities to textiles”, *Business Recorder*, <<http://www.pakissan.com/english/issues/analysis.wto.to.provide.massive.opportunities.shtml>>

<sup>63</sup> Monem Farooqi, “WTO Regime to result in Employment losses in Textile Sector”, *The Nation*, <<http://www.pakissan.com/english/issues/wto.regime.to.result.in.employment.losses.shtml>>

<sup>64</sup> Asim Azam, “From Doha to Cancun: WTO Impact on Pakistan”, <<http://www.pakissan.com/english/issues/from.doha.shtml>>

and handle the challenges. Of course, the size of the pie would increase and it is up to the business community to explore new avenues and protect themselves from threats.<sup>65</sup>

### Recommendations

- More active participation of the LDC's and the developing countries in the WTO talks is required.
- More panels must be established in the Dispute Settlement mechanism.
- The negotiating agenda should not be overburdened with issues such as investment and competition should not be emphasized.
- Developing countries can work through alliances and coalitions and hence can take advantage of their majority in the WTO.
- Consensus rule should be followed instead of voting.
- Groundwork should be done to implement the TRIPS regulations in the developing countries.
- Findings and debates should be made public. There should be more transparency.
- Instead of using the Ministerial Conferences, homework should be done through negotiations in the General Council meetings.

### Conclusion

The WTO is a newly emerging trading regime. The basic objective of the organization is trade liberalization in goods, services as well as ideas. It contains procedures for dispute settlement and special provisions for developing countries. Most of the developing countries have agro-based economies and are the principal exporters of primary and semi-finished goods. Liberalization of trade might help in transforming their economies, to help pay their debts, increase competition and quality. However, it has several disadvantages for the developing countries.

WTO members have to follow the intellectual property rights on patents, copyrights, trade mark etc. Broad based diffusion of technology and piracy of intellectual property would be checked. Thus access to scientific knowledge would be restricted. Developing countries feel that multinational corporations would then have a dominant influence on the policy choices. The

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<sup>65</sup> Asim Azam, "From Doha to Cancun: WTO Impact on Pakistan",  
<<http://www.pakissan.com/english/issues/from.doha.shtml>>

power of developing countries to regulate foreign investment would be reduced, which would further affect the sovereignty of the states. Liberalization in financial services would be detrimental to their domestic financial services industry, especially in banking and insurance services. In the agricultural sectors, developing countries might not be able to compete because of heavy subsidies provided by developed countries on agricultural products. The prices of agricultural products would increase, as patented seed would not be allowed re-use in production. It is speculated that prices of medicines would escalate.

Developing countries are partners in today's interdependent world; hence their apprehensions must be addressed for the smooth functioning of the WTO. However, the WTO must avoid attempts against polarization. It must adopt a balanced position between the interests of developed and those of the developing countries. ■

## DEVOLUTION OF POWER IN PAKISTAN

Asifa Hasan\*

### Introduction

Soon after the 12 October 1999 take over, President Musharraf expressed resolve to restore democracy in the country. The Devolution of Power Plan was announced in August 2000 with the commitment to replace sham democracy with true democracy that would empower the people at grassroots level. This paper presents an analysis of the Local Government system under the Local Government Ordinance (LGO) 2000.

The devolution of power in Pakistan is still in its incipience under the present dispensation, therefore, the success or failure of the system cannot yet be determined. However, this study highlights the salient features, shortcomings and implementation issues, rectification of which could lead to effective devolution of power. The primary source of information for this paper are reports produced by the World Bank, DFID, and Asian Development Bank in addition to working papers presented by various analysts.

### History of Devolution in Pakistan

The system of Local Government is not new to the sub-continent. Local Government was established in the sub-continent by East India Company that later evolved into a system that was accepted and sustained by the local population, regardless of the motives of its establishers. After the Independence, India retained and strengthened the Local Government system. Pakistan on the other hand, due to its weak political system, could not maintain the Local Government system.<sup>1</sup>

### Basic Democracies – 1959

The first military ruler, Field Marshall Ayub Khan (1958-69) introduced the system of Basic Democracies. He announced the election of 80,000 Basic Democrats or BDs in May 1959. Elected on direct adult franchise, and non-party basis the BDs were supposed to provide membership of a four-tiered

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<sup>1</sup> For more on the local government system in the Sub-continent see Hugh Tinker: *Foundations of Local Self Government in India, Pakistan and Burma* (Bombay, Lalvani Publishing House, 1967), Shahid Ali Rizvi: *Local Government System in Pakistan* (Karachi, the Center for Research in Local Government, 1980), Aziz Beg: *Grass roots Government* (Rawalpindi, Pakistan Patriotic Publications, 1962).

Local Government system. The Basic Democrats served as the Electoral College for the election of the president and members of National and Provincial Assemblies. This system entirely excluded the politicians and political parties, whereas the bureaucracy was in charge of the state resources and local politics, resulting in gradual alienation of the masses. This kind of democracy further centralized the control over the federal units through a narrow political base.

Gradually, the denial of provincial autonomy and suppression of political views combined with economic policies that disenfranchised the common man, fuelled the domestic unrest. Polarization on ethnic lines in addition to the simmering resentment against the policies of the West Pakistan bureaucracy in East Pakistan led to violent protests and countrywide strikes. Ayub Khan handed over the power to General Yahya Khan in March 1969 who scrapped the system of Basic Democracies, but the damage had already been done.

### **Local Government System – 1979**

In July 1977, General Zia-ul-Haq, seized control of the country by deposing the elected Pakistan People's Party (PPP) government of Prime Minister Zulfikar Ali Bhutto. Like his predecessor, General Zia revived the local bodies system in September 1979 through provincial ordinances. Three tiers of Local Government were established: union councils, tehsil committees, and zila councils. Elections to the union councils/town committees were held on non-party basis. The councilors served as the Electoral College for electing the chairmen and vice chairmen of zila and tehsil councils. The local councils in this system were not entrusted with general administration, law and order or policing. These responsibilities were retained by the civil bureaucrats such as commissioners and deputy commissioners.

Unlike the BD system the Local Government officials under this system did not form the Electoral College for the Provincial and National Assembly and the President. The motivation for creating the local bodies was again akin to that of Ayub Khan's, to serve "as the civilian base of his military government, supporting it in return for the economic and political benefits."<sup>2</sup> Therefore it was reduced to a mechanism to assure state patronage to pro-military officials rather than empowering the people at grassroots level or improving the service delivery. The system eventually came to an end with the revolt of the parliament against government's invariable refusal to share the authority with the elected politicians.<sup>3</sup>

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<sup>2</sup> International Crisis Group (ICG), *Devolution in Pakistan: Reform or Regression?*, ICG Asia Report N°77 (Islamabad/Brussels: 22 March 2004).

<sup>3</sup> Ibid.

### **Intermediary Civilian Governments**

The Local Government system remained ignored under the civilian governments of Z.A.Bhutto and later Nawaz Sharif and Benazir Bhutto. Ironically the civilian governments in Pakistan that claimed to be the proponents of democracy did not encourage or nurture the Local Government system for two reasons; one, the affiliation of the system with the illegitimate and suppressive military regimes and two, the insecurity of the politicians who considered the Local Government a threat to the political system entrenched in feudal mindset. Therefore, skeptics argue that the military and civilian regimes are equally responsible for the crisis of governance in Pakistan.

### **Devolution of Power Plan (2000)**

President Musharraf, like his military predecessors has revived the Local Government system in an effort to reform the political arena of Pakistan. The government set up the National Reconstruction Bureau (NRB) to formulate policy options to improve the governance mechanism in the country and propose plans for its implementation. The provincial governments promulgated the Local Government Ordinance 2001 in their respective provinces to install a new integrated Local Government System to function within the provincial framework and adhere to the Federal and Provincial laws.<sup>4</sup>

The devolution plan proposes a regime of reforms such as political reforms, judicial reforms, civil service reforms, police reforms, and accountability and transparency. The overarching aims of the devolution of power plan were the devolution of political power, decentralization of administrative and financial authorities, decentralization of management functions, diffusion of power-authority nexus, institutionalized distribution of resources, and empowering citizens to take control of the local policy over the type and method of delivery of the essential services.

The Local Government Plan proposed establishing a three-tier system of government, at Union, Tehsil (sub-district) and Zila (district) levels. The district is envisaged to take over some responsibilities of the province in political, administrative and financial fields. The district functions now involve, district coordination, education, health, community development, information technology, law and magistracy, works and services, land revenue, agriculture, environment, finance and planning and rural development. These functions were the responsibility of the provincial government without any participation from the lower tiers. Tehsil Municipal Administration (TMA) is responsible for the municipal services such as intra-city or intra-town or tehsil network of water supply, sanitation, conservancy, removal and disposal of waste, drainage,

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<sup>4</sup> The New Local Government System,  
<[http://www.nrb.gov.pk/local\\_government/default.asp](http://www.nrb.gov.pk/local_government/default.asp)>

roads, bridges and related infrastructure, land use control, master planning of the urban and rural infrastructure and its maintenance, environment and law enforcement. Union Council is the lowest tier of Local Government system. Previously consisting of 21 directly elected numbers, the union council membership has now been reduced to 13. The union councilors constitute the Electoral College for district and Tehsil councilors and the district and tehsil nazim and naib nazim. They are also responsible for monitoring union functions and small development schemes. A plethora of accompanying structures has been introduced to lend support to the three main tiers. For example, the Village Councils and Citizen Community Boards (CCBs) are the union level structures responsible for increasing citizen participation in decision-making at grassroots level and strengthening transparency and empowerment through citizen monitoring systems.

The four Provincial Local Government Ordinances have been placed in the Sixth schedule of the 1973 Constitution and therefore cannot be amended or repealed without the previous sanction of the President. Recognizing only the federal and provincial authority the Constitution does not recognize the Local Government as the third tier of the system. Therefore, critics argue that the Local Government system lacks constitutional support. The 1973 constitution declares the Local Government as a provincial subject and grants the provinces complete authority to create Local Governments.<sup>5</sup>

President Musharraf articulated the devolution agenda of the military government in the following words,

“We have started this democratic process from the lower strata, from the level of masses, common people. We have started it from District, Tehsil and Union Council Level. Had we started it from the top, it would have meant that we were handling the power to the same privileged people again and not the masses.”

The fundamental problem with this approach is that the logical devolution of power is not possible to start from the bottom to the top. The bottom-up approach is effective when a degree of decentralization exists in the top tiers. In a highly centralized system such as Pakistan's, the devolution or decentralization is successful when the logical flow of power from the top-down is made possible with all the important linkages in place, without

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<sup>5</sup> Article 32 of the Constitution of Islamic Republic of Pakistan, 1973 states, “the state shall encourage local Government institutions composed of elected representatives of the areas concerned and on such institutions special representation will be given to peasants, workers and women”.

Article 140A provides the constitutional cover to the local government, and it states, “Each province shall, by law, establish a local government system and devolve political, administrative and financial responsibility and authority to the elected representatives of the local governments. ”



alienating any special pillar of the governing structure. Pakistan being a polity with a shaky and unstable political system is not yet ready to introduce independent administrative tiers, as envisaged by the current regime for the Local Government. In order to have effective devolution, decentralization must trickle down from the federal government to the provinces and from provinces down to local governments, at political, fiscal and administrative levels.

The devolution plan has completely bypassed the provinces by envisaging the decentralization of powers directly from the center or federal government to local governments, the provincial governments were alienated from the process by bringing the local bodies under the direct supervision of the center, creating animosity and confusion about the authority. Provincial governments though bound by the constitution to create local governments have not played a positive role in the implementation of the Local Government system since they view the plan as undermining their authority. In our federal system the provinces form the second most important tier of the government, therefore implementation of the plan is impossible without the constructive engagement of the provincial governments.

Resentment of the provincial governments towards the devolution plan is a crosscutting issue that inhibits the process at all three levels i.e., administrative, political and fiscal.

### **Political Devolution**

Over the decades, the political system in Pakistan has become saturated with rampant corruption, sycophancy, over centralization of authority and dismal service delivery. A number of factors such as feudalism, unethical and immature party politics, inefficient and corrupt bureaucracy and most of all repeated military interventions and dismissal of the elected governments are deemed responsible.

Aim of the political devolution is to infuse fresh blood into the corrupt political system, to provide positive measures for the marginalized masses i.e., women, workers, peasants to have access to politics and to introduce a measure of stability into a turbulent political scene by creating a system of accountability between politicians and local electorate.<sup>6</sup>

The elections of the local governments were completed in five phases from December 2000 to July 2001 under military supervision, resulting in installation of district and sub-district governments in 97 districts and 4 city districts. The political parties were barred from participation in the elections of local government. Provincial governments were responsible for the Local

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<sup>6</sup> *Devolution in Pakistan: Annex 1 – Recent History*, Volume II Devolved Service Delivery Study (DSD): Prepared by the World Bank, Asian Development Bank (ADB) and DFID (July 2004).

Government elections, however, the military regime gave the task to Federal Election Commission of Pakistan (ECP). This rendered fair and free elections impossible and the process susceptible to political manipulation and pressure from the center.<sup>7</sup> There have been allegations of rigging at the district level in indirect election of the Nazims. The non-partisan nature also created political loyalties along caste/sub-caste/biradri lines.

The directly elected union councilors serve as the Electoral College for the election of the district nazim and district naib nazims. Each tier of the Local Government has a term of office for four years, with a two-year limit for the nazim and naib nazim. There are three major drawbacks of indirect elections, one, they disenfranchise the voters from selecting district nazims and naib nazims, two the process of election for both the posts can be corrupted through political manipulation by the influential, and three, indirect elections “do not encourage candidate-Nazims or Naib Nazims to develop coherent development strategies, policy platforms, nor ideologies”.<sup>8</sup> Indirect elections also deprive the nazims and naib nazims of meaningful constituencies, which reduces the independence and authority of the Nazim and Naib Nazim as compared to the unelected officials such as District Coordination Officer (DCO). This weakens the accountability linkage with the voters, since re-election of a nazim is not decided by them. It should be recognized that indirect elections vitiate the spirit of meaningful devolution and democracy.<sup>9</sup>

Two arguments about the involvement of political parties in the elections prevail; the proponents of the party less local bodies elections argue that political parties never campaigned at the grassroots level in any case, therefore the voter in a village always voted in support of the political affiliations of the leader of the village, so the absence of political parties is not really depriving the voter of his right to choose. They also argue that inclusion of the political parties in the Local Government elections, could lead to the culture of corruption and self-aggrandizement becoming entrenched to a deeper level, necessitating the exclusion of the political parties from the local government.

Advocates of the party based elections claim that as the political affiliations of the candidates were obvious in the Local Government elections, it was unnecessary to enforce a ban on the political parties. Although the number of new entrants increased, yet thirty percent of district nazims in

<sup>7</sup> Bushra Asif, *Local Government Reforms in Pakistan*, Report from the CSIS Project: Pakistan's Future and U.S. Policy Options (1 December 2003), p.28, <http://www.csis.org/saprog/031201.pdf>.

<sup>8</sup> Charles H.Kennedy, “Analysis of Pakistan's Devolution Plan”, Draft prepared for Department for International Development project: “Building Democracy in Pakistan: Future Options”, Wake Forest University, Wake Forest (September 2001), p.3.

<sup>9</sup> Ibid.

Punjab were former MPAs or MNAs and approximately ninety percent belonged to established political families.<sup>10</sup> Exclusion of the political parties from the process was a radical move, which the weak political system of Pakistan is not yet ready to absorb. There is a need to recognize that such radical moves will only serve to alienate important groups, consequently weakening the system.

The aim of barring political parties was to defeat the age-old affiliations of a powerful minority with their constituencies and encourage broader participation of people from all walks of life. The desired end result would be improved accountability and transparency. However, through four years of the local governments' existence it has become obvious that barring political parties from the system does not ensure transparency and accountability, but institutions created for this purpose do. By barring the political parties the government is renouncing them as the sole reason for the failed political system, whereas the root cause of the problem is untimely dismissal of the elected governments, which denies the voter the right to unseat a corrupt politician and elect an efficient candidate. The political parties in future should be allowed to contest for Local Government and along side an honest effort should be made to strengthen the political institutions to ensure accountability and transparency.

Indirect election combined with the large district size in Pakistan discourages electoral accountability. Both these factors exempt the elected representatives from striving to deliver in order to be re-elected. They also render the arena open to political abuse.

“International evidence suggests that in the countries where devolution has resulted in increased accountabilities and in turn to improvements in service delivery, the key has been a combination of small electoral district size, direct elections of office holders, and mechanisms for direct citizen monitoring of, and participation in, local government policy-making.”<sup>11</sup>

The prominent achievement of the political devolution, however, is the inclusion of a large number of female councilors to promote gender equity. Inclusion of 36,187 women councilors has been a good step, but they are faced with many problems such as absence of remuneration, sharing the workspace with men, gender differentiated access to bureaucratic authorities and the social mindset that discourages decision-making by women. Lack of

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<sup>10</sup> Nick Manning and Zahid Hasnain (World Bank), Doug Porter and Musharraf Cyan (Asian Development Bank), Jackie Charlton (UK Department for International Development), “Devolution in Pakistan – Preparing for Service delivery Improvements”, Draft 9, a working paper prepared for the Forum on Intergovernmental Relations and Service Delivery in Pakistan (27-29 June 2003), p.27.

<sup>11</sup> Ibid, p.50.

experience, skills and authority profoundly impedes their participation. Authorities need to create a conducive environment and conditions for the effective participation of women and invest in capacity building to ensure the required output.

### **Fiscal Decentralization**

Success of the devolution plan largely depends on effective fiscal decentralization. The fiscal management in Pakistan has been highly centralized, inhibiting the transfer of funds to the provinces and the Local Governments. Over centralization of decision-making and financial control in the past has been one of the major reasons for the national crisis of governance.

The Constitution of Pakistan defines the expenditure responsibilities of the federal and provincial government. The *Federal Legislative List* specifies the functions of the federal government and the *Concurrent List* details the areas that can be undertaken by either or shared by the federal government and the provinces or jointly by both. The unspecified functions are presumably to be performed by the provincial or Local Governments.<sup>12</sup> However, the over-centralized system causes vertical fiscal imbalances between the two levels of the government, as the upper levels of the government play a dominant role in the areas of shared responsibilities.

Revenue collection is highly centralized in Pakistan. Around ninety percent revenue is collected at the federal level; 7-8 percent at the provincial level and remainder at the local level. The 1973 Constitution of Pakistan assigns most taxes to the federal government with a few exceptions such as Agriculture Income Tax (AIT), Urban Immovable Property Tax (UIPT), Motor Vehicle Tax (MVT) and Stamp Duties. Main source of provincial revenues is transfer based on the share of federal tax collection. The National Finance Commission fixes the formula every five years, called award, for the ratio of the federal/provincial share for the divisible pool of shared taxes. The 1997 award allocated 37.5% of the divisible pool to the provinces on the single criterion of population, determining the "Straight transfers", which include taxes and royalties on natural resources in the provincial domain. The 1997 award is still current, as a consensus on the award has not been reached since 2002. Federal fiscal transfers to the provinces have increased from 65% of the provincial revenues in 1977-1978 to 87% in 2000-01. Local governments in Pakistan were fiscally self-sustaining in the past, with octroi taxes and export fees being a major source of the local revenue collection in provinces. The

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<sup>12</sup> Federal government is responsible for foreign affairs, defense, banking and currency, postal service, transportation (ports, airports, railways), whereas the provincial responsibilities are police services, justice, roads, education and health.

octroi tax was abolished in 1998 and in compensation, the provinces receive 2.5% of General Sales Tax (GST).

The much-required shift of responsibility from federal to provincial governments has not occurred under the devolution plan. Agricultural Income Tax at the provincial level has the prospect of increasing the tax base but it is administered at the provincial level. The functions of the Local Government require substantial funds, exceeding the revenue generated by them. Therefore they heavily rely on the fiscal transfers from the provincial governments. To bring about significant fiscal decentralization, all provinces have established Provincial Finance Commissions (PFC) to make awards for the distribution of provincial resources to local governments. All provinces apply a different set of criteria and formulae for the fiscal transfers to the districts, tehsil and union administrations. The progress in creating the necessary secretariats and required analytic support for the PFCs has been slow. Currently the Departments of Finance provides secretariat support to the PFCs, including preparation of working papers, arrangement of meetings etc., therefore the PFCs do not yet work as permanent bodies. Absence of a secretariat poses a constraint on the working of private members and Local Government representatives, inhibiting the duties of the PFCs to monitor the implementation of distribution of formulae, prepare and maintain data and redress grievances.

Under the LGO, districts have been encouraged to raise revenue, however, there are two problems; one, a weak tax base and two, certain district taxes which are impractical to impose such as elementary education and health services tax. It is argued that it is not pragmatic to expect greater output from the districts, as the taxes assigned to them are not effective in producing a significant share of the own-source revenue (OSR). "Incentive for local revenue effort are linked to the buoyancy and potency of taxes assigned to local government."<sup>13</sup> Therefore, the taxes that can stimulate higher returns should be assigned to the districts. Local Government should also be encouraged to charge for some services in order to improve their quality.

Administrative autonomy of the districts remains curtailed and undefined. The current arrangement of the fiscal transfers is managed in such a way that a substantial part of the budget is not in control of the district government. They are unable to reallocate resources or change composition of the workforce. To disburse funds, a provincial account, Account IV has been created in the State Bank of Pakistan for each district to act as the Sub account to the Account I (Provincial Consolidated fund), but the provincial government have formulated their own procedures for release of funds to the

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<sup>13</sup> *Devolution in Pakistan – Annex I Recent history*, Volume II Devolved Service Delivery Study (DSD): Prepared by the World Bank, Asian Development Bank (ADB) and DFID (July 2004), p.37.

district and other local governments. Except for Punjab, elsewhere the salaries are paid from the Provincial Account I and not the district controlled Account IV. Districts must seek approval from the provinces for the transfer of funds, resultantly the salaries are still paid from the provincial budget. Provinces show reluctance to transfer salaries to Account IV for a number of reasons; one, no formula has been devised for secure distribution of salaries, two, in absence of reliable employee databases paying sanctioned posts runs the risk of over funding districts with less posts, and lastly, provinces argue that the pool of district budgets provides the government with sufficient balance to cover shortfalls. Cash flow position of the provinces becomes a factor in obstructing the flow of funds to the districts, a major hindrance in smooth administrative working of the system. PFCs have not developed a proper mechanism for the fiscal transfers yet and though in theory they are formula-based but in practice they are subject to province-district relations. Local Governments also lack the autonomy in preparing the salary budget. Neither local governments nor provincial governments can decide the pay scale, as it is under the rubric of federal government. In case of NWFP and Sindh the salaries are transferred through provincial Account I, and the districts must seek approval from the province for the release of funds, not possessing the authority to allocate or change resources independently.

Jurisdiction confusion undermines the incentive for collection, due to lack of confidence about the collection being deposited in the account of the Local Government. The Federal Government, in some cases, discourages the collection of toll and zilla tax. Dependent on fiscal transfers the local governments have little motivation to raise additional taxes.

Constraints on the district governments in managing their own budgets seriously inhibits their potential for fiscal management. A provincial government provides sizable funds for the schemes to be identified by the elected members of Provincial Assembly. In case of Balochistan, these allocations were made by withholding the district development funds. There is conflict and overlapping in the provincial and Local Government development activities, which hampers the development process. MPAs have been asked to seek scheme approval through the District Development Committee; which has confused accountabilities and responsibilities for the use of resources.<sup>14</sup> Provincial governments have concerns about transfer of large development funds to the Local Governments as they fear that their authority could be compromised by giving the financial charge to the Local Governments, since they could abandon the on-going schemes initiated by the provincial government to start new schemes. At the level of Tehsil Municipal Administration (TMAs), there have been complaints of delays or inadequacy in transfer of funds. Functional PFC secretariats are required to take notice of

<sup>14</sup> *Devolution in Pakistan – Preparing for Service Delivery Improvements*, op. cit., p. 41.



such complaints and provide redress, which they have so far not been able to. There are discrepancies between budgeted funds and releases to district governments, and no monitoring mechanisms to check erratic transfers of the funds.

Vertical programmes<sup>15</sup> pose a hindrance to the development schemes of the local governments, as they are one of the main constraints on the district and TMA autonomy. Large share of the resources is channeled through the vertical programmes denying the fiscal space to the Local Governments to invest in development projects. This undermines the potential of the PFC to develop into formula-based transfers for the Local Governments. The elected provincial governments are strong supporters of the vertical programmes but they serve to re-centralize control over investment decisions and alienate the Local Governments. Emerging from the over centralized system of the past, the provinces are somewhat insecure that the newly assigned roles to the Local Governments and the allocation of funds to them will leave the provinces with only residual roles. Provinces fear that giving complete autonomy to the Local Government will vitiate the provincial authority. Therefore, “provinces are tempted to use other, less transparent, mechanisms to shape Local Government policy.”<sup>16</sup> To remove these doubts and insecurities, the roles and responsibilities of the federal and provincial governments should be redefined.

Donors and research institutions confirm that the major cause of delay in implementation of the development schemes and tension are reflected by the district complaints of delays in payments. Devolution of power cannot meet much success without fiscal decentralization and efficient transfer of funds; and without the autonomy in budget allocation and development policymaking, service delivery cannot be improved.

### **Administrative Devolution**

Administrative devolution aims to improve the accountability of the key government actors, thereby reforming the service delivery. A symbiotic relationship between various departments is imperative for effective service delivery. The system rests on accountability of the key government actors to stimulate effective service delivery. The aim is that the senior officials at district and tehsil level should consider themselves to be accountable for their actions, efficient fiscal management and staff behaviours.<sup>17</sup> Administrative devolution however is not very effective yet, requiring profound reforms at the

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<sup>15</sup> Federal or provincial government programs that provide services within local government's functional jurisdiction, and the executive authority for which is not exercised by the local government.

<sup>16</sup> *Devolution in Pakistan – Preparing for Service Delivery improvements*, op.cit., p.44.

<sup>17</sup> Ibid, p.18.

structural level. A quick analysis of the administrative devolution reveals that the over ambitious nature of the plan that sought a radical change by sidelining both the bureaucracy and the provincial government lay at the heart of the implementation issue. Reluctance of the provincial governments to help implement the system due to their insecurities severely inhibits the process. The issues of the grievances of the provincial government and the bureaucracy towards the local governments is the overarching issue that so far plagues the spirit of devolution, causing implementation problems.

The authority for implementation of the Local Government system lay with the provincial government, therefore there are profound problems in administrative devolution and effective implementation of the system. Provincial governments undermine the authority of the Local Government by continued interference in staff management and controlling the transfer of funds and resources. The institutions envisioned to ensure success of the Local Government are not in place yet, therefore, the political relationship between the nazim and the ruling provincial leadership plays a profound role in effecting the system. It determines the extent of political control that the district nazim can exercise within the Local Governments in addition to inhibiting freedom in policy making to meet the demands of the constituents. The flow of funds and implementation of the local development schemes widely depend on this relationship.<sup>18</sup> Coordination between the three pillars of the governance system i.e., provinces, bureaucracy and the Local Government in Pakistan is imperative to the success of the Local Government.

#### *Jurisdiction Issues*

LGO does not provide any solution for the ambiguity about the responsibilities and lack of coordination between the provincial and Local Government. The system has built in confrontation between the provincial and district administrations with the latter being dependent upon the provincial funds and personnel and the former being aggressively keen to ensure that its writ fully runs in the districts. Opposition to the Local Government is most severe where the political affiliations of the nazims and the provincial government diverge. In certain places the conflict results due to the government ruled provincial government and the opposition ruled local or city government, sometimes due to the duplication of the functions and the overlapping of powers that have not been clearly defined. The incompatibility slows down the service delivery. Though the Local Government members are elected at the district level yet the supervision is also managed at the provincial

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<sup>18</sup> *Devolution in Pakistan: An assessment and recommendations for action*, Volume I Devolved Service Delivery Study (DSD): Prepared by the World Bank, Asian Development Bank (ADB) and DFID (July 2004), p. 31.



and federal level. This duplication of authority in the administrative hierarchy has led to many issues.

The district governments have inherited the responsibilities of the provincial government, but the ambiguous jurisdictional lines between different districts create confusion. Overlapping of jurisdiction exists especially in the health, education and water and sanitation (W&S). The government has not been able to install a mechanism to ensure coordination amongst the dispersed governments.

Similar issues exist within the Local Governments. Before devolution, the road management and transport regulation was assigned to a range of organizations. Despite jurisdictional overlaps, well-defined functional and technical distinctions prevented confusion. Post-devolution setup dismissed the previous system without laying out a well-grounded plan. There is confusion in Sindh at the district level over the ownership of the former district council network. It has neither been devolved to the tehsil level, nor delegated to W&S. the provincial government retains the responsibility for the fear of “provincial work redundancy and loss of control over district affairs.”<sup>19</sup> Provincial governments must delegate the authority of the concerned departments to the district governments instead of expecting them to evolve their own processes and procedures.

Within the Local Government lack of investment in capacity building is an important issue. Most councilors and members of the oversight bodies do not comprehend their responsibilities. Provinces must invest in capacity building of the staff of the Local Government at all levels in order to receive an effective output. In addition only the technically sound staff should be assigned the duties that it is trained for.

#### *Role of the Bureaucracy and Related Issues*

The civil service in Pakistan certainly needed reforms in order to create an efficient and honest workforce but the reforms proposed by the NRB were based on the “radical reformist agenda” proposed by the World Bank in its civil service reform report of 1998, which underlined inefficiency, corruption and cadre system as the main problems of Pakistan’s over centralized bureaucracy. NRB embarked on a complete reform of the system to undermine the authority of the bureaucracy by abolishing the positions of the divisional commissioner, deputy commissioner and assistant commissioner. This was an extreme measure, which has undermined the service delivery, therefore, not helping but vitiating the spirit of devolution. Never before in the history of Pakistan, bureaucracy was subordinated to the elected representatives, but under the devolution plan in order to curtail bureaucratic powers it has been subordinated to the nazims. After the abolition of the post

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<sup>19</sup> *Devolution in Pakistan – Preparing for Service Delivery improvements*, op.cit., p. 24.

of the deputy commissioner, nazims are in administrative political control of the district and the District Coordination Officer (DCO) and the District Police Officer (DPO) report to the nazim. The DCO serves as the chief advisor to the district nazim, and is in charge of the twelve newly established District Offices (DO) and coordinates the work of the Executive District Offices (EDOs)<sup>20</sup>. Replacing the single office of the Deputy Commissioner with a dozen Executive District Officers (EDOs) creates confusion among the mostly illiterate population due to the similar nomenclature of the twelve offices. A large number of people holding applications do not usually know whom to access regarding their problems.<sup>21</sup>

A clear imbalance of institutional relationship exists between the DCO and the nazim. Though the DCO has been subordinated to the nazim, yet the actual authority resides with the DCO, who not only possesses extensive administrative experience but also has a “corporate interest in maintaining their authority – perhaps to the extent of sabotaging the reforms, or the institutional authority of individual nazims. The nazims, by contrast are mostly inexperienced in administrative matters, and have no corresponding cadre networks to draw upon.”<sup>22</sup> The nazims often complain that the DCO and the DPO do not consider themselves to be answerable to the nazims, since their postings and salaries are determined by the provincial government.

Politically motivated inter and intra district transfers are an area of conflict between provincial and Local Government. This problem is severe in districts that are not politically aligned with the province. The uncertainty and insecurity caused by this triggers administrative crisis. Local Governments do not have the autonomy over personnel decisions such as hiring, posting, performance, monitoring and rewarding. Some of these functions are supposed to be carried out by the Local Government but provincial interference persists. The DCO reports to the nazim; though he is representative and part of the federal cadre. His transfer is managed outside the district. The EDOs report formally to the DCO and not to the line ministries in divisional/provincial hierarchy, but their transfers are determined at the provincial level. This complicates the administrative dilemma.

Transfers are often used as a covert policy instrument to express rivalries. A mechanism should be devised to restrain this behaviour. The Local Governments can not function properly unless they are in charge of the transfers of their own staff, as the involvement of the provincial government in transfers is not restricted to grade 17 and above but goes down to the

<sup>20</sup> The district administration is coordinated by the DCO, and consists of twelve groups headed by EDOs. The groups are responsible for sectors such as agriculture, community development, education, finance and planning, health, information technology, law, literacy, revenue and works and services.

<sup>21</sup> Muhammad Anwar, “Capital Concerns”, *The News* (Islamabad), 17 April 2005.

<sup>22</sup> Charles H. Kennedy, op.cit., p.9.

district structures. There is a need for district bureaucracy independent of external influences as suggested by the World Bank.<sup>23</sup>

*Citizen Participation, Accountability Structures and Performance Management*

True empowerment of the people has been generally neglected in Pakistan, as there is lack of understanding about the rights and duties amongst the masses. Lack of capacity building and proper training is an important issue where the government needs to invest. There has been a proliferation of new systems, departments, rules and procedures under the devolution plan, but the training for proper understanding and implementation is missing. Not much orientation has been given to the councilors and the oversight bodies about their responsibilities.

Inter-departmental accountability systems that place checks on the performance of officials are essential to induce good work ethics and ensure that the goals are being met in an effective, efficient and consistent manner. Performance management responsibility was transferred to the districts from the provincial governments. The most important accountability mechanism was Annual Confidential Reports (ACRs). Preparation of the ACR is the main instrument for assessing the performance of the public officials in Pakistan. At the district level, ACR of the DCO is prepared by the district nazim and countersigned by the provincial Secretary. DCO prepares the annual ACR for EDOs countersigned by the district nazim. The EDOs prepare the ACR of the DOs, countersigned by the DCO. This, however, is not an effective way of enforcing the accountability. The authority of the nazim to write the ACRs of the DCOs was an ineffective tool for measuring the performance and was viewed as a routine matter to be placed in an officer's file at the time of promotion since the provincial government offers senior positions to the officers regardless of their performance in the previous tenure. Weaknesses in the ACR system discourage strong incentives for improved performance.<sup>24</sup>

Citizen engagement in the effective implementation of the envisaged plan is essential. Oversight bodies such as village and neighborhood councils, and CCBs were designed to suggest and plan community projects. A total of 1,600 Citizen Community Boards (CCBs) are registered across the country, as 25% of the development funds must be allocated to the projects identified by the CCBs. But development and empowerment of the CCBs has mostly been

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<sup>23</sup> Ansar Abbasi, "WB wants district govts empowerment", *The News* (Islamabad), 11 January 2005.

<sup>24</sup> Nick Manning and Zahid Hasnain (World Bank), Doug Porter and Musharraf Cyan (Asian Development Bank), Jackie Charlton (UK Department for International Development), "Technical Annex: A stocktaking of recent structural changes towards devolution in Pakistan" Draft 9, Prepared for the Forum on Intergovernmental Relations and Service Delivery in Pakistan (22 June 2003).

neglected. The funds allocated to the CCBs have been accumulating and not being put to use.

LGO calls for establishing public accounts committee at all three levels of the Local Government to review the accounts and produce audit reports of respective governments, which would allow public monitoring of the government transactions. The committees, however, have not been notified in any district with the exception of Khairpur and in no district or TMA any audit report has been presented to the council.

Monitoring committees are responsible for identifying the problems at service facility level and bringing them to the attention of the respective councils and the concerned EDOs. But they have not been performing their duties for a number of reasons, one, the committee members are often not elected through competitive election rather selected by the nazim, therefore, are not always qualified and willing to do the job; two, some committees are formed by distributing the councilors amongst them, with the result that the councilors are not even aware of what committee they belong to. Another reason for the poor performance of the committees is lack of traveling allowances and transport facilities, which increases the cost of field visits. In some districts there is a general feeling among the councilors that “since bureaucracy is not answerable to the Local Government and is in fact sometimes trying to subvert it, monitoring of teachers and health officials is an exercise in futility.”<sup>25</sup>

#### *Implementation of the Police Order and Access to Justice*

Over the years there has been gradual deterioration in the law and order situation that has enervated the public confidence in the ability of the police to maintain public safety. According to a CIET<sup>26</sup> survey (2003), 22 percent of the households admit that they would contact police for public safety, only 12 percent had admitted any contact with the police in past five years and only a third were satisfied with the performance.

Under LGO, major reforms in the Access to Justice programme and the Police Order 2002 have been designed with the aim to increase the efficiency of the police and make them accountable to the citizens. However, there has been limited progress on the implementation of the Police Order due to reluctance of the provincial governments to cede control of the police to District Public Safety Commissions. Major areas such as budgeting, training, capacity building in addition to the responsibility of the nazim, the police and departments of law and home are unclear. Post of the District Police Officer (DPO) has been established, who reports directly to the nazim, but remains the employee of the provincial/federal government. The DCOs complain

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<sup>25</sup> Ibid.

<sup>26</sup> Community Information, Empowerment and Transparency

about the use of police by the nazims, and ironically, the nazims complain of absolutely having no control over police. Overlapping of administrative powers interferes with the maintenance of the law and order situation in the country.<sup>27</sup> Nazims do not have the authority to enforce an accountability check on the DPOs, except for Punjab, they cannot initiate the ACR of the DPO elsewhere. Nazims assert that removing the authority of the former District Magistrate in completing the ACR of a former district superintendent of Police has deteriorated the law and order situation.<sup>28</sup> Lack of progress on implementation of Police Order may lead to reintroduction of the executive magistracy undermining the basic percepts of devolved governance.

District Public Safety Commissions (DPSCs) play an indispensable role by monitoring and punishing the excesses of the police by the citizens and ensuring that the police delivered, keeping in with the law and order and their assigned role. The function of the DPSC is to investigate the cases of excesses, ensuring registration of FIR and approving district's annual policing plan. The widespread perception in most districts is that the DPSCs cannot control the police.<sup>29</sup> DPSCs do not have the powers to enforce any of its decisions; it can only recommend an action against a police officer to the DPO. However the DPSCs have not been set up yet. Effective DPSCs that en public confidence do not exist in most districts. Despite their limited mandate, the DPSCs can be effective if supported and implemented properly. Unless some serious effort is invested in establishing DPSCs as effective bodies, the public disillusionment with the system will only grow.

## Conclusion

Envisaging multiple layers of political, fiscal and administrative authority, the Devolution of Power Plan 2000 is an unprecedented effort of devolving power to people at such an extensive scale. This plan is an effort to replace the existing local bodies system by ending the domination of the bureaucracy, placing a check on the manipulation of the provincial government and obliging the provincial government to strengthen the fiscal base of the local government. Although the plan is in its incipience yet, but there are visible signs of positive change such as inclusion of women in politics, increased accessibility of the people to the elected representatives such as nazims and limited citizen participation in oversight, however the inherent conflicts within the system and the rivalry of the provincial and Local Governments are inhibiting the growth of the system.

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<sup>27</sup> Dilshad Azeem, "Nazims want power to better law and order", *The Nation* (Islamabad), 6 October 2004.

<sup>28</sup> *Devolution in Pakistan: An assessment and recommendations for action*, op.cit., p. 32.

<sup>29</sup> Ibid.

Federal to province devolution, the missing key element is imperative to successful devolution of power. The federal government must ensure fiscal and administrative devolution from the center down to the provinces first, before expecting the provinces to forego their responsibilities in favour of the Local Government. This will not only reinstate the confidence of the provinces but it will also give the federal government legitimate reasons to legally bind the provinces to defeat the dominance of the feudal politics and ensure the empowerment of the people. The government must recognize the importance of coordination amongst the involved institutions to achieve integrated development and improve the coordination between the provincial and Local Government.

Government must take cognizance of the fact that Pakistan has a weak political system and the radical change envisioned by the NRB will not only jolt the system but also cause delays in acquiring the objective of the exercise, that is grassroots empowerment and effective and efficient service delivery. Provincial government, bureaucracy and the Local Governments are all important pillars of the devolution plan, sidelining or alienating any one of them will not bear the desired result. The institutional faults within the system, due to the reluctance of the provincial government to cooperate cause frustration amongst the Local Government members, leading to faulty service delivery and therefore rendering the devolution plan a futile exercise. In order to gain the desired objective of citizen empowerment, access to justice and effective service delivery, the government must involve provincial governments in modifying the faulty provisions of the system and ensure their honest and effective participation. ■

## THE POLITICAL ECONOMY OF PAKISTAN-SOUTH KOREA RELATIONS: 1947-2004

Dr Ahmad Rashid Malik\*

### Introduction

This paper analyzes bilateral economic relations between Pakistan and South Korea from 1947 through to 2004 in the field of trade, investment, and economic cooperation. It is argued here that economic relations between Pakistan and South Korea have been strengthened during the last decade and the non-complimentary economic relationship of the 1950s and 1960s between the two countries turned to become complementary after the latter attained a remarkable economic growth in the late 1970s, and began to supply with high quality equipment and machinery and also emerged as one of the leading investors in the 1990s in important projects in Pakistan. Knowing that South Korea borrowed Pakistan's Second Five Year Plan (1960-65), today South Korea has been regarded as a model for speedy economic development for Pakistan. Moreover, the liberalization of Pakistan's economy opened new avenues for the promotion of bilateral trade and economic cooperation between the two countries. South Korea has also become a major source for Pakistan's highly ambitious the Lahore-Islamabad Motorway Project. This paper, therefore, looks at the political economy of Pakistan-South Korea relations and sees how Pakistan could benefit from the latter's experience of miraculous development.

### Diplomacy

Modern contact between Pakistan and South Korea could be traced to the early 1950s. Pakistan was one of the first countries that offered military assistance to the United Nations effort during the Korean War.<sup>1</sup> However, this assistance could not materialize for one or the other reason. Nevertheless, Pakistan emerged as the supporter of the United States in this conflict that provided the basis on which the future course of relationship between Pakistan and South Korea could be established. Pakistan recognized both North and South Korea as two separate independent political entities but avoided taking sides. Pakistan extended full support to Korean unification

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<sup>1</sup> Information on the Korean War and Pakistan's position has been taken from S. M. Burke & Lawrence Ziring *Pakistan's Foreign Policy* (Karachi: Oxford University Press, 1990), pp. 126-133.

through peaceful means without external interference in accordance with the North-South Communiqué of July 1972.<sup>2</sup> In line with its policy to support peaceful unification of the two Koreas, Pakistan welcomed the first-ever Korean Summit held in Pyongyang in June 2000.

Both countries established consular relations in 1968. South Korea opened its Consulate General office at Karachi the following year. Pakistan reciprocated by opening its Consulate General at Seoul the same year. Both countries established full-fledged diplomatic relations by elevating the offices of Consulates General to the levels of embassies in 1983. Regarding high level visits by Pakistan dignitaries, President General Muhammad Zia ul Haq visited Seoul in 1985. Prime Minister Muhammad Khan Junejo and Prime Minister Benazir Bhutto visited Seoul in 1988 and 1996 respectively. However, no prime minister or president from the Republic of Korea has ever reciprocated by visiting Pakistan so far.

### **President Musharraf's Visit**

President General Pervez Musharraf went on a state visit to South Korea on 5-7 November 2003 to enhance bilateral diplomatic ties, to achieve better political understanding on global and regional matters, and to further expand the scope of bilateral economic cooperation between the two countries.<sup>3</sup> The visit of President Musharraf, however, was business oriented as within hours of his arrival in Seoul, he addressed heads of South Korea's four major business organizations including the Federation of Korean Industries, which emphasized the significance Pakistan attached to South Korea for mutual economic cooperation. In his address, President Musharraf rightly remarked that 'Korean investment and technology and Pakistani human capital could bring rich dividends to both countries'. He asked the South Korean entrepreneurs to benefit from Pakistan's unique geographical location and favourable business climate.

He laid particular emphasis on cooperation in the textile sector, information technology, oil and gas, and minerals development. Pakistan's comparative advantage in textiles and Korean technology could yield a major breakthrough in their bilateral economic relations besides exploring other lucrative sectors such as telecommunications, engineering, infrastructure and autos. South Korea expressed its keenness for the possibility of investing in oil and gas sector. A Memorandum of Understanding (MoU) was signed between Pakistan Ministry of Petroleum and Korea National Oil Corporation (KNOC)

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<sup>2</sup> Joint Communiqué issued at the end of the visit of the Prime Minister of Pakistan to the Democratic Peoples Republic of Korea, 21-26 May 1976, Ministry of Foreign Affairs, Government of Pakistan, *Joint Communiqués 1947-76*, n.d. p.403.

<sup>3</sup> See two articles of Dr. Ahmad Rashid Malik, 'Musharraf's South Korean Visit', *The Nation*, 5 November 2003 & 'Musharraf's Korea Visit', *The Nation*, 8 November 2003.



to explore oil and gas in Pakistan. Under this MoU, a Pak-Korea Joint Working Group was to be set up for the development of energy and mineral resources. Two more agreements were inked concerning cooperation in information technology, signed between Korea Software Industry Association (KOSA) and Pakistan Software Houses Association (PASHA), and energy and mineral development besides an accord related to export, credit, and re-lending facility for the development of commercial projects undertaken by South Korean firms in Pakistan. The information technology agreement covered areas such as e-government and public information, software development e-education, development of human resources in IT, exchange of experts, and holding of joint exhibitions and seminars. President Musharraf also proposed that a direct aviation link should also be established between the two countries to facilitate trade and commercial activities. The South Korean side responded positively to this proposal. To further boost bilateral trade between the two countries and enhance South Korean investment in Pakistan, President Musharraf also proposed that a Joint Ministerial Commission should be set up for the promotion of trade and investment. Hitherto secretary level consultations were being conducted between the two governments.

Prospects in textiles and autos between the two countries are encouraging as mentioned in the latter part of this paper. Pakistan is one of the biggest producers of cotton. Pakistan will not be facing quota restrictions for the export of its cotton goods under the World Trade Organization (WTO). In this context, President Musharraf asked the Korean textile entrepreneurs to jointly explore such opportunities with their Pakistani counterparts. Kia-Hyundai joint venture with Dewan Farooque Motors could be further expanded by the export of autos from Pakistan to other regions. Hence, more investment could be made in this sector. While President Musharraf encouraged the Korean businessmen to actively participate in privatization programme in Pakistan, he regretted that 'the current level of investment was not commensurate either with the potential of the Korean private sector or the opportunities available in Pakistan'. It was expected that the accord on commercial credit facility would help diminish any misperceptions and boost South Korean investment in Pakistan. Nevertheless, these agreements and proposals laid greater emphasis on business and increased cooperation in various fields between the two countries under the rapidly changing environment.

### **Economic Comparison**

Just a quarter century ago, South Korean economy looked typically underdeveloped and agrarian, but today South Korea has become world's 13th largest economy by producing US\$ 457 billion Gross National Product

(GNP).<sup>4</sup> Whereas Pakistan's economy is largely confined to agricultural output (i.e., cotton based) for the last 57 years and its GNP could not go beyond US\$ 61 billion. The resource-less and aid-led South Korean economy was replaced by speedy industrialization and self-sufficiency. On the contrary, Pakistan's economy became foreign aid-led after 1960. The situation has only reversed a couple of years ago. Pakistan could not catch up with the miracle that occurred on the Han-gang River, Japan, and elsewhere in East Asia. In comparison with South Korean GNP, Pakistan's GNP was only 12 percent of South Korean GNP. Gross Domestic Product (GDP) percentage growth of Pakistan recorded 4.4 percent in 1999-2000 while South Korea increased to 7.8 percent. In 2001 South Korea's exports accounted 45 percent of its GDP (i.e., US\$ 205 billion), while Pakistan's exports accounted only 16 percent of its GDP (i.e. US\$ 9 billion), thus making South Korea's exports 19 times larger than Pakistan's exports.<sup>5</sup>

Pakistan's population is about three times bigger than that of South Korea, and its illiterate population is 34 percent higher than South Korea's total population. While a number of just 4 million was added to South Korea's population during 1991-2002, Pakistan's population increased by 28 million during the same period. Therefore, the high population growth in Pakistan has further added to its overall underdevelopment. In South Korea the case is otherwise. In terms of land area Pakistan is spread over 796 thousand square km, while South Korea's land area is over eight times less (about 99 thousand square km) than Pakistan's. Moreover, in terms of basic communication facilities such as railways and roads, South Korea's infrastructure is far superior to Pakistan's. For instance, South Korea's total length of railways track is over 3,119 km long while Pakistan's railway track is over 8775 km long. At the same time South Korean road network is spread over 88,775 km while the total length of roads in Pakistan is 96,811 km. It should be realized that South Korea's geographical area is over eight times smaller than Pakistan's.

South Korean economic development could be divided into three distinct periods: economic turmoil period (1945-53), the reconstruction period (1954-61), and the rapid economic growth period (1962 - present). Pakistan's economic history can be divided into the following five distinctive periods: export-led period (1947-54), planned period (1955-71), mixed and nationalized period (1971-77), mixed and deregulated period (1977-89), and liberalized period (1990 to present). Therefore, unlike South Korean economy, Pakistan's economy has gone through fundamental changes and largely remained inconsistent during the past 57 years. During the Korean War (1950-53), South Korean economy was badly damaged which took a long time to heal.

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<sup>4</sup> *World Bank Development Report 2001* (Washington, D.C.).

<sup>5</sup> *Ibid.*

Whereas Pakistan emerged as a great beneficiary from this war as its exports greatly increased during the Korean War boom.

Consequently, Pakistan's overall economic outlook was better than South Korea's during the 1950s and 1960s. For instance, when South Korea devised its first five-year plan in 1962, Pakistan was implementing its second five-year plan. The per capita income of Pakistan was US\$ 120 in 1962 and that of South Korea during the same period was US\$ 87. However, in 2000 South Korean per capita income increased to US\$ 8,910, while that of Pakistan increased to only US\$ 440. It was only after 1962 that South Korea laid its focus on the establishment of textiles, export-led growth, heavy industry, and self-reliance to speedily promote its economic development. Today South Korea has become the 6th largest producer of steel in the world. Pakistan set up its textiles industry in the 1950s—much ahead of South Korea—but could not develop its heavy industry. In fact Pakistan's experience in heavy industry became a misery. Its steel mill, twice the size of a South Korean steel mill, was a failure during the last 30 years. In the later stage, South Korea developed its electronic industry and its indigenous auto industry besides developing its petrochemicals and ship building industry whereas Pakistan could not even focus on its electronic industry.

There have been striking similarities as well as sharp differences between the major economic indicators of both countries over the past four decades. Pakistan can learn several lessons from the South Korean experience of economic development of which notable are: Pakistan must control its ever increasing population and must fully exploit its natural resources to overcome its growing poverty. It must make a better and more efficient use of its human resources through literacy and education and export oriented speedy industrialization through effective use of its potentials related to present day market economy. Pakistan also must achieve high economic growth and increase its GDP by focusing more on sophisticated industries by coping with global demand instead of high concentration on agricultural outputs.

### **Trade and Commerce**

Although the history of diplomatic relationship between the two countries is relatively short, South Korea has become one of Pakistan's major trading partners in recent years with the active contribution of its private sector.<sup>6</sup> Trade trends of the two countries can be divided into the following three distinctive periods:

- (a) Advent of bilateral trade from 1947 to 1979
- (b) Expansion of bilateral trade during 1980-1989 and
- (c) Strengthening of bilateral trade from 1990 through to 2004

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<sup>6</sup> Data on trade has been taken from IMF, *Direction of Trade Statistics* (Various Volumes).

**(a) Advent of Bilateral Trade: 1947-1979**

Bilateral trade between Pakistan and South Korea remained inconsistent and did not constitute any substantial part of their global and regional trade during 1947-65. Even during this period both countries' bilateral trade was not mentioned in IMF *Direction of Trade* for years 1953 and 1963-4. For example, in 1951 Pakistan's exports to South Korea were just US\$ 0.3 million which did not constitute any substantial part of either Pakistan's exports or South Korea's imports from Pakistan. Moreover, the situation remained unchanged until the mid 1960s. This was attributed to the fact that South Korea largely remained locked into an agrarian economic set-up. There were number of other reasons for this low level of commerce: For instance, East Asia was still overcoming the wounds of World War II. The region was largely underdeveloped. The Korean War further damaged the prospects of trade among the regional countries, although Pakistan, in terms of its exports, immensely benefited from this war for the time being. Manufacturing industry was non-existent except for Japan but it was also under occupation and could not freely trade to help boost the regional trading activities at least until 1952. Pakistan's exports were mainly raw materials such as cotton and jute. As for imports, these were mainly textiles and machinery which South Korea could not provide at that time. Pakistan also largely remained agrarian but started making headway toward industrialization. So naturally Pakistan's trade with Japan developed while trade between Pakistan and South Korea could not take any concrete shape.

It is interesting to note that Japan's trade with Pakistan both in terms of its exports and imports was far larger (almost four times) than its trade with South Korea during the early 1950s. At some point, Japan's trade with South Korea was nominal in the early 1950s as it was not a significant trading partner of Japan and comparatively Japan's trade with Pakistan was far greater than its trade with South Korea during this period. In terms of Japan's exports, South Korea's share slightly improved compared to Pakistan's but of Japan's imports, Pakistan's share remained greater than South Korea's during the late 1950s. In the 1950s and 1960s Japan, Indonesia, China, and India emerged as major trading partners of Pakistan. While trade with other East Asian countries including South Korea simply could not develop.

However, in the 1960s Japan's trade with South Korea increased at a rapid speed compared with Japan's trade with Pakistan as South Korea embarked upon its First Five Year Development Plan in 1962 and set up the foundations of its textiles and plywood industry in the 1960s. It was able to start exports by the end of its First Five Year Plan. In 1968, South Korea, for the first time, shipped goods worth US\$ 25.30 million to Pakistan that witnessed a major breakthrough in both countries' bilateral trade after 1947. South Korea's share of Pakistan's imports from East Asia thus increased to 24

percent while at the same time South Korea's share of Pakistan's global imports increased to 2.5 percent. Pakistan's exports to South Korea could not rise to any substantial level until 1973 when its exports exceeded US\$ 5.5 million but then steadily declined in 1977. But Pakistan's exports to South Korea rose to US\$ 11.5 million, i.e., the highest amount since the beginning of trade between the two countries, but declined by 60 percent, i.e., scaled down to US\$ 6.9 million next year. Pakistan's imports of goods from South Korea continuously increased from US\$ 1.2 million in 1971 to US\$ 80.3 million in 1979. At this point, South Korea's share of Pakistan's global imports rose to 2 percent, while at the same time South Korea's share of Pakistan's imports from East Asian countries rose as high as 13 percent. However, in Pakistan's global exports South Korea's share remained insignificant, i.e., only 0.3 percent. Although two-way trade between the two countries could not jump beyond US\$ 87.2 million by 1979, it was an encouraging step toward an increase in trade between them in the years to come.

Pakistan's exports to South Korea remained somewhat inconsistent during 1967-79 but imports from South Korea steadily increased during this period. This trade covering a period of 13 years though small in volume, largely benefited South Korea as it exported more goods to Pakistan than it imported from Pakistan. Therefore, from 1968 to 1979 South Korea accumulated a trade surplus against Pakistan. It was only in 1967 that Pakistan accumulated a tiny trade surplus worth US\$ 0.6 million vis-à-vis South Korea. However, in subsequent years up to 1979 trade deficit of Pakistan steadily increased particularly after 1973 and reached US\$ 73.4 million by 1979.

#### **(b) Expansion of Bilateral Trade: 1980-89**

Bilateral trade between the two countries developed bit slowly during the early phase for one or the other reason as pointed out above, but trade witnessed positive changes during the 1980s. In terms of Pakistan's exports to East Asian countries, percentage share of South Korea constantly increased from 1982 through to 1999. At some points, South Korea's percentage share of Pakistan's exports to the East Asian region jumped as high as 20 percent in 1991. Thus South Korea became an important market for Pakistani goods after Japan in East Asia during this period. Pakistan's exports to South Korea continuously rose from US\$ 7.1 million in 1981 to US\$ 144.5 million in 1989. It was mainly due to the high economic growth that was recorded above 11 percent in the South Korean economy. South Korea's share of Pakistan's global exports increased at an average of three percent during 1986-89. Furthermore, in Pakistan's cumulative exports to East Asia, South Korea's share reached as high as 16 percent in 1986 and 1987 but remained around 14 percent up to 1989.

Pakistan's imports from South Korea during the 1980s slightly fluctuated but over all increased. For instance, Pakistan's imports from South Korea in 1980 were recorded at US\$ 73.1 million but reached US\$ 211.7 million in 1989. However, during 1981-85 imports from South Korea slightly declined. South Korea's share of Pakistan's global exports remained around 2 percent during the 1980s while at the same time South Korea's share of Pakistan exports to East Asian countries reached as high as 16 percent in 1986 and 1987 but slightly declined to 14 percent in 1988 and 1989 respectively. In Pakistan's imports from East Asian countries, South Korea emerged as an important source of Pakistani demands. For instance, South Korea's share of Pakistan's imports from East Asia reached as high as 18 percent in 1988 and 17 percent in 1989. In 1981-83, South Korea's share of Pakistan's imports remained around 13 percent. South Korea emerged as an important source of Pakistan's import requirements from the East Asian region, which helped strengthen trade between the two countries in the coming decade. It is interesting to note that during the 1980s Pakistan exports to South Korea were fewer than it imports from that country unlike the 1970s. As a result of this trend, Pakistan faced constant trade deficit with South Korea of which the highest point was reached in 1981 when Pakistan trade deficit soared to US\$ 102 million but then steadily registered a decline in 1987.

**(c) Strengthening of Bilateral Trade: 1990-2004**

Bilateral trade between the two countries strengthened as they made major strides after Pakistan opened up new avenues under its liberal trade policy in the 1990s and South Korea's private entrepreneurs found new opportunities for trade and commerce in Pakistan. Consequently, trade experienced quantum jump during the 1990s compared to the previous decade. South Korea's exports to Pakistan, which remained stagnant after 1988, recovered in 1993, registering US\$ 447 million, a scale even larger than the peak established in the couple of previous years. Exports of Pakistan to South Korea constantly increased from 1990 to 1996. The two-way trade amounted to US\$ 601 million in 1999 including years 1996 and 1995 when bilateral trade remained over US\$ 600 million.

During this period, Pakistan's exports to South Korea also witnessed a major breakthrough as exports reached US\$ 279 million in 1993, taking South Korea's share of Pakistan's global exports to 2.6 percent and 13 percent of Pakistan's exports to East Asia. In 1995 South Korea's share of Pakistan's global exports reached as high as 3.6 percent and in Pakistan's exports to East Asia reached 15 percent, the highest percentage share ever recorded in trade between both countries. However, in 1998 Pakistan's exports to South Korea drastically shrank to US\$ 140 million as a result of economic sanctions imposed by several of Western countries following nuclear detonation conducted by Pakistan the same year. Nevertheless, these low level exports of

Pakistan to South Korea recovered in the following year when exports rebounded to US\$ 248 million, thus increasing South Korea's share of Pakistan's global exports to 3 percent and 14 percent of Pakistan's total exports to East Asia.

South Korea's share of Pakistan's global imports jumped to 5 percent at this point. While at the same time, South Korea's share of Pakistan's imports from East Asia jumped to 22 percent. This mainly occurred after the signing of the Islamabad-Lahore Motorway Project undertaken by Daewoo Corporation that brought construction machinery, equipment, and expertise to construct this modern Motorway. South Korea's share of Pakistan's imports from East Asia remained around 14 percent in 1994, 1998, and 1999. However, during 1995-96 South Korea's share of Pakistan's imports from East Asian countries slightly declined and remained around 13 percent for these years. As for Pakistan's exports to East Asia, South Korea's share went up as high as 20 percent in 1991. Therefore, it must be understood that South Korea emerged as an important market for Pakistan's imports during the last three decades while it also emerged as one of the leading export destinations for Pakistani goods. In terms of South Korea's exports to South Asia, exports to Pakistan registered an increase of 14 percent in 2002 while South Korea's exports to India and Sri Lanka witnessed a declining trend of 2 and 1 percent respectively.<sup>7</sup>

In 2003, Pakistan's exports to South Korea declined to US\$ 206 million but at the same point imports slightly recovered and reached US\$ 349 million. As exports to South Korea declined, percentage share of South Korea also declined to 1.7 percent in Pakistan's overall exports. Similarly, South Korea's share of Pakistan's imports recorded 2.6 percent during this period. South Korea's share of Pakistan's exports to Asia also witnessed a negative trend i.e., a decline to 9 percent from 15 percent. The percentage share of South Korea also decreased to 9.4 percent from 11.2 percent in Pakistan's imports from Asia as compared to the previous year. Therefore, bilateral trade between the two countries has declined during the past five years (2000-04) from US\$ 625 million in 2000 to US\$ 404 million in 2004 (first three quarters).<sup>8</sup>

Like the 1970s and 1980s, Pakistan's trade deficit with South Korea widened throughout the 1990s. In 1993, Pakistan's trade deficit reached US\$ 280 million. In the following years, the trade deficit declined but again rose to US\$ 238 million in 1998. There had been a declining trend of trade deficit of Pakistan with South Korea in the year 2001 and 2002, which declined to US\$ 47 million and US\$ 48 million respectively. However, Pakistan's trade deficit

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<sup>7</sup> Korea International Trade Association, *Korea Trade Statistics*, 2003.

<sup>8</sup> IMF: *Direction of Trade Statistics* (Quarterly March 2005).

again increased to US\$ 143 million in 2003 and declined to US\$ 44 million in 2004 (provisional data).

### **Private Sector Role**

Several South Korean *Chaebols* (conglomerates) have been actively undertaking business in Pakistan in various areas such as infrastructure, chemicals, petrochemicals, electronics, automobiles, light industry, and trading since the early 1990s. At present there are around 37 Korean conglomerates and medium companies that are operating in Pakistan. For instance, Daewoo Group completed Pakistan's first modern Motorway in 1997. The project stands out as a lasting symbol of Pakistan-South Korea cooperation. The project was conceived by Prime Minister Mian Muhammad Nawaz Sharif to provide the country with a link of limited access high-speed highway to bring most parts of the country together that were being neglected in the past so that it could accelerate the pace of economic growth and other commercial activities. It was also believed that such a system of modern road network would promote trade between Pakistan and landlocked Central Asian countries in this age of increasing globalization as Pakistan earnestly wished to kick-start trade expansion to overcome its myriad economic woes. Moreover, the ten-member Economic Cooperation Organization's (ECO) regional trading success solely depends on a speedy road and railway network by providing them access to the Arabian Sea. Therefore, the idea of building a modern network of roads in Pakistan was in line with the very idea of ECO itself.

Moreover, Hyundai Corporation has completed a number of important infrastructure projects. Daelim Corporation participated in the construction of Pakistan's largest private power production project. While Samyang Group helped set up Pakistan's largest polyester plant and Samwha Printing Corporation, and LG are strongly enhancing their presence in Pakistan. Recently Samsung Electronics has set up television assembly plant in collaboration with Digital World Pakistan at Lahore. This shows how actively South Korean *Chaebols* are exploring avenues of trade and business in Pakistan.

Auto industry in Pakistan has been growing at a rapid pace. It is learnt that auto industry in Pakistan has become the 10th largest in the world and the industry is contributing around Rs 30 billion annually to the national exchequer with deletion level reaching 70 percent. The adoption of the new engineering techniques would be having a positive impact on future auto production in Pakistan. Therefore, investment in this sector of the economy is considered lucrative.

Traditionally the Japanese auto entrepreneurs have dominated the auto industry in Pakistan. Japanese sidetracked the European auto-makers such as the British and Italians. German and American automakers also lost their market's share to the Japanese automakers as a result of relatively cheaper autos offered by them in Pakistan by the early 1980s. Nevertheless,

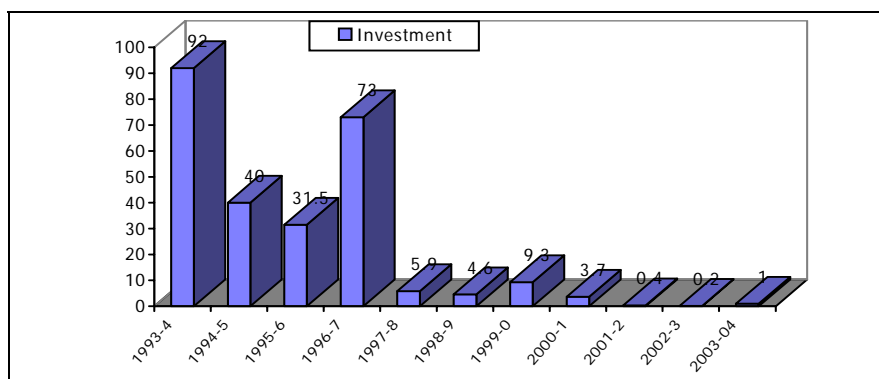


the Japanese automakers are now facing competition from the new entrant i.e., Kia-Hyundai, the South Korean auto joint enterprise. The company also took over Kia operations in Pakistan as the latter company merged into Hyundai. The company launched six different kinds of vehicles and breached the overall monopoly of the Japanese vehicles in the local market. During 2002-03, Dewan Farooque Motors, for instance, snatched 6.3 per cent share in the over all production of 1300, 1600cc, and 2000cc segments while its sale share increased to 6.8 per cent. Therefore, auto industry is in the process of innovation and in the position of take-off and has the capacity to further attract foreign investment in this sector and South Korean assemblers can play a much greater role.<sup>9</sup>

Nevertheless, South Korean *Chaebols* have a short history of Foreign Direct Investment (FDI) in Pakistan and their relative size of investment to other competitors is quite small at present. South Korea was the first country in East Asia with which Pakistan signed a bilateral investment agreement in 1988. As a result of this agreement, South Korean private sector capital interest grew in Pakistan in the beginning of 1990s—at a time when Pakistan opened up its business and started deregulating its economy. This had a positive impact on private sector business.

South Korean total investment was recorded US\$ 197.6 or 2.4 percent as per accumulated share of Pakistan's total FDI by 2004.<sup>10</sup> Textiles, food, general trading, communications, and electronics were the main thrust areas of South Korean investors over the last few years. They are keen to further enhance their participation particularly in the areas of telecommunications and information technology besides transportation and autos.

**South Korean Foreign Direct & Portfolio Investment in Pakistan during 1992-2004**  
(US\$ Million)



Source: State Bank of Pakistan.

<sup>9</sup> Dr Ahmad Rashid Malik 'Korean Auto Assembling in Pakistan', *Link* (Karachi: Pak-Korea Business Forum), Vol.2 (March 2004).

<sup>10</sup> Board of Investment 2004.

By investing US\$ 93 million in FDI in 1993-4 South Korea emerged as the second largest source of foreign investment in Pakistan after the United States. In the next couple of years, South Korea ranked 5th largest FDI investor in Pakistan. However, from 1996 onwards South Korean private capital started declining and it did not play any significant role in investment in Pakistan. At this point, Pakistan's over all foreign investment also showed a declining trend. Therefore, among other traditional investment partners of Pakistan (such as the United States, Britain, Germany, United Arab Emirates, Saudi Arabia, Japan, and Hong Kong), South Korea emerged as a new investment partner of Pakistan.

In the subsequent years, investment flow from South Korea declined to US\$ 0.4 million during 2001-02 which was a 50 percent decline from 2000-01, i.e., US\$ 0.4 million. The FDI flow slightly increased to US\$ 1 million in 2003-04, thus making South Korea's share of Pakistan's total FDI 2.4 percent at present. If the Government follows a consistent policy and gave preferential treatment to foreign investors to build confidence rather than penalizing them as it happened in case of Daewoo's Motorway Project explained above, Pakistan can attract substantial amount of investment from the South Korean private sector.

### **Bilateral Cooperation**

South Korean *Chaebols* started lending their credits to the Government of Pakistan in the early 1990s. The amount of commercial credits, which the Government of Pakistan owes to four major South Korean *Chaebols* namely, Daewoo, LG, Ssangyong, and Samsung, is US\$ 873 million as of 28 April 1999.<sup>11</sup> Pakistan's National Highway Authority and Pakistan Tele Communication Ltd are the main borrowers. The largest outstanding credit and debt that Pakistan owes to South Korean *Chaebols* belong to Daewoo Corporation in connection with the construction of the Islamabad-Lahore Motorway details of which have already been discussed earlier.

After the commercial credit of Daewoo was not paid in time and dispute emerged between Daewoo and Finance Ministry of Pakistan about delays in due repayments and ultimate rescheduling by the Paris Club, Daewoo's further interest in investment and business badly dwindled.

After 9/11 Pakistan obtained debt stock treatment from Paris Club to enhance its fiscal space. Considering these matters, in August 2003 both Pakistan and South Korea agreed to reschedule official and commercial loans and credits worth US\$ 494.1 million and the two separate agreements worth US\$ 91.6 million and US\$ 402.5 million respectively were inked on 11 October 2003 at Islamabad.<sup>12</sup> According to the agreement total official debt will be

<sup>11</sup> Government of the Republic of Korea: Ministry of Finance and Economy.

<sup>12</sup> *The Nation, Dawn, The News, & Business Recorder*, 12 October 2003.

repayable over 38 years including 15 years of grace period at interest rate of 3.5 percent per annum. While non-official debt is payable in 23 years including 5 years of grace period.<sup>13</sup>

South Korean Government also offers technical assistance in a wide range of areas in the form of official loans facility, grant aid and technical cooperation in the development of Pakistan's socio-economic sector. Total disbursed and outstanding public and publicly guaranteed medium and long term debt of South Korean Government to Pakistan is US\$ 738.45 million as of 31 March 2002, which is 5.9 percent of the entire outstanding debt of Pakistan. In this sense, South Korea ranked 5th in Pakistan's outstanding debt after the United States, Japan, Germany, and France.<sup>14</sup> In 2001-2 Pakistan's debt service payments to South Korea had been US\$ 5.230 million, whereas in the previous year Pakistan's debt payments to South Korea had been US\$ 18.630 million.<sup>15</sup>

Grants are just 18 percent components of foreign assistance received by Pakistan in the year 2000-1. Donors have converted their grants into loans over the years. Therefore, the Government of the Republic of Korea also offers nominal grant assistance to Pakistan. For instance, in 1999-2000, offered US\$ 0.2 million worth of assistance to Pakistan mostly in the shape of equipment and material for various social sector development projects. Also humanitarian assistance of US\$ 50,000 in cash was donated to the cyclone victims in Badin, Sindh in 1998. Moreover, 29,673 bottles of polio vaccine worth US\$ 50,000 were supplied to the National Institute of Health for the eradication of polio under the campaign of World Health Organization (WHO). In a bid to assist Pakistan government in its relief operation in areas in Sindh and Balochistan affected by heavy rains and flood, Korea provided US\$ 20,000 for this purpose in August 2003.

Technical cooperation of the Korean government is carried out by Korea International Cooperation Agency (KOICA) with the aim to share country's development experience with developing countries and to help promote economic growth, to enhance friendly partnership, and to contribute toward the promotion of peace and prosperity. The association strongly believes in strengthening its ties with Pakistan in the human development area. Under this backdrop KOICA is endeavouring strenuously to strengthen human relationship through human resource development between the two countries since 1991. In this connection, KOICA has offered various training courses to the Pakistani trainees held in South Korea. As many as 296 people have participated in various training courses during 1991-2002. In 2003 KOICA invited 30 participants to South Korea in 30 different courses. This showed

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<sup>13</sup> *The Nation*, 14 & 17 August 2003, *Dawn*, & *Business Recorder*, 17 August 2003.

<sup>14</sup> Government of Pakistan, *Economic Survey* 2002.

<sup>15</sup> *Ibid.*

that KOICA is primarily emphasizing on the need to promote human resource and capacity building development in Pakistan for government officials and professionals. KOICA also dispatched experts and volunteers to Pakistan in the field of promotion of small and medium size enterprises and transfer of development experience of South Korea in health, education and population welfare. The Korea Trade Association (KOTRA) carries out official-led commercial activities. The office of KOTRA has been functioning at Karachi.

The first ever South Korean trade festival was held in Lahore in 1999 with the assistance of the Embassy of the Republic of Korea. With this success the second festival was organized in Karachi in 2000. These festivals tended to promote trade and commerce between the two countries. For long it was realized that a business platform was urgently needed to identify difficulties and to suggest remedies for the promotion of bilateral economic activities. This need was mostly felt by the businessmen of the two countries that have been engaged in bilateral business over a period of time. Realizing this necessity, the foundation of a new business body namely Pakistan-Korea Business Forum (PKBF) was laid down in June 2003 at Karachi in order to provide a channel of network between the business communities and the two governments. Within short span of time, membership of the Forum has tremendously increased and now it has emerged as one of the leading business fora in the country. The publication of *Link*, a quarterly magazine of PKBF, is a step in the right direction in promoting the above objectives of the Forum. Pakistan and South Korea share a centuries old Common Buddhist heritage, which invariably links the two countries in strong historical bonds of cultural cooperation. In this context, both countries signed a Cultural Agreement in 1985, which provided a framework for cooperation in the field of culture, art, film and sports, tourism, education, information, broadcasting, and youth affairs.

### **The Future**

Prospects for trade and economic cooperation between Pakistan and South Korea seem encouraging in the 21st Century. South Korean economy staged a big comeback in 1999 by showing a positive outlook. Its *Chaebols* recovered from shocks and completed successful restructuring. South Korean business community is quite active and aggressive. Remarkable progress has also been noted regarding Pakistan's macro economic front together with its growth rate that is touching around 8.4 percent. Pakistan badly needs trading partners in Northeast Asia. After Japan, South Korea is best stationed and Pakistan may promote its ambitious trading and commercial links. The prospect of trade, investment, and economic cooperation between the two countries must be seen in the context of changes brought by WTO. The signing of a Preferential

Trade Agreement (PTA) between the two countries would lead to greater expansion of trade and investment activities.

Looking at the large size of the South Korean economy, Pakistan's exports to South Korea should further be expanded to a greater extent. To create a balance in trade with South Korea, Pakistan must diversify its goods to South Korea from traditional items to finished and semi-finished to value added and non-traditional items. South Korean entrepreneurs may lay their focus on textiles industry in Pakistan similar to the way they developed textiles industry in Bangladesh, Sri Lanka, China etc. Pakistan is a major producer of raw cotton and with South Korean textiles technology, know-how, and capital, Pakistan can become a hub for quality textiles exports to meet world demand under its recently emerged Textile Vision for the 21st Century.

Other than textiles, investment in infrastructure development, oil and gas, fisheries and food could also be regarded as promising areas for South Korean investment in Pakistan. Pharmaceuticals and information technology could also bring in substantial South Korean investment in Pakistan. Above all, auto industry particularly assembling, spare parts and joint ventures are indeed lucrative areas for South Korean private sector to enhance their participation because the use of South Korean autos is on the rise in Pakistan. South Korean transportation experience has no doubt set an example for quality public transportation in Pakistan during the past five years. In public transportation South Korean businessmen enjoy a virtual monopoly over other competitors. This sector can further be strengthened in the years to come. A direct air link between Karachi and Seoul could further promote commerce and trade between the two countries.

On the diplomatic side, there is also a need to further enhance bilateral exchanges. Under the prevailing global circumstances, a visit by a top South Korean leader to Pakistan has been long over due since 1985. Time has come that this visit must be materialized. Therefore, based on mutual dynamisms of development and prosperity of the two people of Pakistan and South Korea, economic relations must be further strengthened and deepened between them and efforts should be made to construct a more meaningful relationship between the two countries in the years to come. ■

## NFC AWARD CONTROVERSY: A BROADER PERSPECTIVE

Rashid Ahmad Khan\*

### Introduction

For the third consecutive year, the national budget for FY 2005-6 was prepared and presented before the National Assembly without finalizing National Finance Commission (NFC) Award as the provinces failed to reach consensus on a formula for the horizontal distribution of their share of funds from federal divisible pool. The budget, therefore, had to be based on the existing Award.<sup>1</sup> But the good thing after three years of inconclusive controversy is that the provinces have agreed to repose confidence in President General Pervez Musharraf and accept whatever decision he would take on the Award.<sup>2</sup> Hopefully, the decision by the President would bring an end to the acrimonious debate on the Sixth NFC Award. But the NFC Award controversy during the last three years, revealed many an important aspect of center-province and inter-province relations, particularly in the financial areas. It would, therefore, still be useful to discuss and analyze in a broader perspective the NFC Award controversy as it raged on during the past three years.

It would be appropriate to state at the very outset what this paper does not propose to discuss. The paper does not purport to devise a consensus formula for distribution of financial resources between the center and the provinces and among the provinces of Pakistan. The paper will also not go into the merits or demerits of the respective positions of the center and those of the four provinces on NFC Award during the controversy that still remains unresolved. However, the paper will discuss in detail the controversy on NFC Award involving the center and the four provinces of Pakistan in the broader context of historical issue of provincial autonomy in Pakistan. The running theme of the paper would be that the current controversy on NFC Award is inextricably linked to the broader issue of provincial autonomy and unless this issue is resolved to the satisfaction of parties involved, center-

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<sup>1</sup> Under the existing NFC Award, the provincial share is 37.5 per cent, while remaining 62.5 per cent goes to the center. After including 2.5 per cent GST in lieu of *octroi* and *zila* tax and subventions and grants, the provincial share goes up to 42.5 per cent. See *Dawn* (Islamabad), 3 June 2005.

<sup>2</sup> See the statement of Sindh Chief Minister Arbab Ghulam Rahim, *Dawn* (Islamabad), 25 June 2005.

province relations in Pakistan, especially in the fiscal area will always remain under stress.

The paper is divided into three parts. The first part contains a brief discussion on the issue of provincial autonomy in its historical perspective, focusing on the evolution of center-province relations, especially in the fiscal area under four constitutions of Pakistan, i.e. Interim (1947-54), 1956, 1962 and 1973 Constitutions. The second part will consist of a detailed discussion on the controversy on NFC Award between the center and the provinces on the one hand and among the provinces, on the other, highlighting the contentious issues associated with NFC Award and the positions of the respective parties on these issues. The third part will form the conclusion based on the discussions in the preceding two parts along with some suggestions to approach the issue in future.

### **The Issue of Provincial Autonomy**

The issue of provincial autonomy, i.e. distribution of powers, especially financial powers between the center and the provinces, has been an important issue much before the emergence of Pakistan and India as independent states in 1947. As stated by G. W. Chaudhury, provincial autonomy in undivided India was a product of a long period of constitutional development from 1860 to 1919. Its foundation had been laid down soon after the 'Mutiny' (1857) when the British came to the conclusion that highly centralized system established by the East India Company was proving "inconvenient and prejudicial to administrative efficiency."<sup>3</sup> The British were forced to accept provincial autonomy as the product of "inexorable forces of events." In the Preamble to the Montagu-Chelmsford Report, the authors recognized the provinces as "the domain in which the earlier steps towards the progressive realization of responsible government should be taken."<sup>4</sup>

A survey of the constitutional and political history of India before 1947 would reveal that the demand for greater provincial autonomy was related to 'popular demand for constitutional or responsible government in the country'<sup>5</sup> In other words, the struggle for democracy was closely linked with demand for provincial autonomy. The British concessions on more democratic and more representative institutions in India were inevitably accompanied by further steps towards decentralization. As G. W. Chaudhury has aptly remarked, "A certain parallelism is discernible between the constitutional changes and the attempts at decentralization."<sup>6</sup> From this it

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<sup>3</sup> G. W. Chaudhury, *Constitutional Development in Pakistan*, (London: Longman Group Ltd., 1969), p. 23.

<sup>4</sup> Ibid, p. 23.

<sup>5</sup> Ibid, p. 24.

<sup>6</sup> Ibid, p. 24.

follows that the forward movement of democratic political process in the country has led to demands for more provincial autonomy. This explains the emergence of demand for greater provincial autonomy as the main issue in Pakistan and India after 1947. Since provincial autonomy is meaningless without financial autonomy, the demand for greater provincial autonomy has invariably been expressed in the form of demand for more equitable distribution of resources both at vertical and horizontal levels. The current controversy over NFC Award in Pakistan is, therefore, a continuation of the same process. We will come back to a further discussion of this issue in this context after we complete our survey of the issue of provincial autonomy in the historical perspectives that we started earlier.

The Government of India Act 1935 introduced federalism for the first time in India, according the status of legal entities to the provinces. But the Act ensured the dominance of the center over the provinces through its various provisions. The Act was, therefore, subjected to severe criticism by both Congress and the Muslim League for concentrating powers in the hands of the center. But it is important to note that the area of provincial autonomy was further curtailed in the legislative field under the Interim Constitution adopted by Pakistan after making some changes and modifications in the 1935 Act.

Apart from the distribution of financial resources between the center and the provinces, which heavily weighed in favour of the former, there were two other areas under the Interim Constitution, which formed the core of debate on the issue of provincial autonomy during the early years of Pakistan. These were the administrative relations between the center and the provinces and the powers of Governor-General. Under a number of articles of the Interim Constitution, the center could influence the provincial politics and policies. Under Article 122, it was obligatory on the federating units to exercise their authority to ensure respect for federal laws enforced in their respective provinces. The federal government was empowered under Article 126 in general, and sub-sections 2 and 5 in particular, to issue directives to the provincial governments as to the manner in which the executive authority of the provinces was to be exercised for the purpose of preventing any grave menace to peace, tranquility and economic life of Pakistan or any part thereof. Once a directive was issued, the provincial government had to comply with it. In case of non-compliance, the provincial government could be proceeded against under law as guilty of misconduct. Article 126 was invoked against Hamidul Haq Chaudhury, East Bengal Minister for Finance, Commerce and



Industries, because he failed to comply with a directive of the Federal Government as claimed by the latter.<sup>7</sup>

But the most comprehensive article that gave sweeping powers to the center to exercise administrative control over the provinces was 92-A. The article laid down:

“If at any time the Governor-General is satisfied that a grave emergency exists whereby the peace or security of Pakistan or any part thereof is threatened or a situation has arisen in which the government of a province cannot be carried on in accordance with the provisions of this Act, he may by Proclamation direct the Governor of a province to assume on behalf the Governor-General all or any of the powers vested in or exercisable by any provincial body or authority. Any such Proclamation may contain such identical or consequential provisions as may appear to the Governor-General to be necessary or desirable for giving effect to the objects of the Proclamation, including provisions for suspending in whole or in part the operation of any provision of this Act relating to any provincial body or authority.”<sup>8</sup>

This provision of the Interim Constitution empowered the center to dismiss any provincial government during emergency or on the pretext of failure to carry out the provincial administration in accordance with the Act, which practically meant the wills and whims of the center. The center invoked this power against the provinces on a number of times during the early years of Pakistan’s history. The constitutional machinery was suspended and central authority was imposed on the Punjab, Sindh and East Bengal.<sup>9</sup>

Another source of the dominance of the central government over the provinces were the wide powers of the Governor-General, including the power to appoint and dismiss the provincial governors. This was also misused for political purposes in Pakistan.<sup>10</sup> The original 1935 Act had given the Governor-General “the widest discretionary powers and special responsibilities’ because the British believed strong executive was in the interest of India. But the nationalist parties of India, including Congress and Muslim League did not agree with the British. The exceptionally wide powers of the Governor-General through which a complete dominance of the center over the provinces was, therefore, the target of continuous criticism by both Congress and the Muslim League.

This is why the very first decision taken by the new state of Pakistan immediately after independence was to do away with the discretionary powers

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<sup>7</sup> Mehrunnisa Ali, *Politics of Federalism in Pakistan*, (Karachi: Royal Book Co., 1996), pp. 53-54. For Articles, 122 and 126 of the Interim Constitution, see Constitutional Documents (Pakistan), op. cit., 95, 97.

<sup>8</sup> Constitutional Documents (Pakistan), op. cit.

<sup>9</sup> Chadhury, op. cit., p. 28.

<sup>10</sup> Ibid.

of the Governor-General by amending the Indian Independence Act, 1947. Although the Governor-General still retained comprehensive powers under the Interim Act, which included among others the power to appoint the Prime Minister and other federal ministers, who were to hold office during his pleasure, the power to appoint principal military officers, Advocate-General of the Federation, the Chief Justice and the judges of the High Courts. The discretionary powers of the Governor-General ended under the Act adopted by Pakistan. From 14 August 1947, the entire field of government activity was brought under the control of the cabinet, which being responsible to the Constituent Assembly became the real authority. Under the Interim Constitution, Pakistan moved a few steps closer to the parliamentary democracy as the Governor-General had to use all powers mentioned above on the advice of the cabinet.

The removal of the discretionary powers of the Governor-General under the Interim Constitution of Pakistan reflected the desire of the people of the new state for a more democratic polity and devolution of powers from the center to the provinces. The powerful Governor-General had become the symbol of not only a powerful executive but of a federal arrangement with a strong center and weak provinces. The nationalist parties in India had strongly opposed this arrangement under the 1935 Act. After the establishment of Pakistan the opposition to the discretionary powers of the Governor-General intensified. The Founding Fathers had to positively respond to the demands of the people to remove the discretionary powers of the Governor-General as their presence not only negated the spirit of the parliamentary system of government, they seriously undermined the autonomy of the provinces.

This response found its reflection in the relevant provisions of the 1956 Constitution. For example, the power of the President to appoint Prime Minister was qualified with the condition that the person so appointed must be "from amongst the members of the National Assembly", who in his (President's) opinion was most likely to command the confidence of the majority of the members of the National Assembly.<sup>11</sup> Similarly, although, under clause 6 of the same article, the Prime Minister was to hold office during the pleasure of the President, the President was barred from exercising his power under this clause unless he was satisfied "that the Prime Minister does not command the confidence of the majority of the members of the National Assembly."<sup>12</sup> This provision was inserted in the Constitution keeping in mind the dismissal of Kwaja Nazimuddin's ministry in 1953 by Governor-General Ghulam Mohammad despite the fact that the former enjoyed the confidence of the majority of the members of the Constituent (Legislature) Assembly.

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<sup>11</sup> Government of Pakistan, *The Constitution of the Islamic Republic of Pakistan*, (Karachi: Department of Advertising, Films and Publications, 1956), Article 37(3), p. 25.

<sup>12</sup> Ibid, p. 25.

Under the 1956 Constitution, the discretionary powers of the head of the state (President) were further reduced and in the exercise of his functions, the President was to act in accordance with the advice of the Cabinet or appropriate Minister or the Minister of State.<sup>13</sup> Under the 1956 Constitution, the area of provincial autonomy was enlarged through an increase in the number of items in the Provincial List and transferring the Residual Powers to the provincial legislatures. As G. W. Chadhury remarks: "The architects of the 1956 Constitution had to provide maximum room for decentralization in view of the number of powerful factors, political, economic, psychological working towards demand for regional autonomy. The Constitution, he commented, on close scrutiny could be found to have granted what the Awami League chief, H. S. Suhrawardy called 98 per cent of provincial autonomy."<sup>14</sup>

The enlarged area of provincial autonomy under the 1956 Constitution was reflected in the distribution of financial powers between the center and the provinces in the legislative, administrative and financial areas. Although 1956 Constitution retained the control of major sources of income in the hands of the center, some of the taxes like estate and succession duties on agriculture and stamp duty were returned to the provinces. The provinces also shared with center proceeds from income tax, sales tax, export duty and excise tax. One half of the proceeds from the income tax were divided between East Pakistan and West Pakistan in the ratio of 45:55. East Pakistan retained half the net proceeds of the sales tax collected in its area. The grants-in aid was given annually at the discretion of the central government and could not be claimed as a matter of right by the provinces.<sup>15</sup> Although financial relations between the center and the provinces under the 1956 Constitution were not much different from those under the Government of India Act 1935, the distribution of resources between the center and the provinces under the 1956 Constitution indicated a definite improvement in favour of the provinces when viewed against the background of change in the original scheme immediately after independence.

### **The Commission**

An important provision in the 1956 Constitution was the establishment of NFC under Article 118. The Commission to be constituted by the President was meant to make recommendations as to the distribution between the Federation and the Provinces of the net proceeds of the following taxes:

- (1) Export duty on jute and cotton, and any other specified export duty.
- (2) Taxes on income other than corporation tax

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<sup>13</sup> Article 37 (7), *Ibid*, p. 25.

<sup>14</sup> Chadhury, *op. cit.*, p. 106.

<sup>15</sup> Mehrunnisa, *op. cit.* p. 104.

- (3) Specified duty of Federal Excise
- (4) Taxes on sales and purchases; and
- (5) Any other specified tax

These measures were taken to satisfy the demands of provincial autonomy, which, if not reasonably satisfied, as G. W. Chaudhury has rightly remarked, could have led to the movement for secession by subversive elements.<sup>16</sup>

The 1962 Constitution introduced a presidential form of government with concentration of powers in the hands of the center. The area of provincial autonomy was much curtailed as compared to the one under the 1956 Constitution. Under the 1956 Constitution, the provincial cabinet enjoyed the real authority; while the Constitution of 1962 ensured the direct control of the center over the provinces through a number of provisions. The provincial executive, under the 1962 Constitution, was responsible to the provincial governor, who was appointed by the President. The members of provincial cabinet were appointed and removed by the Governor with the concurrence of the President. According to Article 66 (2) of the 1962 Constitution, the Governor of a province in the performance of his functions was to be subject to the directions of the President.<sup>17</sup>

According to G. W. Chaudhury, the Constitution of 1962 lacked the essential characteristics of a federal state.<sup>18</sup> The Constitution, however, retained the provision for constituting a National Finance Commission by the President to make recommendations as to the distribution of resources between the center and the provinces. As compared with the function of National Finance Commission under the 1956 Constitution, the National Finance Commission under the 1962 Constitution was given an additional one. According to the 1962 Constitution, the National Finance Commission was to present a report to the President on the progress made during the period of an economic development plan, to remove the disparity between the provinces and between areas within the provinces. The Commission was also to make recommendations as to the manner in which the disparities were to be removed in the next development plan. The recommendations were to be considered by the National Economic Council while formulating its plan for economic development in the country.<sup>19</sup>

The 1973 Constitution was framed keeping in view the main demands of the popular movement that brought down Ayub Khan's autocratic system

<sup>16</sup> Chadhury, op. cit. p. 106.

<sup>17</sup> Government of Pakistan, *The Constitution of the Islamic Republic of Pakistan*, (Karachi: Ministry of Law and Parliamentary Affairs, 1964), Part IV, p. 43.

<sup>18</sup> Chaudhury, op. cit. p. 219.

<sup>19</sup> See Articles 144 and 145, *Constitution of the Islamic Republic of Pakistan*, op. cit. pp.79-82.

based on the 1962 Constitution with a powerful President and concentration of powers in the center, Under the 1973 Constitution, therefore, the area of provincial autonomy, including financial autonomy was considerably enlarged. The Constitution contained a comprehensive scheme for the distribution of revenues between the federation and the provinces under Chapter I of Part VI of the Constitution.

### **The Controversy**

Constitution of National Finance Commission by the President every five years for the distribution of financial resources between the center and the provinces is a constitutional requirement under Article 160 of the Constitution. The President of Pakistan constituted the current NFC, 6th on 26 July 2000 to determine distribution between the federation and the provinces of net proceeds of the following taxes:

- (a) Taxes on income, including corporation tax, but not including taxes on income consisting of remuneration paid out of the Federal Consolidated Fund.
- (b) Taxes on the sale and purchase of goods imported, exported, produced, manufactured or consumed.
- (c) Export duties on cotton.
- (d) GST on services

Before the installation of new governments at the central and the provincial levels following parliamentary elections on 10 October 2004, the National Finance Commission had held five meetings; the first being on 9<sup>th</sup> July 2001 while the 5<sup>th</sup> and the last meeting was held on 22 September 2002. During these meetings, a broad based consensus was developed on all major issues, except on certain unresolved issues like the net hydel profit of Government of NWFP and method of distribution of amount equivalent to 2.5% out of 15% sales tax among the provinces. The meetings also succeeded in securing some understanding/compromise on the demand of adopting multiple indicators for resource distribution among the provinces by way of trading off between various facets of the problem.<sup>20</sup> However, the meetings also revealed that the points of divergence among the stakeholders were abundant; while areas of convergence were very few. For example, there were serious reservations from Balochistan to distribute resources between the federation and the provinces on the basis of population. Sindh staked its claim to make revenue collection as the basis of resource distribution on the fact that it contributed more to the divisible pool; and therefore, it demanded that the

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<sup>20</sup> *National Finance Commission Award: Contentious Issues and Ways of Rapprochement*, Syndicate Research Paper, (Lahore: National Institute of Public Administration) unpublished, pp. 29, 30.

collection principle should be used for revenue sharing. The Government of Sindh cited the example of Karachi, which remained the major point of collection with 65% of revenue from the income and sales tax collected from Sindh. The Government of NWFP, though, favoured the distribution formula on the basis of population, presented the claim for additional resources in view of the vast backwardness in that province.<sup>21</sup>

The deliberations of the meetings of NFC held before the elections revealed that apart from the basis for distribution of resources from the divisible pool, there were also other issues on which the stakeholders had distinctly divergent vies. For example, the provinces questioned the composition of divisible pool and demanded that the Federal Government should transfer certain taxes and entrust their collection to the provinces. The provinces had also serious reservations on the Federal Government's Debt Reduction and Management Strategy. The meetings failed to reach an agreement on the principle determining the benchmarks for receipts and expenditures for the Federal as well as the Provincial Governments. There was also a lot of criticism by the provinces with regard to additional financial burden because of the introduction of Devolution Plan without providing the provinces additional grants to meet the requirements of the Devolution Plan. Net hydel profits also dominated the meetings of NFC held before the elections as NWFP always made it a point to raise this issue at the very outset of the meetings. Balochistan also remained critical of the Federal Government for not satisfying its demands on gas royalty and Gas Development Surcharge issue. It was also during these meetings that the provinces pleaded for distributing resources between the federation and the provinces on the basis of 50:50 ratios. The issue of distributing 2.5% of 15% sales tax among the provinces also dominated the meetings of NFC. The provinces also criticized the Federal Government for disbursing far less funds to the provinces than projected under the 1997 Award.<sup>22</sup>

### **Democracy and Consensus**

The installation of elected governments both at the center and in the provinces following 10 October 2002 elections gave a new turn to the issue of distribution of resources between the center and among the provinces from the divisible pool. The reason was that the political parties, which succeeded in forming the governments in the provinces, had made certain commitments to the people during the election campaign. The issues of poverty, unemployment and provision of basic necessities for the people had prominently figured in the election campaign. This was inevitable as the incidence of poverty and the rate of unemployment had shown upward trends

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<sup>21</sup> Ibid, pp. 35.

<sup>22</sup> Ibid, p. 35.

in the country.<sup>23</sup> Poverty and unemployment were serious issues for the people of both rural and urban areas. Muttehidha Majlis-e-Amal (MMA) in its election manifesto had promised to “ensure provision of bread, clothes, shelter, education, jobs and marriage expenses to all citizens.”<sup>24</sup> The political parties, which had come to power in the provinces with the support of the people of rural as well as the urban areas came under pressure to demand larger share from the center to finance projects to provide jobs to the unemployed and bring down the level of poverty in their provinces.

The last NFC Award (6<sup>th</sup>) came into effect from 1 July 1997 and expired in June 2002. As per constitutional provision, the new award was due for distribution of resources in 2002-3. But the award could not be finalized because of the failure of the stake holders to reach a consensus on the formula, according to which the resources were to be distributed between the center and the provinces on the one hand, and among the provinces on the other. The new governments declared their dissatisfaction over the previous arrangement and rejected the existing modalities. Hence the resources had to be assigned according to the revised previous formula. For this purpose, the Distribution of Revenue and Grants-in-Aid (Amendment) Order 2002 (Order No. 6 of 2002) was issued. This order, which took effect from 1 July 2002 provided for the distribution of resources on the basis of population according to 1998 Census. As a result, the shares of Punjab and Balochistan were slashed and those of Sindh and NWFP increased. The position of provincial shares for the financial year 2002-3 under Order No. 6 of 2002 is given below:

Province	Share in 2002-3	Previous Share	% Increase/Decrease
Punjab	57.36%	57.88%	0.9% Decrease
Sindh	23.71%	23.28%	1.8% Increase
NWFP	13.62%	13.545%	2% Increase
Balochistan	5.11%	5.30%	3.7% Decrease

<sup>23</sup> According to Economic Survey of Pakistan: 2001-2002, poverty had increased from 21.8% in 1996-97 to 28.2% in 1998-99. The level of poverty in rural areas (31.95) was higher than in the urban areas (19.13). Government of Pakistan, *Economic Survey of Pakistan: 2001-2*, (Islamabad: Economic Adviser's Wing, Finance Division), p. 50. The rate of unemployment at national level in the year 2002 was 7.8%. Unemployment in urban areas (9.92%) was higher than in the rural areas (6.94%). *Economic Survey of Pakistan: 001-002, Ibid.* p. 174.

<sup>24</sup> Rashid Ahmad Khan, “A Comparative Study of Manifestos of Major Pakistani Political Parties in Election 2002”, *IPRI Journal*, Winter 2003, Vol. III, Number I, Islamabad Policy Research Institute, Islamabad, p. 30.

In its election manifesto, MQM declared that it was in favor of “maximum provincial autonomy and, therefore, wishes that power be transferred from the center to the provinces and from the provinces to the elected local bodies so that the people of every part of the country feel involved in government affairs.”

<<http://.mqm.org/manifesto/manifesto-1998-provincial-autonomy.htm>>

(*Syndicate Research Paper*, National Institute of Public Administration, Lahore, op. cit.) p. 45.

After its constitution in July 2000, the 6<sup>th</sup> National Finance Commission held a number of meetings to evolve consensus on the fundamental questions relating to the distribution of resources between the stakeholders. In meetings held before the October Elections (the last of such meetings was held on 22 September 2002), a lot of spadework was completed, except disagreement in certain areas. But the Commission thought it prudent not to announce the award in view of the new civilian/political set up coming into power following the October 2002 Elections.

As soon as the process of installation of new governments in the center and in the provinces was complete, the 6<sup>th</sup> NFC began its deliberations to reach a consensus on the resource sharing formula. However, it soon became clear that it was not an easy job as the provinces under the new political dispensation pressed for greater share (50:50 ratio) in the divisible pool of resources. The three smaller provinces i.e., Sindh, NWFP and Balochistan rejected the old formula for the distribution of funds among the provinces based on population; where as Punjab favoured the retention of population as the sole indicator for resource distribution among the provinces. This led to serious differences between the federation and the provinces on the one hand, and among the provinces, on the other. The Federal Government tried to secure consensus by agreeing in principle to increase province's share from 37.5 per cent on which the last (1997) Award was based. In the NFC meeting held in Karachi on 5 February 2004, the respective positions of the provinces on the criterion for resource distribution became clear. The three smaller provinces were unanimous that there should be more than one criterion for the resource distribution among the provinces. Punjab insisted on keeping population as the only criterion for resource distribution among the provinces. Sindh wanted that revenue generation should be the basis of resource distribution. Balochistan demanded that the size of the federating unit should also be taken into consideration; while NWFP demanded that backwardness and poverty should also be included as one of the indicator for the distribution of resources among the provinces.<sup>25</sup> The demand of Sindh for making revenue generation as the basis of horizontal distribution of resource was based on the fact that Sindh contributed largest share of national revenue. According to a statement by Parliamentary Secretary for Finance Division, Omar Ayub in the National Assembly, Sindh contributed about Rs.1.085 trillion or 56.7 per cent to Pakistan's Rs.1.9 trillion revenue collected during 1998-2003, but it got only Rs.221.3 billion or 26.7 per cent of the total Rs.826.8 billion disbursed to the four provinces under the

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<sup>25</sup> *Dawn* (Islamabad), 6 February 2004.



National Finance Commission Awards from 1998 to 2003.<sup>26</sup> Omar Ayub also explained the reason why the share of Sindh was less than its contribution to the national revenue collection. He said that major Sindh collections in the shape of customs and taxes came through the two major seaports, Karachi and Port Qasim. “This competitive advantage to Sindh is only due to these sea ports from where major contribution comes,” he said in response to a question of MQM Member National Assembly Kanwar Khalid Younas during the Question Hour.<sup>27</sup>

In terms of area, Balochistan is the largest province of Pakistan; but its population is only 5 per cent of total population of the country. Since the 1997 NFC Award for resource distribution was based on population, the share of Balochistan was only 5.11% of 37.5 % disbursed by the federation among the provinces from the divisible pool. The share of other provinces is as under:

Punjab	57.36%
Sindh	23.71%
NWFP	13.82%

In view of the smaller share of the Balochistan Province, the Provincial Government had to borrow money from the State Bank of Pakistan to run its day-to-day expenses. During the Financial Year (FY) 2003-4, Balochistan had obtained Rs.3 billion from the State Bank for running day-to-day expenditure. With the establishment of democratically elected government in the province, there was demand for more funds to finance development projects aimed at raising the standard of living of the people of the province and eliminate poverty. Hence, Balochistan under the newly elected government not only asked to include the size of the province as one of the indicators for the resource distribution among the provinces, it also demanded of the center to pay Rs.4 billion the center owed to the province on account of gas development surcharge.<sup>28</sup>

Just before the preparation of the provincial budget, Balochistan’s Finance Minister, Syed Ehsan Shah had indicated that the province was going

<sup>26</sup> *Dawn* (Islamabad), 30 March 2004.

During the same period, Punjab was provided Rs.397.9 billion, when its contribution to the national revenue was Rs.675.8 billion. The NWFP was provided with Rs.109.6 billion; while its contribution was Rs.105.2 billion in the form of collection from that province. Similarly Balochistan was given Rs.97.9 billion when the Federal Government received a total amount of Rs.46.8 billion in the form of revenue collection from that province during the period 1998-2003. *Dawn* (Islamabad), 30 March 2004.

<sup>27</sup> *Ibid.*

<sup>28</sup> *Dawn* (Islamabad), 19 July 2004.

to have a deficit budget for 2004-5. He also said that Balochistan needed more funds for its development. The province, he said, needed maximum funds to complete development projects launched by the provincial government. Regarding the difficulties in the way of reaching a consensus on NFC Award, the Finance Minister of Balochistan said, "consensus could not be developed as every province had its own problems." In this regard he gave the example of Balochistan by pointing out that the province would get 82 per cent more share from the federal resources if the area were adopted as the criterion for the resource distribution among the provinces. But the province would be a big loser if scattered population were to be taken as the basis for formula to distribute resources among the provinces.<sup>29</sup>

Like Balochistan and Sindh, the NWFP also challenged the rationale of basing the arrangement for the resource distribution solely on the criterion of population. The reason behind the demand of the NWFP was the same as it was in the case of Sindh and Balochistan. If the resource distribution among the provinces were based solely on population, then Punjab being the most populous province of the country would take the largest share, as it had been the case in the past. But the new government of NWFP had come to power with a mandate to better the living conditions of the people of the province through initiating development projects. In fulfilling promises made to the people during the elections, the new leadership of the province needed funds. It is also to be noted that parts of the NWFP province are the most underdeveloped and backward. The level of poverty is the highest in the province as compared to other provinces. These facts were bound to generate demands for more funds from the center. The new provincial government, therefore, on the one hand demanded the inclusion of backwardness as one of the criteria for the resource distribution among the provinces and, on the other, asked the center to pay the full annual amount of royalty on hydel power generation and the arrears due from WAPDA.

The position of NWFP regarding the basis of resource distribution among the provinces was elaborated by the Provincial Finance Minister Sirajul Haq in a press conference in Peshawar on 15 May 2004. He had said that population should not be the only criterion for the distribution of resources among the provinces. According to him NWFP had proposed that the formula for the distribution of resource should be worked out on the following basis: 80 per cent on population basis; 19 per cent on the backwardness of the area, one percent on poverty and one per cent on the basis of area. He blamed the previous NFC Award based on population for high level of poverty in NWFP. The unjust distribution of resources caused economic imbalance in the society', he said and claimed that per capita income in NWFP was the lowest among all the federating units. He was right in

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<sup>29</sup> *Dawn* (Islamabad), 8 June 2004.

pointing out that an unjust system of distribution undermined the foundation of the federation and, therefore, demanded that the center should take practical measures for strengthening the units of the federation. Explaining why NWFP insisted on 50% share in the divisible pool, the Finance Minister of the Province said that if the center agreed on 50 per cent formula, the NWFP would get Rs.46 billion, which would be spent on the development work in the province.<sup>30</sup>

Sindh joined NWFP in demanding 50 per cent share for the provinces from the divisible pool; but insisted on giving greater weight to revenue generation in the formula for resource distribution among the provinces. In demanding the transfer of 50 per cent resources from the center to the provinces, Sindh had also demanded that 2.5 per cent GST collected by the center on behalf of the provinces should be kept out of it.<sup>31</sup>

Starting from different perspectives, the federation and the four provinces tried to develop a consensus on the NFC Award on which the 2004-5 budget was to be based. But the NFC meeting held in Karachi in the first week of February 2004 failed to reach the agreement. However, Federal Finance Minister Shaukat Aziz, who chaired the meeting, claimed that the differences had been narrowed down as the Federal Government had in principle agreed to enhance provincial share in the divisible pool from the existing level of 37.5 per cent.<sup>32</sup> Before the convening of the next meeting of NFC, the Federal Government indicated its readiness to enhance the share of the provinces to 45 per cent. Later on the offer of the Federal Government was raised to 47% per cent. But in an informal meeting held on April 16, the provinces rejected the offer, insisting that the share of the province must constitute 50 per cent of the divisible pool. It should be noted that at 47 per cent provincial share amounted to Rs.225 billion, whereas in case resources were distributed between the provinces and the center on 50 per cent basis, the provinces were to get Rs 272 billion out of a total of Rs.545 billion in the divisible pool.<sup>33</sup> Initially the Federal Government was confident that consensus on NFC would be achieved by 31 March 2004. But a meeting held on 30 March 2004 in Quetta failed to remove the differences on the ratio for sharing resources between the center and among the provinces. The provinces refused to show any flexibility on their stand and insisted on 50 per cent share from the divisible pool. Not only there was stalemate between the provinces and the center on distribution ratio, there were also differences among the provinces over the basis of the formula for distributing 50 per cent share among the four provinces. For example, Punjab did not agree with other

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<sup>30</sup> *Dawn* (Islamabad), 17 May 2004.

<sup>31</sup> *Dawn* (Islamabad), 7 May 2004.

<sup>32</sup> *Dawn* (Islamabad), 6 February 2004.

<sup>33</sup> *Dawn* (Islamabad), 17 April 2004.

provinces on the issue of inducting indicators other than population as the basis for distribution of federal resources and demanded that the next NFC Award should be finalized on the basis of population. Balochistan, NWFP and Sindh reiterated their demand that population should not be made the main criterion for the next award.<sup>34</sup> In the meeting held on 31 March 2004 in Quetta, the provinces again insisted on 50 per cent share in the divisible pool. As the Finance Minister of NWFP, Sirajul Haq said after the meeting, all the provinces concurred on the point that the center must reduce its share and provide 50 per cent resources to the center.<sup>35</sup> Although lot of optimism was expressed by all the parties attending the Quetta meeting of NFC, the fact remained that there was little progress on the next NFC Award as none of the province was ready to budge from its stand.

### **The Main Issue**

In the opinion of the former Federal Finance Minister, Shaukat Aziz , the main issue was horizontal distribution for which resources came from the provinces. However, provinces disagreed with this view. In their opinion, main issue was not the horizontal distribution of resources between the provinces, rather the refusal of the center to accept the province's demand for reduction in the share of the center and transfer of 50 per cent resources to the provinces. In a number of rounds of intensive discussions held in Islamabad during mid-April, representatives of the provinces announced their agreement to share among themselves resources on the basis of a multi-factor formula provided that the Federal Government would enhance their share. Thus the onus of finalizing the 6<sup>th</sup> NFC Award was squarely put on the Federal Government. The provinces made it clear that they would be in a better position to finalize the percentage of the multi-factor formula once they had a clear picture of their share in the federal divisible pool. The provincial sources made it known that unless the center raised the provincial share at least to 49 per cent; they would not be able to prepare their next year budget. The Finance Minister of NWFP said that the provinces were not ready to reduce their share below 50 per cent. On the other hand, so far as the center was concerned, the Federal Finance Minister told the participants at the Islamabad meeting that the federation would not give more than 46 per cent of the resources in the divisible pool to the provinces.

There is yet another issue, which has become the bone of contention between the center and the provinces. It is the rate of tax collection charges by the Federal Government. Under the Constitution, the Federal Government could charge only 1 percent on tax collection; but in practice for the last thirty years, the rate of tax collection charges by the Federal Government has been 5

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<sup>34</sup> *Dawn* (Islamabad), 31 March 2004.

<sup>35</sup> *Dawn* (Islamabad), 1 April 2004.

per cent. The higher rate of tax collection charges was justified by the federal Government on the basis of higher defence and other expenditure. The provinces, however, did not agree with the explanation given by the Federal Government in defence of higher tax collection charges. Their view was reflected in the statement of the Finance Minister of NWFP, Sirajul Haq, who told Shaukat Aziz in one of the meetings of NFC, that there was no need for higher defence expenditure because of the peace process with India and also because coalition forces led by the US were deployed along the western borders. "When there is no security threat, there is no need for higher defence budget," Haq is reported to have told the Federal Finance Minister Shaukat Aziz.<sup>36</sup>

A number of formal and informal meetings of NFC were held following the installation of civilian elected governments to finalize the NFC Award for the next budget; but the parties failed to agree on the formula for the distribution of resources between the center and the provinces. There was complete deadlock on the resource distribution formula between the center and the provinces. Although Punjab had given up its insistence on making population as the sole criterion of distribution of resources, and the four provinces had in principle agreed to a multi-factor formula, still the issue of sharing the resources among the provinces was not very clear. Even the statement by the Federal Finance Minister Shaukat Aziz that the federal Government had agreed to increase provincial share in the divisible pool from 46 per cent to 47 per cent did not cut the ice with the provinces, which remained firm on their demand for a 50 per cent share.

In order to break the deadlock, the Federal Government took the initiative and offered the provinces seven options on horizontal distribution of resources from the divisible pool. The first option gave an 80 per cent weightage to population, 10 per cent to backwardness or poverty, six per cent to inverse population density (IPD) and four per cent to revenue collection. In the second option, population was given 85 per cent, 10 per cent to backwardness, 1 per cent to IPD and four per cent to revenue collection. In the third option, population got 90 per cent weightage, four per cent each to revenue collection and backwardness and 2 per cent to IPD. The fourth option provided for 65 per cent to population and 5 per cent each to three other factors. The fifth option offered 88.35 per cent weightage to population, 5.7 per cent to backwardness, 4.15 per cent to revenue collection and 1.7 per cent to IPD. In the sixth option, 87.8 per cent weightage was provided for population, while poverty, IPD and revenue collection would get 6 per cent, 2 per cent and 4.2 per cent, respectively. The seventh option gave 90 per cent weightage to population and 2 per cent to backwardness; while IPD and

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<sup>36</sup> *Dawn* (Islamabad), 16 April 2004.

revenue collection were to receive four per cent weightage each.<sup>37</sup> The provinces were unable to reach consensus even on the seven options offered by the Federal Government.

Since consensus on the resource distribution formula could not be reached between the provinces and the Federal Government, on the one hand, and among the provinces on the other, the Federal Government decided to implement 5<sup>th</sup> NFC Award for another year-2004-5. Likewise, the provincial finance departments were conveyed the message to prepare their budgets on the basis of previous award of 37.5 per cent share for the provinces, coupled with subventions and grants. But, at the same time, it was given to understand that the current NFC would continue its deliberations after the presentations of budgets by the Federal and Provincial Governments for the purpose of finalizing an award for the future in relaxed environment and without the pressure of budget deadlines. The stakeholders reached this decision just when they were left with less than two weeks to finalize their budgetary projections. The Federal Government had made it clear to the provinces that it could not offer more than 47 per cent of the divisible pool because of some additional expenditure during fiscal year 2004-5. The provinces, however, rejected the offer of 47 percent and instead opted to base their budgets on the previous award in the hope that they would successfully press the Federal Government to agree on 50 percent share under the new award. The provinces clearly told the Federal Government that they could not agree to 47 per cent for the next five years as, they claimed, the Federal Government had given a commitment of 47.8 per cent before the 2002 elections. The provincial governments stated that they had made promises to the electorate on the basis of that commitment, which were impossible to fulfill if they got 47 percent from divisible pool.<sup>38</sup>

#### *FY 2005-6: Search for Award*

In early 2005, hopes were high for a consensus Award. In February, Prime Minister's advisor on finance and revenue, Dr. Salman Shah said that next NFC Award would be settled before the finalization of next budget as, according to his claim, 95 per cent issues relating to the Award had already been settled and the remaining ones would be settled amicably.<sup>39</sup> In April

<sup>37</sup> For further details, see *Dawn* (Islamabad), 19 April 2004.

<sup>38</sup> *Dawn* (Islamabad), 22 May 2004.

<sup>39</sup> *Dawn* (Islamabad), 27 February 2005.

In another statement on 6 May 2005, the Advisor to the Prime Minister on Finances and Revenue expressed the hope that NFC Award would be finalized within two weeks. He even hinted at the expected share of the provinces under new Award.

According to him, each province was expected to get Rs. 20 to 25 billion additional funds in new Award, bringing the total amount to Rs.250 to 270 billion. See *Dawn* (Islamabad), 7 May 2005.

provincial finance ministers and the federal government reached an agreement to start discussions on the Sixth NFC Award and finalize it before 2005-6 budget. According to press reports, the federal government, offered to include 2.5 per cent GST in the federal divisible pool and the gradually increase the province's share to 50 per cent in 2009-10, the final year of the next Award. But the provinces said that it was not acceptable as in real terms it would come to 47.5 per cent; while the provinces demanded 50 per cent.<sup>40</sup> Sindh continued to hold to its earlier position that distribution of resources should be based on revenue collection, population, backwardness and inverse population growth. NWFP and Balochistan were also in favour of a multiple formula for the distribution of resources.<sup>41</sup> However, these two provinces opposed Sindh's demand to make revenue collection as the basis of distribution

The hopes for agreement on a consensus formula for distribution were further raised when in May, Dr Salman Shah stated that Sindh had given up its demand for making revenue collection as one of the criteria for horizontal distribution of resources under Sixth NFC Award. Instead, he said Sindh was demanding that personal income tax collection should be given some weight in the resource distribution formula, instead of total revenue collection.<sup>42</sup> Balochistan supported Sindh's proposal to make personal income tax collection as one of the criteria of distribution of resources among the provinces.<sup>43</sup>

But these hopes were dashed when Sindh denied it had given up its "principled" stand on making revenue collection as one of the criteria for horizontal distribution. Explaining the position of Sindh, the provincial finance minister Syed Sardar Ahmad stated that revenue collection was one of the indicators in the distribution of resources since 1964 providing for 30 per cent of province's share. But revenue collection was dropped from the formula after the creation of Bangladesh. There was, therefore, he said, nothing wrong in putting it back in place. Elaborating Sindh's stand on horizontal distribution of resources, Sardar Ahmad said that Sindh demanded that population should have maximum weightage followed by backwardness, poverty and revenue collection.<sup>44</sup>

According to Dr. Salman Shah there were three main issues, which hampered the finalization of the Sixth NFC Award: sharing of gas development surcharge between Sindh and Balochistan, Sindh's demand to make revenue collection one of the criteria of horizontal distribution and transfer of 2.5 per cent GST in lieu of *octroi* and *zila* tax formerly collected by

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<sup>40</sup> *Dawn* (Islamabad), 29 April 2005.

<sup>41</sup> *Ibid.*

<sup>42</sup> *Dawn* (Islamabad) 10 May 2005.

<sup>43</sup> *Dawn* (Islamabad), 24 June 2005.

<sup>44</sup> *Dawn* (Islamabad), 13 May 2005.

the provinces. Besides these issues, there was also the issue of vertical distribution of resources. Provinces demanded 50 per cent share; whereas center offered 47 per cent. Despite the optimism expressed by Prime Minister's advisor on finance and revenue, Dr. Salman Shah that "gap is not big and can be bridged in a gradual manner", the stakeholders failed to reach an agreed formula for vertical as well as horizontal distribution of resources. As a consequence, the province's share had to be fixed on the basis of Fifth (1997) Award, which had in fact expired in 2002.

## Conclusion

The demand for resource transfer from the center to the provinces is the most important component of the broader issue of movement for provincial autonomy. Pakistan inherited a federal structure under the Government of India Act, 1935, which provided for the control of the center over all the important and major sources of income. The British had deliberately provided for a concentration of powers in the hands of the center because they aimed to exploit the resources and the market of India through a strong center.

After its establishment, Pakistan adopted with certain changes and modifications the Indian Independence Act 1947, which was based on the 1935 Act, as its Interim Constitution. Under the Interim Constitution (1947-54) Pakistan moved to parliamentary form of government by divesting the Governor-General of special and discretionary powers and vesting real authority in the cabinet, but there was little change in the federal structure, which guaranteed dominance of the center over the provinces. Rather, proceeds from some of the taxes, which formed the provincial share, like income tax, sales tax and export duty on jute were taken over by the center to meet the expenditure of defence in view of security threat from India, and on refugees. Some of these taxes were returned to the provinces, when situation on the borders eased and influx of refugees stopped, but certain taxes, which were originally on the provincial list, were permanently retained by the center. This gave rise to resentment in the provinces, particularly in East Bengal, which later assumed the shape of a province wide movement for greater provincial autonomy.

In response to popular demands articulated through political parties, press and other civil society organizations, the framers of the 1956 Constitution expanded the area of provincial autonomy in the legislative and to some extent, also in the fiscal area as residual powers were transferred to provinces. But the center retained the administrative control over the provinces and continued to control major sources of income. The area of provincial autonomy was drastically curtailed under the 1962 Constitution, which was enforced by Ayub Khan after he lifted Martial Law imposed in 1958. The popular mass movement against the highly centralized and



autocratic rule of Ayub Khan, which raged in both parts of the country aimed to not only replace the presidential system of Ayub Khan, it also demanded further enlargement of the parameters of provincial autonomy. The parameters of provincial autonomy fixed under the 1973 Constitution were in response to those demands.

A survey of the past history of Pakistan would reveal that the demand for larger provincial autonomy has been an important issue in the politics of the country. In response to this demand, there has been a progressive increase in the quantum of provincial autonomy under various constitutions of Pakistan, except under the 1962 Constitution. But this increase has been largely in the legislative sphere. So far as the administrative and financial areas are concerned, the center still retains dominant control.

The past history also reveals a link between democracy and demand for greater provincial autonomy. The participatory democracy produces governments, both at the central and provincial levels, which have to be responsive to the needs and problems of the people. To meet the demands of the electorate, the provincial governments would inevitably ask for transfer of more funds from the center to the provinces and greater fiscal autonomy. Political parties participating in democratic electoral process make certain commitments to the electorate, which they would be hard pressed to fulfill in case they came to power. The current controversy over the 6<sup>th</sup> NFC Award can be understood in this context. The electorate, which voted for political parties forming the present governments in Sindh, NWFP and Balochistan have great expectations from them. These governments, therefore, are under great pressure to solve the urgent problems, like unemployment, lack of health, educational facilities and lack of infrastructure development. In order to do this job, the provincial governments would logically press for more funds from the center.

There are two other factors, which are likely to further strengthen the province's case for transfer of more funds from the center and greater fiscal autonomy. One: under Devolution of Power plan, the provinces are being asked to devolve necessary funds to the District Governments for undertaking development works. This will generate more vigorous demands from the provinces asking for the reduction of center's share in the divisible pool and transfer of some of the taxes to the provinces so that more funds under Provincial Finance Commission are transferred to the District Governments.

Second: dominant control of the center over the national resources have been justified in the past in the name of need to spend more on defence and ever increasing federal liability on debt servicing. In view of easing of tension on our eastern and western borders as a result of satisfactory progress in Pak-India peace process and improvement in relations with Afghanistan, the Federal Government may be in a position to transfer more funds to the provinces. Similarly, the present government's successful policy of reducing

reliance on the foreign borrowing and retirement of external debts will provide justification to the provinces to demand greater share from the divisible pool. Both in the short term and long term perspectives, the province's demands for greater share in the divisible pool, transfer of collection of some of the taxes from the center to the provinces are likely to gain momentum as democracy and democratic institutions get consolidated in the country, economy achieves self-reliance and peaceful environment is created in the region.

The federal government cannot be alone blamed for failure to finalize Sixth NFC Award. In fact the present government has shown unprecedented flexibility in meeting the demands of the provinces on vertical distribution. It was primarily the differences among the provinces on horizontal distribution, which blocked further progress on vertical distribution. But all the stakeholders feel that finalization of NFC Award is in their interest and any further delay would make the issue more complex and difficult. There is, therefore, strong possibility that the intervention of President would produce an acceptable formula for distribution of resources.■