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Structural Adjustment, Employment, Income Distribution and Poverty

A. R. KEMAL

The Structural Adjustment and Stabilisation Programmes of the IMF, World Bank and other international financial institutions for Pakistan have called for a reduction in the fiscal deficit, a restricted role of government in the economy, rationalisation of tax structure, removal of subsidies on consumption and production, etc. with a view to fostering efficiency, higher levels of output, stability of prices, etc. To what extent these objectives have been realised has rarely been examined. Firoze (1986) is probably the only exception who concludes that because of the structural weakness and adherence to just financial criteria these programmes have resulted in accumulating structural problems rather than alleviating them. These programmes also have significant implications for employment, poverty and income distribution.

The present paper examines the adequacy of these programmes in realising the intended objectives and their impact on employment, income distribution and poverty in Pakistan. The plan of the paper is as follows. Section I traces out changes in the structure of protection resulting from import liberalisation and tariff rationalisation and their impact on the level of efficiency. Section II examines trends in fiscal deficit and inflationary tendencies in the economy. To what extent employment and employment cost has contributed towards containment of the fiscal deficit has been examined in Section III. Trends in income distribution and poverty during the period of the Structural Adjustment Programme has been examined in Section IV. The main conclusions of the paper are summarised in Section V.

I. STRUCTURAL ADJUSTMENT AND EFFICIENCY

Pakistan initiated the process of structural adjustment in the late Seventies in the perspective of an over-valued rupee, high tariffs, stringent import policy,

compensatory rebates to exports and other policy interventions in international transactions. The process of import liberalisation initiated in the late Seventies has been carried forward and at present there are only one hundred products on the Negative List and about 50 products on the Restricted List while the quantitative restrictions have been removed from all the products.

Liberalisation of the import regime has been accompanied with tariff rationalisation. The unweighted average rate of statutory import duty has been reduced from 79.2 percent in 1982- 83 to 58.2 percent in 1993-94 and the dispersion around the mean has fallen from 49.8 to 24.6 percent over the eleven-year period. The rate has further been reduced to 49.4 percent in the 1994-95 budget. The average import duty rate weighted by value-added in import competing products in 1990-91 was 105.3 percent but due to widespread smuggling and misuse of exemptions, the implicit nominal protection was 61.6 percent.

The high rates of statutory import duties have caused major distortions in the tariff structure. With a view to encouraging various activities, duty exemptions and concessions have been granted to the import of raw materials, intermediate inputs and components but these concessions have been grossly misused. As a result the incidence of import duty, weighted implicitly by imports, on average, was only 24.1 percent in 1992-93.

The impact of tariff rationalisation on the protection enjoyed by various economic activities can be better assessed through changes in the effective protection rates. The average rate of effective protection, according to the Corden definition, has increased from 66 percent in 1980-81 to 77 percent in 1990-91. [See Table 1 and Naqvi and Kemal (1991)]. That the tariff rationalisation process has led to raising rather than the lowering of the average rate of effective protection (EPR) is surprising but can be explained by the peculiarities of the nominal protection structure in Pakistan. The tariff rationalisation left nominal protection to output virtually unchanged because tariffs were redundant in a number of industries but the nominal protection to most of the inputs fell rather sharply. Moreover, removal of fiscal anomalies which had resulted in negative effective protection to a number of industries in 1980-81 also tended to raise the average rate of effective protection.

Dispersion around the average EPR is high (see Table 1) but mainly due to a few outliers; EPR for most of the industries cluster around the mean which is expected to have a positive impact on allocative, technical and X-efficiency. A sharp fall in the Domestic Resource Cost from 3.31 in 1980-81 to 1.44 in 1990-91 shows a substantial improvement in efficiency. Induction of new technology, easy

access to the imported raw materials and lower EPRs to various industries have played a major role in the improvement in efficiency levels. It seems that the basic objective of Structural Adjustment to enhance the efficiency levels has been realised.

Table 1

Effective Protection in Pakistan: 1990-91

	Average Rates of Protection		Dispersion Around the Mean	Coefficient of Variation
	Z Definition	U Definition		
Corden	77	43	71	163
Scott	117	54	85	158
Balassa	171	63	92	145

Source: [Kemal, Mahmood and Ahmed (1994).]

II. TRENDS IN FISCAL DEFICIT AND INFLATION RATE

The fiscal deficit was as high as 8.9 percent of GDP in 1978-79. Due to a massive resource mobilisation effort, as a part of the structural adjustment and stabilisation programme, it was brought down to 5.3 percent of GDP by 1980-81. The declining trend in fiscal deficit was, however, reversed in 1981-82 and by 1987-88 fiscal deficit peaked at 8.5 percent of GDP. The Structural Adjustment and Stabilisation Programme of the IMF initiated in 1988 aimed at bringing down the budgetary deficit to 4.8 percent of GDP by 1990-91. While it did decline to 6.5 percent of GDP in the first two years of the Programme, it shot up to 8.7 percent in 1990-91. Despite all the efforts to bring it down, it was still as high as 7.9 percent of GDP in 1992-93. (See Table 2.)

The declining fiscal deficits were not associated with price stability. When the fiscal deficit declined in the 1978-79 to 1980-81 period, the inflation rate soared to 12.4 percent. On the other hand, the rising fiscal deficits during the Eighties were accompanied with falling inflation rates mainly because government resorted to non-bank borrowing for financing the fiscal deficit.

III. STRUCTURAL ADJUSTMENT AND EMPLOYMENT

The fiscal deficit may be reduced either by mobilising additional resources or by containing public expenditure. A reduction in public expenditures may be effected by restricting either the acquisition of commodities or limiting the employment cost through a reduction in the employment and/or limiting the increase in

Table 2
Trends in the Budgetary Deficit in Pakistan

Years	Budgetary Deficit as a Percentage of GDP	Rate of Inflation
1978-79	8.9	6.6
1979-80	6.2	10.7
1980-81	5.3	12.4
1981-82	5.3	11.1
1982-83	7.0	4.7
1983-84	6.0	7.3
1984-85	7.8	5.7
1985-86	8.1	4.4
1986-87	8.2	3.6
1987-88	8.5	6.3
1988-89	7.4	10.4
1989-90	6.5	6.0
1990-91	8.7	12.7
1991-92	7.4	9.6
1992-93	7.9	9.3

Source: Economic Survey, 1985-86 to 1992-93.

nominal wages below the inflation rate. The IMF Stabilisations and Structural Adjustment Programmes, generally suggest restrictions on both the wage increases and the size of the government. For example, Thomas (1987) found that the share of wages of government employees in GDP in Brazil over the adjustment period fell. On the other hand, Van Ginneken (1990) found that despite restrictions on employment, the employment cost of the government employees did not fall in the developing countries. To what extent changes in the budgetary deficit have been associated with changes in employment cost in Pakistan has been examined below.

Employment cost fell as a percentage of non-development expenditures but increased as a percentage of GDP during the 1980-81 to 1987-88 period. (See Table 3). During the 1988-89 to 1992-93 period, however, employment cost, both as a percentage of total public expenditure as well as of GDP, fell significantly. Interestingly enough non-development expenditures have continued to increase despite a fall in the employment cost.

Table 3
Trends in Employment Cost of the Government in Pakistan

(Rs in Billion)

Years	Non-development Public Expenditures	Non-development Expenditures as a Percentage of		Employment Cost: Salaries of Government Employees	Share of Employment Cost in Public Expenditure	Share of Employment Cost in GDP
		Public Expenditure	GDP			
1980-81	37.8	59.5	13.6	15.8	41.8	5.7
1981-82	44.5	62.7	13.7	17.9	40.2	5.5
1982-83	57.7	66.2	15.8	21.9	37.9	6.0
1983-84	71.9	72.0	17.1	27.4	38.1	6.5
1984-85	83.8	71.7	17.7	30.8	36.8	6.5
1985-86	94.7	70.4	18.4	34.6	36.5	6.7
1986-87	116.2	76.3	20.3	42.0	36.1	7.3
1987-88	133.6	74.1	19.8	47.3	35.4	7.8
1988-89	153.1	76.1	19.9	54.1	35.3	7.9
1989-90	165.6	74.7	19.2	57.2	34.5	7.5
1990-91	195.7	75.0	19.1	63.3	32.3	7.0
1991-92	236.4	73.2	19.5	71.0	30.6	6.7
1992-93	277.8	78.7	20.4	79.6	28.7	5.9

Sources: (i) Economic Survey, 1985-86 and 1992-93.

(ii) Unpublished data obtained from the Federal Bureau of Statistics.

(iii) Non-development Expenditures are essentially the current expenditures which include acquisition of commodities and employment cost.

The decline in employment cost has been brought about by containing the increases in nominal wages of the government employees and even more importantly by imposing a complete ban on recruitments and encouraging early retirement in the government, autonomous and semi-autonomous organisations, and the government-sponsored corporations. Even though no hard data are available to ascertain the fall in employment in the public sector, yet rough estimates, based on the number of persons retiring and ad hoc employees failing to get regular employment, indicate that employment in the government may have gone down by about ten percent during the last three years. (See Tables 4 and 5.)

Table 4
Trends in the Civil Employees of the Government

Year	No. of Persons	Growth Rate
1966	79,000	-
1970	83,047	1.26
1973	86,939	1.54
1977	1,11,692	6.46
1980	1,21,153	2.74
1983	1,53,144	8.12
1986	1,87,925	7.06
1989	2,23,900	6.01
1992(E)	2,03,000	-3.21

Source: Federal Government Civil Servants Census Report, 1989.
E = Estimated.

Table 5
Approximated Trends in Employment in the Government

Period	Total Employment Cost	Impact of Increase in Wages	Impact of the Grant of Increments	Cumulative Effect of Wage Increases and Increments Since 1980-81	Employment Cost if there was no Wage Increases and no Increments	Index of Approximated Employment
1980-81	16,673	0	417	-	16256	100
1981-82	18,586	1673	465	417	16031	98.6
1982-83	22,915	2468	573	2555	17319	106.5
1983-84	28,687	3958	717	5596	18416	113.3
1984-85	32,259	2204	806	10271	18978	116.7
1985-86	36,409	2938	910	13281	19280	118.6
1986-87	44,172	5777	1104	17129	20162	124.0
1987-88	49,618	3601	1240	24010	20767	127.7
1988-89	59,432	2893	1411	28851	26277	161.6
1989-90	59,840	1867	1496	33155	23322	143.5
1990-91	66,249	4435	1656	36518	23642	145.4
1991-92	74,002	6047	1850	42609	23496	144.5

Source: [Kemal (1994).]

Besides restricting employment in the public sector, privatisation of public enterprises has also adversely affected the employment situation. Total employment in the 71 units sold and 53 units where the management has also been transferred is 43.9 thousands and 37.7 thousands respectively. Out of these 17.3 thousands workers employed in the privatised manufacturing firms, 7,495 workers have so far have opted for the golden handshake.¹ In other words, 43.2 percent workers employed in public enterprises have been laid off by the new owners. (See Table 6.) Kwiatowski (1994) for Poland and Botelho and Addis (1994) for Mexico reached similar conclusions. On the other hand Park (1994) did not find any retrenchment in Korea after privatisation only because the economy and the business of privatised firms grew rather sharply.

Table 6
Golden Handshake Opted by the Workers

Activities	No. of Workers Opted for the Scheme	Total Workers in the Manufacturing Firms Whose Management has been Transferred	Proportion of Workers Opting for Golden Handshake
Automobiles	482	3,467	13.9
Cement	1,784	5,254	34.0
Chemicals and Ceramics	678	2,191	30.9
Engineering	817	1,583	51.6
Fertilisers	72	539	13.4
Vegetable Oil	2,759	3,019	91.4
Roti Plants	—	—	—
Rice Mills	567	753	75.3
Miscellaneous	336	529	63.5
Total	7,495	17,335	43.26

Source: Privatisation Wing, Finance Division.

¹Financing the golden handshake option is essentially the responsibility of the government. Unless otherwise stated, the government makes the payment to the workers. So far, the government has paid half the amount due to workers on account of golden handshake. The other half has been paid by the producers. Government paid Rs 312.3 million out of total payment of Rs 616.2 million for the golden handshake. This comes to 4.3 percent of the bid value.

IV. TRENDS IN INCOME DISTRIBUTION AND POVERTY

The freeze on wages and slower growth of employment has led to a deterioration in the personal income distribution through changes in the functional income distribution. The share of wages in national income fell from 32.3 percent in 1987-88 to 30.0 percent in 1990-91 with serious implications for personal income distribution.

Whereas personal income distribution improved in the 1979-80 to 1987-88 period, it has worsened considerably in the 1987-88 to 1990-91 period; the Gini coefficient increased sharply from 0.35 in 1987-88 to 0.41 in 1990-91. A comparison of the shares in income of the lowest 20 percent and the highest 20 percent households also suggest some improvement in income distribution upto 1987-88 but a sharp deterioration in the subsequent period (see Table 7). The increase in income inequality in the rural areas has been even more pronounced; the Gini coefficient jumped from 0.307 to 0.410 over the three-year period. The income inequalities in rural areas have increased because the elimination of subsidies on inputs tends to lower the incomes of both the poor and the rich, but the increase in output prices to compensate for increasing input prices benefitted the bigger landlords relatively more than the poor. This has also resulted in a higher incidence of poverty which increased from 13 percent in 1987-88 to 14 percent in 1990-91. (See Table 8.)

Table 7

Functional Income Distribution

Period	(Percentage Share)	
	Wage Share in National Income	
1980-81	30.2	
1981-82	30.2	
1982-83	30.1	
1983-84	30.7	
1984-85	30.1	
1985-86	31.8	
1986-87	33.0	
1987-88	32.3	
1988-89	30.0	
1989-90	30.2	
1990-91	30.0	

Source: [Chaudhary (1992).]

Table 8

Income Distribution in Pakistan

Period	Gini Coefficient			Household Income Share	
	Total	Rural	Urban	Lowest 20%	Highest 20%
1963-64	0.355	0.348	0.368	6.4	45.3
1966-67	0.351	0.314	0.388	7.6	43.4
1968-69	0.328	0.293	0.370	8.2	42.0
1969-70	0.330	0.295	0.361	8.0	41.8
1970-71	0.326	0.273	0.359	8.4	41.5
1971-72	0.344	0.309	0.381	7.9	43.0
1979	0.375	0.319	0.380	7.4	45.0
1984-85	0.428	0.345	0.379	7.3	45.0
1985-86	0.355	0.330	0.354	7.6	44.0
1986-87	0.346	0.312	0.357	7.9	43.6
1987-88	0.348	0.307	0.366	8.0	43.7
1990-91	0.407	0.410	0.390	7.3	44.5

Source : Federal Bureau of Statistics.

Income inequalities have also been accentuated by changes in the incidence of taxes during the Structural Adjustment period. Since the focus of the programme has been on indirect taxes on goods not necessarily consumed by the rich, the tax incidence has increased the most for the lowest income group. The incremental burden goes on falling as incomes rise and for the highest income group, tax incidence, in fact, has declined over the 1987-88 to 1990-91 period (see Table 9). Compared to a decline of 4.3 percent in the tax burden for the most rich, the tax burden on the poorest class has increased by 10.3 percent. This pattern of the increase in tax burden is essentially a reflection of the emphasis on additional indirect tax mobilisation particularly the sales tax under the structural adjustment programme. The increase in sales taxes has essentially come from those products which form a relatively higher proportion in the poor's consumption bundle.

V. CONCLUSIONS

Tariff rationalisation, import liberalisation and certain other measures to effect structural changes in the economy have resulted in significantly higher levels of efficiency. However the stabilisation programmes have contributed very little

Table 9

The Percentage Increase in Tax Burden by Income Groups

Income Groups (Rs per Month)	Percentage Increase in Tax Burden as a Percentage of Income Over 1987-88 to 1990-91
Upto 600	10.3
601 - 700	6.8
701 - 900	4.7
901 - 1000	4.4
1001 - 1500	3.0
1501 - 2000	2.3
2001 - 2500	1.8
2501 - 3000	0.9
3001 - 3500	1.5
3501 - 4000	0.2
4001 - 4500	2.4
4501 - Above	-4.3

Source: [Kemal (1992).]

towards stabilisation of the economy. There is no correlation between the fiscal deficit and the inflation rate.

Despite containing the employment cost through limiting the wage rate and reducing the employment by about 10 percent, the non-development expenditure and fiscal deficit have continued to increase. The employment situation has further worsened due to privatisation.

The structural adjustment programme has been accompanied with rising income inequalities and poverty. The Gini coefficient increased from 0.34 to 0.41 and the proportion of the poor has increased from 13 percent in 1987-88 to 14 percent in 1990-91. Three factors contributed to rising income inequality. Firstly, there has been a decline in employment. Second, the tax incidence on the poor has increased and it has declined on the rich. Third, the input subsidies have been withdrawn which affected the poor and the rich alike while increase in prices of output of agricultural goods has mainly benefitted the rich.

The structural adjustment programme contributed towards increasing efficiency, but had adverse implications for employment and equity. While efficiency improvement is significant for the long-run growth of the economy the equity considerations must not be ignored. The Structural programmes, therefore, must be accompanied with the targeted welfare programmes.

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**Comments on
“Structural Adjustment, Employment,
Income Distribution and Poverty”**

The evolution of the structural adjustment programmes of the World Bank and the IMF introduced in 1980s bears recall. The Structural Adjustment Loans (SAL) of the World Bank arose initially as a complement to the programmes of short-term stabilisation through demand management offered by the IMF to developing countries facing balance of payments difficulties in the wake of external shocks. In addition to the credit tranches available under the stand-by agreements, the IMF introduced new credit facilities, such as the Extended Financing Facility (EFF) introduced in 1974 and the Structural Adjustment Facility (SAF) established in 1986. These arrangements were introduced in order to improve the “resource allocation and expansion of supply capacity” to enable countries to mitigate the effects of external shocks.

The main features of the structural adjustment programmes are an emphasis on policy orientation and incentive structure to improve economic performance. The standard package of policies consist of an emphasis to shift macroeconomic policy management towards increased reliance on the market mechanism and enhanced role of the private sector, reversing the past emphasis on planning, government intervention and the role of the public sector. The new watchwords are deregulation, disinvestment and decentralisation.

The various critiques of the structural adjustment policies of the IMF and the World Bank, including concerns about its lack of having a human face, have resulted in significant modifications of these programmes and they have gradually evolved from a short-term focus to a broader medium-term view of structural adjustment. It is, however, still a long way from one which would enable a country to adapt flexibly to a changing world economic environment, without losing sight of its long-term objectives, such as bringing about structural and institutional changes in the economy that would ensure its broader social and human resource development. This broader aim of restructuring the economy requires a more activist role for the government than that implicit in the IMF-World Bank structural adjustment programmes.

Dr Kemal’s paper examines the adjustment experience of Pakistan since the late seventies and its impact on the efficiency of and equity in the economy. Dr Kemal chooses the two main components of the adjustment programmes, viz.

trade policy measures and fiscal policy measures and looks at their impact on economic efficiency, employment, income distribution and poverty. The paper does not provide a meaningful and exhaustive analytical framework for his conclusions. On the basis of some partial indicators, with which one can cavil at length, Dr Kemal reaches the not very surprising and generally-held conclusion that "structural adjustment programme has contributed towards efficiency, but had adverse implications for employment and equity". The subject of the paper is very topical and has deservedly received an important place in the agenda of this meeting. However, its scope is too broad to be dealt with satisfactorily in the brief space and with the rather cavalier methodology employed by it. I also find it difficult to agree with his conclusion that the structural adjustment programme has contributed significantly to the economy's overall efficiency.

The paper does not define very clearly the time period and the policy package which are included in his discussion of the structural adjustment programme. Neither is it clearly brought out which of the measures were undertaken mainly to stabilise the economy from the external or internal shocks and which others were intended to liberalise the economy. Although the author tends to concentrate on the latter, he is unable to clearly distinguish between the problems of short-term crisis management with those of long-term development. One of the major problems brought about by the structural adjustment programmes is that the goal of long-term development has been sacrificed at the altar of short-term adjustment.

The paper tries to show through the analysis of recent reforms in the tariff structure that the basic objective of the structural adjustment "to enhance the efficiency levels has been achieved." However, this claim is hard to maintain in view of the finding that the tariff rationalisation process has led to raising rather than the lowering of effective rates of protection and that the recent measures for duty exemptions and concessions have been grossly misused. A major difference between the concessions handed out in Pakistan with the ostensible goal of promoting efficiency and export competitiveness and that in the East Asian economies is that in giving such concessions that the latter scrupulously adopted the "reciprocal principle" of never giving anything away to business for free without stipulating a monitorable, time-bound performance standard in return. If that were done, Pakistan's industrial structure would be much more diversified than it is today and would not be a hostage to the powerful lobby of textile industrialists that has retarded its industrial development.

Dr Kemal analyses the next component of the structural adjustment programme, the fiscal deficit and the inflation rate in the brief space of less than two pages. Dr Kemal's main finding in this regard is that the main impact of high

fiscal deficits has not been on inflation (indeed there seems to be an inverse relationship between the ratio of fiscal deficits to GDP and the rate of inflation). Since the high fiscal deficits were financed largely by non-bank borrowing, its main effect was to drive up the interest rate and crowd out private investment. Dr Kemal does not go into a detailed analysis of the reasons for rising budget deficits and the political economy of their expansion and contraction. Nor is any disaggregation of the components of the deficit undertaken to bring out more clearly the impact of reduction of the fiscal deficit.

The second part of Dr Kemal's paper consists of analysing the impact of structural adjustment measures on employment, income distribution and poverty. It is unfortunate that Dr Kemal restricts his discussion of the employment impact to only government employment and on privatised state enterprises, which together constitute less than 10 percent of total employment. What is more important is to look at the possible impact of structural adjustment policies on other sectors, especially agriculture and industry. Are there any grounds to be more optimistic about the impact of reforms on small-scale industry or on non-farm employment? What are the policy measures needed to promote labour-intensive export industries and have the reforms made any headway in that direction? These are the questions which are not only not answered by Dr Kemal's paper, but are not even posed by him as being pertinent.

The worsening of income distribution and to some extent of poverty incidence in the late 1980s does cause considerable concern. However, to what extent this is directly attributable to larger structural issues such as the increasing concentration of the land distribution and the slowing down of the remittances from the Gulf region, which had provided one of the main impetus for growth and poverty reduction in the 1980s, is a debatable issue which requires more detailed research. Among other missing elements in the paper are a detailed investigation of the impact of devaluation and financial liberalisation on both efficiency and equity.

Indeed, what I find more disappointing about the paper is a lack of any analytical framework in which the various partial analyses undertaken by Dr Kemal could fit into, I am sure he is quite capable of doing it and would do so in future. It is on this ground that I find the paper a bit disappointing, especially as it comes from someone who has given much better evidence of his analytical skills in the past and is widely regarded as a leading macroeconomist of the country.

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