

BTI 2012 | Pakistan Country Report

Status Index	1-10	3.81	# 110 of 128	
Political Transformation	1-10	3.43	# 111 of 128	➔
Economic Transformation	1-10	4.18	# 104 of 128	➔
Management Index	1-10	3.18	# 112 of 128	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Stiftung’s Transformation Index (BTI) 2012. The BTI is a global assessment of transition processes in which the state of democracy and market economy as well as the quality of political management in 128 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	173.6	HDI	0.504	GDP p.c.	\$	2688
Pop. growth ¹	% p.a.	1.8	HDI rank of 187	145	Gini Index		32.7
Life expectancy	years	65	UN Education Index	0.386	Poverty ³	%	60.3
Urban population	%	37.0	Gender inequality ²	0.573	Aid per capita	\$	16.4

Sources: The World Bank, World Development Indicators 2011 | UNDP, Human Development Report 2011. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

Executive Summary

In the period under review, Pakistan has experienced three external shocks. Civil war in Afghanistan has finally spread to the western parts of Pakistan, and these areas now constitute an integral part of the “AfPak” theater. In summer and autumn 2010, almost a quarter of the Pakistan’s territory was hit by the worst flooding in the country’s history. Infrastructure has been destroyed and millions of Pakistanis have become refugees. The army’s role in managing the disaster was appreciated by the Pakistani public, whereas the behavior of the civilian administration and political parties was criticized by many national and international observers. The army did not use its central role in disaster management to challenge the government. At the same time, Pakistan, like many other countries, still suffers from the impact of the 2008 financial crisis. Under these circumstances, it is remarkable that Pakistan has at least managed the formal transition from a (liberal) dictatorship under General Musharraf to a civilian government under the leadership of President Asif Ali Zardari and his Pakistan People’s Party (PPP). Three achievements stand out: Firstly, the coalition government of PPP, Awami National Party (ANP), Muttahida Qaumi Movement (MQM) and several smaller partners has survived its first two and a half years in office. Coalition governments in Punjab, Khyber-Pakhtunkhwa (KPK, formerly North-West Frontier Province), Baluchistan and Sindh are still operating. There have been no serious attempts by the federal government to topple provincial governments. Even the grand Punjabi coalition of the Pakistan Muslim League-Nawaz (PML-N) and the PPP, which uneasily unites the main government party and the main opposition party, is still in power. Secondly, Pakistan has progressed towards a Westminster-style political system. Under pressure from the opposition and an active (suo moto) Supreme Court, President Zardari has been stripped of the wide-ranging executive powers he inherited from his predecessor, Musharraf. Prime Minister Gilani (PPP) has emerged as the leader of the government, while Zardari has taken on the role of crisis manager in the coalition governments, in particular in Sindh. Thirdly, the army has lost its formal political role with the 18th Amendment.

Regarding the quality of democracy, progress has been more modest. Politics is still confrontational, the lines between government and judiciary are unclear, and the army high command is much involved in decision-making, in particular with regard to internal and external security as well as foreign policy.

History and Characteristics of Transformation

Democratization of state and society on the one hand and liberalization and modernization of the economy on the other have proceeded at different paces. In recent years, Pakistan's political and economic development has seen many ups and downs. Modest attempts at democratization ended with General Ayub Khan's military coup in 1958. Ayub's "guided democracy" turned out to be a military dictatorship, although his macroeconomic management was quite successful. In the late 1960s, Pakistanis from many walks of life turned against the dictatorship. General elections in December 1970, however, produced an electorate divided between West and East Pakistan, and, after civil war and Indian intervention, the eastern part became a sovereign state (Bangladesh). In the remaining western part, Zulfikar Ali Bhutto was elected as prime minister. His populist rhetoric and policies transformed Pakistan's political culture. Political and social mobilization by his Pakistan People's Party (PPP), and by his opponents, reached new heights. The nationalization of banks and key industries, however, set Pakistan back economically, and at the end of his rule, Bhutto's style of governance became increasingly authoritarian. Bhutto was overthrown and executed by General Zia ul-Haq's in a military coup. Under Zia (1977 – 1988), economic policies were essentially liberal: Economic growth in agriculture and in industry gave rise to a new class of entrepreneurs. On the political front, his dictatorship was harsh and oppressive. Army officers took control of large parts of the state apparatus, including public enterprises. At the same time, Islamic militancy was encouraged and became a major political force. Following Zia's still unsolved fatal plane accident, reasonably democratic elections were held in 1988, which brought Benazir Bhutto, Zulfikar Ali Bhutto's daughter, to power. Benazir's governments (1988 – 1990, 1993 – 1996) had to work under the tutelage of the army and the intelligence agencies, a fate shared by the governments led by her archrival Nawaz Sharif (1990 – 1993, 1997 – 1999). Continuous power struggles between elected governments on the one hand and the presidents and the army chiefs on the other, as well as the spillover of the civil war in neighboring Afghanistan, made these governments inwardly focused and preoccupied with law and order problems. It was only after General Musharraf's 1999 military coup that a government under a unified command once more focused on economic policy. Remarkable short-term macroeconomic performance was boosted by liberalization of trade and key industries, an inflow of foreign investment after 9/11 and long-needed investment in infrastructure. President Musharraf allowed private electronic media to thrive and paid more respect to the freedom of the press than any of his civilian predecessors, but he did not liberalize Pakistan politically. The 2002 presidential referendum and parliamentary elections were rigged, and the elected government had only little autonomy. Governments under Musharraf failed to

curb sectarianism and “Talibanization”, in particular in the Afghanistan–Pakistan border region. Islamic militancy in the Khyber-Pakhtunkhwa province (KPK), suicide terrorism in major cities, and insurgency in Baluchistan caused an unprecedented erosion of the writ of the state. However, the ultimate challenge to Musharraf’s rule came from civil society, in particular from the legal fraternity. After the unsolved murder of Benazir Bhutto in 2007, a PPP-led coalition government came to power and her widower, Asif Ali Zardari, became president. Under his rule, state power and economic performance have been undermined still further. The 2008 financial crisis and 2010 floods would have been a heavy burden for any government, but crisis management under Zardari has been erratic. The strengthening of institutions like the police and the judiciary is key for the near future.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 10 (best) to 1 (worst).

Transformation Status

I. Political Transformation

1 | Stateness

For more than five years, the state's monopoly on the use of force has been challenged seriously and successfully by non-state actors in several parts of the country. The most affected are the Federally Administered Tribal Areas (FATA), western and northern parts of Khyber-Pakhtunkhwa province (KPK), central Baluchistan, Karachi, and southern Punjab. Army operations to win back KPK territory have brought mixed results, but militants have been prevented from establishing a parallel state on a long-term basis, in particular in Swat. More importantly, and contrary to some predictions, the devastating floods of 2010 do not seem to have strengthened the support base of the Pakistani Taliban in affected areas. In Baluchistan the situation is still tense: Ethnic Baluch nationalists blow up pipelines, attack army and police convoys, and increasingly target ethnic Punjabi fellow citizens. In Karachi the situation has clearly deteriorated. More than 1,000 people have been killed in 2010 alone in a conflict for hegemony in Pakistan's most populous city. Armed clashes between party workers of the Muttahida Qaumi Movement (MQM), the Awami National Party (ANP) and the PPP, as well as suspected members of the Pakistani Taliban, have been paralyzing the city for the past two years. Restoration of state authority in Karachi is most crucial for Pakistan's economy.

Pakistan's identity as a state and as a nation has always been under debate. Some strands of thought see it as a state for the Muslims of South Asia, others see it as an Islamic state. More importantly, however, Pakistan is a multiethnic (read: multilingual) state, with Punjabis constituting almost half of the populace, and Pashtuns, Sindhis, Muhajirs (descendants of Urdu-speakers from India) and Baluch the remainder. In principle, citizenship and nationhood are not challenged seriously by the minorities. Ethno-linguistic identity and Pakistani patriotism are by no means mutually exclusive. Although the centralist and inefficient policies of dictatorships and civilian governments alike have taken a toll on patriotism, only few Pashtuns,

Question

Score

Monopoly on the
use of force

3

State identity

5

Sindhis and Muhajirs challenge the concept of the (de facto Punjabi-dominated) nation state. In Baluchistan, however, an escalation of violence in recent years has led to an anti-Pakistan climate, and Punjabi-speakers have become victims of targeted attacks. An effort has been made on part of the government to strengthen the legislative power of the (ethno-linguistically defined) provinces (the 18th Amendment to the constitution). As a symbolic measure, North-West Frontier Province has been renamed Khyber-Pakhtunkhwa. Discussion is underway to subdivide the largest province, the Punjab.

Although Pakistan is officially an Islamic republic, the balance between secular and religious principles is a matter of dispute. Pakistan is governed by a hybrid system, in which secular laws and Shari'ah uneasily co-exist. As a rule, secular principles override religious laws when both are at variance. However, competing Islamic groups feel emboldened by this ambiguity and sometimes settle their conflicts by violent means, with Shi'ite and Ahmadi minorities usually at the receiving end. The anti-blasphemy provision of the criminal code is used by religious extremists to terrify religious minorities and political opponents. Sunni extremist groups use their political clout to influence public opinion, or even to impose their world views by force. The proactive Supreme Court has so far refrained from tackling these sensitive issues.

No interference of religious dogmas

3

Traditionally, the state apparatus could fulfill at least the most basic administration duties, such as the maintenance of law and order and the collection of taxes. During the period under review, however, state capacity to administer the country has further deteriorated, partly due to factors beyond the control of the state authorities (floodings, etc.). However, the recent calamities have, once again, demonstrated the low degree of administrative power of the state, as state authorities (except the military, to some extent) seemed incapable of dealing with the human tragedy resulting from the natural disaster. Implementation of new policies, like land or education reforms, proved to be much more difficult, and often even impossible. In times of political and administrative crisis, the Pakistan Armed Forces (PAF) restored order and confidence. It is still considered to be the best-functioning public institution. Remote areas of Baluchistan, interior Sindh and the FATA have always been beyond the reach of the state, and even the PAF found it difficult to operate there. In many of the conflict-affected areas like Swat and Waziristan, civil administration is virtually nonexistent, or the army is temporarily the only local state institution. The disastrous floods of 2010 pose a new challenge to all state institutions. Initially, flooding led to a breakdown of state administration in the most heavily affected areas of KPK, Baluchistan, Punjab and Sindh. Many government buildings and large parts of the road and rail infrastructure were destroyed. The army and international aid agencies provided immediate relief to tens of millions of affected citizens. The total cost of the damage is expected to

Basic administration

4

exceed \$10 billion. The real test for the civil administration will be the reconstruction and resettling effort.

2 | Political Participation

Despite several military coups, elections are an established political practice in Pakistan. Although virtually all elections have been manipulated to some extent, they are generally accepted as an orderly means for selecting those in power. The last general elections of 2008 were assessed as exceptionally free and fair by all national and international observers, and by the people as well. There is a problematic debate, though, on whether the current government should resign after completing only half of its tenure and hold mid-term elections, because of its failure to deliver – demands for good governance conflict with the right of the democratically elected government to conclude its term in office. Women and religious minorities have the legal right to vote, but their representatives are elected through separate constituencies, giving them less political influence.

Free and fair
elections

6

Elected governments have only limited autonomy vis-à-vis the (indirectly elected) president, the army, the powerful intelligence services, and even the civil bureaucracy. Domestic and international security policies and all issues considered to be vital for the survival of the state are essentially decided by the army high command. The current government of Prime Minister Gilani faces the same constraints, although legally speaking, the 18th Amendment to the constitution has shifted the balance of power between president and prime minister in favor of the latter. The prime minister is now the chief executive, and the head of state has become a largely ceremonial post. The army seems to be reluctant to rule directly, and the Supreme Court has committed itself to democratic values. Still, Pakistan's "civilian government" remains under the extensive tutelage of the military, and the state administration is de facto sidelined by veto powers (prominent families, notables, clans) at the local level. This difficult situation has not improved in the past two years – rather, this concludes that there even has been a slight decrease in the elected authorities' effective power to govern.

Effective power to
govern

2

Numerous NGOs take advantage of freedom of speech and freedom of the press to engage in a broad range of topics, including human rights, HIV/AIDS and environmental concerns. Electronic and other new means of communication allow even greater participation on a short-term basis, at least among the middle classes. Pakistan's party political landscape is comprehensive, and includes Islamist and ethnic as well as mainstream conservative and secular parties. Intelligence agencies and other authorities monitor and at times suppress these groups. The level of their actual interference depends on current political expediencies. Public gatherings critical of the government can still expect harassment by security forces.

Association /
assembly rights

5

In principle, freedom of opinion and the press have become the cornerstones of a vibrant public debate over the last decade. A plurality of private print and electronic media ensures that manipulation is becoming more and more difficult for the government. Outright prohibitions have been an exception at all times, and President Musharraf's last attempt to impose censorship during the 2007 "emergency" had only limited effects. However, investigative reporting, in particular on security issues, is still being monitored by intelligence agencies and puts reporters at high risk. More recently, moral and religious issues have become very sensitive, as can be seen from the debate on the blasphemy law. Intimidation and pressure tactics by religious organizations and powerful television anchors have reached such a level that it has become dangerous to address these issues openly. This has been aptly demonstrated by the religiously motivated assassination of Governor Salman Taseer on 4 January 2011. The governor had advocated a review of the law. In general, governments, police and courts behave reactively or even passively with regard to limitations of freedom of expression by powerful religious leaders.

Freedom of
expression

5

3 | Rule of Law

For decades, the separation of powers between the executive, legislative and judicial branches has been compromised by the interference of the former with the latter two. Parliament was bypassed in the formulation of laws, and the higher courts were frequently coaxed to pass politically motivated judgments. In recent years, the legislative branch has begun to stand up against encroachments by the executive, supported by the mass media. For example, when Chief Justice Iftikhar Muhammad Chaudhry, who had earned the reputation of being independently minded, was removed from office at the behest of President Musharraf in 2007, massive protests by lawyers and members of the opposition parties followed, resulting in Musharraf's downfall. Since then, the picture has been reversed. Now it is the rights of the democratically elected government, of President Zardari and of the assemblies that are being abused by an increasingly proactive Supreme Court and its suo moto notices. The Supreme Court enjoys the support of the major opposition parties – in particular the PML-N – and parts of the powerful media.

Separation of
powers

3

Below the highest level, the judiciary is professionally differentiated and fairly independent. However, structural and institutional weaknesses, lack of resources and personnel, the de facto powers on the ground, and corruption in the administration and the judiciary create severe functional deficits in the entire judicial system.

Independent
judiciary

3

The Supreme Court under Chief Justice Chaudhry, has, however, begun to encroach upon the rights and proceedings of the lower courts, as well as on the limited rights of the parliament to appoint judges. The composition of a regulatory body for the

appointment of senior judges has become the main contentious issue between the Supreme Court on the one hand and the president and the parliamentary majority on the other. Judges and the legal fraternity at large now seem to be split along political lines, hampering the judiciary's autonomy. Ordinary citizens had by and large lost trust in the legal system even before this because of its inefficiency, the massive backlog of cases, and the corruption of judges. Populist calls for "speedy justice" have recently been taken up by Islamist extremists who want to legitimize a system of physical punishment, although this has met resentment from the general public.

Corruption has always been a problem in Pakistan, and it has become rampant in recent years. Corrupt practices have accelerated at all levels under the new democratic government, which severely affects the business climate and the trust of the population at large. On the other hand, there is a vibrant anti-corruption discourse, and although corruption charges have been used by governments and the intelligence agencies to intimidate, blackmail or eliminate political opponents, it is fair to say that the general value of holding politicians accountable has remained strong. Occasionally, officeholders have received negative publicity, and as a result it has been possible to prevent the reelection of some politicians who had been exposed as corrupt.

In general, and despite the return to a popularly elected government, the decline in state control over the entire territory, the ups and downs of communal violence, anti-terrorism campaigns etc. have contributed to a further decline in the quality of protection of citizens against the violation of their civil rights in recent years. Civil rights are protected very differently in urban and rural areas. In rural areas, traditional customs and conservative backlashes against modernization deprive women and the poor of equal rights and basic freedoms. In some areas, landowners and tribal leaders operate private militias and prisons. Even in the cities, religious conflicts jeopardize freedom of worship for Shi'ites, Hindus, or Christians. The Ahmadis, having been declared non-Muslims by various Pakistani courts, are targeted with blasphemy charges. Christians and other minorities, and even Muslim sects have become victim to discrimination by extremist groups. Poor neighborhoods are subjects to various infringements of rights by land mafias, religious extremists, political and ethnic entrepreneurs, and the police.

4 | Stability of Democratic Institutions

With a political system officially grounded in the 1973 constitution, Pakistan ostensibly follows a Westminster-style parliamentary system, with a powerful prime minister and a ceremonial president. This system is still preferred by the majority of Pakistanis. The reality has always been different, and the country has been ruled by the military and bureaucratic elite for most of the time. Since the February 2008 parliamentary elections, which, in contrast to most previous polls, were by and large

Prosecution of
office abuse
3

Civil rights
2

Performance of
democratic
institutions
3

free and fair, the democratic institutions have had more clout. The grievances of the smaller provinces are being addressed, as can be seen from the negotiations between the federal government and Baluchistan on provincial autonomy. The indirectly elected President Zardari has been stripped of most of the power he involuntarily inherited from his predecessor Musharraf. The government under Prime Minister Gilani sets its own priorities, with the notable exceptions in internal and external security policies, including the nuclear arsenal. In other policy fields, it is rather unclear if the government is unwilling or unable to set its preferences and rule effectively. It may be fair to say that Pakistan is currently co-ruled by the democratic government and the army high command.

The military and the bureaucratic elites have only very rarely accepted the principle of democratic governance in Pakistan. Over the last 60 years, the president – who is elected indirectly by an electoral college – and the army chief have emerged as the two main power centers. Elected governments had to work under their tutelage. Prime ministers, in turn, follow an authoritarian style of governance and show little respect for parliament. At the same time, the principle of loyal opposition is largely ignored. Although the present chief of army staff (COAS), General Ashfaq Kayani, is more committed to civilian rule, immature and inexperienced political leadership has brought back authoritarian traditions, giving the bureaucratic elite, and the COAS even more so, substantial influence.

Commitment to
democratic
institutions

2

5 | Political and Social Integration

Pakistan's tradition of political parties goes back to colonial times, but post-colonial bureaucratic and military elites have never allowed them to take control. As a result, parties are not programmatic political bodies that compete in aggregating interests, but personality-centered and patronage-based platforms. As in many developing countries, the buying and selling of votes is common, and members of parliament often switch between parties before and after elections. As in many first-past-the-post (FPTP) electoral systems, a two-party system has evolved, with the PPP as the center-left and the PML-N as the center-right party. In addition, there are some regional parties with national weight, such as the Awami National Party (ANP) in KPK and the Muttahida Qaumi Mahaz (MQM) in urban Sindh. The basic system has been sustained both by the social values still prevalent in rural areas and by the manipulation of state authorities. Under rapid social change, the system is beginning to erode. There are a number of younger parliamentarians, including some women, who are more open to democratic accountability. At the same time, ideological differences are sharpening, in particular on social and moral issues. Additionally, a subset of party workers has become militant, as demonstrated in Karachi where supporters of the MQM clashed with those of the PPP and the ANP (although all three parties are coalition partners at the national level).

Party system

4

Traditionally, there are many active interest groups in Pakistan. However, independent, well-organized and effective associations like the Citizen Police Liaison Committee, Lawyers for Civil Rights or the Women's Action Forum, have come up only in the last two decades. Electronic media and new means of wireless communication have made them increasingly vocal, although formal political institutions barely take notice of their campaigns. It should also be noted that new public interest groups (environmental, health, gender issues) have to compete with conservative interest groups like the clergy and the military establishment, which use new media for their own purposes. Interest groups in general address only a limited range of concerns, usually those affecting the urban population. The interests of the majority population are scarcely accounted for, except by clan-based political entrepreneurs or religiously-motivated groupings with dubious democratic credentials.

Interest groups
3

There is little reliable survey data on democratic values that covers both urban and rural areas of Pakistan. Given the volatile security situation, the 2008 parliamentary elections' voter turnout of 44.5% indicates at least moderate consent to democratic norms. In the same way, the scale of political protest against Musharraf points to growing approval of democratic values. By the same token, the public campaign that forced President Zardari to renounce the far-ranging constitutional powers he had inherited from his predecessor Musharraf, can be seen as an approval of the right to democratic and responsible governance. At the same time, it is well known that democratic principles are violated in political practice at all levels, and by government and opposition forces alike.

Approval of
democracy
n/a

Self-help organizations have been mushrooming in Pakistan's urban areas since the 1990s. Some of them, like the Edhi Foundation, have turned into effective service providers. All these organizations respond to the failure of the state to provide basic services to the citizens. They are, however, still too sparse and too unevenly distributed for a fast-growing population, and many of them lack reliable funding. In times of crisis, Pakistanis show solidarity with their fellow citizens, as the 2010 flood relief efforts have demonstrated. Here religious organizations, some of which have ties with political extremists, have gained some prominence. It is too early to say whether the social capital of service providers can be transferred into political capital for the affiliated parties.

Social capital
4

II. Economic Transformation

6 | Level of Socioeconomic Development

Question
Score

Socioeconomic
barriers
3

The sheer number of people living in poverty is not (or not yet) the main problem with regard to socioeconomic development. According to World Bank data, Pakistan's revised poverty rate (\$2 per day) is at 60.3% (2005), which is much better than India's (75.1%) or Bangladesh's (81.3%). Even inequality as such (Gini value at 31.2 for 2005) is not more rampant than in many other cases. Pakistan seems to be stuck in the middle of human development in South Asia: Pakistan's HDI was put at 0.57 (rank 125), which is a little better than Bangladesh (0.54), but worse than India (0.61). There are, however, huge disparities between provinces. Socioeconomic development is lagging behind in Baluchistan, large parts of KPK, and in FATA. On closer inspection, there are even more alarming figures at national level. The overall literacy rate of 53.7% stands out, and even more so the female literacy rate (40.0%). The kernel of truth may be found in the female enrollment ratio, which is among the lowest in the world (82.6% for primary and 75.8% for secondary education). Women and members of religious minorities such as Ahmadis, Christians, Hindus and Sikhs remain partially excluded from society, in particular with regard to access to education or offices. Pakistan's education system perpetuates many inequalities, in particular gender inequality. It perpetuates social structures and mentalities to such an extent that Pakistan's competitiveness for the twenty-first century seems questionable.

Economic indicators		2007	2008	2009	2010
GDP	\$ mn.	143171.2	163891.7	161819.0	176869.6
GDP growth	%	5.7	1.6	3.6	4.1
Inflation (CPI)	%	7.6	20.3	13.6	13.9
Unemployment	%	5.1	5.0	-	-
Foreign direct investment	% of GDP	3.9	3.3	1.4	1.1
Export growth	%	2.3	-5.3	-3.3	15.8
Import growth	%	-3.5	3.5	-15.2	4.4
Current account balance	\$ mn.	-8286.0	-15654.5	-3993.4	-1490.0

Economic indicators		2007	2008	2009	2010
Public debt	% of GDP	54.6	58.7	57.3	56.8
External debt	\$ mn.	41531.1	49057.4	54587.9	56772.9
Total debt service	\$ mn.	2644.6	3017.6	3494.9	4338.4
Cash surplus or deficit	% of GDP	-4.2	-7.4	-4.8	-
Tax revenue	% of GDP	9.8	9.9	9.3	10.0
Government consumption	% of GDP	9.2	12.5	8.1	7.9
Public expnd. on edu.	% of GDP	2.8	2.9	2.7	-
Public expnd. on health	% of GDP	2.6	2.6	2.6	-
R&D expenditure	% of GDP	0.67	-	-	-
Military expenditure	% of GDP	3.0	2.8	2.8	-

Sources: The World Bank, World Development Indicators 2011 | International Monetary Fund (IMF), World Economic Outlook 2011 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2011.

7 | Organization of the Market and Competition

In principle, the foundations of market competition are largely in place in Pakistan, with almost unrestricted competition, all but equal opportunities for market participants and a government-guaranteed regulatory regime. Actual market access, however, may depend on informal ties, and former government members, civil servants and former army officers dominate lucrative parts of economy. The military has become a corporate actor whose behavior systematically distorts fair competition. Furthermore, since it is estimated that about two thirds of non-agricultural employment remains in the non-regulated informal sector, the institutional framework cannot be said to be entirely appropriate.

Despite unfavorable conditions on both the domestic (insurgencies, sectarianism) and foreign policy (global war on terror) fronts, Pakistan has opened up markets and privatized businesses in various sectors of the economy since 1999. However, the military's foundations still dominate many profitable sectors in both industry and services. The fact that some important members of the political class dominate some vital parts of the economy (e.g., sugar) raises suspicions about price fixing. It is too early to say whether the enactment of the 2010 Competition Act will provide effective means to control the "cartelization" of economic units.

Market-based
competition
5

Anti-monopoly
policy
5

Like many of his predecessors, Musharraf continued to liberalize foreign trade (tariffs), although export subsidies for items such as cotton or leather remained. At the same time, some state companies such as Karachi Electric Supply Company or Pakistan Telecommunications Company were privatized. However, after some cases provoked public scrutiny, and the privatization of Pakistani Steel Mills had been stopped by the Supreme Court, the process seems to have come to a standstill. With regard to free trade, Pakistan is part of trade regimes like the South Asian Free Trade Area (SAFTA) and the SAARC Preferential Trading Arrangement (SAPTA), but it has blocked all attempts by India to start liberalizing trade between the two neighbors.

Liberalization of
foreign trade

7

All recent governments in Pakistan have been formally committed to interest-free banking, but an outright Islamization of the banking system has become very unlikely. Conventional and Islamic banks easily coexist, with no negative effects on the banking system as such. There are some fears that banks may be used by members of the political elite, because in the past loans were written off for political reasons. Generally speaking, the banking system still has to deal with the issue of providing long-term loans, which is hampering long-term investments and economic planning. Indicators (bank capital to assets 1.4%, bank non-performing loans 23.4%) show that the financial crisis did not spare Pakistan, but the banking system is still working reasonably well.

Banking system

6

8 | Currency and Price Stability

After a five-year period of price stability with inflation rates ranging from 3.1% to 4.5%, 2005 marked the beginning of volatile inflation, with rates rising to 9.1%, then falling to 7.6% (2007), and soaring again to 20.3% in the crisis year, 2008. In 2009 inflation rate was very high at 13.6%. The burden on the population is huge, and inflation is one of the main political issues in Pakistan. Major factors are food and oil prices, aggravated by the depreciation of the Pakistani rupee. A forecast by the Economist expects a consumer price inflation of 10.4% in 2011. Much will depend on the State Bank of Pakistan, which is considered to be fairly independent. The resignation of its governor in 2010 is widely seen as a bad sign.

Anti-inflation /
forex policy

3

To avoid bankruptcy, Pakistan's government agreed to a \$7.6 billion bailout package with the IMF in November 2008. At that time, Pakistan's fiscal deficit had risen to 6.8%, and the country's trade imbalance stood at \$15 billion. The latest figures for public and external debt (stable at \$39 billion and \$40 billion) and for total reserves (up to \$90 billion in 2009 from \$57 billion in 2008) may indicate a process of stabilization. The government has proved unable, however, to implement a stand-by agreement with the IMF, which included an understanding over the

Macrostability

4

introduction of a “revised general sales tax” to improve fiscal policy. Critics in government argue that the expansion of the tax base (rural income) should come first.

9 | Private Property

Pakistan’s economy has always been based mainly on private property. In recent years, deregulation and privatization of remaining state enterprises (banks, telecommunications, oil, gas) have contributed to more economic growth. Private property is protected by law, and private companies are able to act freely. However, the acquisition of private property, in particular the sale of land to military officers, as well as the awarding of contracts, is still affected by very high levels of corruption and nepotism. This has worsened under the new government. The main problem, however, is the lack of trust in political stability and in the judicial system. Here the proactive Supreme Court, which has protected private property against vested interest in some cases, could act as a role model for lower courts.

Property rights
6

Privatization and deregulation under Musharraf encouraged entrepreneurial activity. However, military-run businesses are excluded from the disinvestment of inefficient state enterprises, and real estate property is subject to speculative price hikes and non-transparent sales’ practices. President Zardari has been in no position to rein in the military establishment. On the contrary, observers note that members of the political class are using their political clout in order to achieve dominance in some economic sectors (e.g., sugar).

Private enterprise
6

10 | Welfare Regime

Pakistani society outside the cities is still characterized by semi-feudal stratification. Even under the new democratic regime, mainstream political parties have shown no particular interest in challenging these conditions. The “Benazir Income Support Programme” of PKR 34 billion, which entitles the poorest families to a monthly payment of PKR 1,000., has been criticized as a party-political measure by most observers. It remains to be seen whether the rehabilitation of flood victims will provide an opportunity to gather more information on people’s needs and adopt new measures against poverty. Until now, welfare and social security have remained low-priority areas. Public health expenditure ranks among the lowest worldwide (0.8% of GDP). Official welfare regimes only cover public service employees, in particular in the armed services. Pakistan’s main social safety nets are still informal, based on membership in families or clans. Their ability to compensate for poverty, old age, sickness and unemployment reaches new limits in a rapidly modernizing society.

Social safety nets
3

With some notable exceptions like the army and other corporate employers, social background rather than merit decides individual chances to participate in the formal or informal economy, and in society in general. Generally speaking, public education does not function as means for upward mobility in Pakistan. This is documented by Pakistan's low literacy rate (53.7%; females: 40.0%) and the low enrollment ratio (primary 84.8%, secondary 32.9%). Women and religious minorities suffer most from unequal access to education, jobs, and public offices. As a rule, welfare indicators are much worse in FATA, Baluchistan and large parts of KPK.

Equal opportunity
3

11 | Economic Performance

After five years of strong performance, with growth rates from 4.8% to 7.7% per annum, Pakistan has been hit by the financial crisis in 2008 and 2009, with GDP growth falling to 2.0% and 3.7% respectively. Given the high population growth rates, this figure is too small to bring any economic benefit. Even worse, FDI has decreased from to 3.9% of GDP in 2007 to a dismal 1.4% in 2009. Pakistan needs foreign investment as growth had been driven mainly by a few sectors, like the expansion of the telecommunications sector and a construction boom. Agriculture is still vulnerable to drought and flooding, and the industrial base remains largely dependent on textiles, where Pakistan's producers face tough competition. Unemployment is rated at 5.1% only (for 2008), but it should be noted that Pakistan's economy still fundamentally rests on informal labor.

Output strength
4

12 | Sustainability

Pakistan's successes in environmental policy have been modest, as can be seen from its position (rank 125 of 163) in the Environmental Performance Index, which focuses on measures to limit environmental stresses to human health, safeguard ecosystem vitality and improve natural resource management. There has been some progress with regard to restrictions on automobile emissions, with the notable exception of trucks and overland buses. Still, air pollution levels in urban areas remain at nearly twice the world average, and all major rivers suffer from heavy pollution. Absent or inadequate sewage systems and an environmental consciousness that is in its infancy provide additional curbs on environmental sustainability.

Environmental
policy
5

Pakistan's education policy is the one of main structural hurdles for economic development. The state's low investment in education over recent decades has led to a growth of madrasahs, with the number of religious schools exceeding 20,000 and exact student numbers unaccounted. Traditionally, educational institutions have an elitist bias, favoring secondary and tertiary education in the English language.

Education policy /
R&D
3

Private English middle schools have mushroomed during the last decade, with some good performance in urban areas. However, the economic stagnation of the last two years has hit the middle classes, and some cannot afford costly private education any more. Pakistan still grapples with a low rate of literacy, a lack of participation in rural areas and high drop-out rates. With educational spending at 2.9% of GDP, Pakistan's government is bound to reproduce this sorry state of affairs. Even tertiary education is lagging behind South Asian competitors, although the Higher Education Commission had shown a remarkable performance under Musharraf in internationalizing Pakistan's universities. Likewise, expenditure on R&D increased from 0.44% to 0.67% in the period from 2005 to 2007. The 18th Amendment to the constitution foresaw a devolution of education policy to province level, which is likely to reverse the positive trend of the last five years.

Transformation Management

I. Level of Difficulty

Pakistan managed the peaceful transition from a military-led to a democratically elected government in 2008 – 2009, but the essential structural constraints on a democratic and an economic transformation remain. For a number of reasons, many of which have to be attributed to successive Pakistani governments' policies, the armed conflict in Afghanistan has spread to a substantial part of Pakistani territory. FATA, large territories of KPK and Baluchistan, Karachi and even parts of southern Punjab are now in the focus of the new AfPak policy. Furthermore, relations with India deteriorated in the aftermath of the November 2008 Mumbai terrorist attacks, and Pakistan was hit by unprecedented floods in summer and autumn 2010, which affected more than 20% of Pakistan's large territory. Rail and road infrastructure was largely destroyed in the affected areas, as were crops, villages and houses. The deluge hit a country that had not been exempted from the global financial and economic crisis. Add to this widespread poverty, lack of efficient state institutions in many rural areas, demographic imbalance resulting from decades of massive population growth, a low level of adult literacy, and large-scale discrimination against women in rural areas, and you get an impression of the daunting task faced by President Zardari and Prime Minister Gilani in the period under review.

Structural
constraints
8

Pakistan's high level of constraints is to some extent alleviated by a flourishing civil society in all major cities. The country is home to numerous NGOs, both domestic and international. The level of participation in public debate is fairly high in urban areas, and it extends to all age groups. Aided by a vibrant and untamed private electronic media, people of all classes and educational backgrounds can get hold of criticism leveled against the government and the authorities, including the armed forces. The debate is hampered by a lack of solid education among many of the newly mobilized urban dwellers and by a lack of trust among people of different political or religious creeds and viewpoints. In rural areas, the situation is even worse. Here, lack of education, limited reach of mass media and social constraints restrain the expansion of the public sphere. In addition in these areas (which of course form the largest part of the nation) civil society traditions are extremely weak.

Civil society
traditions
7

Pakistani politics have always been somewhat confrontational. The initial cleavage within Pakistani society emerging in the early decades after independence set apart the middle class elites of the independence movement from local political forces and vested interests of West Pakistan (at that time) that had no particular interest in nation building or social development. Recurring interference by the bureaucratic and military elites set a new dividing line between pro-establishment and anti-establishment forces. Even President Zardari's democratically elected government faces a similar confrontational atmosphere. Pakistan's political climate is dogged by a culture of distrust, fostered by repeated coup d'états and an escalation of the terrorist violence that spilled over from Afghanistan. Although sectarian violence has affected Pakistan for two decades now, the surge of terrorist violence and suicide attacks of recent years has no precedence. A culture of fear that reduces governmental capacity has taken hold in Pakistan, as illustrated by the reaction of the political classes and the wider public with regard to the assassination of Punjab governor and Zardari-confidant Salman Taseer by his own security guards on 4 January 2011. Hate speeches by religious leaders of various ideological backgrounds utterly condoned the murder, which was committed on religious grounds. Taseer was accused of the "crime" of pushing for the reform of the blasphemy law. The assassination of Federal Minister for Minorities Shabaz Bhatti, a member of Pakistan's Christian minority, on 2 March 2001 also fits into this pattern. Additionally, bonds of solidarity between the Pashtun tribes on either side of the Pakistan–Afghanistan border limit the effectiveness of military operations and border control in that area. The escalation of conflict in Baluchistan province and the deep distrust by the local population of Pakistani mainstream society further aggravates the conflict scenario.

Conflict intensity

9

II. Management Performance

14 | Steering Capability

Generally speaking, Pakistani governments have shown little political leadership, in particular when it comes to political and economic reforms. Against that backdrop, the policies of privatization and deregulation pursued by the governments under President Musharraf had earned domestic as well as international praise. His successor Zardari has been not so successful. Apart from the November 2008 \$7 billion bailout (to which there was no alternative), Zardari has shown very little leadership, and Prime Minister Gilani's role in policy formulation seems to be limited. The tax reform (introduction of a revised general sales tax) was suggested by the donor community. Other urgent concerns like the revitalization of the economy or the energy crisis do not seem to be high on his agenda. He has shown

Question
Score

Prioritization

3

some skills in keeping his coalition together and his arch-rival Nawaz Sharif out of the government. His attempts to devolve power to the provinces through the 18th Amendment to the constitution are also commendable. He failed, however, to get the vital support of the MQM, the dominant party in Karachi. As a result, violence in Karachi has been taken to new levels. The Charter for Democracy of 2006, which aims to keep the military out of politics, is still waiting to be implemented as a long-term strategy.

Important reforms, such as the devolution of power (under Musharraf), tax reform and the 18th Amendment (under Zardari), all met with mixed results, and this is largely due to implementation failures. The incumbent government's implementation policies are hampered by two additional constraints: The Punjab, Pakistan's largest province, is ruled by an uneasy coalition government under the leadership of the PML-N, which is the main opposition party at federal level. Although Zardari's PPP-led coalition federal government is, in principle, free to set its own priorities, it has to keep an eye on the Punjab's veto power in the implementation process. Furthermore, a proactive Supreme Court has started to weigh down implementation processes.

Implementation
3

Musharraf's governments showed leadership, but only limited will to learn from past mistakes. There has been no improvement under Zardari. The 2010 tax reform, which is still waiting to be implemented, is a case in point. Like Musharraf in 2000, the democratically elected government failed to consult and include the relevant veto players in society. Even worse, tax reform has been portrayed as being imposed from outside, a pattern recognized from past experiences. If the government fails to reform its tax system now, it will be forced to re-negotiate with international donors on less favorable conditions sooner rather than later.

Policy learning
3

15 | Resource Efficiency

Musharraf's governments made partially effective use of the available personal, financial and organizational resources. Reform policies in general and their implementation in particular tended to marginalize existing institutions and to create new ones, which operated under different regimes with regard to payment, recruitment and organizational procedures (e.g., the National Data Registration Authority). Under Zardari, this practice has been continued and discontinued at the same time. The government ignores existing, functioning and well-funded institutions and sets up new ones. Efficient and committed institutions like the Higher Education Commission are being drained, simply because they were established under the wrong government. The same applies to other reforms, such as the devolution of power and police reform. Admittedly, this waste of resources under the cover of a politics of vengeance has some backing among the electorate.

Efficient use of
assets
3

Previous governments had failed to establish coherent coordination mechanisms among the various parts of government (federal and provincial level, ministries and specialized bureaus, civil and military leadership). Now that the provincial government of Punjab is led by the opposition party, things have gone from bad to worse. The federal government faces rival agendas from the Punjab government, an activist judiciary, the army, and even the vibrant mass media. Over the last two years, opposition leader Nawaz Sharif has quite successfully tried to outperform President Zardari as a political strategist. Nawaz' 10-point agenda for political and economic reform of December 2010 is a case in point. All-party conferences have been brought in as a fresh idea to bring in some consistency on the basis of political agreements. If they are to succeed, parties have to agree on key questions like the distribution of power between federal and provincial level, the role of Islam in politics, the reform of the tax system, and so on. It is difficult to envisage such a broad consensus.

Policy
coordination
3

Corruption is present at virtually every administrative level in Pakistan. Circumstantial evidence suggests that it has been taken to new heights in the period under review. People in business contend that blackmail and extortion by civil servants and confidants of the incumbent government are on the rise. This seems consistent with the apparent siege mentality of a government that cannot be sure of its most immediate future. By the same token, policies of anti-corruption bodies have traditionally been biased against politicians in general and the opposition in particular. Political personalities and their patronage networks have remained their focus, whereas state institutions like the judiciary, the bureaucracy and the military have by and large been exempted from prosecution. Notably, nepotism in the private sector is scarcely covered even in the media. As long as businesses and politics run according to informal rules at best, it is unlikely that mainstream political parties will become more active. It should be noted, however, that the proactive Supreme Court under the leadership of Chief Justice Chaudhry has repeatedly moved against corrupt individuals, but given the scarce resources available to the court, it remains to be seen whether this can kickstart systemic change.

Anti-corruption
policy
2

16 | Consensus-Building

Among mainstream political parties, the business elite, the bureaucracy and the military, the politics of market reform are accepted in principle, although sharp differences remain with regard to the extent to which deregulation should include the nation's strategic assets or affect specific sectors of the economy. Democratization, by contrast, meets with opposition from the military, the bureaucracy, and even parts of the business elite, whereas all political parties, including the Islamist ones, are in principle committed to this goal. Militant Islamists may have a completely different agenda, but their support in society and

Consensus on goals
3

their influence on policy makers is marginal. Over the years, a lack of consensus has emerged with regard to Pakistan's apparent dependency on external donors, both financial and military – neighbors like India and Afghanistan and partners like the United States, China, and E.U. countries.

Opposition parties, and sometimes even parties in government, remain in denial, whereas the military, business and administrative elites cannot agree on priorities and partners.

Although Musharraf was forced to step down by a large pro-democracy coalition, and his successor as army chief, General Kayani, has committed himself to civilian rule, veto players like the military and bureaucratic elite, major landowners, tribal leaders and some members of the business class still have the power to stop the reform process, if they collaborate. Fiercely anti-democratic actors like the Pakistani Taliban or sectarian groups hold some influence at the lower echelons of state institutions. The blasphemy law, the reconciliation policy towards India, and the relationship with the United States are cases in point. The main opponents of democratization can be found in Pakistan's elite. To co-opt or even to isolate these forces, Pakistan needs continuous civilian rule and strong leadership, which Zardari and Gilani have failed to provide. It is encouraging, however, that the military establishment has so far refrained from taking advantage of the weakness of the democratic leadership.

Anti-democratic
actors

4

President Musharraf proved unable to build institutions that could bridge political, ideological, religious and interest-based cleavages. Instead he sidelined or dismantled existing institutions, preventing the development of consensus-building on power-sharing mechanisms in time (elections) and in space (federalism). President Zardari invested heavily in consensus-building at the beginning of his time in office, when he assembled PPP, ANP, and MQM in one coalition at the federal level, and accepted a junior partnership in the PML-N government in Punjab for his PPP. Despite these encouraging moves, confrontation rather than compromise has remained the order of the day in Pakistani politics. At least some of the credit goes to PML-N opposition leader Nawaz Sharif and to Chief Justice Iftikhar Muhammad Chaudhry. Both men seem to be united in their aim to prevent a stabilization of Zardari's rule. Until political parties and other players agree in the most basic rules of the game, "conflict management" will de facto remain the privilege of the army leadership.

Cleavage /
conflict
management

3

Musharraf consulted civil society and NGOs at the beginning of his rule, but over time he followed quite effectively his predecessors' practice of sidelining them. The government under Zardari has a much broader base in society, but it does not consult or include non-party-based civil society to a notable extent. Given the difficult situation of the government, it has to be considered a positive development that it has refrained from cracking down on organized civil society (in contrast to

Civil society
participation

3

Nawaz Sharif's government in the 1990s). It nevertheless remains difficult for civil action groups to influence policy-making. In the public sphere, they have to compete with the (hidden) power of interest groups like the army or the clergy. Furthermore, the mass media is trying to shape the political agenda, at the expense of parliament and civil society.

Musharraf's rule deepened existing wounds in society and created new ones. By entering into a grand coalition with Nawaz Sharif, Asif Ali Zardari initially acknowledged the need for reconciliation, but as the breakup of the short-lived alliance and the recurrent confrontational situations demonstrate, both men have failed to deliver. The fact that the murder of the liberal politician and businessman Salman Taseer has not been unequivocally condemned among mainstream parties, has opened a gap between the old liberal elite and the political mainstream. The government's arrest warrant for Musharraf, who lives in exile in London, is not a step towards reconciliation either.

Reconciliation
5

17 | International Cooperation

The Musharraf regime worked closely with the international institutions on its economic reform agenda, but it had no real plan to democratize the system. Military and political aid was used for narrow and short-term political purposes, and not to implement strategic choices. Cases in point are the security sector (army, paramilitaries, police), fiscal reforms and education policy. President Zardari took a step towards a strategic international partnership when he initiated the Friends of a Democratic Pakistan group in September 2008. Although this forum includes all major donors and player, including the United States, China, the United Nations and the European Union, it has prevented neither conflict nor deadlocks. It has even been rather ineffective as an instrument to prevent or curb rent-seeking: Pakistan still prefers to outwit individual donors than to engage in a long-term strategic dialogue.

Effective use of
support
4

Although it is the largest contributor to U.N. missions, Pakistan is among the least trusted members of the international community. Its political commitment to long-term strategies has always been shaky. President Zardari has had no opportunity to surprise international stakeholders. A window of opportunity could open in the context of the Afghanistan peace process and the reconciliation with the Taliban, if Pakistan abstains from its old plan to attain "strategic depth" vis-à-vis India. It should go hand-in-hand with a sustained military campaign in Swat, Waziristan and Malakand to root out the so-called Pakistani Taliban. A good auditing of the international flood relief would also be helpful in this regard.

Credibility
3

Pakistan is member of regional blocs like the South Asian Association for Regional Cooperation and the Economic Cooperation Organization, and it even enjoys observer status at the Shanghai Cooperation Organization. However, cooperation is held back by tense relations with its direct neighbors India and Afghanistan, and by a general disposition towards bilateralism, as can be seen by its cooperation with countries like China, Saudi Arabia and the United States. It has to be noted that the relationship between Pakistan and China is getting broader and deeper. It covers political, military, economic and cultural issues. To attach Pakistan's economic and political security to China's, however, is only one option for Pakistani strategists. If realized, it would have definitely an impact on the perspectives of democratization and market reforms.

Regional
cooperation
5

Strategic Outlook

Over the last 50 years, Pakistan has often been falsely labeled a failing state. The period after the storming of the Red Mosque has seen this fallacy become partially true. The army is now involved in military operations in FATA, KPK and Baluchistan. Karachi, the economic hub of the country, is witnessing political and sectarian strife reminiscent of the 1990s, when the city was a war zone. Tax earnings are in no way sufficient to sustain the budget. Public education is so underfinanced that it is a liability for economic growth and will become even more so in future. One of the foremost tasks is to lessen the burden of defense expenditures. An energy crisis has not just led to a unique policy of institutionalized blackouts in all major cities, but to slowing down of economic growth as well. The IMF had to rescue Pakistan from bankruptcy during the 2008/2009 financial crisis.

In Pakistan, the task list is in the hands on an extraordinarily weak government which has been formed during a process of transition from dictatorship to democracy. Strong veto players in the military, in the civil administration and among the traditional elites have taken a back seat for a moment and are waiting for their chance to interfere. There is still no trust among mainstream political forces that the other side will abide by the rules written down in the constitution or in political agreements. To make matters worse, the public reaction to the religiously and politically motivated assassination of liberal governor Salman Taseer has shown that Pakistan's political mainstream cannot agree on even the most basic principles of the political game.

At the same time, Pakistan is a frontline state in the fight against international terrorism, and it is a key neighbor country in the international effort to stabilize Afghanistan. Western leaders have made it a habit to demand "more" from the Pakistani government. Neighboring India, with whom Pakistan still has a number of unresolved international issues, is meanwhile making progress on an economic as well as on a political front.