CHAPTER VI

EXPLANATIONS OF GROWTH DIFFERENCES
AT THE SECTORAL LEVEL: INDUSTRY

In this chapter we will examine the growth differences of the SACs in their industries sector. This is important because the concept of growth and the process of industrialization are quite inextricably linked that they are often treated as synonymous.

As in the agricultural sector, our interest in examining the industrial growth rates is to know whether sectoral policies were different among and within the SACs during the period of our analyses, and if so, how these differences explain differences in growth rates of output in the industries sector. In section 6.1 period-wise growth rates and in section 6.2 cross-country growth rates for selected periods will be examined. Section 6.3 deals with the analyses of growth differences for periods immediately following the four episodes. In the final section 5.4 a comparative analyses of growth differences among the SACs with emphasis on noneconomic factors will be given to show how differences in their sectoral policies were shaped by different contextual factors and how these policy differences may have contributed to differences in growth rates in the industries sector.

Before we embark on analyzing growth differences, a few introductory remarks are necessary to clarify certain terms and other issues so that the core analyses
that follow may be understood clearly. First, the term ‘industry’ must be clarified. In its broadest usage it refers to a major sector of economic activity: agriculture or rubber growing, mining, banking, services and so forth. This term is also used to delineate one of three broad sets of activities: manufacturing, construction, and utilities and sometimes mining as well, with either ‘agriculture’ (excluding mining) or ‘primary production’ (including mining) and ‘services’ as the other two sectors.

‘Manufacturing’ is a less ambiguous term, which includes the production of all goods (not services) that require some transformation from a primary material or semifinished product. Even within manufacturing there is a classification between large scale and small scale. We will not go into the details of these terminologies, except to say that the term as used here refers only to large and small scale manufacturing and will use output data originating under that classification.¹

In general, the term industrial policy is used to denote a wide range of programmes and measures designed to achieve a multiple set of goals. For example, these goals may include, among other things, increasing the output for consumption by the population, create balanced regional development, employment generation, prevention of excess capacity and self-reliance. Specific goals call for specially

¹ Including small-scale manufacturing in our analysis poses a serious problem. Different countries use competing systems of classification; at one extreme there is the traditional cottage industry which employs perhaps ten to fifty workers and at the other extreme the ‘modern small-scale industry’ employing hundred or more workers. Output originating in this segment is therefore not strictly comparable across countries. In spite of this difficulty we will include this segment in our analyses.
designed programme measures. We will not, however, include in our discussion all
these programmes, and will confine ourselves only to those that are intended to raise
manufacturing output. In this context we will mention the import-substitution
industrialization strategy since it was widely adopted by most of the SACs at one point
or the other in their quest for industrial development. The basic mechanism underlying
import-substitution is simple. To start, a country will identify large domestic markets
as indicated by substantial imports over the years: then it will ensure technologies of
production can be mastered by local manufacturers or that foreign investors are willing
to supply technologies, management and capital. After this, the country will erect
protective tariff barriers; either tariffs or quotas on imports to overcome the high initial
cost of local production and make it profitable for potential investors in target
industries. From the above description we can see that protective tariffs and import
quotas are the two instruments that are most commonly used to achieve import-
substitution industrialization. In our ensuing discussions of industrial growth
differences we will have more to say about this approach and explain those differences
in growth within the context of import-substitution industrialization strategy. 2

There are a number of clearly defined patterns of industrial growth associated
with economic development. 3 For instance, countries with high per capita incomes

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2 We will not undertake in this chapter a detailed analysis of why import-substitution may fail to
achieve its desired goal or explore these two instruments in-depth. Wherever it is relevant, we will
merely refer, to the negative impact these two policy instruments have on industrial output.

3 For a detailed discussion of this phenomenon, see Chenery H. and Syrquin, Moises (1975). Patterns
tend to have higher fractions of GDP produced by industry and larger shares of labor force employed in it. We will not, however, include in our cross-country comparisons of industrial growth rates any discussion of patterns of development, because factors other than those induced by policy also may influence growth and development of a particular country. We will mention two such factors: one is the resource endowment of a country. Each country's land based resources and labor force largely determine its structure and pattern of industrial development. Second, is the initial industrial base a country inherits that influence its pace of development. These two factors are clearly different for different SACs and therefore, inclusion of patterns of development in the discussion of cross-country comparisons of industrial growth rates may be misleading. With these remarks we will proceed to explain period-wise growth rates in the industries sector.

6.1 ANALYSES OF PERIOD-WISE GROWTH RATES

Period-wise growth rates in the industries sector will be analyzed in the same manner we examined the agricultural growth rates in Chapter Five. First, we will explain briefly the nature of each country's manufacturing sector (which is the main focus of our analyses) and the major policy initiatives taken by the government towards this sector. Then the differences in growth rates, if any, will be explained in terms of differences in those policy initiatives.

The period-wise growth rates in the manufacturing sector that we will examine in this section are given in table 3-9 in Chapter Three (they are also given in this
chapter in tables 6-1 through 6-5). They refer to the same countries and to the same periods for which we earlier compared the aggregate growth rates over time in terms of broad macroeconomic policies (see Chapter Four, sections 4.1.1 through 4.1.6).

For a much broader understanding of growth differences, it was felt necessary to know more about sector specific policies and the sectoral growth rates associated with those policies. It was for this reason we examined the growth differences in the agricultural sector in Chapter Five. To compliment that analyses, period-wise growth rates in the industries sector will be examined in this chapter.

6.1.1 Bangladesh

In Bangladesh the manufacturing sector was composed of seven major items; cotton, paper, steel ingot, sugar, fertilizer, Jute processing and cement. Together they constituted nearly 85 percent of all manufacturing output produced in 1990. Together they contributed nearly 10 percent of the value added (in 1984-85 prices) to GDP in 1989/90. From 1973 to 1986 the number of people employed in the industries sector more than doubled and the development expenditure allocated to it increased by a substantial 92 percent (in nominal terms).

During the years 1970/71 through 1976/77 growth in industrial output in Bangladesh slowed. Three important factors contributed to this. One, was the policy

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4 We will be using the terms manufacturing and industries sectors interchangeably in this chapter.
5 The major items that constitute the manufacturing sector of each SAC and its contribution to total manufacturing were listed in Key Indicators of Developing Asian and Pacific Countries (1993). Economic Development Resource Center. Asian Development Bank, Manila.
of nationalization carried out by Mujib’s government. At the end of the civil war that led to Bangladesh’s independence, the new government under Sheik Mujibur Rahman, committed to socialism as one of its tenets, nationalized all of the jute, cotton, textile and sugar mills as well as all manufacturing enterprises abandoned by their former west Pakistani owners. As a result, 85 percent of the assets of the industries sector were in the public sector by the year 1976, and this slowed manufacturing growth.

Second, was the existence of a structural imbalance in the form of excess capacity and shortages of raw materials. These problems arose because plants had been set up in the context of an integrated Pakistan market. When that market was lost after the civil war, this led to excess capacity and shortages of critical raw materials. The third factor was a serious shortage of foreign exchange that prevented Bangladesh from importing the essential raw materials needed to spur manufacturing growth. However, the pace of growth began to improve slowly during the years 1977/78 through 1979/80. This was due to several policy initiatives undertaken by the Zia regime. The most important among them was a decision to encourage private enterprise in manufacturing activities. After assuming power in 1975, Zia’s government raised the ceiling on private investment to Tk 10 crores which was only 3 crores in the previous year. Other measures included divesting some of the smaller firms taken over after independence, establishment of a stock exchange, the setting up of an investment

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corporation of Bangladesh (ICB) and the decision to pay compensation for units nationalized. By the fall of 1978, seventy-seven firms worth Tk 33 crores had been sold back to private investors.\textsuperscript{7} The cumulative effect of all these measures was to raise manufacturing output during 1978-80, notwithstanding the negative effects of earlier policy measures. The average growth rate, therefore, stood at 6.0 percent for the years 1970/71 to 1979/80.

Table 6-1

<table>
<thead>
<tr>
<th>Years</th>
<th>Growth Rate (Annual Average Increase)</th>
<th>Direction of Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970/71 - 1979/80</td>
<td>6.0%</td>
<td></td>
</tr>
<tr>
<td>1980/81 - 1989/90</td>
<td>4.9%</td>
<td>—</td>
</tr>
</tbody>
</table>

Note: — = Decrease
Source: Table 3-9

During the years 1980/81 to 1989/90 manufacturing growth declined to 4.9 percent (see table 6-1). The primary reason for this was a substantial fall in total Gross Fixed Investment (GFI). It fell from 16 percent of the GDP in 1980/81 to below 12 percent in 1989/90.\textsuperscript{8} While the public share more or less stagnated, the private sector's share fell from 9.4 percent to 6 percent during the same period.

\textsuperscript{7} For an analyses of various measures taken by the Zia regime to revive the manufacturing growth, see; Bangladesh: Current Trends and Development Issues. A World Bank Country Study (1979). World Bank, Washington, D.C.

Several factors, mostly policy induced contributed to this fall in GFI. After encouraging private sector for a while, the Zia regime formulated and implemented an industrial policy framework (which was later pursued by Ershad) containing several features that lowered GFI in the industries sector. This, in turn, moderated manufacturing growth during the years 1980/81 to 1989/90. Three features of this framework are worth noting: (1) the high effective interest rates and the problems linking the financial and industrial sectors, (2) inward orientation and limited domestic markets; and (3) domination of State Owned Enterprises (SOEs). These features have been reinforced by such policy factors as high protection levels, excessive and misguided regulation, ad hoc policy-making and poor infrastructure. We will briefly discuss these features below.

The most important element was the existence of high effective interest rates as a result of the tight money policy followed by the government to contain inflation. The cost of capital remained high throughout the 1980s. This made it difficult for many manufacturing establishments (especially small) to obtain the necessary capital. The high cost of capital also created a ‘default culture’ as businesses contracted debt that could not be repaid with few apparent penalties, because of an inefficient legal system, the inefficient businesses kept going rather than closing down. As a result, the financial system’s resources were locked into loss-making enterprises. Secondly, with the exception of ready made garments (RMG), the manufacturing sector as a whole
has remained strongly oriented towards domestic market. This focus on internal market has limited growth, since it is small and can only grow as rapidly as disposable income. Thirdly, as mentioned earlier in this section, large manufacturing subsectors received only remarkably little investment, and SOEs invested little as it was thought that continuing small investments to improve operations were not necessary. The combined effects of all these factors was to reduce GFI and thus to reduce growth in output in the manufacturing sector to an average of 4.9 percent during the years 1980/81 to 1989/90.

6.1.2 India

In India the manufacturing sector was composed of six major items; cement, finished steel, jute manufacturing, sugar, tea and paper and paper board. Together, they constituted nearly 60 percent of total manufacturing output produced in 1990. This sector also contributed nearly 20 percent of the value added (at constant 1980/81 prices) to GDP in the same year. From 1970 to 1988 the number of people employed in this sector increased by 33 percent.

During the years 1950/51 to 1959/60 growth rate in the manufacturing sector averaged 6.6 percent. This fell to 4.8 percent in the years 1960/61 to 1969/70. Growth resumed during the years 1980/81 to 1989/90 reaching an average rate of 6.7

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9 For a discussion of factors that thwarted the investment in private manufacturing during the 1980s, see: Bangladesh: From Stabilization to Growth. A World Bank Country Study, pp. 54-57. (Op. cited)
percent during this period (see table 6-2). In this section we will explain the reasons for these differences in growth rates over time.

Table 6-2
Growth of Manufacturing Output At Constant (1960/61 Prices)
(In Percentages)

<table>
<thead>
<tr>
<th>Years</th>
<th>Growth Rate (Annual Average Increase)</th>
<th>Direction of Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950/51 to 1959/60</td>
<td>6.6%</td>
<td>—</td>
</tr>
<tr>
<td>1960/61 to 1969/70</td>
<td>4.8%</td>
<td>—</td>
</tr>
<tr>
<td>1980/81 to 1989/90</td>
<td>6.7%</td>
<td>+</td>
</tr>
</tbody>
</table>

Note: + = Increase — = Decrease
Source: Table 3-9

In India, even before independence, there was almost universal acceptance of a very important regulatory role for the state with regard to industrial growth. Many in industry and those responsible for moulding public opinion felt that the state must not only prescribe the pattern of industrial investment, but also control the process of industrial change. After independence the industrial policy regime sought to achieve several objectives simultaneously. They included increasing production and productivity, pursuance of self-reliance through import substitution industrialization policies, encouraging small scale industries with a view to generating employment and fostering entrepreneurial development. The principal instruments of policy were an

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11 There was, however, one major exception. Gandhi had grave distrust of the state and therefore, he emphasized decentralized processing and manufacturing largely to meet the needs of local markets.
elaborate industrial licensing framework under the Industries Development and Regulation (IDR) Act of 1951 and a protective foreign trade regime. It is within this background that one should examine the manufacturing growth rates in India for different periods.

During the years 1950/51 to 1959/60 growth in the industries sector was shaped by two major developments: one was the decision of the government of India to expand the public sector and develop its defense industries in it. Prime Minister Nehru, an early and enthusiastic supporter of state planning, along with other leaders, recognized from the very beginning that India would eventually become an important member of the world community. This required building up of her armed forces to defend its security interests, and they decided in this context that defense industries would be developed by the public sector.  

Building defense industries for a modern force necessitated the building up of heavy industries (for e.g. metallurgical and machine tools) to build and feed the defense industries. This decision led to the creation of a large and diversified defense industrial complex in India during the 1950s.

The second development that influenced manufacturing output was the passing of the Industrial Development and Regulation (IDR) Act of 1956. This act delineated the lines between public and private sectors, and stressed the need for large degree of

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12 The Indian Planners, therefore, paid great emphasis in developing a strong industries sector. For example, in the First Five-Year Plan (1950/51 to 1955/56) the actual outlays to industries and mining as a percentage of total outlays was 10 percent. This increased to 40 percent during the Second Five-Year Plan (1956/57 to 1960/61). See: Statistical Year Book (1970), p. 728, Table 245. Five-Year Plan Outlays for Public Sector. C.S.O. Government of India.
self-sufficiency in manufacturing. The desire for self-sufficiency continued to be the basic strategy that guided India's industrialization well into the early 1980s and it contributed to moderate growth in manufacturing during the years 1950/51 to 1956/60. Especially private manufacturing which was largely confined to consumer goods, grew at a faster pace to supply the domestic market with substitutes for imports, which were increasingly restricted by tariffs and quantitative controls. In brief, the large defense related public investment created demand for capital goods, basic metals and construction materials. The import-substitution industrialization program also led to strong private sector manufacturing growth centering on consumer growth. These two factors together contributed to a 'reasonable' rate of growth of 6.6 percent during 1950/51 to 1959/60 (see table 6-2).

During the years 1960/61 to 1969/70 growth in the manufacturing sector slowed mainly because of the rigorous regulatory framework set up in the early 1960s. The immediate necessity for regulation was the pursuance of a policy of import-substitution industrialization to ensure self-sufficiency in manufacturing, and to save foreign exchange. Nonetheless, several features of this framework acted to slow growth during this period. To begin with, the pervasive regulatory regime reduced internal competition, raising production costs and decreasing product quality. Three main features of the regulatory framework were responsible for this. First, the licensing system for investment, which was a widely used instrument of control in
India inadvertently helped to limit competition by maintaining a seller’s market that limited entry, changes in product mix and the expansion of successful firms. Second, the Monopolies and Restrictive Trade Practices Act (MRTP Act) and technology licensing policies in some cases helped to protect the markets by limiting competition. Thirdly, internal competition was also hindered by the reservation of certain industries and products for small scale firms and the public sector. In the case of public sector enterprises lack of competition, and the preferences in government procurement led the managers to perceive the market as captive and to act accordingly. Because of these three factors managers in both public and private enterprises lacked incentives to improve product quality and to reduce costs. Yet another factor that slowed growth during the 1960s was the absence of import competition. As an instrument of import-substitution industrialization strategy, policymakers granted protection almost on demand through numerous overlapping instruments. Very little consideration was given to the relative costs of domestic protection versus imports. Import restriction also resulted in the scarcity of many important raw materials needed for domestic production. The above mentioned factors clearly contributed to reduced manufacturing growth of 4.8 percent during the years 1960/61 to 1969/70.

During the years 1980/81 to 1989/90 the rate at which manufacturing output grew rose to 6.2 percent (see table 6-2). This rise was largely due to a reorientation of

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the industrial policy framework set in motion in the mid-1970s and accelerated since 1985. Within this reoriented policy, efforts were made to stimulate domestic consumption and exports while relaxing import controls to some degree. On the domestic regulatory front the measures enacted since 1985 included (1) delicensing of 30 percent product groups and 82 pharmaceutical products, (2) substantial easing of licensing requirements for increasing capacity, (3) broad banding (allowing licensed capacity to be used for producing similar products) in 35 industrial groups; and (4) some reduction in the list of products reserved for small-scale industry. In addition to these measures, in the early 1980s, the government enlarged the scope for new investment by MRTP firms and streamlined the administration of the control system, placing greater emphasis on efficiency on the import side, a few non-tariff barriers to imports have been eased. For example, in the capital goods, the 1985 import export policy raised the number of products on Open General License (OGL) from 750 to 1,007 in April, 1987.14

The manufacturing sector's performance has improved since 1985 indicating payoffs to the policy changes mentioned above in the form of renewed growth which averaged 6.2 percent during the years 1980/81 to 1989/90.15 At the disaggregated level, growth was concentrated in a few sectors, such as electronic equipment and

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14 For a listing and general discussion of the effects of these policy features on growth, see, India: Recent Developments and Medium Term Issues, p. 35. (Op. cited).
15 Value added in manufacturing has grown at about 8.5 percent p.a. over the years 1986-89. See; India: Recent Developments and Medium Term Issues, p. 38. (Op. cited).
computers, transport vehicles and cement that have received most of the reforms. We will now try to view this policy of liberalization implemented over time within a broad political economy framework. Controls in India, as in many other countries, were the product of an interventionist ideology and once established they grew even more elaborate. However, by mid-1970s several groups, including the bureaucracy and many conservative members of the Congress party had slowly begun to recognize the inefficiencies of the control regime. After returning to power in 1980, Mrs. Gandhi, it has been alleged, wanted to cultivate the support of the business community. These two factors were, therefore, important in the government’s decision to liberalize the control regime which was in place for many years. The liberalization measures, however piecemeal, have in fact resulted in a modest increase of 1.9 percent (in value added) in the manufacturing sector during the years 1980/81 to 1989/90 (see table 6-2).

6.1.3 Malaysia

In Malaysia, the manufacturing sector constituted of eight major items: cement, animal feed, iron and steel, liquefied petroleum gas, kerosene, refined sugar, soap and soap products and galvanized iron sheets. Together they provided 80

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17 For a brief description of the background in which Mrs. Gandhi introduced limited liberalization measures in the early 1980s, see: Kohli, Atul (1988). Chapter One. India’s Democracy. Princeton University Press, Princeton, NJ. Kohli argues that this interpretation of Mrs. Gandhi’s moves in the realm of economics is plausible because liberalization brought little pain politically and it was concerned with deregulation of industrial licensing and softening of restrictions on monopolies. Both these measures had big business support.
percent of all manufacturing output in 1990. This sector also contributed 24 percent of the value added (in 1978 prices) to GDP in 1989/90. From 1975 to 1990 the number of people employed in this sector, and the development expenditures allocated to it rose by 547 percent and 752 percent (in nominal terms) respectively. In the years 1970/71 to 1979/80, the manufacturing sector grew at an average annual rate of 9.2 percent, whereas in the years 1980/81 to 1989/90 it dropped to 7 percent, a decrease of 24 percent over the previous period (see rows one and two in table 6-3). We will explain below this decrease in the manufacturing growth rate of Malaysia over time.

Table 6-3

Growth of Manufacturing Output At Constant (1978 Prices)
(In Percentages)

<table>
<thead>
<tr>
<th>Years</th>
<th>Growth Rate (Annual Average Increase)</th>
<th>Direction of Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970/71 - 1979/80</td>
<td>9.2%</td>
<td>—</td>
</tr>
<tr>
<td>1980/81 - 1989/90</td>
<td>7.0%</td>
<td>—</td>
</tr>
</tbody>
</table>

Note: — = Decrease
Source: Table 3-9

At the time of independence the bulk of manufacturing intended for the domestic market such as food, beverages and construction materials were dominated by the British. The vast majority of the small scale cottage industries related to processing of agricultural produce and food manufacturing were in the hands of the
Chinese and to a very limited extent Indians. Malay participation in manufacturing was negligible.\textsuperscript{18}

The years 1970/71 through 1979/80 was a distinct period for Malays as it was marked by a sustained effort to industrialize that country. Two major policy initiatives, the Investment Incentives Act of 1968 and the Foreign Trade Act of 1971 formed the cornerstone of its thrust towards industrialization.\textsuperscript{19} The main emphasis was on export-led industrialization through the introduction of export-related incentives, and the establishment of Free Trade Zones (FTZ) in a number of locations. There was also an increase investment in the manufacturing sector due to the aggressive campaign for foreign and domestic private investments. As a result, total investment expanded to 25.7 percent of GNP during 1971-75 compared to only 16.3 percent of GNP over 1966-70.\textsuperscript{20} The upshot of all these developments was an ‘impressive’ rate of growth of 9.2 percent in the manufacturing sectors during the years 1970/71 to 1979/80.

During the years 1980/81 to 1989/90 growth slowed to an average of 7.4 percent. Three important factors contributed to this slow growth. First, was the increasing role of Public Sector Enterprises (PSEs) and the accompanied fall in private

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{18} Fong Chan Onn (1989). \textit{The Malaysian Economic Challenge in the 1990s.} \textit{Transformation For Growth}, p. 199. Longmans (P) Ltd., Singapore
\item \textsuperscript{19} This period also saw the introduction of the Industrial Coordination Act of 1975 as an instrument to achieve the New Economic Policy (NEP) objectives with regard to Bumiputera equity participation and employment in the manufacturing sector. However, by subjecting industries to various regulatory provisions this measure tended to slow growth during the 1980s.
\item \textsuperscript{20} See: \textit{The Malaysian Economic Challenge in the 1990s}, p. 207. (Op. cited).
\end{enumerate}
\end{footnotesize}
investment; second, the negative effects of licensing system on manufacturing growth; and third, the global recession of 1980-82 and its impact on the Malaysian economy. We will now discuss each of these factors, in turn, rather briefly.

To a great extent the preoccupation with industrialization during the 1970s reflected the influence of the emerging Malay middle class, with its impatience for an expanded role in business management. This desire to fully participate in the growing industrial activities continued into the 1980s and in this context the Malayan perception has been that government owned businesses have the most room for Malay managerial talents. Therefore, they pushed for a greater role for government in the development of industries.21 As a result, during the years 1980/81 to 1989/90 the government became the major source of financing of industrial development. Public investment saw its contribution expanding to 17.6 percent of the GNP during 1981-85 from a low of 10.6 percent during 1976-80. Private investment relative to GNP, however, remained stagnant at 17.6 percent during the same period (1981-85), and it fell to 11.0 percent of GNP in 1986. This decline in private investment acted to moderate growth during the 1980s.

Government intervention also slowed manufacturing growth by introducing an extensive network of industrial licensing. This system was introduced to achieve a wide range of objectives, which have ranged beyond profitability to income

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21 For a discussion of Malay interests in the participation of industrial activities of that country, see: Malaysian Economic Challenge in the 1990s. Chapter One. (Op. cited).
distribution, restructuring of society’s pursuit of socioeconomic and employment objectives, development of backward regions and industrial diversification. While each objective may be appropriate for a public enterprise, the multiple objectives sought to achieve by the licensing system have in fact reduced growth in several areas of the manufacturing sector. For instance, licenses required for installing new machinery slowed technological upgrading and this in turn slowed growth. This slow growth partly reflected also the additional costs and uncertainties in terms of time required for processing applications through bureaucracies.

The years 1985-86 saw the most severe recession since the country’s independence which was in part triggered by the global recession of 1980-82. As a result of this externally induced recession, Malaysia’s real per capita income fell by 18 percent during the years 1985-86. This, in turn, reduced personal consumption substantially and acted to slow growth of manufactured goods. A second related development that took place due to the slow down in international economic activity is also worth mentioning. It curtailed the demand for Malaysian exports. This along with reduced personal consumption spending slowed manufacturing output growth during the years 1980/81 to 1989/90 to an average of 7.0 percent.

6.1.4 Pakistan

In Pakistan, the manufacturing sector is composed of eight major items; cement, cycle tubes, urea, sugar, cotton yarn, vegetable products, cotton cloth, and

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mild steel products. They together produced nearly 70 percent of all manufacturing output in Pakistan in 1990. This sector also contributed nearly 22 percent of the value added (in 1980/81 prices) to GDP in 1989/90. From 1970 to 1990 the number of people employed in the manufacturing sector rose by 42 percent. During the years 1950/51 to 1959/60 this sector grew at an average annual rate of 18.3 percent and this rate dropped to 9.4 percent during 1960/61 to 1969/70, a drop of 40 percent. During 1970/71 to 1979/80 the growth rate dropped further to 7 percent rising slightly to 7.3 percent in the years 1980/81 to 1989/90 (see rows one, two, three, and four in table 6-4). We will interpret below these fluctuations in the manufacturing growth rates of Pakistan.

It has been mentioned earlier (in Chapter Four, section 4.1.5) that Pakistan in 1947 had practically no modern industry. Cut off from its traditional source of industrial commodities (India) Pakistan developed a very substantial industries sector in a very short period of time through the efforts of its civil service. Three major factors determined the course of industrial growth during the 1950s. They are (i) the partition of the subcontinent (a historical factor), (ii) the decision of the government of Pakistan not to devalue its rupee in 1949 or 1952 but to rely on exchange controls and quantitative restrictions to control imports (a policy related factor), and (iii) the size of the domestic market (a historical factor). Partition left Pakistan with a surplus area in food and agricultural raw materials and deficit area in manufacturing of all types.
Therefore, the government’s policy favored industrialization through its decision not to devalue the rupee (see section 5.1.5). This decision raised the price of agricultural exports (because of the unfavorable exchange rate) and when the import of manufactured goods were curtailed, the prices of later goods rose and, therefore, its profitability. In terms of simple market theory, the rate of profit in manufacturing industries generally exceeded the ‘normal’ rate and this induced many to enter manufacturing activities and expand the supply of manufactured goods. The relatively large domestic market also facilitated domestic production of manufactured goods (especially consumer goods). In summing up, we may note that Pakistan had no industrial capacity immediately after partition and because of this there was an adjustment in the productive structure within the country that decidedly favored the industries sector. Further, the industries sector also benefited from the government’s decision not to devalue its rupee, but to rely on import controls to keep payments in balance as this resulted in exceedingly high profitability for that sector. The country’s large domestic market also afforded an opportunity for its manufacturers to raise output.

Table 6-4

Growth of Manufacturing Output At Constant (1980/81 Factor Cost) (In Percentages)

<table>
<thead>
<tr>
<th>Years</th>
<th>Growth Rate (Annual Average Increase)</th>
<th>Direction of Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950/51 to 1959/60</td>
<td>18.3%</td>
<td></td>
</tr>
<tr>
<td>1960/61 to 1969/70</td>
<td>9.4%</td>
<td>—</td>
</tr>
<tr>
<td>1970/71 to 1979/80</td>
<td>7.0%</td>
<td>—</td>
</tr>
<tr>
<td>1980/81 to 1989/90</td>
<td>7.3%</td>
<td>+</td>
</tr>
</tbody>
</table>

Note:  + = Increase  — = Decrease
Source: Table 3-9

The growth rate in manufacturing, nonetheless, began to slow down considerably during the years 1960/61 to 1969/70 (especially in the later half of the 1960s) due to two important reasons. First, there was a war between India and Pakistan in 1965 and this led to a severe shortage of funds with which to finance several projects in the industries sector. The second was the reduced growth in the capital goods sector, from a high of 18.7 percent during 1960-61 to 3.0 percent in 1969/70 due to a sharp decline in investment.²⁴ The bottleneck to production created by the nonavailability of capital goods had three dimensions to it. First, because of the overvalued currency and the artificially low prices of imported goods, industries adopted technologies that required large amounts of foreign capital equipment and foreign raw materials. Secondly, as the domestic production of consumption goods substituted for imports (import-substitution effect) a large fraction of total foreign

exchange earnings became available to import capital goods, and raw materials. Nonetheless, industrialists waited till early 1960s to invest until they could get import licenses for capital goods rather than purchase locally produced capital goods. That is, maintaining an overvalued currency combined with direct licensing of capital goods imports tended to discourage the domestic production of goods to substitute for certain scarce imports. Thirdly, because the currency was overvalued, exports both of manufactured goods and of agricultural raw materials were discouraged so that bottlenecks could not be eased by exporting to purchase imports. For these reasons, overall investment in the manufacturing sector declined drastically thereby curtailing growth in output during the years 1960/61 to 1969/70.

As a result of the economic and political developments of the 1970s, manufacturing growth rate began to fall again during this period. Three main developments that contributed to this reduced growth may be mentioned. First, there were the political conditions which contributed to the Indo-Pak war and the creation of Bangladesh in 1971. Second, was the nationalization of private industry by Bhutto between 1972-74. Third, was the increased cost of investment brought about by the massive devaluation of the Pakistani rupee in May 1972. We will discuss these developments, in turn, rather briefly. The separation of the East wing (Bangladesh) reduced domestic demand and therefore, local manufacturers of substitutes for

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imported goods encountered limits to demand for their products. The nationalization of private sector units under Bhutto plus the growth of investment in large-scale manufacturing have greatly increased the role of the public sector particularly for important products such as the fertilizer, cement, vegetable oil, petroleum products and iron and steel. A third reason for slower growth during the 1970s was the increased cost of investment brought about by the devaluation of the rupee in May 1972. A devalued rupee (by raising cost) made it impossible to import machinery and equipment needed to modernize the manufacturing sector. The cost reducing efforts have also been minimal because of a monopolistic domestic market that permitted producers to maximize profits at sub-optimal level. The combined effect of all these factors was to reduce average growth in the manufacturing sector to 7.0 percent during the years 1970/71 to 1979/80.

Nonetheless, growth rate began to rise slowly during the years 1980/81 to 1989/90. This was due to several measures initiated by the Zia government in order to encourage private investment in the manufacturing sector. Three important steps to spur private sector activities taken by the Zia government are worth mentioning: First, an ordinance named Protection of Rights in Industries was passed in 1979 that set forth limited conditions under which only industrial property could be nationalized, and the procedures for ensuring adequate compensation to former owners in the event of nationalization. This step, in turn, instilled confidence among the private sector
manufacturers. This act also clearly defined public industrial monopolies and little manufacturing was reserved for exclusive public ownership. Several of the nationalized industries were also returned to private ownership under this ordinance. Second, was the creation of a new financial institution, Industries Development and Finance Corporation (IDFC) to facilitate financing of private industrial investments. The third measure that spurred growth was the adoption of a flexible exchange rate.

However, private sector manufacturers has not responded to these overtures enthusiastically for many reasons. For instance, they were apprehensive as to whether a new regime may again resort to nationalization as Bhutto did. Industrialists in Pakistan were also critical of the inadequate infrastructure facilities particularly in energy. The high cost of investment as a result of the devaluation of 1972 and world wide recession also have rendered investment less attractive in the public sector. The cumulative effect of these developments was to dampen manufacturing growth and it registered only a modest 0.3 percent increase during the years 1980/81 to 1989/90 over the previous decade.

6.1.5 Sri Lanka

In Sri Lanka, eight major industries, cigarette, cement, tyre, rubber, steel, paper and paper products, sugar and milk processing constituted nearly 75 percent of all

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26 By 1981-82 private sector investment in manufacturing, in real terms, had increased by nearly three times over the low point in 1974-75, but it was (in constant prices) still barely above the level of 1971. For an analysis of investment activities both in the private and public sector up to 1983. See, Pakistan: A Country Study (1984). (Op. cited).
manufacturing output in 1990. The manufacturing sector also contributed approximately 22 percent of the value added (in 1975 prices) to GDP in 1989/90. From 1971 to 1990 the number of people employed in this sector increased by 116 percent. The development expenditure allocated to it increased by 80 percent (in nominal terms). During the years 1950/51 to 1959/60 growth rate in the manufacturing sector averaged only a mere 0.7 percent. It, however, rose to a substantially high rate of 9.9 percent during the years 1960/61 to 1969/70. The growth rate then fell to a low of 4.9 percent during the years 1970/71 to 1979/80 (see table 6-5). We will explain below these growth differences for the periods identified above.

Table 6-5

<table>
<thead>
<tr>
<th>Years</th>
<th>Growth Rate (Annual Average Increase)</th>
<th>Direction of Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950/51 to 1959/60</td>
<td>0.7%</td>
<td></td>
</tr>
<tr>
<td>1960/61 to 1969/70</td>
<td>9.9%</td>
<td>+</td>
</tr>
<tr>
<td>1970/71 to 1979/80</td>
<td>4.9%</td>
<td>—</td>
</tr>
</tbody>
</table>

Note:  + = Increase  — = Decrease

Source: Table 3-9

In the early 1950s (and right up to mid 1970s) the manufacturing sector in Sri Lanka continued to be dominated by the processing of agricultural produce for both the export and domestic markets. The most important manufacturing industries were those engaged in processing the principal export commodities, tea, rubber, and
coconut. Industrial activities accounted for only about 7 percent of the GDP during the 1950s, and half of this comprised food, drink and tobacco products.  

The extremely low rate of 0.7 percent average growth during the years 1950/51 to 1959/60 was due largely to two reasons: one was the small size of this sector. The second, and a more important reason was the threat of nationalization of the plantation sector by the Bandaranaike government (1956-60). It was the plantation sector that supplied raw materials for the country's processing industries. The Bandaranaike government that came to power in 1956 with its radical policies threatened to nationalize the plantation sector (they were eventually nationalized during 1973-75) and other critical industries. His government also placed several restrictions on foreign investments. Specifically, because of the threat to nationalize the plantation sector and the lack of any real allowance made to the plantation owners (who were mostly small holders with less than thirty acres) for the loss of their income due to falling rubber and tea prices (in real terms) in international markets they ran down their assets and made little or no investments. This led to a fall in output in the plantation sector and reduced overall growth in manufacturing during 1950/51 to 1959/60 as the plantation sector was supplying most of the raw materials for the manufacturing industries.

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Manufacturing, however, received a boost in the early 1960s as a result of the government’s import-substitution industrialization policy.29 Import controls were enforced because of shortages in foreign exchange and this made it difficult for consumers to obtain foreign products leading to the emergence of a protected and profitable ready-made home market. This, in turn, afforded an opportunity for both private and public sector manufacturing to expand their activities with the former concentrating on consumer goods. Several new manufacturing units were started in the public sector as well. For example, in 1958, the National Textile Corporation was formed and it set up an integrated textile mill in 1960 that supplied 90 percent of the country’s requirements. The Ceylon Tyre and Tube Corporation, established in 1962 with the help of the Soviet Union, had an annual capacity of 100,000 Tyres. Two sugar factories were also set up in 1963. All these developments tended to raise manufacturing output.

There was, however, no clear policy towards the industries sector during the years 1960/61 to 1969/70. Since the government’s policy was ambiguous, it created an unwillingness on the part of investors to enter into what they felt were high-risk industrial ventures. This had a moderating influence on private sector manufacturing growth. Nonetheless, in spite of the slow growth in the private sector, overall growth in output rose to 9.3 percent during the years 1960/61 to 1969/70.

Between the years 1970/71 to 1979/80 growth in output in the manufacturing sector slowed considerably. In real terms it recorded only an average rate of 4.9 percent (see table 6-5) which was less than half of the growth rate for the years 1960/61 to 1969/70. This slower growth was largely due to the policies pursued by the coalition government of Mrs. Bandaranaike (which included the communists) that was in power during 1970-77. This government sought to implement a New Industrial Policy (NIP) with multiple goals and some of them had the opposite effect of reducing growth.\textsuperscript{30} The major thrust of the NIP was to reorganize the existing industrial structure to achieve the social and political objectives of the government. The government wanted to adopt a socialist oriented approach in the development and regulation of industry and it developed most of the heavy, basic and essential industries in the public sector. However, from the very beginning, many industries in the state sector were troubled by such problems as management inefficiency, technical deficiencies in planning, overstaffing and defective price policies. The combined effect of all these policies was to reduce substantially the growth in manufacturing output during the years 1970/71 to 1979/80.

\textsuperscript{30} The government carried out its Industrial Policy by establishing a number of Industrial Development Corporations (IDC) each responsible for a particular sector of industry. For a detailed discussion of this policy and its implementation, see; Karunatileke (1971). Economic Development in Ceylon, pp. 355-360. (Op. cited).
6.2 ANALYSES OF GROWTH DIFFERENCES ACROSS COUNTRIES

In sections 6.2.1 through 6.2.3 we will compare the growth differences of five SACs across countries (Nepal is not included for reasons mentioned in section 4.2 in Chapter Four). The three sectoral growth rates we will compare across countries are:

(7b) Bangladesh’s 4.9 percent with Malaysia’s 7.0 percent; (8b) Sri Lanka’s 9.9 percent with India’s 4.8 percent; (9b) Pakistan’s 7.3 percent with Bangladesh’s 4.9 percent (see table 3-9 in Chapter Three). These rates are selected for comparison across countries because they correspond to the same countries and periods for which we examined the aggregate and sectoral (agricultural) growth rates (see sections 4.2 and 5.2 in Chapters Four and Five respectively).

6.2.1 Bangladesh and Malaysian Growth Rates

In this section we will explain the differences in growth rates in the manufacturing sector between Bangladesh and Malaysia, and then compare those rates across country.\textsuperscript{31} During the years 1980/81 to 1989/90 Bangladesh had a rate of growth of 4.9 percent and Malaysia 7.0 percent.

In Bangladesh, the growth rate of 4.9 percent was the result of a substantial fall in gross fixed investment (GFI). It fell from 16 percent of the GDP in 1980/81 to below 12 percent in 1989/90. During the same period the public sector’s share stagnated, while the private sector’s share fell from 9.4 percent to 6.0 percent (see

\textsuperscript{31} As mentioned earlier in this chapter findings of cross-country comparisons of growth rates in the industries sector must also be viewed with caution, because factors other than those induced by policy(s) can also affect output in the different subsectors of the manufacturing sector.
section 6.1.1). This fall in GFI was the result of certain features of the industrial policy implemented by the Zia government in the early 1980s and later pursued by the Ershad government during the remainder of this decade. Three important factors contributed to the fall in GDI and the consequent drop in manufacturing output. One was the high interest rate due to tight money policy; two, the inward orientation of the policymakers; and three, domination of state owned enterprises (SOEs). These factors acted to lower investment and growth. The negative impact of the above three factors has also been reinforced by such additional factors as high protection levels, excessive and misguided regulation and ad hoc policy-making and poor infrastructure. The combined effect of all these factors was to slow manufacturing growth.

In Malaysia, the manufacturing growth rate during the 1980s was largely influenced by the government’s decision to expand the public sector’s share in manufacturing activities because of the desire of its middle class. The Malay middle class wanted to participate in the business management to enhance their prosperity. However, growth slowed from the previous decade as a result of the implementation of several provisions designed to promote the noneconomic goals relating to the New Economic Policy (NEP). Manufacturing growth also slowed during the years 1980/81 to 1989/90 due to the global recession of 1980-82 and its impact on the Malaysian economy. Global recession caused output to fall in two ways: First, it reduced the real income per capita, lowering personal consumption expenditures. Secondly, the
slow down in international economic activity also reduced Malaysian exports to other countries. The cumulative effect of these two factors was to reduce manufacturing growth in Malaysia during the years 1980/81 to 1989/90.

In comparing the two growth rates across countries we may note that the lower rate of Bangladesh was due to a substantial fall in its GDI, and its ad hoc policymaking; while the Malaysian rate was higher because of the relative efficiency of its public sector enterprises (PSEs) and its lesser regulatory control mechanism compared to Bangladesh.

6.2.2 Indian and Sri Lankan Growth Rates

India's average growth rate in the manufacturing sector during 1960/61 to 1969/70 was only 4.8 percent while Sri Lanka had an ‘exceptionally’ high rate of growth of 9.9 percent, which is more than double the Indian rate. India’s growth rate was lower mainly because of the extensive regulatory framework that was in place during this period. Several features of this regulatory framework contributed to slow growth by reducing internal competition and raising production costs which in turn lowered manufacturing output (see section 6.1.2). Whereas in Sri Lanka the manufacturing sector received a boost during the same period as a result of the government’s import-substitution industrialization programme. This programme created a protected and profitable home-market to which private manufacturers responded favorably and thus raised output in this sector during the years 1960/61 to 1969/70.
While comparing the two growth rates we may safely conclude that India’s rate was lower because of her extensive regulatory framework, several features of which, as we have seen above, reduced output. For example, these features by limiting competition has raised the cost of production and lowered product quality both tended to reduce output. On the other hand, Sri Lanka’s growth rate was much higher due to the implementation of import-substitution industrialization programme that created a protected and profitable home-market for the country.\(^{32}\)

**6.2.3 Bangladesh and Pakistani Growth Rates**

During the years 1980/81 to 1989/90 Bangladesh had an average annual growth rate of 4.9 percent and Pakistan 7.3 percent. The reasons for the slower growth of manufacturing output for Bangladesh have been mentioned earlier (see section 6.1.1). Various policy measures of the government, instead of contributing to increased output tended to reduce it by making investments costly and therefore difficult to undertake. On the other hand, in Pakistan several measures initiated by the Zia government sought to encourage private sector investments and this raised manufacturing output. Especially, the Protection of Rights in Industries Act of 1979 alleviated the fears of private sector manufacturers regarding nationalization of their plants, and encouraged their participation in the manufacturing sector raising output in

\[^{32}\] Here one point with respect to import-substitution industrialization policy pursued by both India and Sri Lanka must be made clear. India began to implement this strategy much earlier (in the early 1950s) and by the 1960s its negative effects began to set in slowing manufacturing growth. Whereas, Sri Lanka began to pursue this policy systematically only later (in the early 1960s) and therefore its negative effects began to appear only in early 1970s. This partially accounts for the differences in growth rates between the two countries for the years 1960/61 to 1969/70.
it. Several of the nationalized industries were also returned to private ownership under this act. These measures along with the adoption of a flexible exchange rate accelerated manufacturing growth in Pakistan.

In comparing the two growth rates we may safely conclude that Pakistan’s rate was substantially higher because of the cumulative effects of various policy measures undertaken by the government of Zia-ul-Huq; particularly, the measures taken under the Protection of Rights in Industries Act of 1979. The enactment of this act together with the adoption of a flexible exchange rate raised manufacturing output in Pakistan. Whereas in Bangladesh average growth rate was lower as a result of its tight money policy (that raised the interest rate) and a misguided regulatory mechanism that tended to slow investment and therefore growth.

In summing up our discussion of growth differences across countries, we may conclude that the lower growth rate of Bangladesh during the years 1980/81 to 1989/90 was due mainly to the high cost of borrowing and a misguided regulatory mechanism, that tended to slow both investment and growth. On the other hand, the Malaysian growth rate was much higher because of the relatively higher efficiency with which it operated its Public Sector Enterprises (PSEs). Malaysian manufacturing units in the public sector produced more output compared to the inefficiently run State Owned Enterprises (SOEs) in Bangladesh. India’s growth rate was much lower (half of Sri Lanka’s) during the years 1960/61 to 1969/70 chiefly due to its highly restrictive
control regime that raised production costs and reduced product quality. Sri Lanka’s growth rate was higher because of its import-substitution industrialization policies that created a protective and profitable domestic market which was taken advantage of by both public and private sector manufacturers. They set up several units in the manufacturing sector (private initiative was mostly in the consumer goods subsector) raising Sri Lanka’s output in manufacturing during the years 1960/61 to 1969/70.

From the above discussion it is apparent that specific policies and the way in which they are implemented in the manufacturing sector can influence growth in that sector. This is demonstrated by the fact that a rigorous implementation of the regulatory mechanism tended to reduce growth in India; while Sri Lanka, through the pursuance of a policy of import-substitution industrialization, with less complicated control mechanisms, managed to achieve a higher growth rate. Mention may also be made of the high cost of borrowing (interest rate) in Bangladesh that reduced its GFI which in turn reduced its manufacturing output during the years 1980/81 to 1989/90. These findings add credence to our contention that differences in sectoral policies can indeed lead to differences in sectoral growth rates.

6.3 GROWTH DIFFERENCES ASSOCIATED WITH FOUR EPISODES

In this section we will examine the growth differences in the industries sector for a period immediately following each episode in the same manner agricultural growth rates were examined in section 5.3 (in Chapter Five).
6.3.1 Independence and its Aftermath

In India during the years 1955-60 industrialization was viewed as the engine of growth and industrial production rose considerably during this period, averaging 7.9 percent. The most important reason for this increase in output was the emphasis given to the industries sector in India’s Second Five-Year Plan (1956-60). This plan gave increased importance to build up a strong industries sector, particularly in basic and heavy industries that supported defense needs, thereby contributing to an increase in manufacturing output. Whereas in Pakistan, after an initial spectacular increase in manufacturing output in the early 1950s, as a result of its import-substitution industrialization strategy, growth began to slow because of the stagnation in other sectors. In particular, agricultural sector registered reduced growth in output during this period thus reducing the raw materials available to the industries sector. This slowed manufacturing growth. During the same period industrial policy-making in Sri Lanka by the SLFP (which was supported by the communists) had a negative impact on manufacturing growth. Even though the SLFP government was not ideologically committed to socialism it was not averse to adopting the leftist rhetoric that promised to nationalize all foreign owed plantations and other key industries which tended to slow growth substantially to 1.7 percent during 1955-60.

Let us now look at the differences in manufacturing growth across country for the years 1955-60 (a period after the first episode) in terms of their policy differences. India adopted economic self-sufficiency as one of her basic development goals and to achieve this in the industries sector made substantial investments into it during the country's second five-year plan. This created a strong industrial base in the basic and heavy industries subsectors, leading to a growth rate of 7.9 percent for India during 1955-60. Pakistan, on the other hand, began to develop shortages in her critical sectors (such as agriculture) that, in turn, reduced the availability of raw materials to its manufacturing units slowing growth to a modest 4.7 percent during 1955-60. The Sri Lankan growth rate was only 1.7 percent during the same period, the lowest among the three countries. This was in large measure due to the threat of nationalization of all foreign owned plantations and other critical industries. To appease the left the SLFP government, supported by the communists, resorted to the threat of nationalization that held back the necessary investments to modernize the plantation sector that was supplying most of the raw materials for the processing industries. The processing industries constituted the major portion of the manufacturing sector in Sri Lanka during the 1950s and hence the lower growth in output.

6.3.2 First Oil Shock (1973-74)

In this section we will briefly review the initiatives taken by the SACs in the industries sector, if any, in response to the first oil shock (1973-74). A similar
treatment of the second oil shock will be given in section 6.3.3 below. We will be
using here the same approach we employed to analyze the agricultural growth rates in
Chapter Five. The focus of inquiry will be on how the SACs managed to conserve
their scarce resources when faced with rising oil bills and whether any special attention
was given to increase the manufacturing output in their overall macro policy
management.

6.3.2.1 Bangladesh

During the first oil crisis Bangladesh did not face any serious shortage of
development funds (see section 5.3.2.1). Much of its shortfall in external reserves has
been offset by foreign assistance. Therefore, its industrial policy did not undergo any
major changes and the government continued to emphasize increasing the
manufacturing output by making the necessary investments in this sector. This led to a
substantial rate of growth of 18.2 percent during 1974-77.

6.3.2.2 India

India’s balance of payments deteriorated during the first oil shock due to the
increase in the price of imported oil. Nonetheless, her external payments were
financed mostly with foreign assistance and growing remittances of Indians working
abroad (see section 5.3.2.2). However, India also experienced severe droughts in
1972 and 1973 causing serious shortage of agricultural raw materials including food.
This shortage of raw materials caused manufacturing output to fall and it averaged
only 6.1 percent during 1974-77.
63.2.3 Malaysia

Unlike other countries, Malaysia in the years 1973-74 did not experience any balance of payments problem since it earned substantial revenues from the sale of petroleum to other countries. The government’s industrial policy therefore remained unchanged during this period and the growth averaged 8.6 percent during 1974-77.

63.2.4 Pakistan

During the first oil shock Pakistan’s terms of trade did not fall for the reasons mentioned earlier (see section 4.3.2.4 in Chapter Four). Nonetheless, manufacturing output fell considerably during the years 1974-77 as a result of the nationalization programme initiated by the Bhutto regime. This along with other restrictive regulatory measures introduced during Bhutto’s period reduced manufacturing growth to 4.0 percent which is nearly 40 percent lower than the average growth rate for the entire years 1970/71 to 1979/80.

63.2.5 Sri Lanka

When Sri Lanka experienced the first oil shock it was going through a severe balance of payments problem. The country also had a serious fiscal problem in the form of budget deficits. These two difficulties created a serious shortage of funds needed for investments in the industries sector, including infrastructure. As a result of this, growth averaged only 2.8 percent which was the lowest among the five SACs.

6.3.2.6 **Explanations of Growth Differences**

Bangladesh had the highest growth rate and Sri Lanka the lowest after the first oil shock. This was in large measure due to differences in their policy responses to this episode. Bangladesh received substantial amounts of external assistance at this time because it was struggling to rebuild its economy after the civil war of 1970-71, and the government therefore continued to make the necessary investments in its industries sector, including the infrastructure, raising substantially the manufacturing output (18.2 percent). Whereas, Sri Lanka experienced a critical shortage of funds during this period as external assistance was not forthcoming due to the radical policies of the SLFP government. Major banks and other foreign owned operations were nationalized by then and as such resources could not be mobilized internally to finance the needed imports for domestic manufacturing. There was also a dramatic fall in private investment.\(^{36}\) These factors led to an unusually low rate of manufacturing growth for Sri Lanka during 1974-77. Pakistan’s growth rate was also much smaller (at 4.0 percent) during this period largely due to the programme of nationalization undertaken by the Bhutto government. India’s growth rate was smaller (6.9 percent) compared to Bangladesh’s and Malaysia’s, and higher than Sri Lanka’s. This was mainly because of the droughts she experienced in 1972 and 1973 that reduced the availability of raw materials necessary for domestic manufacturing. Malaysia’s growth

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rate was second only to Bangladesh's (though only half of Bangladesh's) and this was chiefly due to the fall in public expenditures that reduced fixed investment.

6.3.3 Second Oil Shock (1979-82)

In this section we will examine the policy responses, if any, of all the SACs to the second oil shock to know whether we can attribute differences in their manufacturing growth rates during the period after the second shock to differences in their policy(s).

6.3.3.1 Bangladesh

Bangladesh, unlike the first oil shock, was severely jolted by the second shock that deteriorated its terms of trade during 1979-82. The volume of external assistance the country received during the second shock was also smaller compared to what it received after the first shock, leading to lower levels of investment in the industries sector. This lower investment moderated growth and it registered only 7.3 percent during 1983-85, a period following the second shock.

6.3.3.2 India

India was experiencing several difficulties in her economic front when she faced the second oil shock. For instance, it suffered from a disastrous drought during 1979-80 that reduced the raw materials available to feed the manufacturing units, causing output to grow at a slower pace. Its balance of payments position was also very precarious at that time and the fear of inflation real. Nonetheless, real public fixed investment grew by 3 percent and 5 percent respectively in 1979/80 and
1980/81.\footnote{See, India: Macroeconomics and Political Economy, 1964-1991, p. 153. (Op. cited).} This was indeed considerably more rapid than in the first crisis years. A large part of this increased investment went to energy and infrastructure sectors (coal, petroleum, electricity and railways) which kept the growth at 7.4 percent, slightly higher than its rate after the first crisis.

6.3.3.3 Malaysia

Unlike the first oil shock, the second shock in 1979 and the world recession of 1980-82 had severely strained the Malaysian economy. Two important effects acted to slow growth, nonetheless slowly. One was the reduced exports, as a result of world recession and two, lower personal income due to domestic recession. These two factors together reduced domestic demand for goods and services leading to a lower growth rate (8 percent) for Malaysia during 1983-85.

6.3.3.4 Nepal

Nepal's growth rate after the second shock was unusually low (1.3 percent) mainly because of the difficulty she experienced in importing raw materials for its manufacturing sector. Domestic industries like stainless steel, nylon, textiles and soap industries depended on imported raw materials.\footnote{See, Pradhan Radhe, S. (1984). Industrialization in Nepal: A Macro and Micro Perspective, p. 84. N.B.O. Publishers, New Delhi.} Another factor that slowed growth was the lack of an effective machinery to implement its Industrial Policies of 1974 and 1979.
6.3.3.5 **Pakistan**

Pakistan had a worse external position when it experienced the second oil shock. Nonetheless, she was able to increase its manufacturing output mainly due to several initiatives taken by the Zia regime to revive its lagging manufacturing sector. In particular, the Protection of Rights in Industries Act passed in 1979 encouraged the private sector to expand its manufacturing activities. This, in turn, increased investment in the manufacturing sector, leading to an increase in output in that sector.

6.3.3.6 **Sri Lanka**

When Sri Lanka experienced the second oil shock her economy was much stronger than when she encountered the first shock and its manufacturing sector, therefore, registered a ‘reasonable’ growth rate of 5.3 percent during 1983-85. This was due to continued public expenditures undertaken by the government mainly on public works like the Mahaweli project that helped manufacturing output to grow. For example, government expenditure rose from 39.1 percent of GDP in 1981 to 41.3 percent in 1982\(^{39}\) and they were paid for largely by higher earnings from tourism and increased worker remittances from abroad.

6.3.3.7 **Explanations of Growth Differences**

In this section we will give a brief summary of explanations for differences in the manufacturing growth rates of the SACs following the second shock. Nepal had the lowest rate after the second shock. As explained in section 6.3.3.4 above, its

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lowest growth rate was due to a severe shortage of funds with which she could buy the necessary raw materials to feed its manufacturing units during this period. Bangladesh and India had more or less the same rates (7.3 percent and 7.4 percent respectively). Both countries experienced shortages of foreign exchange and did not take any drastic steps to reduce the consumption of gasoline. As a result, they fell short of critically needed funds to invest in industries, leading to slower rate of manufacturing growth. This was more so in the case of Bangladesh. India, on the other hand, made attempts to revitalize its manufacturing sector by making slightly higher levels of public investments (see section 6.3.3.2) and this yielded a smaller increase in its manufacturing output, confirming our basic premise that differences in policies could account for differences in growth rates. Pakistan and Malaysia had the highest growth rates (9.2 percent and 8.0 percent respectively) after the second oil shock. Pakistan had the highest growth rate among the six SACs largely due to the policy initiatives taken by the Zia regime. In particular, the privatization effort, and the clear definition of what the public sector monopoly would be in the future, provided in the Protection of Rights in Industries Act, instilled renewed confidence among private sector manufacturers and this facilitated growth in the manufacturing sector. Mayalsia also performed better compared to other SACs largely because there was no need for her to import gasoline as she had a plentiful supply of this resource.
It is also useful to compare the manufacturing growth rates of the SACs over the two shocks to know more about whether policymakers were better prepared to handle the second shock as a result of their experience with the first shock. We will do this for Bangladesh, Nepal, Pakistan and Sri Lanka whose growth rates are significantly different from the rates they registered during the first oil shock.

Bangladesh’s and Nepal’s growth rates were 7.3 percent and 1.3 percent respectively which were less than 50 percent of their respective growth rates during 1974-77. The reduced growth, in the case of Bangladesh was due to the much more modest volume of external assistance she received from foreign donors, and as such the lower manufacturing growth rate has nothing to do with Bangladesh’s experience during the first oil shock. Nepal’s growth rate also dropped during the period after the second oil shock as the country had undergone considerable difficulty in importing the much needed raw materials, owing to shortage of funds, on which its manufacturing growth depended. Whereas, Pakistani and Sri Lankan growth rates rose to 9.2 percent and 5.3 percent respectively after the second oil shock. In the case of Pakistan, this growth rate was primarily due to the enactment of Protection of Rights in Industries Act to reverse the negative trend in manufacturing output set in due to the nationalization programme of Bhutto. The Pakistani government also took several measures to curtail the consumption of gasoline (see section 5.3.3.5). Thus, as we can see Pakistan’s management of the second oil shock was in marked contrast to
Bangladesh's and Nepal's, two countries when faced with reduced external assistance have not initiated any meaningful steps to conserve the consumption of gasoline. In the case of Sri Lanka growth expanded mainly as a result of its strong public investment programme, in project like Mahaweli, which was financed out of funds from tourism and remittances from Sri Lankan workers abroad. Therefore, it appears that Pakistan is the only country that has taken effective steps to improve her external payments position during the second oil crisis. Sri Lanka also redirected her resources to those projects that generated manufacturing growth, and as a result of this its growth in that sector was higher than what it was after the first oil shock.

6.3.4 Public Sector Investment Boom (PSIB)

In this section we will examine the effects of Public Sector Investment Boom (PSIB) the fourth episode, on the growth of manufacturing output in three countries: Malaysia, Pakistan and Sri Lanka (the other three countries are not included in our analyses for reasons explained in section 5.3.4 in Chapter Five). Pakistan had the highest growth rate at 9.3 percent during 1983-86, a period after the fourth episode. One of the major reasons for this was the maturing of public sector investment made in the previous years.  

Malaysian manufacturing growth rate was a modest 5.4 percent and this was in large measure due to the expansion of its public sector undertaken in response to the demands of the Malay middle class (see section 6.1.4). Sri Lanka's

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growth rate was the lowest at 2.3 percent during 1983-85 mainly because of her efforts to concentrate the entire public sector investment on one single project to the exclusion of other manufacturing activities. Growth also slowed because of the worsened terms of trade during 1979-82 as it aggravated the poor performance of the plantation sector. This poor performance, in turn, led to lower growth as the plantation sector was supplying the manufacturing sector much of the raw materials it needed.⁴¹

We will now explain the differences in manufacturing growth rates across country in terms of their policy differences. Pakistan’s average growth rate in its manufacturing sector was the highest (9.3 percent) mainly because the large volume of public investment she made in the previous years began to mature during 1983-86. Malaysia, on the other hand, registered only a modest growth rate of 5.4 percent during the same period because its public investment was very slow to mature. This was the result of various regulatory constraints imposed on this sector by the government because of its Bhumiputra policies. Sri Lanka’s growth was the lowest chiefly because of its efforts to concentrate the entire public sector investment on one single project to the exclusion of other quick yielding projects. To sum up, the differences in manufacturing growth rates across the three countries may be explained in terms of the priority policymakers assigned to this sector; depending on the volume of investments allocated, (higher for Pakistan) and the way in which expanded public

sector manufacturing units were run, (in Malaysia with several restrictive measures imposed to justify the New Economic Policy goals) and to the type of investment made (single project in Sri Lanka).

6.4 COMPARATIVE ANALYSES OF GROWTH RATES WITH EMPHASIS ON NONECONOMIC FACTORS

In this section we will give a comparative analyses of period-wise growth differences in the industries sector of the SACs. Our main focus, as in Chapters Four and Five, will be on the contextual (noneconomic) factors that shaped each country’s policy responses to their central task of raising manufacturing output. A comprehensive analysis of comparative growth differences is not given here for reasons explained in section 5.4 in Chapter Five.

First, we will compare the period-wise growth rates of two countries: one, Pakistan whose rate has dropped between the 1950s and 1960s with Sri Lanka, a country whose rate has increased during the same period. In Pakistan, manufacturing growth slowed over time for two reasons: one was the war between India and Pakistan in 1965 which led to a severe shortage of funds needed to make the necessary investment in the industries sector, including infrastructure. The other, was a reduction in the supply of raw materials, especially agricultural raw materials, as a result of its import-substitution industrialization policy which, as we have seen, favoured the industries sector at the expense of its agricultural sector. This shortage of agricultural raw materials, in turn, slowed manufacturing growth as the former
sector was supplying the raw materials to the later sector. Whereas Sri Lanka’s output grew during this period mainly because of the creation of a protected and profitable home-market (as a result of the government’s import-substitution industrialization programme).\textsuperscript{42} This market afforded an opportunity for both private and public sector manufacturers to expand their activities, and led to a significant increase (more than ten times) in its manufacturing output during the years 1960/61 to 1969/70 over the previous decade.

We will also examine one set of growth rates across two countries for evidence that will support our premise that differences in growth rates can be explained in terms of differences in their policies. The two countries selected are Pakistan and Sri Lanka. The two main reasons for the smaller rate of growth for Pakistan from the 1950s to the 1960s have been mentioned above in this section. We noted, for instance, the severe shortage of funds necessary to finance several projects in the industries sector felt by Pakistan as a result of her war with India in 1965. This shortage of funds was one reason for its slow manufacturing growth during the 1960s. War was, indeed, a noneconomic factor that shaped the sectoral policy of Pakistan during this period. For Sri Lanka the higher rate of manufacturing growth was due to its policy of import-

\textsuperscript{42} We must note that Pakistan’s manufacturing growth rate dropped during the 1960s while pursuing an import-substitution industrialization strategy whereas Sri Lanka’s rate rose. This apparent contradiction was due to the time frame in which this strategy was implemented in the two countries. Pakistan adopted it in the early 1950s and therefore its negative effects (for example, the shortage of raw materials developed in the agricultural sector) began to set in the late 1950s and early 1960s. On the other hand, Sri Lanka adopted this strategy only in the late 1950s and its negative effects therefore began to manifest itself only during the late 1960s and hence the timing explains the higher growth in Sri Lanka during this period. [Refer also to footnote 32 in this chapter].
substitution industrialization that provided a protected and profitable market for its
domestic manufacturers, which in turn, increased output in the manufacturing sector.
This policy stemmed basically from the conviction of Sri Lankan policymakers that
self-reliance is a national goal they have to pursue at any cost. Therefore, we may
conclude that the higher growth rate in Sri Lanka was due to the pursuance of an
effective import-substitution industrialization strategy that provided the country with a
profitable domestic market. Whereas, Pakistan’s rate slowed down mainly due to a
shortage of critical funds required for investment in the manufacturing sector as a
result of its war with India in 1965.

Another source of support for our premise may be found in the comparative
analysis of growth differences in the industries sector following two episodes: one,
independence and its aftermath; and two, the PSIB. For a period immediately
following the independence, 1955-60, (the First Episode) India had a growth rate of
7.9 percent, Pakistan 4.7 percent and Sri Lanka 1.7 percent. After independence,
India had the highest growth rate and this was evidently due to the strong support
policymakers gave to this sector during its Second Five-Year Plan (1955-60), and the
setting up of defense industries in the public sector. The decision to develop its
strategic industries in the public sector was rooted in the policymakers’ belief that state
should guide and control major industries in India (see section 6.1.2 above). In
Pakistan by 1956-60, the negative effects of import-substitution industrialization
strategy (in the form of shortage of raw materials) had already set in. The early
pursuance of this strategy by Pakistan was the result of the loss of its manufacturing
base due to partition (see section 4.1.2 in Chapter Four). Therefore, partition was
indirectly responsible for Pakistan’s growth rate during 1955-60. Sri Lankan growth
rate was the lowest (1.7 percent) because of the threat of nationalization held out by
the SLFP government headed by Mr. Bandaranaike, to appease the left wing (a
distinctly noneconomic factor) which was supporting the SLFP government.

The second episode that offers support to our premise is the PSIB and it is
concerned with three countries: Malaysia, Pakistan, and Sri Lanka (see section 4.3.4
in Chapter Four). Pakistan had the highest growth rate during 1983-86 and this was
mainly due to the maturing of its public sector investment made during the earlier
years. Sri Lanka had the lowest rate because of her efforts to concentrate the entire
public investment on a single project (Mahaweli) to the exclusion of other quick
yielding projects because of its potential to grant political patronage in the form of
jobs. The Malaysian manufacturing growth rate (5.4 percent) lay in between the
Pakistani and Sri Lankan growth rates. This was because of Malaysian policymakers’
decision to introduce various regulatory measures to the working of its PSEs to
promote the noneconomic goals contained in its New Economic Policy (NEP) such as
increasing the equity of Bhumiputras in business enterprises. In brief, on the basis of
the above analyses, we can conclude that these two episodes provide enough support

to our premise that growth differences in the manufacturing sector can be explained in terms of policy differences that are, in turn, shaped by differences in noneconomic factors.

We will now highlight the contextual (noneconomic) factors that shaped the relevant policies we have discussed above in relation to the two episodes: we will do this for one instance each from the two episodes (as we have done with respect to the agricultural sector). In the case of independence and its aftermath (First Episode) Sri Lanka had the lowest growth rate and this was in large measure due to the radical rhetoric to nationalize its industries put forward by the SLFP government, which was supported by the communists. The emergence of a government supported by the radical left was a unique factor in the political economy of Sri Lanka and this acted to lower growth in that country. Regarding the other episode, the Public Section Investment Boom (PSIB) also Sri Lanka had the lowest growth rate as it made most of its investments in one project (Mahaweli) to protect the patronage interests of the policymakers.

To sum up, three major conclusions can be derived from the above analyses of manufacturing growth rates of the SACs.

One, in several instances there is clear evidence to show that there is a link between policy and growth in the industries sector. For instance, India's decision to locate its defense industries in the public sector led to a high rate of manufacturing
growth for that country (7.9 percent) during 1955-60. Also the SLFP government’s radical policies discouraged plantation owners from making the necessary investments in replanting leading to a critical shortage of raw materials for manufacturing units and this reduced the Sri Lankan growth in that sector.

**Two**, contextual (noneconomic) factors do shape the SACs industrial policies. This is evident from the strong support Pakistan’s Civil Service (CSP) gave to build a large industries sector for that country during the early 1950s as it lacked an industrial base. Another example is the Malaysian government’s efforts (because of its political compulsions) to give Bhumiputras (sons of soil) a large stake in manufacturing by incorporating various restrictive provisions in their industrial policies, that in turn, slowed its manufacturing growth.

**Three**, in most periods contextual factors were different, both within and among the SACs, providing additional support to our basic premise (besides those given in the agricultural sector) that differences in contextual factors can be used to explain differences in growth rates. We will mention two such instances: one, India’s growth rate during the 1960s and 1980s, and two, the growth rates among Bangladesh and Pakistan. India’s growth rate improved considerably during the 1980s over 1960s mainly due to several liberalization measures initiated by the government since the mid-1970s. As mentioned earlier, India in the 1960s had a very restrictive policy towards its industries sector in the form of licensing and other regulatory measures.
that lowered its growth rate to 4.8 percent (see section 6.1.5). From the mid-1970s, however, there was a growing awareness among Congress Party members that restrictive policies were slowing growth in the industries sector. This along with a perceived need for support from the business community persuaded Mrs. Gandhi to introduce the partial liberalization measures that, in turn, enhanced manufacturing output to 6.7 percent. Bangladesh’s manufacturing growth rate was lower (4.9 percent) than Pakistan’s (7.3 percent) during the years 1980/81 to 1989/90. In the case of Bangladesh, this lower growth rate could be attributed to (among other things) several policy measures initiated by the Ershad government that made private investment costly to undertake. Whereas in Pakistan the Zia regime initiated several measures to encourage the private sector and this resulted in a higher rate of manufacturing growth for that country. This difference in approach to private sector vs. public sector between the two governments reflect the two different ideologies among them; Pakistan supporting private enterprise and Bangladesh state owned enterprises (SOEs).

To conclude, evidence presented in this chapter based on extensive analyses of manufacturing growth rates of the SACs amply provide strong support to our premise (in addition to those based on aggregate analyses in Chapter Four, and agricultural sector analyses in Chapter Five) that policy differences, and hence, the contextual factors that shape those differences, can be used to explain differences in growth rates.
In the next chapter we will present a summary of earlier chapters and the major conclusions.