FINAL

REPORT OF THE

PANEL OF ECONOMISTS

MEDIUM-TERM DEVELOPMENT IMPERATIVES

AND STRATEGY FOR PAKISTAN

Planning Commission
Government of Pakistan
April, 2010

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PREFACE

I am pleased to submit the Final Report of the Advisory Panel of Economists to the Planning Commission, Government of Pakistan on 'Medium-term Development Imperatives and Strategy for Pakistan'. The Panel had earlier submitted the Interim Report, "Economic Stabilization with a Human Face".

We expect that this report will be an important input into the preparation of the Tenth Five Year Plan, with relevant chapters on the Macroeconomic Framework, Growth Strategies and Development Priorities, Institutional Framework for Development and Social Policy and Social Protection.

I would like to place on record my deep appreciation of the inputs provided by the members of the Panel, especially the Convener, Dr. Rashid Amjad, and Chairpersons of the Working Groups, Dr. Akmal Hussain, Dr. Naved Hamid and Dr. Asad Saeed.

I would also like to thank the Planning Commission and Pakistan Institute of Development Economics for all the support provided.

Dr. Hafiz A. Pasha
Chairman
Advisory Panel of Economists

PANEL OF ECONOMISTS

Dr. Hafiz A. Pasha **CHAIRPERSON**
Dean Social Sciences
Beaconhouse National University, Lahore

MEMBERS

1. Dr. Naved Hamid
Professor & Director
Centre for Research in Economics and Business
Lahore School of Economics, Lahore

2. Dr. Akmal Hussain
Distinguished Professor
Beaconhouse National University, Lahore

3. Dr. Asad Sayeed
Director and Senior Researcher
Collective for Social Science Research, Karachi

4. Dr. Ali Cheema
Associate Professor
Lahore University of Management Sciences (LUMS)
Lahore

6. Dr. Riaz Riazuddin
Advisor
State Bank of Pakistan
Karachi

7. Qazi Muhammad Tousif Akhtar
Chairperson
Department of Economics
University of Balochistan, Quetta

8. Dr. Akhtar Hassan Khan
Former Secretary Planning and Development
Islamabad

9. Dr. Aisha Ghaus Pasha
Director Research
Institute of Public Policy
Beaconhouse National University

10. Mr. Haris Gazdar
Senior Researcher
Collective for Social Science Research, Karachi

11. Dr. Rehana Siddiqui
Joint Director
PIDE, Islamabad

12. Dr. Qazi Masood Ahmed
Director Research
IBA, Karachi

13. Dr. Faisal Bari
Associate Professor
Lahore University of Management Science, Lahore

14. Mr. Saqib Sherani
Principal Economic Advisor
Ministry of Finance, Islamabad

15. Dr. Nasser Ali Khan
Director
Institute of Management Sciences, Peshawar

16. Dr. Ijaz Nabi
Dean Social Studies
Lahore University of Management Science
Lahore

CO-OPTED MEMBERS

17. Dr. Azam Chaudhry
Associate Professor
Lahore School of Economics
Lahore

18. Syed Ashraf Wasti
Research Economist
Applied Economic Research Centre, Karachi

19. Dr. Ather Maqsood Ahmed
Professor and Head of Economics Department
NUST Business School
NUST, Islamabad

20. Mr. Muhammad Sabir
Principal Economist
Social Policy Development Centre (SPDC)
Karachi

21. Mr. Savail Hussain
Chief Manager Exports
Sayyed Engineers (Pvt.) Ltd
Lahore

Dr. Rashid Amjad **CONVENER**
Vice-Chancellor
Pakistan Institute of Development Economics
Islamabad

SUMMARY
CONCLUSION AND MAIN RECOMMENDATIONS

MACRO-ECONOMIC FRAMEWORK

- Pakistan today faces multiple challenges on the security, political and economic fronts. Therefore, the Panel suggests that the 10th Plan, from 2010-11 to 2014-15, should not target like previous Plans for high growth rates of GDP of 7 to 8 %. Instead, a realistic strategy is proposed which is based initially on the removal of physical constraints to growth and an improvement in the investment climate within the next two years. Thereafter, the expectation is that the growth process will pick up momentum. As such, from a GDP growth rate of about 3% in the base year of the Plan, the growth rate could rise to 5% by 2012-13 and approach 7 % by 2014-15. Overall, the average growth rate expectation during the Plan period should be just above 5 %.

- Financial sustainability of 10th Plan will need to be ensured by vigorous efforts at domestic resource mobilization and strong economy in current expenditure. With the fiscal deficit falling to 4 % of the GDP by the end of the Plan, there will then be enough fiscal space to finance from the budget a Plan size of cumulative public investment during the next five years of Rs 3.4 trillion (at 2009-10 prices).

- The large improvement in the balance of payments position in 2009-10 augers well for future sustainability of international transactions. Continued access to releases from the IMF SBA will lead to a peaking of foreign exchange reserves in 2012. Thereafter, repayment of these credits will put some pressure on the balance of payments. However, an import cover of reserves of over three months can be ensured throughout the plan period as FDI and other flows rise as the economy starts showing dynamism in the last few years of the Plan.

- It needs to be emphasized that even with an average growth rate of GDP of about 5%, significant poverty reduction can be achieved provided the planners follow a strong inclusive growth strategy. This will involve focus on rural development, removal of infrastructural bottlenecks, balanced regional development especially growth and development in Baluchistan, Khyber Pakhtunkhwa and FATA, employment generation, enhanced social protection and on investing in the people.

II. GROWTH STRATEGIES AND DEVELOPMENT PRIORITIES

- Pakistan's growth experience suggests while it has been able to achieve fairly decent rates of economic growth, the outcome has neither been inclusive in ensuring a fairer distribution of the benefits of growth nor has the process been sustainable. The reasons have included neglect of social indicators, a skewed distribution of assets, weak institutions of governance, inward looking

economic policies and structures, poor levels and rates of savings and investments (largely owing to inequitable tax structures and the reluctance of the elite to contribute to the financing of economic growth on the basis of capacity to bear such a burden). This has resulted in the heavy dependence on external assistance (in turn helped by fortuitous events internationally) and the accumulation and continued growth of domestic and external debt. In addition, the requirements of security, further complicated by the recent surge in extremism and militancy in some parts of the country, have resulted in scarce resources being diverted from critical investments in human development.

- Many of these factors are likely to continue to serve as binding constraints in the foreseeable future. Given the uncertain international environment, there is a need to identify sectors and activities that can help revive growth domestically, while ensuring that it is inclusive and sustainable.

- Given the pattern of growth over the last 20 years, our estimates suggest that on the basis of the average ICOR of 3.65, taking the annual growth in the labour force of 2.95% and an average employment elasticity of 0.465, assuming a historical current account deficit of 3.06% of GDP and a national savings rate of 16.86% of GDP, the sustainable annual growth rate will be under 5.46%. This would result in 14% of the annual increment to the labour force being added to the stock of the unemployed. However, if all annual additions to the labour force are to be accommodated the country will have to achieve an annual growth rate of 6.35%. Financing this will require additional resources of 3.26% of the GDP. By raising the ICOR to the more realistic 4.00, keeping the rest of the assumptions the same, the achievable annual growth rate from available resources is estimated at 4.98% but this will result in the annual increment to the unemployed of 21% of the addition to the labour force. For the entire annual addition of the labour force to be absorbed will require an annual growth rate of 6.35% but this will mean a financing gap of 5.48% of the GDP.

- A two-fold approach is recommended to address this fundamental challenge. On the one side, it is proposed to shift emphasis on sectors which have the capacity to enhance the employment generating ability of the economy. On the other, to focus on relaxing the growth constraints by enhancing competiveness and encouraging savings.

- To keep the ICOR low and spur growth through a shift in the pattern of development we propose strategies and public spending priorities that focus on sectors and activities with higher employment elasticities so as to accommodate the young labour force of 80 million presently endowed with limited education and skills or of indifferent quality. To this end we recommend interventions in agriculture and livestock which provide direct employment to 44%, in housing and domestic commerce and for promotion of SME clusters.

- For the agriculture sector we recommend an early introduction of BT Cotton, greater reliance on technology for delivering extension services and improved marketing laws to benefit both farmers and consumers. The primary focus of

interventions in the livestock sector should be to enhance yields of milk and meat and improve access to markets through assistance in the adoption of modern farming practices, development of effective insemination centres to upgrade the genetic base of the animals, better quality animal feed, training in animal care and disease prevention and better access to animal health services.

- To improve housing and commerce, we recommend rationalization of stamp duties and development and commercialization charges, reforms in zoning and building regulations and property taxation of rented properties, revisions in rent control legislation, especially its pro-tenant bias, better contract enforcement and secure land titling systems.

- The strengthening and creation of SME clusters requires facilitation of market research to assist innovation, better public information and knowledge of buyer needs, markets and production mechanisms, export processing zones (EPZ) with decent quality physical infrastructure and proper bonded warehousing capability, improvement in the legal environment for protecting foreign patent holders, promotion of entrepreneurship in new ventures and public-private partnerships in setting up common facility centers that would provide access to technology, machining facilities and market related information and other common services.

- To ease the constraints to growth, especially the financing of the current account deficit, and to enhance the efficiency and competitiveness of the Pakistani economy in general and the heavily protected industrial sector in particular requires continuous and sustainable improvements in total factor productivity and a variety of policy, procedural, institutional, regulatory and legal reforms. Policy suggestions include interventions like reduction in the anti-export bias via an undervalued exchange rate regime, ensuring availability of imported raw materials to exporters at world prices and increasing market access for Pakistani products, particularly in EU markets. Other initiatives to support exports would include development of skills to assist upgrading of industry to enable export of value-added products.

- To facilitate trade there is also a need to further simplify custom procedures, develop an integrated supply chain management service with real-time cargo monitoring and internet-based transactions, invest in infrastructure through better port facilities, create an efficient rail and air freight service and introduce new and less polluting trucks for freight service. There is also a need to exploit the huge potential offered by regional trade, and thereby build strong constituencies for peace, through considering first granting India MFN basis and abandoning the positive list approach, easing visa processing to facilitate freer movement of people, an institutional arrangement for banks to participate freely in transactions relating to L/Cs and payments, opening up of new transportation routes, better information exchange, reduction in NTBs and creating an enabling environment for investment in joint ventures.

- In addition, cost of doing business can be reduced through rationalization of administrative regulation, rationalization of labour levies and instituting a rule-based system for tax refunds.

- To enhance the competiveness of the economy it is also necessary to improve the productivity of the young labour force. For this we recommend skill development initiatives through public-private partnerships and a quality approval process accepted by the key economic players in the domestic economy in the case of youth with limited education and a system for international certification for the better educated to be provided higher level skills. The labour force with such skills will attain mobility, domestically and overseas, thereby enhancing its earning capabilities.

- Finally, to move to a higher sustainable growth rate it is necessary to tackle the lack of domestic savings. For this we propose improving financial intermediation by ensuring real and increased returns on financial savings, development of long-term saving vehicles like pension schemes and life insurance, examining the possibility of new instruments and institutions like portable and mandatory savings/pension schemes and Housing Societies/Credit Unions. To encourage savings on broad scale, particularly in the form that can be used to finance productive investment it is necessary to address the issue of financial exclusion of bulk of the population. This can be done by exploiting opportunities offered by technology in the form of "mobile phone banking".

III: INSTITUTIONAL FRAMEWORK FOR DEVELOPMENT AND POVERTY ALLEVIATION

- In this Report we have attempted to provide the analytical basis for a change in Pakistan's economic policy paradigm for achieving *economic democracy* in order to provide economic citizenship to all of the people rather than a few.

- We have argued that the observed failures to achieve sustained growth and to overcome mass poverty are both rooted in an institutional structure that excludes the majority of the population from the process of investment, access over high quality education, health and equitable access over markets. It is on the basis of this exclusion that a small elite is able to appropriate rents while leaving the majority of the population in a state of economic deprivation. Such an institutional structure not only generates mass poverty, acute inter personal and inter regional inequalities but also places severe stresses on both state and society.

- The present multi faceted crisis of state, economy and society shows that the time has come to bring about structural changes in the institutional framework of Pakistan's economy to be able to achieve inclusive and sustained growth: A broad based economic growth process where the people would be both the subjects of development as well as the recipients of its fruits. Such an institutional structure would enable the people to become the subjects of economic growth as well as the recipients of its fruits. It would be *development for the people by the people*.

- The institutional framework of such an inclusive growth could have four broad dimensions[1]. Some of the concrete elements of each of these dimensions of inclusive growth are briefly indicated as follows:

(i) A small and Medium Farmer Strategy for Pro Poor and Faster Agriculture Growth: State Land for the Landless and Small Farm Development Corporation

- An initial step in providing productive assets to the rural poor could be to allot the available 2.6 million acres of state owned land[2] to the landless. If this acreage could be transferred to landless farm households in holdings of 5 acres each, then as many as 520,000 tenant farmers could become owner operators. This means that out of the total number of tenant farmers (897,000) in the less than 25 acre category, as many as 58 percent would become owner operators.

- However, it is important to recognize that providing ownership of land to the landless is a necessary but not a sufficient condition for alleviating their poverty. For enabling the landless to make the transferred land cultivable and to achieve a sustainable increase in their income a Small Farmer Development Corporation (SFDC), whose equity is owned by small and medium farmers (less than 25 acres holdings), but managed by professionals. The SFDC could provide extension services, equitable access over markets for the purchase of good quality inputs and marketing facilities for their products.

(ii) Inclusive Growth through Equity Stakes for the Poor in Large Corporations: Milk, Milk Products, Livestock and Marine Fisheries

- Demonstrable experience in the field has shown that the milk yield per animal in Pakistan can be doubled through scientific feeding, breeding and marketing. This sector has the potential of contributing an additional US $ 4.5 billion annually to Pakistan's foreign exchange earnings. It is proposed that the Pakistan Poverty Alleviation Fund (PPAF), its NGO partner organizations at the district level and provincial Dairy Development Boards be brought together into a consortium to establish a Pakistan Dairy Corporation (PDC).

- The expansion in the export of marine fisheries is constrained because the storage facilities for transportation do not match the international quality standards. An export potential of 300 million dollars exists over the next three

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[1] This paragraph is drawn from Akmal Hussain, An Institutional Framework for Inclusive Growth, 15 May 2009.

[2] This estimate was provided by Mr. Omer Asghar Khan before his tragic death, when he was Federal Minister for Labour, on the basis of Government of Pakistan's data.

years if such improved management of the marine fisheries industry could be achieved[3].

(iii) Inclusive Growth through Small Scale Industrial Enterprises

- The key strategic issue in accelerating the growth of SSEs is to enable them to shift to the high value added, high growth end of the product market. These SSE's. include high value added units in light engineering, automotive parts, moulds, dyes, machine tools and electronics and computer software.

- Overcoming key constraints faced by SSEs would involve providing institutional support in terms of credit, quality control management, skill training and marketing. This could be done by facilitating the establishment of Common Facilities Centers (CFCs) located in the specified growth nodes in selected towns where the entrepreneurial and technical potential as well as markets already exist. Such support institutions (CFCs) while being facilitated by the government and autonomous organizations such as SMEDA can and should be in the private sector and market driven.

(iv) Inclusive Growth through Participatory Development

- Empowerment means enabling the poor to build their human capabilities and economic resource base for breaking out of the poverty nexus. It is a process of reconstructing a group identity, of raising consciousness, of acquiring new skills and of achieving better access over markets and institutions for a sustainable increase in incomes. Such a process progressively imparts to the poor a new *power* over the economic and social forces that fashion their daily lives.

- The economic strategy requires a national campaign to empower the poor at the level of village/mohallah, Union Council, Tehsil and District. The idea is to facilitate the growth of autonomous community organizations of the poor at the village/mohallah level to be able to break out of the poverty through government line departments, autonomous institutions, private sector firms, NGOs. and donors; and access credit for micro enterprise projects through apex organizations such as the PPAF, Khushali Bank, Small Business Finance Corporation (SBFC), and commercial banks.

- At the moment the scale of micro finance is inadequate, with only 1.5 million clients out of a total of 10 million being served with micro credit facility. Micro credit needs to be substantially enlarged. At the same time special institutional arrangements would need to be made in these apex organizations to take credit to poor women and women's COs, since poor women have even lesser access over institutional credit compared to poor men.

- It is important that such village level community based organisations (CBOs) be autonomous and be permitted to form cluster apex organisations with other CBOs.

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[3] Ibid. page 73.

IV: SOCIAL POLICY AND SOCIAL PROTECTION

- Pakistan finds itself in the midst of a twin crisis at this juncture. The global and domestic economic downturn has resulted in high inflation and reduction in employment opportunities. In addition, the war on extremism has displaced a large number of people and destroyed assets and livelihoods. As such, the share of the poor and vulnerable in society is expected to have increased. A strong and sustained social protection system is thus needed to protect the poorest and the most vulnerable.

- If we take a medium to long run view, there are a number of structural inequalities in society and economy that also require attention. Some of these need to be addressed through a pro active social policy of the state. Social policy as distinguished from social protection can ensure equitable and socio-politically sustainable development in the country. Thus, based on the principle that social policy and social protection are important elements of nation building and in creating a sense of belonging amongst the citizens to the state, this report will also make recommendation on these long term concerns.

A. Social Policy Instruments

- Social policy areas that we highlight in this report are not only important in their own right but are also instrumental in improving labour market conditions which will have a positive impact on employment creation and productivity growth.

a) Residential Land Security for the Marginalized

- Residential insecurity is a persistent feature of social marginalization at the local level. In rural areas this insecurity takes the form of dependent relations between landowners and the landless. Extreme forms of dependence result in bonded labour and other forms of coercion. Less extreme forms of dependence include the loss of political autonomy, vulnerability of services and provisioning to elite capture, restricted labour market opportunities, and chronic lack of tangible asset accumulation on the part of the poor.

- Agrarian land reforms are no longer on the policy agenda for constitutional, political, administrative and economic reasons. There is a constitutional restraint following a Supreme Court ruling. Government can, however, make a significant differece to the position of the landless, poor and socially marginalized by ensuring secure tenure or title to residential or homestead land in rural areas. Such provision can be a significant non-fiscal measure for enhancing social protection, reducing inequality, and unleashing the productive potential of the poor. Past schemes for residential land security were responsible for dramatic changes in social relations in many regions of the country.

- A key feature of rural residential insecurity is that the landless and socially marginalized groups are often resident on land that is actually owned by

government, but is held under the influence of local landowners. The government has the responsibility for providing state land to the landless poor and the socially marginalized. In areas where state-owned land is not available in sufficient area, government can acquire land using the Land Acquisition Act 1894, or through market transactions, and allot it to specially designed schemes for the landless poor and the socially marginalized.

- In urban areas successive rounds of regularization of Katchi Abadis have been very successful in increasing the social status and economic potential of the poor and the marginalized. Programs of regularization – which often relate to the regularization of existing settlements on land owned by the government or government-owned enterprises such as the Railways – should be reviewed, revived and expanded.

b) Forced and bonded labour

- Pakistan is committed to the eradication of forced labour of all types. There are laws and regulations concerning the abolition of bonded labour. Eradicating bonded labour and forms of coercion in economic activities needs to be acknowledged as being integral to economic reforms, and not only seen as a concern for human rights policy.

- Democratic governments have a strong record in acknowledging the curse of bonded labour, and in taking pro-active measures for its eradication. The Sindh provincial government, for example, has notified a separate ministerial portfolio for dealing specifically with the issue of bonded labour. There has also been a manifold increase in the number of police actions against landlords suspected of keeping workers in bondage. There are, however, some serious gaps in the implementation of bonded labour eradication strategies.

- Given the constitutional guarantees of freedom from slavery, forced labour and other forms of economic coercion, it is the duty of the federal government to take the lead in this regard, and set the parameters for initiatives at the provincial and local levels.

- It is strongly recommended:

  - ◊ Federal government set up a commission which will be charged with a plan for the eradication of bonded labour and other coercive forms of labour from Pakistan. The commission must complete its work and make its recommendations within a six-month period.
  - ◊ The commission should consult with stakeholders in communities, legal experts, economists, social scientists, law enforcement officials, and activists, in order to:

    - o Propose an operational definition of bonded labour in Pakistan.
    - o Agree the methodology for conducting a baseline quantitative and qualitative survey of forced labour in the country.

- Pay attention to social dimensions of forced and bonded labour – such as caste, racial and religious discrimination.
- Propose an action plan including a range of law enforcement as well as social policy interventions, with measurable indicators for the eradication of forced labour.
- Propose easily accessible labour adjudication processes at the local level for redressal and equitable contracting in the labour markets.

c) Gender Mainstreaming

- Perhaps the most important social policy initiatives required in Pakistan is gender mainstreaming. Pakistan has one of the lowest labour force participation rates for women. Moreover, access of women to productive activities is limited because of limited access to resources, low investment in human capital, and discrimination in the labour market. In addition malnutrition, limited asset ownership and lack of access to technology limit the participation of women in productive activities. In order to reduce gender disparities multidimensional efforts are required.

- Disparities in education and labour market discrimination, coupled with intra-household inequalities result in disproportionately higher burden of poverty on women. In addition, evidence also suggests that incidence of poverty is higher among the female headed (working) households. Vulnerability of females also increases due to lack of access to resources, assets and social discrimination based on socio-cultural norms. Thus, focused efforts are needed to improve status of women in society. This requires increasing the access to education, health, resources and creating an enabling environment.

- Recommendations for gender mainstreaming will have to be multidimensional.

  - *Allocative:* Improve the supply side of education and health specifically to improve access. This will not only entail constructing more girls' schools but also to target an increase in female teachers and medical practitioners. The indicative goal should be to increase the number of female teachers and female medical staff by 50% in the next 5 years.
  - *Administrative:* Federal and provincial governments will have to ensure that female staff is recruited locally to the extent possible. Where women from other areas are posted, their living arrangements, protection and mobility will have to provided on a priority basis.

- This of course is easier said than done in a predominantly patriarchal society. Measurable indicators for this purpose will have to be devised to track progress of provincial departments and governments over time.

- Legislation by itself may not alter working conditions and improve returns from labour for woman workers given the nature of the informal industry, but it will create a right that women can seek through collective and legal action.

B. Social Protection for Nation Building

- Conflict in NWFP, FATA and Balochistan has severely challenged the ability of the state as well as the legitimacy of the idea of a functioning state in Pakistan. Social protection must be part of the strategy to reclaim the space and legitimacy for the state in Pakistan, through protection to the basic entitlements of people in the conflict-affected areas.

- Besides the conflict areas there are other regions that have suffered extreme deprivation through decades of neglect, and will be potential breeding grounds of alienation and conflict. In the high population provinces of Punjab and Sindh there are deep pockets of deprivation (e.g. southern Punjab, and rural Sindh) where alienation from the state and its institutions can be used to launch further security challenges.

- These regions should be designated as Nation-Building Regions of Pakistan, which must receive priority support in social protection programmes and policies.

- We recommend that social protection be seen as nation-building interventions in conflict-related and particularly deprived regions of the country. In this regard all social protection programmes advocated in this report must be prioritized for these areas. In particular, in the coming fiscal year, there should be provision for "nation-building districts" outlined above.

C. Instruments of Social Protection

(a) Benazir Income Support Program (BISP)

- Benazir Income Support Program (BISP) has evolved in the right direction since its inception. In the second year of the program (FY 10), allocation was doubled from Rs. 34 billion to Rs. 70 billion. The number of beneficiary families was also increased from 3.4 million to 5 million. While the target for the first year (of 3.4 million families) was not achieved, the fact that benefits reached 2 million plus in the first year is no less impressive. Also benefits were also targeted, in lump sum (of Rs. 25000 as a one off grant) to IDPs.

- More important than the roll out is evolution in the targeting mechanism. From a simple NADRA approved list to MNA nomination to a poverty scorecard demonstrates the learning capacity of the BISP organization.

- Once the roll out on the poverty scorecard is completed, BISP should move towards introducing conditional cash transfers. This will essentially mean that transfers are linked to the families sending their children to school, availing adult literacy facilities where available and applicable and women and children seek formal health services.

(b) Employment Guarantee Scheme (EGS)

- We recommend that the EGS for the medium run should be limited to the National Building Regions (NBR) and that also should be staggered in three phases. Both for fiscal reasons as well as reasons for economic distress in the wake of conflict the scheme is recommended to the limited to the NBR. Moreover, we also recommend that the launch of the program is staggered in three phases. In the first phase, the program should be launched in the conflict zones of FATA and Malakand. In the second phase, it should cover the rest of the NWFP province and all of the Balochistan province and in the third phase the poorest 20% of the population in Sindh and Punjab will be covered.

- The virtue of an employment program if benefits are kept on or around a regionally determined minimum wage, it becomes self targeting.

- Apart from the low wage, there are two other criteria used to ensure benefits to remain within the realm of fiscal feasibility as well to ensure that the poorest households benefit. As such we have made the cut off for selection to 30% of the illiterate population and to limit the program to one household per family for 100 days of employment in the year. The capital labour ratio is kept at 40:60 (the same as NREGA in India).

- Since the program is outside the remit of the traditional PSDP, it will require a different implementation mechanism. While details of the mechanism can be worked out once it is decided in principle that EGS is to be implemented. Further details on implementation mechanisms are presented in Section 4.

(c) Nutrition Program for Primary School Going Children

- High food inflation has increased the risk of malnutrition amongst the poor. International and domestic evidence suggests that at highest risk on the nutrition status are school going children and particularly the girl child. This situation is particularly acute amongst IDPs. Since there are a number of design issues associated with the nutritional program – given its controversial pilot done earlier through the *Tawana Pakistan* Program – we recommend that an initial pilot is launched in the NBR.

D. Social Protection Platform

- A Social Protection 'Platform' is an essential institutional intervention if Pakistan is to make any serious attempt at targeted social protection. For example, if the above discussed EGS is to be implemented then we have to know which heads of families are illiterate and we also need to monitor that each family does not take up more than a hundred days of work. Similarly, there can be a debate between school vouchers and noon-meals as alternative ways of ensuring universal enrolment. But neither of the two alternatives can be implemented or monitored to scale in the absence of reliable and regularly updated information and monitoring at the local level and its integration in a vertical chain.

PART I: MACRO-ECONOMIC FRAMEWORK

Macroeconomic Framework for the 10th Five Year Plan[4]

1. The Planning Commission has decided to go ahead with the formulation of the 10th Five Year Plan despite the difficult security and political situation and an economy which is yet to emerge from a recession. The objective is to focus on the path to economic recovery, as some success has been achieved in the process of stabilization during the last two years under the aegis of an IMF SBA. In particular, the current account deficit in the balance of payments has been brought down sharply by over two thirds in the first eight months of 2009-10 and foreign exchange reserves have shown a rising trend. The inflation rate has come down from the peak of 25% to about 13%. The fiscal situation, however, remains under stress due to high war-related expenditures, lower than anticipated tax revenues and aid inflows from donors.

2. Pakistan has been without a Five Year plan since 1998. In the intervening period the country has relied on Annual Plans. This was an expedient strategy during the period of fast growth from 2002-2007, when reliance on the operation of markets appeared to work well and the economy attained a growth rate on average of above 6% and private investment rose sharply. But the experience of this period highlights two major market failures. First, distributional considerations were ignored and the fast growth was accompanied by rising inequalities due to the asset price bubble, imbalanced pattern of growth in sectors with limited labor absorption capacity and a failure of fiscal policy to perform a significant redistributive function due to the stagnation in the tax-to-GDP ratio. The import-based consumption-led growth laid the basis for the subsequent balance of payments crisis in 2008.

3. Second, in the absence of medium to long-term planning adequate provisions were not made for expansion in infrastructure in line with the fast growth. Today, the country has severe shortages of vital inputs like power, gas and water. We are witnessing record levels of power outages and this has become a major factor restricting growth in the economy. The imperative now is to remove these large gaps in infrastructure which could have been anticipated much earlier if the country had remained within the discipline of medium term sectoral planning.

4. The objectives of the 10th Five Year Plan are clear and emerge from the experience of the last few years. First, the economy has to be gradually restored to a trajectory of high growth from about 3 % currently to above 6% in the next five years. Second, the development strategy to be adopted must focus on achieving inclusive and sustainable growth and not just on achieving high rates of growth. This will require keeping the inflation rate in control (especially food prices), the current account and fiscal deficits within manageable levels and focusing on a sectoral growth pattern which creates employment for the growing labor force. Third, the primary emphasis in the

[4] Prepared by the Advisory Panel of Economists to the Planning Commission.

investment plan must be on the removal of the infrastructural bottlenecks on a priority basis, especially in the areas of water, gas and power supplies.

2. Revival of the Economy

5. The economy has suffered a sharp loss of growth momentum since 2006-07. A number of factors have contributed to the plummeting of the growth rate, including the heightened perceptions of risk and uncertainty arising from intensification of the War on Terror and on-going political instability, emergence of large macroeconomic imbalances earlier which have necessitated the resort to contractionary fiscal and monetary policies, surfacing of major supply-side bottlenecks in key inputs like power, water and gas and the global recession which has limited the prospects for achieving export-led growth.

6. Clearly, planning for higher growth will require improvement in the investment climate which has to be based on success in containing militancy and acts of terrorism, improvement in the law and order situation and a return to political stability. Some success has already been achieved in the military operations in the North and relations with the USA have improved to the level of a Strategic Dialogue. On the constitutional front the 18th Amendment has been passed by the Parliament and it will change the institutional structure as abolition of concurrent list and provincial autonomy are very important decisions which will affect the strategies and model which have been adopted in this Report. Meanwhile, the judiciary has emerged as a strong and independent organ of state.

7. On the infrastructure front, projects are being implemented to reduce the power deficit by next year and power tariffs have been enhanced substantially to solve structurally the problem of circular debt. An agreement has recently been signed with Iran for a large gas line pipeline which should commence supplies in the next four years. The federal and provincial PSDPs are focusing on investment in dams and improvements in the irrigation system to reduce water losses.

8. Therefore, there is some basis for optimism that the prospects for growth could improve significantly within the next two years. The Macroeconomic Framework for the 10th Plan, which is presented here, reflects this view. As such, it is projected that the economy will once again show a growth rate in excess of 5 % by 2012-13 (see Table1). Thereafter, the growth momentum could be rapid and a growth rate of 7 percent may be approached by the terminal year of the Plan, 2014-15. Projections of the Macroeconomic Framework for the Plan have been made with the help of seventeen equation Macroeconomic Model developed by the Institute of Public Policy of Beaconhouse National University. [1]

[1] The specification and estimated equations of the model are available with IPP and can be obtained on request.

Table 1

PROJECTION OF GDP BY EXPENDITURE

DURING PLAN PERIOD

(Rs. Billion at constant prices of 1999-2000)

Indicator\Years	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	Average (2011-15)
Private Consumption Expenditure	4,159.6	4,300.6	4,467.0	4,659.4	4,888.4	5,166.2	
		3.4[a]	3.9	4.3	4.9	5.7	4.4
Public Consumption Expenditure	655.5	671.9	688.7	705.9	723.6	745.3	
		2.5	2.5	2.5	2.5	3.0	2.6
Private Investment	618.9	657.5	727.6	790.5	869.2	966.1	
		6.2	10.7	8.6	10.0	11.2	9.3
Public Investment	267.9	294.7	324.2	372.8	438.0	514.7	
		10.0	10.0	15.0	17.5	17.5	14.0
Expenditure on Exports of Goods and Services	1,036.5	1,082.3	1,140.0	1,190.0	1,248.7	1,313.2	
		4.4	5.3	4.4	4.9	5.2	4.8
Expenditure on Imports of Goods and Services	835.5	877.3	929.8	975.2	1,027.3	1,076.4	
		5.0	6.0	4.9	5.4	4.8	5.2
Change in Stocks	95.5	100.3	105.3	110.6	116.1	121.9	
		5.0	5.0	5.0	5.0	5.0	5.0
Gross Domestic Product (at market prices)	5,996.2	6,227.6	6,520.6	6,851.5	7,254.0	7,748.2	
		3.9	4.7	5.1	5.9	6.8	5.3

[a] Annual growth rates.

9. As shown in Table 1, the primary stimulus to growth initially has to come from public investment, while private investment remains depressed, with a likely fall of 7 % in 2009-10. From 2011-12, however, it is expected that private investment will start showing double –digit growth rates in line with the improvement in conditions, as described above.

10. Public consumption expenditure is restricted to a growth rate of only 2.5 percent, as attempts are made to preserve the fiscal balance while a big push is taking place in public investment. Private consumption expenditure shows a modest growth rate initially of about 3% which can approach 6% by the end of the Plan period. Overall, the share of consumption in GDP is expected to decline from 80.3% in 2009-10 to 76.3% by 2014-15.Exports and imports of goods and services are expected to show an average growth rate of about 5% during the tenure of the Plan.

11. Based on the above, the growth rate projection for 2010-11 is close to 4%, which is expected to rise to above 5% by 2012-13, to about 6% in 2013-14 and to near 7% in 2014-15. This implies that the average growth rate of GDP during the Plan period is 5.3 %. Simultaneously, the model predicts that the inflation rate will fall from 12 % in 2009-10 to single digit next year and to 5% by 2014-15.

3. The Fiscal Framework

12. How is the big push in public investment in the Plan to be financed? First, efforts will have to be made to mobilize more domestic resources by raising the tax-to-GDP ratio, which has been languishing at about 10% and is one of the lowest among developing countries. This will have to be raised by over three percentage points during the Plan period, as shown in Table 2.

13. The strategy to raise the tax-to-GDP ratio will involve, first, an early move towards a comprehensive VAT in Pakistan which removes most of the exemptions in the GST currently on goods and extends the tax net to achieve comprehensive coverage of services, second, improvements in tax administration to achieve a more functional and integrated tax system for detecting under filers and non-filers of tax returns and, third, effective levy of direct taxes on agricultural income and capital gains. A strong system of accountability will have to be put in place to minimize corruption in the process of tax collection.

14. The second key element in the fiscal framework is the need to restrict the increase in current expenditure in order to create the necessary 'fiscal space' for public investment. As such, the ratio of current expenditure to GDP is expected to rise by less than 0.5 percent during the plan period. A decline in this ratio is not proposed in view of the substantial increase in federal transfers to the provinces following the recent NFC Award. Some of this increase is expected to be allocated to higher outlays on the operations of social services like education and health. This is consistent with the theme of the Approach Paper to the 10th Plan of 'Investing in the People'. Beyond this, Government will need to achieve economy in the costs of administration and in the currently large subsidies or grants to state-owned entities.

15. The proposed Fiscal Framework during the Plan period does lead to substantial deficit reduction from close to 5 ½ percent of the GDP in 2009-10 to 4% of the GDP by 2014-15. Therefore, about half of the targeted increase in the tax-to-GDP ratio will be used for enhancing the size of the PSDP and the remaining half for deficit reduction.

16. The estimated Plan Size measure as the cumulative public investment financed through the budget is Rs 3389 billion, at 2009-10 prices. Given an existing throw forward of close to Rs 3 trillion, this means that bulk of the resources will be pre-empted by on-going projects unless there is drastic pruning of these projects in line with established priorities in the Plan.

Table 2
FISCAL FRAMEWORK FOR THE PLAN

(Rs. in Billion at current prices)

	2009-10	2010-11	2011-12	2012-2013	2013-2014	2014-2015
Revenues	**1982**	**2382**	**2821**	**3324**	**3936**	**4688**
% of GDP	13.0	13.7	14.3	14.9	15.5	16.2
Tax Revenue	**1525**	**1862**	**2233**	**2656**	**3159**	**3810**
% of GDP	10.0	10.7	11.3	11.9	12.5	13.2
Non-Tax Revenue	**457**	**520**	**588**	**668**	**777**	**878**
% of GDP	3.0	3.0	3.0	3.0	3.0	3.0
Expenditure	**2792**	**3246**	**3719**	**4299**	**5000**	**5837**
% of GDP	18.3	18.6	18.8	19.2	19.7	20.1
Current Expenditure	**2325**	**2672**	**3050**	**3473**	**3962**	**4536**
% of GDP	15.2	15.4	15.4	15.6	15.7	15.7
Development Expenditure (including PSDP)	**467**	**574**	**669**	**826**	**1038**	**1301**
% of GDP	3.1	3.3	3.4	3.7	4.1	4.5
Fiscal Deficit	**809**	**864**	**899**	**974**	**1064**	**1150**
% of GDP	5.3	5.0	4.5	4.4	4.2	4.0

4. Balance of Payments

17. The issue is also whether attempts to stimulate the economy could exacerbate the current account deficit in the balance of payments and lead to an unsustainable situation in terms of the availability of foreign exchange in the economy.

18. The balance of payments projection for the Plan period is given in Table 3. The current account deficit is expected to decline sharply in 2009-10 to about 3% of the GDP, from almost 5 ½ % in 2008-09. The policies for managing aggregate demand, along with relatively low oil prices until recently, have been working in improving the balance of payments position of the country. Coupled with release of further credits from the IMF SBA, foreign exchange reserves are expected to rise by over 4 ½ billion dollars in 2009-10.

19. As the process of growth picks up in the economy, import demand is likely to rise rapidly especially in the last three years of the Plan. Consequently, the current account deficit could rise to almost 4 ½ % of the GDP in the terminal year of the Plan. From 2011-2012 onwards large repayments of debt have also to be made to the IMF, which peaks in 2013-14. The impact of these factors could be a decline in the absolute level of foreign exchange reserves after 2012-13. But even after the fall, these reserves are likely to be equivalent to more than three months of imports of goods and services.

Table 3

PROJECTION OF BALANCE OF PAYMENTS DURING PLAN PERIOD

($ Billion)

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Current Account						
Exports of Goods and Services	25.5	27.1	29.3	31.6	34.1	36.9
Imports of Goods and Services	-36.9	-39.8	-43.0	-46.8	-51.5	-57.1
Net Factor Income from Abroad	5.7	6.1	6.6	7.1	7.7	8.3
Current Account Deficit	**-5.7**	**-6.6**	**-7.1**	**-8.1**	**-9.7**	**-11.9**
(as % of GDP)	(-3.1)	(-3.4)	(-3.4)	(-3.6)	(-3.9)	(-4.4)
Capital and Financial Account*	**6.7**	**8.0**	**9.7**	**11.1**	**12.0**	**11.6**
Use of Fund Credit & Loans	**4.4**	**3.0**	**-1.1**	**-2.9**	**-4.3**	**-2.6**
Change in Reserves	**5.4**	**3.4**	**1.5**	**0.1**	**-2.0**	**-2.9**
Level of Reserves	**14.5**	**17.9**	**19.4**	**19.5**	**17.5**	**14.6**
(in months of imports of goods and services)	(4.7)	(5.4)	(5.4)	(5.0)	(4.1)	(3.1)

* as per IMF, excluding Tokyo pledges (which remain uncertain) but including aid from Kerry-Lugar Bill

5. Sectoral Growth Strategy

20. The projected sectoral growth rates to achieve the target growth rates of GDP during the Plan period are given in Table 4. Emerging constraints of water are expected to limit somewhat the medium-term prospects for agricultural growth. As such the sector is expected to average a growth rate of 3.7 % during the Plan period. Industrial growth is likely to be frustrated initially by the high levels of power outages and start showing some dynamism after 2011-2012, when growth rates in excess of 5 % can be achieved. Overall, the average growth rate of the industrial sector is projected at 6.3 %. The services sector will achieve a growth rate on average of 5.4 %.

21. The process of structural transformation will continue in the economy. The share of the industrial sector is expected to rise from 24.4 % in 2008-9 to 25.8% in the terminal year of the Plan. Similarly, the share of the services sector will rise somewhat from 53.8 % to 54.1%.

Table 4

PROJECTED SECTORAL GROWTH RATES DURING THE PLAN PERIOD

(%)

	Sectoral Shares 2008-09	Sectoral Growth Rates						Average Growth Rate[a]	Sectoral Share 2014-15
		2009-10	2010-11	2011-12	2012-13	2013-14	2014-15		
Agriculture	21.8	3.0	3.5	3.6	3.7	3.8	3.9	3.7	20.1
Industry	24.4	4.5	5.0	5.5	6.0	7.0	8.0	6.3	25.8
Services	53.8	3.2	3.6	4.8	5.2	6.2	7.4	5.4	54.1
GDP	**100.0**	**3.5**	**3.9**	**4.7**	**5.1**	**5.9**	**6.8**	**5.3**	**100.0**

[a] During Planned Period, 2010-11 to 2014-15.

6. Conclusions

22. Pakistan today faces multiple challenges on the security, political and economic fronts. Therefore, the Panel suggests that the 10th Plan, from 2010-11 to 2014-15, should not target like previous Plans for high growth rates of GDP of 7 to 8 %. Instead, a realistic strategy is proposed which is based initially on the removal of physical constraints to growth and an improvement in the investment climate within the next two years. Thereafter, the expectation is that the growth process will pick up momentum. As such, from a GDP growth rate of about 3% in the base year of the Plan, the growth rate could rise to 5% by 2012-13 and approach 7 % by 2014-15. Overall, the average growth rate expectation during the Plan period is just above 5 %.

23. Financial sustainability of Plan will need to be ensured by vigorous efforts at domestic resource mobilization and strong economy in current expenditure. With the fiscal deficit falling to 4 % of the GDP by the end of the Plan, there will then be enough fiscal space to finance from the budget a Plan size of cumulative public investment during the next five years of Rs 3.4 trillion (at 2009-10 prices).

24. The large improvement in the balance of payments position in 2009-10 augers well for future sustainability of international transactions. Continued access to releases from the IMF SBA will lead to a peaking of foreign exchange reserves in 2012. Thereafter, repayment of these credits will put some pressure on the balance of payments. However, an import cover of reserves of over three months can be ensured throughout the plan period as FDI and other flows rise as the economy starts showing dynamism in the last few years of the Plan.

25. It needs to be emphasized that even with an average growth rate of GDP of about 5%, significant poverty reduction can be achieved provided the planners follow a strong inclusive growth strategy. This will involve focus on rural development, removal of infrastructural bottlenecks, balanced regional

development, employment generation, enhanced social protection and on investing in the people.

PART-II: GROWTH STRATEGIES AND DEVELOPMENT PRIORITIES

Chapter 1: Pakistan's Growth Experience

1.1. Introduction

26. This section attempts to devise a medium-term growth strategy and identifies development priorities given the constraints of the current IMF stabilization programme and the vulnerable global environment. This section of the report while reviewing Pakistan's experience argues that despite structural imbalances and the neglect of its social indicators the country has been able to achieve fairly decent rates of economic growth, primarily owing to the liberal availability of financing from external sources.

27. Six inter-linked issues have not only bedeviled Pakistan's prospects of graduating from a developing to an emerging economy but have also been responsible for the repeated patterns of stop-go growth without any significant change in the country's production structures.

28. These include:

    a. The imperatives of a security state which contributed to the political domination of the military, resulting in poor prioritization of spending and the diversion of a large share of resources away from critical expenditures on social services (i.e. education, health and skill formation to upgrade the quality of human capital), greater centralization of administrative and financial powers and resource distribution and continuing conflict with democratic forces in the federating units;

    b. The feudal, industrial and military-bureaucratic leadership has presided over an elite formation process and an economic structure that patronized rent-seeking and was inward looking. Moreover, it lacked connectedness with the rest of the world and was reluctant to create a more equitable society in which the less fortunate segments could have been empowered by establishing a system that was merit-driven and which provided opportunity for social mobility. Such a system would hence have enabled the poor to participate more meaningfully in the process of economic growth, thereby ensuring a fairer distribution of the benefits of growth. This elite structure has been unwilling to contribute, on the basis of capacity, the resources required for instituting a more just society. Instead it instituted a social order that imbibed the feudal value system and promoted a culture that violated the concept of rule of law, creating a crisis of legitimacy of the State and its institutions. This arrangement also actively promoted the creation of an industrial structure that discouraged the development of competitive markets through entry barriers and was unable to compete in global markets without continuing state support and protection or produced low value added products for exports.

c. The low levels of investment and domestic savings; the latter resulting in heavy reliance on external assistance and borrowings for financing investments (this issue is discussed in greater detail below);

d. A low level of commitment to institutional strengthening affected the quality of governance. Weak governance and lack of institutional capacity to prioritize, plan and design development strategies resulted in the poor selection of economic and social projects/ programmes[6], and leakages on account of corruption. The issues concerned with the poor formulation of projects were compounded by ineffective implementation and deficient oversight and evaluation;

e. The relatively low rates of domestic public and private savings and an overly protected industrial structure that contributed to persistent fiscal and external deficits that raised debt levels and the debt servicing requirements hindering the initiation of a process of sustained and stable economic growth; and

f. Fortuitous events internationally at critical moments of the country's history that lead to large inflows of capital on concessional terms, facilitating fiscal indiscipline and the frequent postponement of fundamental reforms[7].

29. These constraints provide much of the explanation why a country which had a growth rate of more than 5% since its independence in 1947 until the 1970s, in excess of 6% for most of the 1980s and in excess of 6% more recently and in 1965 exported more manufactured goods than Indonesia, Malaysia, Philippines, Thailand and Turkey combined, but failed to sustain, let alone, push up growth onto a higher trajectory.

30. The above referred causes and economic determinants of the growth trends and their consequences are encapsulated in Table 1. The Table summarizes the role aggregate demand, reflected in the high fiscal deficit, public debt and rates on inflation, in stimulating growth and its impact on poverty. The remainder of this section examines the structural factors that have influenced the pattern of economic growth and attempts to identify the issues that continue to constrain the sustainability of the broad strategy in achieving the objectives of inclusive and stable growth.

[6] A major issue is the higher cost per unit of public sector construction projects because of corruption, competence of government and other leakages. According to the World Bank, Pakistan Infrastructure Capacity Assessment,, Report no.41630-Pak, November, 2007, corruption accounts for almost 15% of project value, while there are delays in project implementation because of poor planning, design and execution capacity, inadequate contracting procedures and cumbersome contractual processes affect sectoral performance and efficiency, all of which push up unit costs.

[7] Adeel Malik refers to this external aid as "geo-strategic rents", The Political Economy of Industrial Development in 3Pakistan: A Long-term Perspective, Paper read at the Fifth Annual Conference of the Lahore School of Economics, April 20-21, 2009.

Table 1

Economic Indicators

Indicator (%)	Annual Average for		
	1980s	1990/91 – 1994/95	1995/96 – 1999/00
Compound growth rate of real GDP	6.5	4.9	3.3
Poverty incidence	46 (1985/86)	34	33
Inflation (period average)	7.2	11.5	7.9
Fiscal deficit/GDP (excl. grants)	7.1	7.2	6.5
Fiscal deficit/GDP (incl. grants)	6.4	6.7	6.4
Public debt/GDP	66 (mid-1980)	94 (mid-1990)	101 (mid-2000)

Source: Pakistan Development Policy Review: A New Dawn. The World Bank, 2002. Report No. 23916-PAK.

1.2. The Consequences of a Security State

31. For a country which had clocked up an enviable annual growth rate of almost 6% until the early 1990s, Pakistan has among the worst profiles of human development. Its chronic neglect of the social sectors is reflected in its low Human Development Index (HDI), a ranking of 139 among 179 countries compared with a rank of 130 on the basis of per capita GDP[8]. Its HDI contrasts poorly with that of other countries in South Asia partly largely because a much larger share of the resources was set aside for defence (see Table 2) compared with allocations on the military of 1% to 2% of GDP for almost all countries in South or South East Asia and 3% for India.

32. Pakistan's defence expenditure was 3.8% of GDP in 1969-70, which increased to 5.6% of GDP in 1976-77. During Zia-ul-Haq's regime, this spending increased at a rate of 9% per year and exceeded development spending by a large margin, rising to 6.7% of GDP in 1984/85 (Hasan, 1998). Between 1988-96 the share of defence spending declined somewhat, averaging 5.5% of GDP. It has declined to around 3% since 2000 (largely because of the rebasing of the GDP and a definitional change with respect to pensions of defence personnel)-(Table 2).

Table 2
Defense Expenditure (as % of GDP)

1980s	1990s	00-01	01-02	02-03	03-04	04-05	05-06	06-07	07-08
6.5	5.5	3.2	3.4	3.3	3.3	3.3	3.2	2.8	2.7

Source: Economic Survey 1996-97, 2007-08

33. These priorities resulted in Pakistan spending US$24 per capita on defence compared with $12 per capita on education and health combined in 2000, as against US$19 and US$35 per capita spending on these social sectors by India and Sri Lanka respectively (Tables 3a and 3b). By 2008/09 Pakistan's

[8]Human Development Indices (2008) < http://hdr.undp.org/en/media/HDI_2008_EN_Tables.pdf>

expenditure on the military (including pension payments) at around 2.8% of GDP was US$26 per capita as against US$24 on education and health combined, at 2.5% of GDP[9].

Table 3a

Per Capita Expenditure on Education and Health – US$

Country	1997	2000
Pakistan	15	12
India	15	19
Sri Lanka	32	35

Source: World Bank, 2003

34. The consequences are reflected in the following imbalances: a) six active soldiers for every doctor; b) two soldiers for every three teachers paid from the public purse; and c) recurrent expenditure on the military (including pensions) exceeding spending on the country's annual development programme for 15 years, to be reversed only in the last two to three years.

Table 3b
Expenditure on Education

Country	1990		1999		2005	
	% of GDP	Per Capita (US $)	% of GDP	Per Capita (US $)	% of GDP	Per Capita (US $)
Pakistan[1]	2.2	8	2.2	10	2.0	15
Bangladesh	1.5	4	2.0	7	1.9	8
India	NA	NA	3.6	16	3.0	22
Malaysia	5.2	134	5.1	177	5.1	274
Thailand	NA	NA	4.7	96	4.0[2]	103[2]

[1]As % of GNP; [2]Figures for 2003-04,
Source: For Pakistan Economic Survey, various issues.
For the rest, Key Indicators for Asia and the Pacific, 2008; and World Development Indicators, World Bank.

1.3. Inequitable Tax Structure and Skewed Asset Distribution

35. The elite has failed to establish an equitable taxation structure in its own enlightened self-interest that would finance spending on infrastructure development and on the delivery of key social services. Pakistan's consolidated tax to GDP rate is just over 10% which is 5 to 7 percentage points lower than the ratio for counties similarly placed economically (see Section 2). With a large outflow to meet the requirements of defence and keep

[9] At Rs.80=1US$

the rest of the oversized state machinery functional there is a lack of adequate resources to improve the access to, and quality of, education (by enhancing expenditure from under 2% of GDP to the UNESCO recommended 4%), basic health and safe drinking water facilities. Even after some reforms undertaken over the last 7-8 years the system is still highly iniquitous because of either exemptions or light taxation of certain sectors, activities or sources of income.

36. Apart from the lack of investment in the development of human capital that could have provided opportunities for social mobility, another structural factor that has continued to work against the disadvantaged groups has been the skewed distribution of assets, in particular agricultural land. The World Bank shows that with only 37% of rural households owning land (of which 61% households own less than 5 acres and 2% own 50 acres or more) the Gini coefficient of land ownership is 0.66 (and if rural landless households are included, the Gini coefficient is 0.86).[10]

37. The PPP government of Mr. Zulfiqar Ali Bhutto in the 1970s actively promoted the growth of a bloated public sector, much of which continues to be engaged in carrying out a host of economic activities, inefficiently absorbing large volumes of revenues to keep them operational. These demands have contributed to chronic fiscal deficits that along with borrowings in foreign currency to finance development expenditures, have also soaked up a large chunk of resources for servicing the domestic and external debt.

1.4. Fiscal Deficits and Debt Burden

38. There has been a secular increase in the debt to GDP ratio for two decades at a stretch on account of the continued failure of successive governments to reduce the budget deficit, public savings remained negative throughout the 1980s and 1990s. The pressure of this fiscal deficit was primarily fueled by high interest payments. Interest payments formed a significant part of the government expenditures during 1977-88, going up from 1.9% of the GDP in 1976-77, to 4.9% of the GDP in 1987-88 (Table 6).

Table 4

Fiscal deficit (as % of GDP)

80s	'91-95	'96-00	'00-01	'01-02	'02-03	'03-04	'04-05	'05-06	'06-07	'07-08
7.1	7.2	6.5	4.3	4.3	3.7	2.4	3.3	4.3	4.3	7.4

Source: Economic Survey 1996-97 and 2007-08.

39. With this background the deregulation of the interest rate in the early 1990s raised the cost of debt servicing. Since domestic debt had risen in the 1980s the deregulation of the interest rate increased the debt servicing burden. Thus, debt increased from 20.8% of the GDP in 1981 to 42.7% of GDP in 1988 and 43.9% of GDP in 1998 (Table 5) and interest on public domestic debt and defence spending consumed 70% of total revenues as debt

[10] Source: Pakistan Promoting Rural Growth and Poverty Reduction. The World Bank, 2007. Report No.39303-PK.

servicing on domestic debt rose from 3.5% of GDP in 1990/91 to 6.3% in 1997/98 (Table 6). This development forced the government to borrow externally which sharply increased the share of external debt in the 1990s. As a result, the overall growth in debt exceeded the nominal growth of GDP and by 2000 the overall public sector debt had exceeded 100% of GDP as against 52% in 1981 and 77% in 1988 (mostly domestic) and 105% in 2000 which is mostly external.

40. Although since 2001 the debt to GDP ratio has declined to around 57.9% in 2006/07, debt servicing from 11.7% of GDP in 1998/99 to 4.9% of GDP in 2006/07 (Table 6) and the debt servicing to total revenue ratio from approximately 50% in 1999/00 to 32% in 2007/08, space availability continues to be constrained by the growing needs of defence owing to the war on terror and the interest payments on a significant part of the stock of domestic debt contracted at rates that will keep the average interest rate on total debt high.

Table 5
Debt and Current Account Balance (as % of GDP)

	'81	**'88**	**'95**	**'96**	**'97**	**'98**	**'99**	**'00**	**'01**	**'02**	**'03**	**'04**	**'05**	**'06**	**'07**	**'08**
Domestic	20.8	42.7	42.4	42.0	43.3	43.9	46.8	49.6	41.1	38.6	38.0	35.1	33.1	30.5	29.8	31.2
External	31.2	34.4	41.7	43.9	46.9	55.4	54.9	53.5	49.0	45.0	39.5	34.3	31.3	28.2	27.0	29.0
Total	52.0	77.1	84.1	85.9	90.2	99.8	104.2	105.4	97.7	87.8	80.1	71.5	66.0	59.9	57.9	61.3
External Debt (% of exprt earrnings)	296	290	272	256	271	265	327	296	278	280	254	235	214	197	207	208
Current Account Deficit (as % of GDP)	3.7	4.4	4.1	7.2	6.2	3.1	4.1	1.6	0.7	+1.9	+4.9	+1.8	1.4	4.4	5.2	8.6

Source: State Bank of Pakistan, Annual Reports and Economic Survey, various issues.

Table 6
Debt Servicing (as % of GDP

	1980s	90-91	94-95	95-96	96-97	97-98	98-99	99-00	00-01	01-02	02-03	03-04	04-05	05-06	06-07	07-08
Domestic	2.4	3.5	4.1	4.4	4.5	6.3	6.0	5.5	4.5	4.3	3.4	2.9	2.7	2.7	3.3	4.2
Total	5.9	7.2	8.8	8.6	9.2	10.7	11.7	9.7	8.3	10.0	6.3	5.4	4.7	4.7	4.9	5.9

Source: Economic Survey 1987-88, 1996-97 and 2007-08.

1.5. Heavy Dependence on External Flows and Assistance

41. Pakistan's average annual GDP growth which was 6.8% in the 1960s, 4.8% in the 1970s and 6.5% in the 1980s, and higher than that of the other South Asian countries, was achieved through heavy and continued dependence on external resources (remittances and foreign assistance) without structural

weaknesses in industry and exports being addressed. Growth was driven by high aggregate domestic demand; remittances spurred private consumption while government expenditure provided impetus to public demand (financed through budget deficits and external flows). However, in the 1990s, remittances, which had provided the stimulus to the economy during the latter half of the 1970s and most of the 1980s (growing, dropped from around 7% of GDP in the 1980s to 3% in the first half of the 1990s and further to just over 2% of GDP in the latter half (giving an average annual rate of fall of 5.3% in the 1990s) (Table 7). Savings and investments also continued to be low (13.8% of GDP and 18.3% of GDP respectively), macro-economic imbalances persisted [11]. During this period inflation also began to rise (at 9.7% per annum as against the average of 7.2% in the 1980s) because of the fiscal deficit which was being monetized. There was also a sharp decline in the availability of external assistance that had played a key role in financing investment until the 1980s.During the latter half of the 1990s the scheme of Foreign Currency Deposits was introduced which were used by the government as a substitute for declining external assistance (see below). The rate of growth slowed down to an annual average of 4.6% between the 1985-95[12], although there were years of high growth followed by years of slow growth, with a high rate in the first 2 years or so of the government of Mr. Nawaz Sharif.

Table 7
Remittances (as % of GDP)

1980s	1991-95	1995-00	'00-01	'01-02	'02-03	'03-04	'04-05	'05-06	'06-07	'07-08
7.1	3.2	2	1.5	3.3	5.1	3.9	3.8	3.6	3.8	3.9

Source: State Bank of Pakistan, Annual Reports.

42. The 1990s were also characterized by frequent changes in government. The resulting political uncertainty, problems of law and order, political tension with India, the policy inconsistencies, if not reversals, in respect of external trade, the structure of import duties and their transparent and predictable application, income tax, GST and duty drawback systems, rules and regulations, etc. all adversely affected the climate for investment.

43. It is important to note that the dependence on foreign savings remained high and even when remittances were more than 7% of the GDP, Pakistan's dependence on foreign savings was still high, having reached around 5% of the GDP in 2006/07, the dependence having declined in the late 1990s and the first 2 years of the new century because of lack of availability of foreign assistance (Table 8). They financed more than 25% of investment. However, the primary reason why Pakistan did not run into serious difficulties in financing its external debt servicing obligations until the second half of the 1990s was because much of our debt is multilateral and bilateral and on concessional terms, with low rates of interest and long debt maturities. There

[11] An overall deficit of just under 7% of GDP and a CAD of 4.5% of GDP compared with 3.9% of GDP in the 1980s.
[12] Per capita income grew at only 1.2% per annum between 1985 and 1995, partly also because the population growth rate was 3%.

was no extensive borrowing from foreign commercial banks[13], although the composition was changing with more being borrowed at market rates from the mid 1990s with a first Eurobond issue in 1998/99. Despite this advantage, the ratio of external debt to GDP ratio rose from 31.2% of GDP in 1981 to 54.9% in 1998/99 and the ratio of debt to exports increased from 296% to 326.8% over the same period. As the profile of external liabilities worsened, the difficulties of finding the foreign exchange to service these became acute by the second half of the 1990s as the reserves became negligible.

Table 8
Foreign Savings (As % Of Gdp)

1980s	1990s	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
2.7	4.4	0.7	(1.9)	(3.8)	(1.3)	1.6	4.5	5.1	8.4

Source: Economic Survey 1996-97 and 2007-08.

44. The Current Account Deficit has been a major problem throughout our history, averaging 5% of the GDP over 1974-93 (higher than that in any other comparable developing country), 3.9% of GDP in the 1980s and 4.5% in the 1990s while rising to 7.2% in 1996. Thereafter, it declined gradually to 4.1% in 1998/99 and 0.7% of GDP in 2000/01 because external funding was not available to finance investment outlays which also fell, only to rise again to 5% of GDP in 2006/07 having becoming a surplus from 2001/02 to 2003/04 because of improved financial management, external debt rescheduling and liberal availability of grants from bilateral sources after 9/11 (see Table 5)- see more detailed post 2000 discussion in Section 1.8. Its financing has become an increasingly challenging task following the speedy increase in outflows to service requirements of foreign direct investments relating to royalties, dividends and profit repatriations at a time when the debt rescheduling period has also expired.

1.6. Industrial Strategy Based on Import Substitution and the Anti-Export Bias

45. The other weakness was the continued reliance for a long period on an industrial strategy based on import substitution. Under the policy of import substitution, that got additional fillip after the nationalization of the commanding heights of the economy in the early 1970s, the industrial sector was provided a high degree of protection. This period also marked the abandonment of the East Asian route to development that the country had espoused earlier and the adoption of the South Asian model of heavy protection to industry and public ownership of the leading sectors of the economy. The assumption of this approach contributed significantly to the slowing down of industrial growth throughout the 1980s. The GDP growth

[13] Until 2003, partly because they were unwilling to lend to Pakistan with its weak fundamentals. Also, Pakistan was able to roll over and restructure the Eurobonds of US$610 million on more favourable terms in December 1999.

remained steady, if not in some ways robust, during this period and the early part of the 1990s and was largely owing to agricultural growth resulting from an increase in the cropped area[14], liberalization of the import of pesticides and the wider distribution of the benefits of the Green Revolution, largely through the provision of improved seeds, the cotton or white revolution in agriculture and the strong growth in services.

46. An anti-export bias underlay the industrial policy. This operated through the import tariff policy (high foreign trade taxes[15]) disincentivising diversification of exports, especially investment in the value added sub-sectors of industry (as it increased the cost of imported intermediate inputs for processing exports). The overvalued exchange rate also played a key part in discouraging the development of a vibrant export sector (see discussion in Section 2). Moreover, the heavy taxation of rice and raw cotton exports discouraged export-oriented agriculture and lead to substantial investments in the yarn spinning industry (licences issued by government as patronage) which had negative value-added, and contributed to lopsided development in the textile sector.

47. Pakistan was unable to increase its export earnings because it was unable to diversify its exports or move into high value added items owing to the lack of adequate quantity, value and mix of skills and partly owing to the secular deterioration in the country's the terms of trade because of the low value added products being exported.

48. Moreover, as argued above, since government policy on taxation of raw cotton and industry was able to get cotton at well below world prices, combined with an overvaluation of the exchange rate and extra-ordinary incentives for the yarn spinning industry simple processing of domestic raw materials was favoured. As a result, the export industry produced goods for the lower end of the value chain, even in the cotton textiles sector, which contributes directly or indirectly more than 61% of Pakistan's total exports.

49. The strong and powerful textile associations were able to lobby for government support and for a long time were able to maintain the terms of trade in favour of industry at the expense of agriculture, particularly the cotton farmers. Thus, until the mid 1990s export taxes and the government's price policies kept cotton prices in Pakistan almost one-third below world levels, ensuring availability of a primary input to domestic processing industry at a low cost. These depressed prices effectively taxed farmers, reducing the incentive to produce and invest. This resulted in the development of a spinning industry that was essentially focused on the production of low quality (low count) yarn or apparel that concentrated on a narrow range of categories, whose share of world trade also remained stagnant.

[14] Which increased from 19.3 million hectares to 23.1 million hectares in 1997/98.

[15] Foreign trade taxation accounted for 37% of tax revenues in 1990/91 declining to only 30% in 1995/96 after the tariff reform; the average rate of import duty being as high as 35% in 1995/96.

50. Moreover, partly because of the difficulties encountered by the industry in getting fine/special cloth/accessories/dyes, etc. at world prices it is not clear if the textile sector has been able to modify itself adequately to compete in global markets after the liberalization of world trade in textiles and clothing with the end of the Multi-Fiber Agreement at the close of 2004. While Pakistan's share in world trade in clothing increased from 0.9% in 1990 to 1.3% in 2005 that of India grew from 2.3 to 3% and that of Bangladesh from 0.6% to 2.3% over the same period (Table 9). Since excessive incentives were built into the system for the producers at the low end of the value chain, it created problems for those at the higher ends of the value chain. Partly owing to the herd mentality and returns earned on exiting investments capital flows into sub-sectors of industry that have received encouragement in the past at the expense of the other sub-sectors.

Table 9

CLOTHING EXPORTS (AS % OF WORLD EXPORTS)

	1990	2000	2003	2004	2005
Pakistan	0.9	1.1	1.2	1.2	1.3
India	2.3	3.1	2.8	2.6	3.0
Bangladesh	0.6	2.0	2.1	2.2	2.3

Source: International Food Policy Research Institute (IFPRI), Pakistan's Cotton and Textile Economy, Research Report 158, 2008.

1.7. Institutional Capacity to Design and Implement Economic Policy

51. The country took a long time, as late as the early 1990s, to initiate the ethos of deregulation, liberalization and privatization. However, since this policy package was essentially driven by the Washington Consensus[16] the problems in implementing it were muted ownership[17] and lack of policy making and policy executing ability at the administrative and political levels. Weak institutional capacity to design economic strategies and polices resulted in greater reliance on development partners to provide related advice, while the lack of capability to implement policy and programmes effectively influenced the style of policy application, which proceeded in an unsophisticated and simplistic manner. In the past, economic supervision was carried out through administrative controls. But liberalization being difficult to manage requires more professional and deft handling. Given the lack of both commitment and competence, successive governments tried to superimpose the proposed modifications on the economic and industrial structures that had been inherited.

52. The lack of capacity and enthusiasm to implement reforms throughout the 1990s is illustrated by the following:

[16] Imposed by the World Bank, the IMF and the Asian Development Bank, who were the country's major donors and development partners.
[17] Essentially only that of the Nawaz Sharif government.

a) The liberalization of the capital account before the liberalization of the current account without thinking through its implications. As remittances declined and the current account deficit increased the government incentivized the opening of foreign currency accounts through hidden subsidies[18] in search of sources to finance the CA deficits. The artificially sustained additions to the foreign currency deposits[19] of 7% to 8% of GDP enabled financing high levels of CA deficit in the 1990s, which following the May 1998 nuclear tests were forcibly converted into rupees or long-term foreign currency bonds at low interest rates to avert a huge outflow of capital.

   Since inflation was high foreign currency deposits were used as a hedge. The government utilized the foreign currency to finance its Current account Deficit without having to pay the interest directly. The banks, most of whom were State owned, were provided rupees at a fixed exchange rate and hence the subsidy which was also passed on to borrowers, essentially industry.

b) The liberalization of the interest rate before the issue of the burgeoning budget deficit got tackled, resulting in the widening of the gap between government tax revenues and its expenditures.

c) The deregulation of industrial investment before trade liberalization was also a case of wrong sequencing. The result was that a major portion of the manufacturing sector continued to focus on the domestic market and thrived under the protection provided by what came to be known as the 'SRO Culture'. Resultantly, the growth of one domestic industry created the market for another. Growth was therefore neither influenced by nor predicated upon international comparative advantage. All kinds of industries with varying degrees of efficiency flourished. The crisis of the industrial structure today is an outcome of this piecemeal opening up of the trading sector followed by too rapid an adjustment when this sector was actually liberalized under the IMF programme of the late 1990s, not giving industry adequate time to adjust to this change.

d) The process of tariff reform to lower the level of protection available to industry was an issue that was addressed only half-heartedly. A major part of the industrial sector was able to lobby successfully for the retention of the regime of SROs to provide repeated bailouts and postpone the introduction of an incentive system that encouraged efficient producers who could compete internationally on the basis of comparative advantage and the strengths of their business model and practices. Through the arbitrary application of SROs some entrepreneurs managed to secure special deals on rates of import duties affecting the level playing field for those without appropriate access to decision makers. The extent of the reduction in protection

[18] B y taking the entire foreign exchange risk the SBP booked massive losses which increased the quasi fiscal deficit.

[19] The policy also encouraged "dollarization" because these deposits became a conduit for laundering tax evaded money since investments in such accounts were exempt from any scrutiny and tax.

until 1998 was well short of the reforms undertaken by countries such as Indonesia, Mexico, and Philippines with which Pakistan competes in world markets for labor-intensive products (Table 10). The tariffs were reduced rapidly thereafter and by 2007 the average rate was 14%.

Table 10
Trends in Simple Average Tariffs (%), 1985-99

Country	1985	1990	1995	1998	1999
Bangladesh				23.8	22.2
Brazil	51.0	32.2	11.1	14.6	13.6
Chile	20.0	15.0	11.0	11.0	10.0
China		40.3		16.8	
India		81.8	41.0	30.0	32.2
Indonesia	27.0	20.6		9.5	10.9
México	25.2	11.1	13.1	13.3	10.1
Pakistan	**77.0**	**64.8**	**50.7**	**46.5**	**20.4***
Philippines	27.6	27.8	20.0	10.7	10.1
South Africa		11.0	6.2	7.2	8.5
Taiwan, China	26.5	9.7	11.2		8.8
Thailand	41.2	39.8	23.1	20.1	17.1
European Union		8.7	6.8	6.0	5.6
Japan			6.3	5.5	5.2
United States		6.3	5.9	5.2	4.8
Average of all Developing Countries	27.2	23.2	16.1	13.1	11.3
Average Industrial Countries (23)		7.9	6.4	5.4	5.0

Source: Pakistan Development Policy Review: A New Dawn. The World Bank, 2002. Report No. 23916-PAK.

1.8. Reforms Scuttled by Fortuitous Events

53. For most of its history Pakistan has not experienced the kind of crisis that would force the elite structures to undertake fundamental reforms. It managed to receive liberal inflows of foreign assistance during the 1960s (the period of the Cold War), then form oil producers in the 1970s, then the Afghan war during most of the 1980s enabling it to postpone the need for basic reforms.

54. The only serious attempt at financial discipline and related reforms was prompted by the balance of payments crisis as a result of the economic sanctions and the cutting off of financial assistance by multilateral and bilateral donors following the nuclear blast in 1998. The nuclear tests had precipitated the weaknesses and enduring crises. The outcomes in terms of restoration of macroeconomic stability, reduction in inflation and correction/narrowing of the twin deficits were salutary.

55. The process of reform implementation was assisted by political continuity and economic policy consistency over an extended period. The Musharraf regime adopting the Washington Consensus pushed the agenda with vigour and determination without any serious opposition. In view of the nature of the crises and no sympathetic external support there was greater commitment to a more faithful implementation of an IMF stabilization programme.

56. The CAD narrowed to 1.6% of the GDP in 1999/00 and 0.7% in 2001/02, while the external debt to GDP ratio, partly owing to its rebasing, which peaked at 55% in 1998 declined to 45% in 2001/02. The fiscal deficit narrowed to around 4% of GDP in 2001-03 from 7.7% in 1997/98 and inflation fell from 7.8% to approximately 3.3% over the same period (Table 15).

57. Then came 9/11. Pakistan's debt was rescheduled under the December 2001 Paris Club Agreement, a development that was supplemented by simultaneous and synchronized funding by the IFIs. Unfortunately, however, the abundance in capital inflows and, for a variety of reasons, the sharp increase in remittances at a decisive juncture helped relax the fiscal and external financing constraints resulting in the abandonment of the hard decisions to carry out fundamental reforms and re-define priorities. For instance the CA turned from a surplus of 4.9% of GDP in 2002/03 to a deficit of 5.2% in 2006/07, peaking at 8.6% in 2007/08, although in the last year a key reason for the rapid deterioration was the abrupt increase in the international prices of oil and commodities made worse by the failure of the government to pass on to consumers the higher price of oil on a timely basis.

1.9. Impact of Growth and Government Policies on Poverty

58. Pakistan's experience suggests that periods of high growth, as in the 1960s, have also coincided with high levels of poverty while periods of slow growth (1970s) seem to be accompanied with low incidence of poverty, the reasons ranging from skewed asset distribution to specific government policies (see discussion in Appendix I).

59. During the 1970s, the average GDP growth fell to 4.8% from 6.8% in the 1960s while poverty head count declined fell from 47% to 31% of the population during 1969-1979. The reasons for such an outcome included remittances which had touched US$1.4 billion, almost 9.5% of the GDP, by 1978/79 (which stimulated demand for housing and goods like fans, air and water coolers, small electric motors, hand-pumps, water tanks, etc. produced by the small scale sector), larger volumes of public investment that created job opportunities for those with limited skills combined with laws that strengthened labour rights[20] especially following the state takeover of private enterprises and the shifting in the Terms of Trade in favour of agriculture with the large devaluation of the rupee. Therefore, despite a slowing down in the rate of economic growth, employment increased along with earnings of workers for the same level of effort. However, rural poverty continued to be higher than urban poverty largely owing to poor agricultural growth, 2.4%, as against the growth of 5.5% and 6.3% witnessed in manufacturing and services respectively.

60. GDP growth of 6.6% per annum in the 1980s was accompanied by a further decline in the proportion of the population below the poverty line, from 31% in 1979 to 17.32% in 1987-88. Rural poverty also declined as a result of

[20] Improvement in Minimum Wages introduced in 1969; Workers' Welfare Fund (1971); Fair Price Shops Ordinance (Factories Ordinance in 1971-72); Workers' Children's Education Ordinance (1972); Workers' Profit Participation Fund; Employees Old-Age Benefit (EOAB) introduced in 1976

remittances and the improvement in rate of growth of agriculture to 5.4% from an average of 2.4% in the 1970s, mainly as a result of good weather. The reduction in overall poverty is likely to have also been positively impacted upon by higher levels of private investment, to 16.8% of GDP compared with 15.5% in the 1970s, which would have spurred employment opportunities. However, for a variety of reasons the growth rate and the trend in poverty reduction could not be maintained, which principally include the decline in external aid at the end of the Afghan war. This led to a cutback in public investment and a diminution in employment opportunities, also because of public sector recruitment bans for almost 5 years, even for hiring personnel for delivering social services. The deteriorating conditions of growth and poverty were also adversely affected by frequent changes in government policies, a weakening in the bargaining position of trade unions since the 1980s (owing to the presence of military dictatorships) reflected in fewer worker stoppages bans on strikes of labour, growing casualization of job markets and increasing pro-employer attitude of governments. The proportion of population living below the increased from 17.3% in 1987-88 to 32.6% in 1998-99, partly owing to lower rates of growth.

61. The end of the 1990s suffered from an acute drought in 2000 which had negative spill-over effects on agriculture and consequently on farmer incomes. Overall poverty rose further to 34.5% in 2000-01 from 32.6% in 1998-99 while rural poverty increased from 34.8% in 1998-99 to 39.3% in 2000-01. Another factor was the continued skewness in land distribution; only 37% of rural households own land (of which 61% households own less than 5 acres and 2% own 50 acres or more) giving a Gini coefficient of land ownership of 0.66 (and if rural landless households are included, the Gini coefficient is 0.86)[21]. Since there is clustering around the poverty line, especially in rural areas, small movements in the growth rate can influence poverty levels significantly, say because of a good harvest owing to favourable weather conditions.

62. Post-2001 both rural and urban poverty declined primarily because of higher growth in general and agricultural growth in particular. During this period remittances also rose as did development expenditure, rising from 3.8% of GDP in 2001-02 to 5.7% in 2006-07. During this period the 'Khushhal Pakistan Programme' benefited almost 3.2 million households while there was also rapid growth in manufacturing, trade and services.

63. The nature of growth since 2001/02 has sharply widened regional inequalities and the disparities in incomes and assets between the rich and the poor, which has been reinforced by the entrenched elite structures. This, combined with growing poverty from 3 years of high inflation, is damaging social harmony. While poverty did decline and there was an increase in real wages of both unskilled and skilled workers, there was a widening of income inequalities. It is neither desirable nor feasible to separate economic growth from distributional outcomes since they are inextricably linked through employment growth, employment being the primary medium for distribution of growth. Future employment growth without a re-orienting of the growth strategy and re-prioritization of government spending will generate demand

[21] Pakistan; Promoting Rural Growth and Poverty Reduction, The World Bank, 2007. Report No.39303-Pk

for more skilled labour. In an international environment that has become vulnerable, there is a need to create domestic demand by developing strategies and instruments for either creating additional jobs for the relatively less skilled or by providing social protection which could in turn feed into growth through the consumption route.

64. This review of Pakistan's growth experience highlights the factors that need to be addressed collectively or partially if they are not to serve as binding constraints to the development and implementation of a strategy that will ensure the movement of the economy onto a higher broad-based but sustainable and stable growth path.

Chapter 2: Sustainable Growth Rates and Resource and Employment Gaps

2.1. Pakistan's Resource Gap and Employment Gap: Comparing Sustainable Growth Rates to Full-Employment Growth Rates

65. Despite a respectable GDP growth rate over the last 30 years, there is little doubt that Pakistan's growth potential has been constrained by a low savings rate. To a large extent Pakistan has been able to achieve this reasonable growth rate because foreign flows have played a significant role in increasing the resources available to the economy. However, an important question that must be analyzed is what would be the sustainable level of foreign flows because, as seen in the past, if the growth rate requires higher than the sustainable level of foreign flows inevitably results in a balance of payments crises. A second, and equally important, question is the rate of growth required in order to simply maintain existing levels of employment in the face of a rapidly growing labor force in Pakistan (i.e. without an increasing level of unemployment). This section attempts to look at the resource gap that arises after factoring in sustainable foreign inflows and the growth rate required without changing existing levels of employment.

66. As a first step, we need to estimate the availability of resources in the economy, defined as the sum of sustainable levels of national savings and current account balance. Simple averages have been employed to determine sustainability as both these variables do not exhibit a statistically significant time trend[22]. Compared with the twenty year national saving average of 15.55%, the ten year national saving average equals 16.86%, while compared with the ten year current account balance average of -1.27%, the twenty year current account balance average equals -3.06%. Consequently, available resources are calculated by summing the 10 year average savings rate with the 20 year average current account deficit (both excluding 2007-2008), which equals 19.92% of GDP. This number at the minimum presents an optimistic scenario.

67. The next issue is the level of investment required to maintain a certain GDP growth rate as well as the growth in employment associated with this GDP growth rate. To estimate the investment required we need to have a number for the likely ICOR. The ICOR for the last 20 years in Pakistan was found to be approximately 3.65. Compared to international estimates, this number seems like an underestimate, so a more pessimistic but realistic analysis employing an ICOR value of 4 has also been undertaken. Further, an average employment elasticity of 0.465[23] was used to calculate changes in employment associated with different growth rates.

68. The key analysis is shown in Tables 11 and 12, which present different GDP growth rate targets, the investment rates required to achieve these targeted

[22] National saving: t-statistic(p value) → 2.05(0.056), Current Account Balance: t-statsitic(p value) → 0.93(0.362)

[23] Economic Survey (various issues)

growth rates and the increased investment generated by the growth targets (Please refer to Appendix II for a detail of these tables):

Table 11

Resource and Employment Gaps for Various Targeted Growth Rates*

	% of GDP	% of GDP	% of GDP	annual %	annual %	annual %
GDP Growth Rate	Available Resources	Investment Requirement	Resource Gap	Change in Labor force	Change in Employment	Employment Gap
5.0	19.92	18.25	1.67	2.95	2.33	-0.63
5.457	19.92	19.92	0.00	2.95	2.54	-0.41
6.0	19.92	21.90	-1.98	2.95	2.79	-0.16
6.35	19.92	23.18	-3.26	2.95	2.95	0.00
7.0	19.92	25.55	-5.63	2.95	3.26	0.31
8.0	19.92	29.20	-9.28	2.95	3.72	0.77
9.0	19.92	32.85	-12.93	2.95	4.19	1.24

Table 12

Resource And Employment Gaps for Various Targeted Growth Rates*

	% of GDP	% of GDP	% of GDP	annual %	annual %	annual %
GDP Growth Rate	Available Resources	Investment Requirement	Resource Gap	Change in Labor force	Change in Employment	Employment Gap
4.5	19.92	18	1.92	2.95	2.09	-0.86
4.98	19.92	19.92	0.00	2.95	2.32	-0.63
5.0	19.92	20	-0.08	2.95	2.33	-0.63
6.0	19.92	24.00	-4.08	2.95	2.79	-0.16
6.35	19.92	25.40	-5.48	2.95	2.95	0.00
7.0	19.92	28.00	-8.08	2.95	3.26	0.31
8.0	19.92	32.00	-12.08	2.95	3.72	0.77
9.0	19.92	36.00	-16.08	2.95	4.19	1.24

69. The first column of Tables 11 and 12 shows the targeted growth rate. The second column shows the long-term sustainable resources available in the economy while the third shows the degree of investment required. Table 11 reflects an optimistic view with an ICOR of 3.65 while table I-B illustrates a somewhat pessimistic view with an ICOR of 4. The fourth column (defined as the difference between available resources and required investment) shows the 'resource gap' or the gap between sustainable, available resources and the level of investment required to achieve the targeted growth rate. As the numbers show, with the present level of national savings and sustainable current account deficit, Pakistan can achieve a growth rate of approximately 5.45% (4.98%). But in order to achieve a 6% growth rate, Pakistan would

face a 1.98% (4.08%) resource gap, which increases to 8% for a 7% growth rate and 12% for an 8% growth rate.

70. The fifth column of the table shows the average annual increase in the labor force, which realistically is an underestimate because of the demographic transition occurring in Pakistan (and is likely to be in excess of 3%). The sixth column shows the increase in employment generated with the targeted GDP growth rate (assuming an employment elasticity of 0.465). The last column shows the employment gap that will be experienced at each level of targeted GDP growth: Thus any GDP growth rate less than 6.35% will lead to an increase in unemployment in the economy and possible increases in poverty.

71. Finally, Tables 11 and 12 show a fascinating imbalance that exists in the Pakistani economy: If one was to look at long term sustainable growth of 5.45%(4.98%) - (which also appears to be in line with Pakistan's average growth rate of 5.05% over the past twenty years) with the present levels of savings, there would be persistent increase of 0.63 % per year in unemployment and accompanying increases in poverty. But if our objective were to keep employment at its current level i.e. no increase in unemployment, then the economy would be facing a 3.26%(5.48%) resource gap per year which being unsustainable would sooner or later result in a balance of payments crises.

Chapter 3: Savings and Investment

3.1. Gap between Domestic Savings and Investments

72. Maintaining high growth rates on a sustainable basis requires a combination of high levels of national savings and investments and noteworthy growth in productivity. Pakistan has had low rates of investment (although underestimated[24]), largely owing to low levels domestic savings needed to finance this investment. This rate of investment compares poorly with those of other Asian countries like China, India, Indonesia and Thailand who are all able to finance their investments from much more robust domestic savings. Pakistan's rate of investment has fluctuated between 16% and 17 % of GDP for most of its history which, given the Incremental Capital Output Ratios (ICORs) of 4 in the case of other countries in the region (with a Total Factor Productivity growth in excess of 1.5 compared with Pakistan's 1[25]), appears to be low for even maintaining a growth rate of around 6% let alone pushing the economy onto to a higher growth path[26].

Table 13
Investment and Savings Rates (as % of GDP) 2007

	Pakistan	India	China	Indonesia	Malaysia	Philippines	Thailand
Investment	23.0	38.2	44.4[1]	24.9	23.1	15.0	29.9
Domestic Savings	16.0	35.1	52.3[1]	28.9	37.1	10.4	33.4
National Savings	17.8	37.2	53.8[1]	26.1	36.2	29.5	32.0

*For China the figures are for 2006. Source: Key Indicators for Asia and the Pacific 2008, Asian Development Bank. For Pakistan: Economic Survey of Pakistan (07-08);
For India:<http://knol.google.com/k/alexander-emilfaro/government-spending-and-tax-revenue-ZZZas/kpxsjkpzgwux/8#>

73. Moreover, the gap between the rates of investment and national savings which narrowed from 4.7 percentage points of GDP in the 1990s to around 2 percentage points of the GDP between 2000 and 2006 is beginning to grow (see Tables 13 and 14). This gap is met by inflows and borrowings from abroad, with more than 20% of investments being financed by foreign savings, highlighting the shaky foundations on which economic growth rests.

[24] Domestic savings are derived by subtracting the contribution of foreign savings to investment and since we know that the estimated domestic savings are understated (for reasons explained later below) it means that investment levels and rates must be underestimated.
[25] Shantanayan Devarajan and Ijaz Nabi, Economic Growth in South Asia: Promising, Un-equalizing, Sustainable?, World Bank (2006).
[26] In view of the huge investments that will be required in infrastructure connected with energy, roads, rail transportation, ports, irrigation storages and networks, etc., (which invariably have longer gestation periods) to reduce the private sector's cost of doing business and remain competitive, the ICOR will need to be closer to 4. As it is even at historical rates of ICORs resources are inadequate to maintain a growth rate of 6%.

Table 14
Share In Investment (%)

	1970s	1980s	1990s	2005-06	2006-07	2007-08
National Savings	67.5	79.1	74.2	82.3	77.7	64.5
Foreign Savings	32.5	20.9	25.8	17.7	22.3	35.5

Source: Economic Survey of Pakistan (07-08)

74. Not only is such a route unsustainable, it also reduces the margin of error in project selection.

3.2. Domestic Savings

3.2.1. INTRODUCTION

75. According to Rodrik (2005) the causality between savings rates and economic growth is not clear. He argues that while growth in income impacts savings rates positively on a permanent basis higher savings rates only raise GDP provisionally and in the interim. However, savings drive investment and investments generate their own savings. To this end, domestic savings are critical for financing investment since foreign capital can only supplement or complement them- FDI follows a boom and does not create it. And Pakistan has a low rate of domestic savings[27].

3.2.2. LEVELS AND COMPOSITION OF DOMESTIC SAVINGS

76. Pakistan's domestic savings rate (estimated by subtracting foreign savings from investment), while understated (for reasons see below), is low in comparison with that of India and countries with roughly similar GDP per capita levels. (Table 13), although the level of national savings is more respectable, averaging 14.3% of GDP between 1990 and 2000 (also see Appendix I) [28], largely because of net factor incomes and current transfers from abroad in the form of remittances which constitute a much larger fraction of national savings than in the corresponding countries. That this average rose to 17.8% between 2000 and 2007 was again primarily as a result of the sharp increase in capital inflows and remittances after 9/11[29]. The share of net incomes and current transfers from abroad increased from a negative 1.3% of GDP in 2000/01 to a positive 2.2% till 2008.

[27] Domestic savings refer to savings of government, the corporate sector and resident households, while national savings include net factor incomes current transfers/remittances from abroad by overseas migrants. The bulk of this report focuses on the importance of domestic savings, while recognizing the continuing and important role of remittances in providing resources for financing domestic investments.
[28] With the domestic savings rate falling from 16.6% of GDP between 2000 and 2007 to 11% in 2008.
[29] Reasons include debt rescheduling and large inflows of remittances through official channels following the greater scrutiny of funds invested or held abroad by Muslim sounding names. Moreover, the Pakistani diasporas which had done well during the longest spell of economic growth and prosperity that the world had experienced was able to remit fairly large amounts to Pakistan in search of lucrative investment opportunities- which explains the US$5 billion per year of remittances being received in recent years (more than 40% of which were from the US and Europe as opposed to the 80% received from the Middle East and the Gulf in the 1980s).

77. Domestic savings comprise savings of households, retained earnings of the corporate sector and government net savings – revenues greater than recurrent expenditures. Within domestic savings the share of public savings is about 10%, which contributed 1.5% of GDP during 1990 and 2000, with its share rising to beyond 18% during 2004 to 2006. Private savings, which over the same period contributed 90% of national savings, were just 14% of GDP in 2005.

Table 15
Investment and Savings (as % of GDP)

	1990s	2000	2001	2002	2003	2004	2005	2006	2007	2008P
Gross Total Investment	18.8	17.4	17.2	16.6	16.8	16.6	19.1	22.1	22.9	21.6
Changes in Stocks	1.7	1.4	1.4	1.3	1.7	1.6	1.6	1.6	1.6	1.6
Gross Fixed Investment	17.1	16.0	15.8	15.3	15.1	15.0	17.5	20.5	21.3	20.0
(a)Public Sector	7.8	5.8	5.7	4.1	3.9	4.0	4.3	4.8	5.7	5.7
(b)Private Sector	9.3	10.4	10.2	11.1	11.2	10.9	13.1	15.7	15.6	14.2
Net External Resource Inflow	4.6	1.6	0.7	-1.8	-3.8	-1.3	1.6	4.4	5.1	8.3
National Savings	14.1	15.8	16.5	18.4	20.6	17.9	17.5	17.7	17.8	13.3
(a)Public Savings	1.9	-0.1	1.6	1.7	1.6	4.8	3.4	2.3	0.8	-1.0
(i) General Government	-0.4	-0.9	-0.1	0.2	0.0	2.9	1.6	1.6	0.3	-1.4
(ii) Others	2.3	0.8	1.7	1.4	1.6	1.8	1.8	0.7	0.5	0.4
(b)Private Savings	12.3	15.9	14.9	16.8	19.0	13.2	14.1	15.4	17.0	14.3
Net Factor Income	0.2	-1.3	-1.3	0.5	3.1	2.2	2.1	2.0	1.8	2.2
Domestic Savings	14.1	17.1	17.8	17.9	17.4	15.7	15.4	15.7	16.0	11.0

Source: State Bank Annual Report, various issues.

78. The contribution of both government and corporate savings is low. Government savings (other than public sector corporations which averaged less than 0.5% of GDP between 2000 and 2008) are currently negative.

79. According to the State Bank corporate savings are less than 10% of private savings and averaged 1.4% of GDP in between 1990 and 2005 and 1.8% of GDP thereafter (see Appendix III). In contrast, in Thailand during 1970s and 1980s corporate savings were 45% of total private savings and on average 8.5% of GDP rising to 60% of total private savings and 13% of GDP in the 1990s. In Philippines corporate savings were15%-20% of GDP in the 1990s and in Malaysia they were 50% of total private savings.

80. According to the State Bank, the component of household savings (this share being derived as a residual) averaged 10.9% of GDP from 1981 to 2005 rising to 14% between 2000 and 2008 (Appendix III).

3.3. Reasons for Low Savings Rate

3.3.1. Government Savings

81. The primary reason for the low rate of government savings is that Pakistan's tax to GDP ratio (which determines the fiscal space) is barely 10% compared with close to 18% in the case of India, China 18.3%, Indonesia 12.4%, Malaysia 14.8% and Thailand 15.3% (Table 16) and in excess of 32% in the case of OECD countries.

Table 16
Tax Revenue (as % of GDP) 2007

Pakistan	India	China	Indonesia	Malaysia	Philippines	Thailand
10.2	17.7[1]	18.3	12.4	14.8	14.0	15.3[1]

[1] For 2003.
Source: Key Indicators for Asia and the Pacific 2008, Asian Development Bank; for Pakistan: Economic Survey of Pakistan (07-08); for India: <http://knol.google.com/k/alexander-emilfaro/government-spending-and-tax-revenue-as/kpxsjkpzgwux/8#>

82. The main reasons for this low ratio are a) the inelasticity of the tax structure; b) the horizontal inequity of the tax system in that it either does not extend to certain sectors like wholesale and retail for GST and agriculture for income tax, gives preferential treatment to some sectors or activities like some sub-sectors under services for GST and real estate and trading in equities for capital gains and taxes partnerships[30] and the rich lightly; and c) that the administrative system is characterized, for a variety of reasons, by poor collection efficiency.

83. The income tax to GDP ratio is a mere 2.5% which when adjusted for corporate income tax, reveals a personal income tax to GDP collection of

[30] Small companies and partnerships are taxed at only 20% disincentivizing the development of a corporate sector.

perhaps less than 1%. Moreover, tax and economic policies are also speculator friendly. By taxing investments and transactions in speculative activities like the stock/equity market and real estate lightly, the structure disincentivizes investment in productive activities like manufacturing, which cannot surely be the objective of any rational tax policy.

84. To improve public savings the country needs to generate a large revenue surplus (say by broadening the tax base through a phased elimination of exemptions, enlarging the application of GST, containing recurrent expenditures, etc.) and dramatically raise resources from other earnings, say through a more efficient system of user charges for public services and dividends from its holdings in state owned enterprises (the latter will decline with the privatization/dilution of the government holding in public sector enterprises like PTCL, PSO, OGDC, PPL, etc.). The short-term constraints for achieving such an outcome are the present domestic and international environment characterized by economic stagnation, a contracting manufacturing sector (a major contributor of government tax revenues) and declining prices of imported commodities.

3.3.2. Corporate Savings

85. The low estimate of the rate of corporate savings is because of the small size of the corporate sector[31], the inadequacy of the information gathering systems and the faulty computation methodology that tends to under-estimate corporate savings, since it only covers listed companies and not the private, non-listed corporate and SME sectors. And surveys suggest that 13.6% of new investments of SMEs are financed by informal sources, family or friends, roughly 2.8% of GDP. Only Indonesia and Cambodia use more of the informal sources for financing investments (Vincellete, 2006).

86. The government could incentivize savings by the corporate sector through a tax reduction for retention of earnings.

3.3.3. Household Savings

87. Although it is not quite clear if household savings are overall low, they are a function of income levels (real income per capita), growth in GDP, demographics (the high dependency ratio - almost 43% of the population is below 14 years of age- and share of working age population), cultural habits and behaviour[32], the existence of social protection/insurance schemes and the wealth effect of the investments in existing assets. Moreover, other than savings through the informal institution of "Committees" (see below) a major portion of household savings are in the form of gold and silver[33], rather than in the form of financial savings[34]. This is partially because of low real returns on bank deposits, especially in recent years, which has discouraged savings (see Table 15 and 17) and incentivised consumerism instead. The latter was

[31] It is also not quite clear if the retained earnings of the corporate sector are a small percentage of their incomes/profits.
[32] It is generally accepted that the Pakistani middle and upper income groups tend to have more ostentatious lifestyles.
[33] According to the Gold World Council Pakistan is among the top 10 consumers of gold
[34] To illustrate, bank deposits in Pakistan are only 40% of GDP, whereas in China they are 190% and while there are 192 deposits per 1000 persons in Pakistan, in Malaysia the corresponding number is1,250 (Vincellete, 2006). And this

further encouraged by better access to consumer finance in recent years. According to State Bank date household savings as a percentage of GDP increased from 14% in 2000 to 16.8% in 2003, a period which coincided with positive real interest rates (Table 17), only to decline again to and around 13% thereafter with real interest rates becoming negative.

Table 17
Inflation and one Year Deposit Rates

	'95	'96	'97	'98	'99	'00	'01	'02	'03	'04	'05	'06	'07
CPI[1] (% growth)	13.0	10.8	11.8	7.8	5.7	3.6	4.4	3.5	3.1	4.6	9.3	7.9	7.8
Interest rate on time deposits of 1 year[2]	10.9	11.6	11.8	12.1	9.8	8.6	8.9	6.2	2.7	2.8	5.8	6.0	6.8

[1]Source: Economic Survey of Pakistan (07-08)
[2]Source: Key Indicators for Asia and the Pacific 2008, ADB

88. Household surveys suggest that while 56% of the total adult population saves and/or invests either formally or informally of which 39% save regularly only 12% do so with banks[35]. The top four modes of saving are informal in nature of which close to a quarter are through "Committees"[36]. Furthermore, net income and transfers from abroad-remittances of overseas migrant Pakistanis- account for a large proportion of Pakistan's national savings.

89. Remittances, as already argued above have since the second half of the 1970s been critical in keeping the level of national savings elevated, as is apparent from Table 7, their contribution being as high as 7.1% of GDP in the 1980s, their share falling to 2.6% of GDP in the 1990s, rising again to just under 4% of GDP since 2001/02. While the bulk of the remittances finance household consumption, household surveys show that 12% of remittances are saved in financial and non-financial assets.

90. Furthermore, the responsiveness of Pakistan's domestic savings rate to changes in GDP growth per capita is low; the elasticity is only 0.06 percentage points, smaller than in other fast growing economies with similar levels of income. Vincellete (2006) estimates that a 1 percentage increase in the share of urban population leads to a 0.79 percentage point increase in private savings in GDP and 2.75 percentage increase in domestic savings, partly also because of better access to savings instruments in urban areas than in rural areas where savings tend to be in non-formal financial instruments.

[35] According to the Survey results (see footnote below) 41% reported that they did not have enough money and 41% said that they never felt the need to have one. Eighty one percent of those having a bank account maintained one to save or for reasons of safe keeping.
[36] Pakistan: Access to Finance Survey, 2008, sponsored by DFID and supervised by the World Bank

3.4. Recommendations for enhancing household savings

91. Theory suggests that through real rates of return and secure and easy to use vehicles, savings can be increased substantially. Hence, to enhance household savings other than through economic growth we recommend the need for a) greater financial intermediation; b) ensuring real returns on financial savings; c) in the range and quality of credible financial instruments in capital markets for investing savings to incentivize a shift in the investment portfolio of their savings; d) development of long-term saving vehicles like pension schemes and life insurance; and e) examining the possibility of new instruments like Housing Societies and Credit Unions (as in the UK and the US), portable savings (as in Japan) and introducing mandatory savings schemes and instruments-compulsory pension schemes, as in Singapore and Malaysia.

92. We, therefore, recommend that the government consider raising the interest rates on individual investments in instruments on offer under the National Savings Schemes[37], ensuring that they are in real terms positive and sufficiently attractive. In the absence of a robust and nationally broad-based social protection and welfare system higher after tax returns can be given to pensioners and small savers, as is already being done. In our opinion, such an arrangement will not necessarily result in the switching of bank deposits into savings in NSS instruments, suggesting that there will be no net addition in financial savings. Moreover, private financial institutions, especially commercial banks, will be forced to compete for funds by providing higher and positive real returns to depositors as against the negative real returns being received by them currently. However, the weakness in adopting this route is the poor outreach of NSS[38] and the weak management systems and procedures to tap savings. A fair amount of effort is required to strengthen the NSS system to widen its access and make it user-friendly.

93. Another possibility to generate savings that could be exploited is that offered by technology in the form of “mobile phone banking”, as such a vehicle would improve access and outreach substantially, considering more than 60% of the adult population has access to a mobile phone[39].

[37] Disallowing the corporate sector and provident and pension funds from investing in such instruments.
[38] According to the Access to Finance Survey, only 1% of the population saves in NSS instruments.
[39] Access to Finance Survey, op.cit.

Chapter 4: Addressing the BOP Constraint and Enhancing Competitiveness

4.1. Introduction

94. As discussed in Section 1, a major factor that has influenced the pattern of Pakistan's economic growth and historically constrained its potential has been the competitiveness of the heavily protected industrial sector and the large current account deficit and issues pertaining to its financing. To address these issues requires continuous and sustainable improvements in total factor productivity and a variety of policy, procedural, institutional, regulatory and legal reforms to ease the BOP constraint and enhance the competitiveness and efficiency of the economy.

95. These would include cross-cutting interventions like regular adjustment in the exchange rate by only factoring in long-term capital inflows that are sustainable in nature, expanding trade in the region-especially with India, trade facilitation measures, infrastructural investments to promote trade and economic activities in general, reducing the cost of doing business and development of skills to support upgrading of industry to enable it to export value-added products.

96. Unfortunately however, Pakistan's experience with improvements in total factor productivity has not been encouraging. Appendix IV shows that for the economy as a whole, total factor productivity has been increasing at an average rate of 1.1 percent a year[40], with almost three quarters of GDP growth being explained by increases in labour and capital stock. The results highlight that productivity growth in Pakistan, at both the sectoral as well as the aggregate level, while not being sustained, has been slow and that growth has been driven by inputs rather than by productivity.

4.2. Skill Development

4.2.1. INTRODUCTION

97. Until the mid 1990s, the private sector had neglected the skill gap, because production technology tended to be rather simple, industry being heavily protected from both internal and external competition. However, with the opening up of the economy, more complicated technology has been introduced in the production process. The induction of modern technology is rapidly altering the nature of the skills requirement. With the production structures slowly moving out of the intermediate to the higher range of value added products, there is greater demand for both standardized and higher level skills. There is therefore a need to provide skills required by the emerging industrial and services sectors.

98. Keeping in view current demographics and the dynamics of migration to Pakistan and abroad, achieving sustained poverty reduction would require a coherent, robust and durable development strategy that is anchored in the

[40] At 2.4% per year for the manufacturing sector.

enhancement of the productivity of existing assets. The most important of these assets is the relatively young labour force, which will continue to grow at more than 3% per annum in the foreseeable future. Such a focus will enable the country to also reap the considerable potential of the demographic dividend.

4.2.2. Weaknesses of Institutional Arrangements for Skill Development

99. The technical and vocational training institutions managed by the Federal and provincial governments have not escaped the general malaise afflicting educational institutions. They are poorly resourced, ill-managed and misdirected. By internationally accepted standards, efficiency is low; the student teacher ratio ranges between 11 to 13 compared with 15 to 25 in other similarly placed countries. The limitation of resources and their improper deployment directly affects the quality of the training available at these institutions. Moreover, these institutions are not focused on the training of the workforce in the agriculture and livestock sectors, the main drivers of the local economy.

100. The limited funds for consumables, research and other operational support, paucity of instructional aids, obsolete and insufficient equipment, outdated curriculum (largely because it is not demand-driven), poor quality instruction, lack of uniformity in standards and a weak pay structure have all contributed to the inability of these institutions to equip themselves with sound trainers. Salaries, increments and promotions are tied to civil service pay scales. There is limited incentive to improve performance since Higher levels of performance are not adequately rewarded.. Since conditions of service do not attract qualified trainers, courses that are most in demand suffer from severe staff shortages.

101. Moreover, there is limited interaction between the employers and these institutions in the design and content of syllabi resulting in the poor mismatch between the demand and supply of trained labour. Linkages with industry are rudimentary in nature. The system and the employers, who are ostensibly served by the system, operate largely in disregard of each other, despite sporadic efforts by the government to enhance the role of the private sector in technical and vocational training. Moreover, as industry merely criticizes the performance of these institutions, the potential for a healthy interchange is also lost. Students and institutions, therefore, do not benefit from the inputs that could be provided by industry on current technology and practice.

4.2.3. RECOMMENDATIONS FOR SKILL DEVELOPMENT

4.2.3.1. Introduction

102. To improve the productivity of the young labour force, we recommend skill development initiatives through public private partnerships, instead of expanding the operations of the public sector technical and vocational training institutes and skill development centres with training courses that the market

considers inadequate. To this end, we propose a two pronged approach to improve the employment capability of the potential target age group that comprises both those with limited educational qualifications and those having completed at least secondary level mainstream education. Our approach can be summarized into the modality of the intervention, the skills to be provided and the manner of ensuring quality.

4.2.3.2. Modality

103. Two possible instruments could be used to assess their individual efficiencies and efficacies in achieving the objectives of the intervention before opting for either or a combination of these skill enhancement channels. The first could be a supply side intervention in the shape of technical training grants to institutions (managed by either the public or the private sectors) that meet eligibility criteria for such support while the second could be a demand side intervention in the form of training vouchers to those seeking technical training in disciplines of their choice.

104. Organizations claiming capability to impart the different skills should be able to access funding through a transparent and competitive bidding process for the skills approved by the body administering the fund, provided that they have satisfied pre-qualification criteria for eligibility.

105. The range of criteria for evaluating applicants for training grants from the Fund would include the experience and expertise of the faculty in related disciplines, the training content, the material and books, the method of delivery (including capability to conduct training through Mobile Training Facilities), class size and duration and design of practical work, twinning arrangements with international bodies on training content and standard setting.

4.2.3.3. Type of skills

106. An average labourer is generally poorly educated with limited or no skills to get gainful employment. The unskilled landless, casual workers can be assisted by teaching them decent quality basic skills. Therefore, for the unskilled and those with up to elementary level education received in the schooling system providing education of at best indifferent quality we propose we propose simpler, practical skills like driving, masonry, carpentry, catering, repairs of agricultural implements, animal husbandry and related extension work as well as Traditional Birth Attendant, Lady Health Worker and Teacher training for women. We also recommend partnerships with stakeholders in the private sector like the Association of Builders, the Farmers Associations, the associations of Doctors and private school operators, etc., as well the departments of Agriculture, Livestock and Health for approving the training course content, joint designing of the curriculum and the setting of standards to reflect the market demand. Such collaborations would also prove fruitful for the direct certification of the quality of training or for mandating any other authority/agency deemed as credible for the purposes of certification.

107. For the skill development of those with secondary level schooling and above, a wider variety of well-structured and effective technical and vocational training could be on offer. Since the whole range of skills to be instilled in those with such an educational background would be driven by market demand, they would vary over time with the development of the economy and its technological base. However, to ensure demand driven training, the skills communicated should have market relevance to match market opportunities and needs.

108. In this digital age IT services could be a valuable source of economic development and as a provider of employment opportunities, especially for the educated females, who are more socially and physically immobile labour force. We, therefore, also advise that the Government support the potential of IT given a variety of factors that advocate e the adoption of this sector as a dynamic and sustainable source of growth for the less skilled and less capital intensive sub-sectors of IT services; especially with the declining costs of telecommunications as a result of the rapid development in related technologies. There is a huge potential for providing BPO services[41] like customer support (e.g. help lines and reservations), technical support facilities, telemarketing, accounting services, medical prescription entries, processing of insurance claims, processing of mortgage applications, etc[42].

109. In our view, the investments and the potential available in IT can be exploited even in the medium-term if the government continues to support and fund a) the setting up of clusters of technology parks with air-conditioned office space, access to high speed internet broad band connectivity (with a backup plan for bandwith), extended fiber links, central conferencing facilities, ready connectivity via high-speed communication links and LAN integrated with the international gateway at low rates and by permitting full duplex VSAT satellite back up for call centres; b) incentive programmes in HR development , for instance by setting up training centers (through public private partnerships) for developing communication skills and speaking English in UK and American accents; c) company certifications for international audiences; and d) information enabled service delivery within the departments of government to facilitate the accelerated development of IT skills.

4.2.3.4. Certification of Quality of Skills Developed

110. To ensure that the training is of the level and quality demanded by the private sector (especially those engaged in the exports of services and manufactured goods) we strongly recommend the adoption of a system for international certification of these skills. In a globalized world only those skills will have market value, and are likely to be sought by the private sector, that have been

[41] A typical 20 seat call centre with telephony-based equipment using Voice over Internet Protocol technology with router switching, Linux based servers and email and live web based chat voice facilities can be set up for US$75,000 to cover both the capital investment and working capital requirements, with a payback period of under 4 years-given a 5 year tax holiday.

[42] In our view, despite the political compulsion to protect jobs in the west we do not foresee any major reversal in the ongoing rather deep process (which operates at different levels and in complex ways) of outsourcing to offshore locations non-core, routine activities, segments of production processes or even research or development of new products by companies to remain competitive, since reversal would add to costs in times that require cost cutting. In an increasingly globalized world the flow of work and jobs will be driven by market forces.

certified by an internationally recognized organization. Only a credible certification system will have acceptance, ensuring quality and relevance of training, especially if it meets selected international certification standards. Such an approach will provide employability to graduates in line with emerging market needs, and strengthen their capability to earn a higher and steady stream of earnings in markets in Pakistan or abroad.

4.3. Cost of Doing Business

4.3.1 INTRODUCTION

111. The bulk of the issues affecting the climate for investment and cost of doing business arise from requirements to comply with a wide range of government rules and regulations and other factors within the control of the Federal Government and its agencies (for example taxation related matters, availability. and cost of utilities and reliability of supply, access to credit, security and political stability, policy predictability, legal certainty, labor legislation), some of which are beyond the scope of this report. The role of the provincial governments in affecting the cost of doing business relates to the provision of infrastructure, building and zoning regulations, property titling, transfer and registration systems, some labour related laws and regulations and implementation of labour legislation.

112. Private sector planning requires a medium to long term horizon in order to ensure sustainable long term returns. The private sector cannot be expected to take a long-term view while formulating its investment plans when the government, for its own seemingly understandable reasons, takes a short-term view. The private sector generally takes the lead from the government and adjusts the time horizon of the payback period of its investments to bring them in consonance with the signals emanating from government. Any investment in an asset other than financial is irreversible, as it cannot be undone. When an investment decision cannot be reversed, the opportunity cost of investment is the cost of “waiting”. In Pakistan, this cost has risen with the uncertainty and unpredictability of government policies.

113. Policy unpredictability adds to uncertainty and enhances the risk of investment. This reduces the planning horizon of entrepreneurs, which, like any other distortion in the markets, induces non-optimal allocation of resources. Innovation and entrepreneurial risk-taking are discouraged by such distortions.

114. Pakistan’s existing policy formulation system, and the mechanisms, institutional arrangements and capacity for implementation are major causes for the gulf between the objective of the legislation and policy and its practice. Poor implementation, retention of a wide range of discretionary powers that facilitate rent extraction through either selective or delayed policy implementation all raise the cost of doing business. Moreover, implementation related issues exacerbate the problems of uncertainty and unpredictability. For small enterprises, in view of their size and limited managerial and other

resources, these impediments are particularly debilitating for conducting commercial operations competitively.

115. The most important cost of doing business is the time spent and the uncertainty of outcomes in dealing with government agencies, particularly the departments handling Federal and Provincial taxes. Final payments relating to income and property taxes, income tax and GST refunds, electricity and other utility supply and bills are all subject to negotiations. Not only is the final outcome unpredictable but is also time consuming. This imposes a huge cost of doing business not usually captured in cost of doing business indicators. In addition to this general problem there are specific areas which enhance costs unduly. These are discussed in detail below.

4.3.2. MULTIPLE/NUISANCE TAXATION

116. The provincial and local government tax structures also raise the cost of production. For instance, different levels of government levy multiple taxes on the same tax base, e.g., GST is levied at the federal level, professional tax by the provincial government on a wide array of businesses (with an additional 'bed tax' in the case of hotels), while local governments impose a professional fee. Similarly, there is an entertainment tax levied by the provincial government and an entertainment fee by the district government, both of which should be replaced by the GST.

117. There is also an electricity duty[43] and a service charge levied by the provincial government on the use of generators installed by private businesses for ensuring uninterrupted supply of electricity because of the poor service provided by WAPDA!

4.3.3. LABOUR RELATED LEGISLATION

118. The rigidities of legislation affect growth and competitiveness by penalizing 'honest employers/law abiders, although it is not a constraint in practice for those in the informal sector, and many in the formal sector who bribe officials for ignoring their defiance of laws. Entrepreneurs do what they want, increasing or decreasing the workforce, without any factors restraining them from doing so, simply by-passing the laws or by introducing backdoor flexible measures involving an increase in the share of non-permanent or contract workers.

119. Whereas recent or proposed legislation makes a serious attempt to strike an appropriate balance, between the objectives of greater labour market flexibility and autonomy to enterprises on business matters (to reduce cost of doing business) and protecting workers' rights, some of the historical weaknesses remain unaddressed – as reflected in the wide gap between market practices and legislation – including those related to the costs of regular workers on account of labour levies imposed through legislation. This is particularly true in the area of minimum wages, overtime wages, hours of work per day, mode of payment for contract employees, holidays and leaves, cost of living

[43] Of 2.50 paisa for domestic and 1.50 paisa for industrial connections per unit of the electricity tariff covering energy charges, fixed charges, the additional fuel surcharge and the additional surcharge.

allowances, basis for employee retrenchment, termination notice period for employees irrespective of period of service with enterprise, etc., operational matters which are critical for the flexibility required to enhance enterprise competitiveness, which would best be left to labour management negotiations and free play of market forces, rather than being mandated by law.

4.3.4. Labour Levies

120. Under different legislations, enacted both federally and provincially, employers are also required to contribute towards monetary and non-monetary benefits of workers. These essentially relate to seven charges – compulsory salary bonus, Group Insurance, EOBI, Workers welfare Fund (WWF), Social Security, WPPF, Provident Fund or Gratuity and Education Cess – imposed on employers (which according to most estimates cost an additional 25% of the wage bill), three of which are structured in such a manner that they are levied like taxes on profit. The others are taxes on the payroll.

121. The cost burden of these imposed levies is particularly high for sub-sectors and enterprises in which wages constitutes a sizeable share of total production costs, thereby disincentivizing formalization of employment and encouraging employers to remain small.

122. The high welfare related contributions do not create a problem just in terms of costs of operations. Not only is the coverage poor (less than 4% of the non-agricultural labour force), the benefits and services are also of poor quality, being under-funded, underprovided and indifferently managed, with growing concerns about their sustainability from the collections from which they are funded. Governance issues and inefficiencies have also tended to keep the returns to labour low, with decisions of the Boards of Governors of these bodies (with employer and employee representatives appointed by government) manipulated by government officials or political representatives on matters of staffing, project selection and fund deployment.

123. The legislation planned for Labour Welfare and Social Safety Nets is expected to consolidate a body of existing laws, thereby largely attending to issues of internal inconsistencies and overlapping of statutes and the multiplicity of functions and institutional structures and arrangements for managing labour welfare related activities financed from collections. However, the matter of the rates of levies, which raise the cost of hiring regular/permanent labour and affect industry competitiveness, will remain unaddressed without necessarily resulting in better provision of services and welfare schemes and facilities to workers for whom they are intended.

4.3.5. Other Regulatory Legislation and Structures

124. At times the regulations actually block private efforts to improve productivity, efficiency and sustainability of operations. For instance, inefficient and smaller sized units should be allowed to restructure through relocation of assets for facilitating consolidations and mergers. The policies of the provincial government discourage the restructuring of the sugar industrial units by blocking the relocation and consolidation of mills required to achieve scale and production capacities required to maintain international competitiveness.

4.3.6. TRUST

125. Industry operates in a low trust environment. Surveys suggest that most SMEs are constrained to conduct commercial transactions with a handful of suppliers and buyers whom they trust because there is lack of confidence in the formal judicial mechanisms to resolve disputes on a timely basis and enforce contracts in a predictable manner. This inhibits efficient functioning of markets for goods and credit, segmenting markets, raising the transaction cost of organizing large scale production and exchange and discouraging business development. The consequences of such structures are that transactions tend to conducted with third parties on the basis of cash on delivery while manufacturers opt for vertical integration, producing products in which they do not have a competitive advantage, leading to a non-optimal deployment of scarce resources.

126. For small enterprises, given their size and limited managerial and other resources, such impediments are particularly debilitating for conducting commercial operations competitively. They suffer more than the larger enterprises because the transaction costs of dealing with government functionaries through systems characterized by the liberal distribution of discretionary powers are particularly high as a share of operational expenditures, since the fixed-cost element of compliance is invariant with respect to firm size. With a limited capability to absorb such overheads act as a barrier to entry for SMEs or restrict their growth, thereby distorting competition within the economy and affecting quality and efficiency of investment.

127. Finally, the legal and judicial systems have been unable to resolve disputes in an efficient and timely manner, partly because the system of enforcement is weak, opaque and unpredictable and courts costly to access and easily corruptible. Through procedural loopholes alone the actions of the courts can be frustrated and delayed for years, by which time the value of the collateral can be diluted significantly. A law suit for contract enforcement can involve as many as 50 steps/procedures and take almost 3 years to conclude, while a civil law dispute can on average take almost 10 years to be adjudicated in Karachi.

128. All this adversely impacts upon the availability of credit. FIs are reluctant to advance loans to parties that are not ‘blue chip’ as the value of collateral (especially if land is not likely to be accepted as collateral) is undermined by procedural and legal complications.

4.3.7. RECOMMENDATIONS ON REDUCING COST OF DOING BUSINESS

4.3.7.1. Rationalization of Administrative Regulations

129. By reducing the degree of administrative regulation and control of the economy, reducing multiple taxation and by strengthening the accountability of public functionaries not only can cost of doing business be reduced but also opportunities for rent seeking by political and bureaucratic functionaries and the potential for arbitrary exercise of discretionary powers can be curbed.

4.3.7.2. Improving Legal Systems

130. Businesses need a timely, efficient and effective system for the administration of justice, which requires judges who are better qualified, suitably educated and skilled in commercial matters-corporate, banking and tax laws-and appropriately trained to implement clearly drafted procedures and rules on imposition of costs for wasting the time of courts and for effective case management. Moreover, as the economy expands and gets more integrated globally there will be a shortage of lawyers and judges with relevant expertise and experience of commercial matters, corporate law and IPRs, thereby constraining growth of businesses.

131. Businesses should take recourse to courts only as a last resort but this requires feasible options like Alternative Dispute Resolution. Presently, however, the law pertaining to arbitration is basically defective as decisions by arbitrators are not binding and can be reversed in courts. Hence, the need to improve the availability of, and access to, such options.

4.3.7.3. Rule-based Tax Refund Systems

132. The compliance costs and the associated with the GST and withholding tax related refunds and the customs duty drawback payments continue to be major issues. Delays in timely payments, the distortions in the system of processing tax refunds and the high informal costs of obtaining these refunds undermine the competitiveness of Pakistan's exportable sector. The procedures need to be made rule-based and transparent. The best solution is to move towards an exception based system of assessment, where exceptions are made on the basis of an automated risk-assessment system based on pre-determined validity checks. This system would ensure that compliant exporters have access to a fast-track, while non-compliant exporters continue to face with the threat of assessment. This system will strengthen the incentives for compliance.

133. Finally, the government can facilitate the private sector in raising its productivity through greater transparency in its functioning and by disseminating information on domestic and international prices efficiently, improving access to financial services and enabling links to global trade.

4.3.7.4. Reduction and Rationalization in Labour Levies

134. With respect to labour levies we propose the withdrawal of the Education Cess and the (10-C) bonus and the adoption of just one of the present two instruments for severance payments-provident fund or gratuity and EOBI, in line with the government's own decision to discontinue pensions for new recruitments. The nature of labour related levies can then be converted into taxes on payrolls as is the practice internationally.

4.3.7.5. Private Health Insurance for Workers

135. We also propose the option for private/national health insurance scheme[44]. The coverage and quality of medical care facility for workers can be supplemented by their contribution of say 2.5% to 3% of the wage, thereby also creating better ownership among them for such a facility.

4.3.8. RECOMMENDATIONS WITH RESPECT TO INVESTMENTS IN INFRASTRUCTURE

136. According to the World Economic Forum Survey, 2006/07, Pakistan was ranked 67 out of 125 countries in basic infrastructure. Lack of infrastructure has constrained Pakistan's growth and affected the competitiveness of the economy. Pakistan is seriously deficient in the availability of adequate and uninterrupted supply of energy. According to one estimate the cost of outages owing to the acute shortage of power was approximately 9% of value added in the industrial sector, representing a 7% loss in industrial output[45]. It is difficult for a country to develop at a rapid pace without the estimated power shortage of 6,000 megawats by 2010[46].

137. The World Bank estimates that transport sector inefficiencies cost the economy 4% to 5% of GDP annually, while water and irrigation needs an investment of US$70 billion[47]. Moreover, lack of adequate human resources, high taxes and duties on inputs of construction materials[48], corruption (accounting for almost 15% of project value)[49], delays in project implementation because of poor planning, design and execution capacity, inadequate contracting procedures and cumbersome contractual processes affect sectoral performance and efficiency.

138. Investments in economic infrastructure of roads[50], ports, additional power/energy[51] and water storage[52] and conservation (supplemented by public works programs to absorb the rapidly growing labour force) and better management and maintenance of existing assets are critical. They are desirable not only for releasing bottlenecks to growth but also for reasons of access and equity, since in the short-medium term, until the issues of governance and management of social service delivery are tackled effectively, they would be more effective in achieving the objective of inclusive growth than increasing expenditure on social services delivered by the public sector.

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[44] The National Rural Support Programme is running a hospitalization health insurance scheme with Adamjee Insurance for a premium o f Rs.600 per family per annum.

[45] State of the Economy: Emerging from the Crisis, Second Annual Report, 2009, Institute of Public Policy, Beaconhouse National University, Lahore.

[46] Pakistan Infrastructure Capacity Assessment, World Bank, Report no.41630-Pak, November, 2007.

[47]

[48] The cost of these materials is almost 200% higher than is the case in other countries in the region. Pakistan Infrastructure Capacity Assessment.

[49] Ibid.

[50] For instance, Pakistan's road density is only 0.32 km per sq km, suggesting that the country needs at least another 100,000 km network of roads for our road density to reach levels of countries in the region.

[51] Investments also need to be made to reduce transmission, distribution and auxiliary losses and theft.

[52] According to the Medium Term Development Framework, 2005-10, Planning Commission, May 2005, page xxxiv, Pakistan's storage capacity is 9% of average annual flow compared with the world average of 40% and 33% in the case of India.

139. The composition and size of public spending on infrastructure (roads, ports, railways, energy) will also assist in the crowding in of private investments. Increase in public spending on infrastructure, both in its range and quality, should help realize medium-term growth targets while also providing jobs and incomes to those worst affected by the downward slide in the growth rate. Admittedly, the capacity to enhance public spending on infrastructure, unless there is a major re-prioritization and re-orienting of the PSDP, will be constrained by the slowing down of overall growth.

4.4. Trade Facilitation

4.4.1. Introduction

140. Ease of mobility of goods across geographical boundaries can support export competitiveness and thereby economic growth. Empirical evidence shows that improved trade facilitation can:

a) Significantly reduce transaction costs in terms of time and resource use, reliability, predictability and security and thereby increase competitiveness in global markets.
b) Enhance trade volumes by even more than the direct gains from policy reform;
c) Improve government revenues and collection efficiencies;
d) Contribute to overall welfare improvements and economic growth.[53]

141. There is a need to adopt modern, simplified, transparent and reliable clearance procedures to be accepted as a safe and secure supplier in the global supply chain. Hertal and Mirza (2007) show that through trade facilitation reforms South Asia would be somewhat better integrated regionally as a result of which intraregional trade would increase by 75% and interregional trade by 22%.

4.4.2. Pakistan's Efforts on Trade Facilitation

142. The Global Enabling Trade Index, featured in the Global Enabling Trade Report (2008), measures the factors, policies and services facilitating the free flow of goods over borders and to destinations. The index breaks the enablers into four overall areas: (1) market access, (2) border administration, (3) transport and communications infrastructure and (4) the business environment.[54] Pakistan has been ranked at 84 among the 118 other economies studied for this report. Similarly, the Logistics Performance Index (LPI) ranks Pakistan 68 out of 150 countries.[55]

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[53] Milner, Chris, Morrissey, Oliver and Zgovu, Evious (2008). "Trade Facilitation in Developing Countries." Center for Research in Economic Development and International Trade, University of Nottingham.
[54] <http://www.nation.com.pk/pakistan-news-newspaper-daily-english-online/Business/06-Jul-2008/Global-Enabling-Trade-Report-2008-Pakistan-at-84-among-118-countries>.

[55] The Logistics Performance Index aims to shed light on how different countries are doing in the area of trade logistics and what they can do to improve their performance. LPI and its indicators constitute a unique data set to measure country performance across several dimensions of logistics and to benchmark the logistics performance against 150 countries.

143. Table 18 below shows that compared to more efficient countries, such as China, Malaysia and Singapore, Pakistan ranks lower on the pace at which inspections and documents are completed, on the number of days required for clearing cargo through customs as well as on the costs to export and import goods.

Table 18
Variables indicating the Degree of Trade Facilitation in Selected Economies

Country	Documents to export (number)	Documents to import (number)	Time to export (days)	Time to import (days)	Cost to export (US$ per container)	Cost to import (US$ per container)
Pakistan	9	8	24	18	611	680
Sri Lanka	8	6	21	20	865	895
India	8	9	17	20	945	960
China	7	6	21	24	460	545
Nepal	9	10	41	35	1764	1900
Egypt	6	6	14	15	737	823
Malaysia	7	7	18	14	450	450
Singapore	4	4	5	3	456	439
Korea	4	6	8	8	767	747
Thailand	4	3	14	13	625	795

Source: World Bank (2009) "Doing Business 2009: Comparing Regulations in 181 Economies." World Bank and International Finance Corporation**.**

144. International logistics encompass a broad range of activities in connection with trade, including transportation, consolidation of cargo, warehousing, and border clearance and in-country distribution and payment systems. In the case of Pakistan, port and terminal charges for an average sized container ship of 35,000 tons are significantly higher than those prevailing in the region, ranging from US$ 25,100 to US$ 27,200 compared with US$ 23,000 in India, US$ 2,900 in Dubai, US$ 7,200 in Sri Lanka and US$ 3,000 in Singapore.[56]

145. The Government of Pakistan has launched the National Trade Corridor Improvement Program (NTCIP) to cover aspects of trade transport facilitation: ports, road and rail services along the main trade corridors, customs reform, trade facilitation and air transport to enable development of linkages with international quality supply chains.

146. Furthermore, a computerized system is being developed to make the customs clearance procedures completely paperless, web based to provide online

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Arvis, Jean-Francois et al. (2007) "The Logistics Performance Index and Its Indicators- Trade Logistics in the Global Economy." The World Bank.

[56] Business and Finance section, Daily Times, March 24,2009.

access to all stakeholders with information in advance of cargo and facilitate risk management capability. Its objectives will be to reduce the cost of doing business through simplification of procedures, reduction in clearing-agency and port charges (the latter through fewer inspections) and greater predictability and reliability.

147. However, Pakistan is one of the few countries where shipping lines have most of the service contracts directly with the exporters. In all developed countries, freight forwarders do the bulking buying from the carriers and then pass to the exporters (with the exception of large companies like ICI, Toyota, etc). Restructuring the international freight forwarding industry will result in a reduction in the freight bill whilst improving the level of logistics, enable just-in-time deliveries and open up new destinations for exporters.

148. It will also help immensely to reduce the inflated freight bill of the country's import trade. Once international freight forwarding services are recognized as an integral part of the country's trade, there will automatically be an interest to invest in Pakistan's logistics infrastructure.

149. Previously, in an environment characterized by foreign exchange controls, goods had to be imported on a cost plus freight basis whereby the estimated freight cost was covered in the Letter of Credit. Since the core business and expertise of the foreign supplier did not extend to the shipment of goods, he neither had any incentive to save costs nor could he be expected to search for the least cost deals for freight. In fact, so as not to suffer on account of having underestimated freight costs, he would provide a quotation for goods on C&F basis that would actually over-estimate the cost for freight. Today, even after the foreign exchange constraint has been eased, Pakistan is still operating on a C&F basis. A shift to FOB basis would save costs through a more effective use of the services of domestic freight forwarders.

4.4.3. Recommendations on Trade Facilitation

150. Based on the discussion above our recommendations on trade facilitation are listed below:

a) There is a need to further simplify customs procedures for establishing consolidation activities, bonded storage and transport in bond[57]. These initiatives would reduce the constraints to setting up bonded storage and inland container depots. It would also allow the designation of certified factories engaged in the production of exports as bonded facilities.

b) Challenges facing the local logistics industry include developing an efficient less-than-truck- load and less-than-container-load (LTL/LCL) supply chains to serve the Small and Medium Enterprises (SMEs) and to offer an integrated supply-chain management service with real-time cargo monitoring and internet based transactions. This will require

[57] World Bank (2006). "Poverty Reduction and Economic Management Sector Unit South Asia Region." Pakistan Growth and Export Competiveness.

changes in customs procedures regarding bonded warehouses and movement of goods in bond. It will also require better cargo consolidation, cross-docking, and inventory monitoring services and more efficient data interchange between shippers and logistics providers.[58] Warehousing and storage facilities are thus needed as a support measure to facilitate trade and industry to help Pakistan become part of the global supply chain.

c) The existing requirement that all L/Cs in respect of all imports should reflect C&F values should be withdrawn. The resulting savings in the cost of doing business will enhance the competitiveness of Pakistani industry.

d) Freight and forwarding agents (with no assets to offer as collateral) lack access to credit. Making credit more available to them by increasing flexibility in defining acceptable collateral and by requiring full insurance coverage for truck operators can serve as a stimulus for modernizing fleets as well help in consolidating the industry.[18]

e) In Pakistan rail freight is more expensive and less efficient than road and is important for bulk commodities (such as cotton). Creating an efficient rail-freight service requires granting a concession to a private operator through competitive bidding. Such a concessionaire could carry the responsibility of managing goods terminals so that future shippers can count on an efficient door-to-door service which is presently unavailable.

f) Improve the services of domestic freight-forwarders through training programmes financed by government.

g) As a medium term strategy, there is a need to introduce new, safe and less-polluting trucks in the industry that also do not damage the road infrastructural network because of high axle-loads—an upgrade that can be assisted by reducing duties on imported trucks and parts and through tougher safety and axle-limit enforcement. The enforcement of such regulation will also attract first-tier transporting companies with international linkages.

h) Air freight is particularly important for non-traditional exports such as fish, horticulture and floriculture. Investment in storage and freezing facilities would benefit exports of such products. Incentives from government to facilitate and stimulate private sector investment in cold storages at the airport will facilitate exports of these agro products.

i) The major challenges currently facing the port container terminals are the traditional ones of expanding capacity to meet growth in demand, pricing services to encourage efficient use of facilities, decreasing

[58] World Bank (2006). "Poverty Reduction and Economic Management Sector Unit South Asia Region." Pakistan Growth and Export Competiveness.

operating costs and increasing the capacity of land and water access to the terminals.[59] Investment in improved port facilities would lower export costs while improved operating practices at the port will reduce turnaround times (of feeder vessels). Although the set up and operating costs of this proposal are large, the long term gains would outweigh the costs.

4.5. Incentivizing Exports

4.5.1. Overvalued Exchange Rate

4.5.1.1. Introduction

151. According to Rodrik (2007) overvalued exchange rates are associated with shortages of foreign currency, large current account deficits which are unsustainable, balance of payments crisis and stop-go economic growth. He argues that high growth is associated with an undervalued currency. Increased undervaluation stimulates economic growth through an increase in the relative profitability of tradables while slowdown in growth is accompanied by growing overvaluation or reduced undervaluation.

152. Although the causation between currency valuation and growth rates may not be that clear, maintaining an undervalued currency requires higher rates of savings relative to investment or lower expenditures relative to incomes-say through large revenue surpluses, redistribution of incomes in favour of high savers, mandatory saving schemes and building up of foreign exchange reserves[60].

4.5.1.2. Pakistan's Experience with Exchange Rates and Remittances

153. Pakistan has experienced an overvalued exchange rate for most of its history. This was largely because of remittances of overseas migrants, ranging from an average of 7.1% of the GDP in the 1908s to 2.6% in the 1990s and just under 4% of GDP ever since and liberal inflows of foreign assistance during the period of the Cold War, then the Afghan war during most of the 1980s, then after 9/11 and the war against terror since 2001[61].

154. The inflows on the capital account, rather than on the current account (especially those that were short-term, non-recurring and unsustainable in nature as a consequence of the fortuitous events referred to above), and more recently privatization proceeds have propped it up artificially[62]. Hamna (2009) argues that these capital flows had an appreciating effect on the

[59] World Bank (2006). "Poverty Reduction and Economic Management Sector Unit South Asia Region." Pakistan Growth and Export Competiveness.

[60] These arguments are being made while recognizing that the stability of the exchange rate is heavily dependent on productivity of the economy.

[61] Net official capital inflows averaged 1.5% of GDP since 2001/02. Since 2003, foreign portfolio and foreign direct investments also played a key role in financing the current account deficits.

[62] The sharp growth in remittances during current FY09, by more than 20% over the previous year, also includes an element of capital inflow of returning migrants (having lost their jobs), businesses being wound up in the UAE, etc. as one of the outcomes of the contraction in economic activities in the Middle Eastern economies as a result of the global meltdown.

exchange rate. She also argues that by filtering unsustainable and temporary flows the extent of overvaluation ranged from as low as 0.75% in 2001 to almost 23% in 2007.

155. This has been the main reason for the anti-export bias of the policy regime and the repeated experience with the stop-go pattern of economic growth, the balance of payments crisis and the financing of the current account acting as the binding constraint on growth.

156. Remittances resulted in the artificial appreciation of the real exchange rate and the reduction in international competitiveness (Dutch Disease). Remittances have also skewed the incentives for successive governments who have tended to view remittances as a stable source of foreign exchange which could create instability under the worsening international economic environment.

4.5.2. Other Recommendations on Exports

157. While specialization on the basis of comparative advantage helps improve overall productivity if the economy is open to trade- since expansion in exports introduces technological change and diffusion of knowledge- there is a need to develop expertise over a broader range of activities instead of just specializing on one or two activities in which we have a comparative advantage. We, therefore, do not propose any generic support to a sector (to avoid creating distortions) but to factors of production and cross-cutting activities (like skill development, investment in key infrastructure or incentives for exports as a away of incentivizing performance) that are likely to have an impact upon a broad range of sectors and can draw in other complementary investments or technology or knowledge spillovers.

158. We also recommend the provision of an environment in which export industries/exporters are not at a disadvantage. Such an environment would be represented by: a) an undervalued exchange rates; b) availability of imported raw materials, intermediate goods and plant and machinery to exporters at world prices; c) government pro-active initiatives with G20 countries on market access for our products-e.g. GSP and ROZ[63]; and d) incentives/ subsidies to the private sector to develop new markets.

4.6. Regional Trade: Opportunities and Challenges

4.6.1. Introduction

159. While this section discusses both trade between Pakistan and India and between Pakistan and China, its main focus is on the latter and attempts to argue that if trade between India and Pakistan is normalized and overland trade facilitated it has the potential for providing a fillip to the economy and could serve as a growth pole for the Pakistan economy in the medium-term.

[63] According to Gresser (2008) Pakistan's exports of towels to the US are taxed at almost seven times the US tariff rate that is applied to the exports of 75 other developed and developing countries

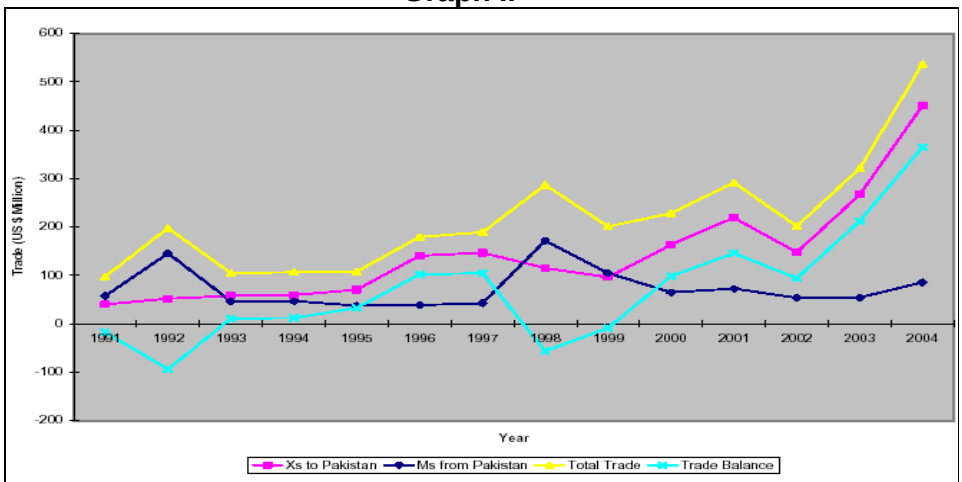
4.6.2. TRADE WITH INDIA

4.6.2.1. Introduction

160. Although the bilateral trade between Pakistan and India in 2007/08 valued US$2.3 billion representing approximately 2% and 5% of Pakistan's total exports and imports respectively,[64] a more comprehensive analysis of trade data reveals that the two countries are important partners in trade. Pakistan's exports to India are almost half its exports to South Asia while its imports from India are in excess of 70% of its imports from South Asia, which in value terms are more than its imports from France, Canada, the Netherlands, Turkey, Iran and Thailand. Nevertheless, trade between the countries is lower than its potential.

Graph II illustrates how trade between India and Pakistan has been increasing since 2002.

Graph II



Note: Graph based on Table A.2, India Reporting Country
Source: Direction of Trade IMF (2006)

161. Although no proper estimates exist on the extent of informal, including illegal, trade between the two countries the World Bank estimated it at US$545 million in 2005, some "guesses" suggest that it is approximately US$ 2 billion[65], with around 50% of it through third countries (technically official trade) like Dubai, Singapore and Afghanistan. The balance represents cross-border informal/illegal trade. Unofficial imports is of items that are either not on the 'positive list' or are subjected to high duties and include betel leaves, tyres, tea, medicines, videotapes, chemical products, cosmetics and jewelry while items in demand include medicines, household products, iron ore, transport equipment including motorcycles and motorcars, plastics, textiles and agricultural products. Informal exports from Pakistan include food products and synthetic fibers.

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[64] State Bank of Pakistan.

[65] India Pakistan Trade takes a Terrorist Hit." Asia Times Online <http://www.atimes.com/atimes/South_Asia/KC12Df03.html>

162. Recent estimates on trade potential suggest that trade could be in a range of $ 3 to $ 10 billion compared with the annual official trade flows over the last six years of less than $400 million; in other words only 4% to 13% of the potential bilateral trade is being exploited. Since Pakistan and India account for almost 90 % of South Asia's GDP, low bilateral trade is an important constraint for growth of South Asian exports to the rest of the world, as well as for an expansion of intraregional trade.[66]

163. Viewed in the larger regional context, South Asia is the least integrated region compared to other regions such as East Asia, Latin America, Europe and Central Asia, Middle East and North Africa as well as sub-Saharan Africa. The reasons for the relatively low trade have been political tensions, the use of import-substitution policies to promote industrialization and the relatively little commitment to regional integration.[67].

4.6.2.2. The Benefits of Trade between Pakistan and India

164. There are several advantages of normalizing trade between the two countries. To begin with, the advantage of geographical proximity – cheaper transportation costs (which will, to exploit the full potential of bilateral trade, require investment in the infrastructure of roads, railway and permission to each others' merchant ships to call at each others' ports) – and trade complementarity in goods in which either country has a comparative advantage are overwhelming.. The shorter distances will render it unnecessary for industry to carry high levels of inventories of raw material, intermediate goods and parts, thereby reducing cost of operations and the country's overall trade deficit while also improving allocation of scarce resources.

165. Cooperation in the agriculture sector could turn out to be beneficial to Pakistani farmers. The success achieved by India in raising yields per acre[68] through improvements in extension services and research and seed, irrigation and mechanical technologies offers opportunities that Pakistani agriculturists can exploit gainfully. The Pakistan textile sector (cotton based fabrics and short-staple fiber yarn/fabric) should be expected to benefit (through increased production and higher productivity owing to a more modern technological base and equipment) from an improved access to the huge Indian market, with the latter having a distinct advantage in polyester fibers and related fabrics. Similarly, Pakistan's leather products (manufactured from the more durable cow skin) will be well-received in the Indian market where leather products are essentially made from goat skin.

166. Opening up trade with India will also have a salutary effect on prices. By depressing inflation rates it will also ease the inflationary burden in Pakistan[69]. The Indian machine tool and capital goods producing industries are regarded as highly developed and efficient. Therefore, access to cheaper capital goods,

[66] Naqvi, Zareen and Schuler, Philip. (2007) "The Challenges and Potential of Pakistan-India Trade." *The World Bank.*

[67] Naqvi, Zareen and Schuler, Philip. (2007) "The Challenges and Potential of Pakistan-India Trade." *The World Bank.*
[68] These differentials have, however, narrowed significantly over time.
[69] For instance, in view of the recent shortage of wheat in the country, Pakistan could decide to import wheat from India rather than from Australia/the US, since this would be a cheaper option.

technology and skills should, by reducing the cost of investment, also improve the productivity and efficiency of Pakistani industry, thereby strengthening our global competitiveness.

167. India has a large demand for energy and Pakistan can serve as a transit route for energy from Iran and Central Asia.

168. The fear of the Pakistani manufacturing sector being swamped and rendered uncompetitive by Indian goods is highly exaggerated. There are several reasons for this. The average Pakistani consumer has tended to be more quality conscious. Our industry has, for a long time, had to compete against both smuggled goods and official imports under the highly generous baggage schemes (for resident and overseas Pakistani traveling or returning to Pakistan). Industry has, therefore, learnt to survive against the heavy competition that it has had to face on account of rather porous borders. Pakistani governments have historically not only had a rather lax attitude to widespread smuggling (including that from India) but have also followed fairly liberal import policies in respect of capital goods, technology import and production processes. Now import tariffs have been substantially lowered and industry is standing up to the threat from cheap imports, especially Chinese products. Moreover, if Pakistani exports can compete with Indian exports in international markets they can compete with Indian products in Pakistan's domestic market. Pakistani industry will, therefore, be able to withstand the competition from India. In any case, the process of globalization and regionalization and greater openness can neither be stopped nor reversed. However, there will be a restructuring of industry as it adjusts to competitive forces resulting in the development of a structure based on comparative advantage, while WTO regulations can be harnessed into providing adequate safeguards against dumping.

169. It is estimated that full SAFTA will help double Pakistan's exports to South Asia[70], although India by preferring FTAs/RTAs with other SAARC countries has more or less signaled the demise of regional trade under SAFTA (Table 19), suggesting that if Pakistan is not to be marginalized in South Asia trade because of FTAs and RTAs it should fully support SAFTA and the first step in the direction would be for us to give MFN status to India.

170. For Pakistan the positive results would be visible in the important employment-intensive agricultural sectors such as wheat, horticulture, meat products (mainly poultry) and other food products and in the sub-sector of textiles.

[70] Although the economic rationale underlying the adoption of SAFTA could also be questioned by asking why the Pakistani industry should be placed at a competitive disadvantage in international markets by the adoption of a policy of zero customs duty that will distort the market by artificially lowering the price of imports from India, even if similar items imported from China are superior in quality and cheaper otherwise.

Table 19
Export Gain for Pakistan in SAFTA Market (percent)[71]

	Output	Effect on Skilled Unemployment	Exports to South Asia	Global Exports	Global Imports
2009-09	0.01	0	5.52	0.17	0.19
2016	0.02	-0.0001	102.41	0.77	1.54

Source: Asian Development Bank (2008) "Quantification of Benefits from Economic Cooperation in South Asia."

4.6.2.3. The Costs and Constraints of Trade with India

171. In the context of South Asia, U.S. Trade and Development Agency in its 2005 report identified the major constraints to trade. Much of the source of trade costs results from lack of trade facilitation and lack of availability of physical infrastructure in South Asia.[72]

172. Five factors account for the high transaction costs of trading:

a) Limited transportation routes,
b) Shipping protocol between the two countries,
c) Restrictions on the number of items permitted into Pakistan from India,
d) Non-availability of rail wagons and
e) Procedural clearances.

4.6.2.4. Overall Analysis: Benefits outweigh the Costs

173. To achieve successful regional integration in South Asia (particularly between Pakistan and India), three crucial steps need to be taken:

a) Deepening of trade by reducing not only tariff barriers but also non-tariff barriers and addressing trade facilitation issues.
b) Expanding the scope to include trade in services and investment and stimulate structural change in the region.
c) Initially focusing reform and policies on a limited number of key industries to demonstrate the process and benefits of reform such as the textiles and clothing sector and the automotives sector of manufacturing.
d) The above-suggested priority sectors are situated in the manufacturing sector. This is not to say that priority sectors in other economic areas are not feasible. Given the importance of the services sector in South Asia, and the potential for rural development by cooperation in the agricultural sector, consideration could also be given to explore the opportunities for intraregional trade and cooperation in each of these

[71] Asian Development Bank (2008) "Quantification of Benefits from Economic Cooperation in South Asia." *United Nations Conference on Trade and Development.*

[72] Banik, Nilanjan and Gilbert, John. (2008) "Regional Integration and Trade Costs in South Asia." ADB Institute Working Paper No. 127.

two sectors. Processed food in agriculture and ICT and tourism in the services sector are potential alternative priority sectors.

174. As other successful regional cooperation and integration initiatives have demonstrated, regional cooperation is a win-win situation that is beneficial to the entire region. By focusing on and recognizing the longer term and dynamic benefits of regional integration, this three-pillar approach transcends the limitations of the zero-sum game short-term approach to regional cooperation. The long term approach acknowledges that benefits will accrue to all members of the regional group, irrespective of their size. The long term approach highlights that while static benefits for the larger countries in trading with the smaller countries may seem limited, the longer term dynamic effects from integrating with smaller neighboring countries are substantial. For smaller economies, the exploitation of comparative advantages in particular phases of the regional production chain will provide a substantial boost to intraregional trade, investment and integration with the neighboring countries.

175. The peace dividend of a more economically integrated and rapidly developing region, as exemplified by the European experience, could be a major additional benefit for the countries in South Asia-extended trade relationships would reduce potential for conflict by creating strong constituencies for peace. Peace and stability in the region would spur the 'neighborhood effect' in FDI. The perception of South Asia as a stable region for investment would substantially increase FDI into the region. Moreover, as the experience of EU and ASEAN suggest, the true benefits of regional trade are only realized through the investment channel.

4.6.2.5. Policy Suggestions to Enhance India-Pakistan Trade[73]*:*

176. In the light of the discussion the following several steps need to be taken to expand regional trade, and especially between the two neighbours.

177. The sequencing of policy implementation should be such that as a first step trade relations between the two countries should be normalized by trading on the most favoured nation (MFN) basis. As a second step, policymakers should address problems related to information exchange, trade facilitation, banking, non-tariff barriers, visas and communication. As a third step, an enabling environment for investment has to be created so that India and Pakistan can enter into joint ventures.

178. The main policy suggestions are outlined below:

(a) Normalization of Trade

As a first step, and perhaps the most important one, India and Pakistan need to normalize trade with each other on an MFN basis. It is essential to move from a positive list approach to a negative list approach. It is important for the two countries to have a common Harmonized System of Codes and greater transparency.

[73] Taneja, Nisha (2006) "India-Pakistan Trade." Working Paper No. 182. ICRIER <http://www.icrier.org/pdf/WP182.pdf.>

a) Banking

i) As there is evidence of anonymous transactions between trading partners, payments through formal channels assume a greater role. Currently, the payments system is formalized through the Asian Clearing Union which is inefficient as payments are often delayed. The two countries need to have an institutional arrangement so that state, private and foreign banks can participate freely in banking transactions.

ii) There needs to be greater transparency to address problems related to confirmation of L/Cs and to payments.

b) Transport Routes

i) As there are only two operational routes, Mumbai-Karachi sea route and the Attari/Wagah rail link on the land border, new routes should be opened up. Opening the Attari/Wagah border to allow transportation of goods by road should be done at the earliest as the road link for movement of passengers is already operational.

ii) New rail and road links for example, the Khokrapar-Munabao link and the Srinigar- Muzaffarabad link (for goods transportation) should be opened.

c) Transport Bottlenecks

i) Abandoning the positive list approach would allow goods to move freely on the direct routes, thereby lowering transaction costs.

ii) The rail protocol should be amended such that restriction on wagon balancing is removed and wagon availability is improved.

iii) Measures such as simplified border procedures should be introduced at the land borders.

iv) The shipping protocol should be amended so that third country and non-national flagships can ply on the Mumbai-Dubai sea route. This would help in lowering shipping costs.

d) Information Exchange

i) As new firms enter into Indo-Pak trading, trade needs to be facilitated through superior information exchange on commodities and quantities to be traded. Establishing web portals towards this end would perhaps be the quickest in terms of implementation.

ii) Information on each other's policy environments should be disseminated to traders. Such information should be made available on government websites. Improving information flows between the two countries will reduce the search costs for trading.

e) Non-Tariff Barriers

There is a need to quickly reduce non-tariff barriers which are more pernicious on Pakistani exports to India. Moreover, there is also a need for a simplified and harmonized system of Technical Barriers to Trade (TBTs) and sanitary and phyto-sanitary standards (SPS). In the latter case the protocols will have to be negotiated under SAFTA.

f) Visas

Visa restrictions should be eased by eliminating city specific visas prior to entry and police reporting on arrival.

g) Communications

Uninterrupted telecommunication links between the two countries would facilitate trade between the two countries and thus there is a need to enhance communication channels between the two economies.

h) Investment

i) Currently there are no India-Pakistan joint ventures. As several Indian companies are showing an interest in having joint ventures in Pakistan, it is important to understand the nature of such investments and provide timely facilitation.

ii) Governments of India and Pakistan need to set up an institutional mechanism that would guarantee each other's investments. The two countries should work together to enhance and facilitate trade and investment. The suggested roadmap should serve as an important tool for policymakers of the two countries.

4.6.2.6. Conclusions

179. The nature, level and range of products in which trade may take place between the two countries will essentially depend upon the success achieved in reducing transaction, search and market information costs: (a) the scale and quality of the economic infrastructure required to handle larger trade volumes (presently there is just a one rail link and a single land crossing encumbered with frequent checks which contribute to costs); (b) the manner in which issues related to tariffs on agricultural produce, subsidies, non-tariff barriers and "rules of origin" in respect of items traded and product coverage are resolved; (c) availability of information on production facilities and technologies; and (d) the ease with which people in general, and businessmen in particular, can travel from their home country to the other. Businessmen would have to be granted general purpose visas instead of city-specific visas that also require police reporting. In other words, if robust trade between the two countries is to be promoted, their governments will have to play a much more positive role, which in turn would hinge on the normalization of relations. The viability of the process will depend upon a continuing political commitment to trade expansion and to the need to manage disputes while keeping other interfaces for engagement intact.

4.6.3. TRADE WITH CHINA

180. China has become Pakistan's main trading partner accounting for almost one-fifth of Pakistan's total trade in 2006. Pakistan's trade with China increased from US$794.76 million in 2000 to US$3,421.57 in 2006, due to huge domestic demand and an increase in investment spending that led to a rise in imports from China.

Table 20
Pakistan's Bilateral Trade with China (million US $)

Period	Exports	Share	Imports	Share
1990	66.91	1.2%	336.68	4.6%
1991	61.36	0.9%	358.44	4.2%
1992	54.12	0.7%	420.78	4.5%
1993	59.97	0.9%	436.59	4.5%
1995	121.16	1.5%	515.26	4.4%
1996	118.88	1.3%	574.27	4.7%
1997	158.20	1.8%	584.80	5.0%
1998	154.96	1.8%	422.75	4.5%
1999	180.72	2.2%	446.76	4.4%
2000	244.65	2.7%	550.11	5.0%
2001	289.38	3.1%	487.02	4.8%
2002	236.37	2.4%	698.54	6.3%
2003	259.64	2.2%	957.33	7.3%
2004	300.58	2.3%	1,488.77	8.3%
2005	435.68	2.7%	2,349.39	9.4%
2006	506.64	3.0%	2,914.93	9.8%

Source: Ghani et. Al (2009)

181. Although bilateral trade with China has increased, it remains concentrated in a few commodities. Machinery and transport equipment (most of which consisted of telecommunications equipment and general industrial machinery) and manufactured products (comprising mainly textile yarn and fabrics and iron and steel) respectively accounted for 48 percent and 24 percent of Pakistan's total imports from China in 2006. Pakistan's exports to China were dominated by textile yarn, fabrics and made-up articles, which together accounted for nearly 78 percent of total exports to China (Ghani, Musleh Uddin and Qadir, 2009).

182. Pakistan and China have signed a comprehensive Free Trade Agreement (FTA) covering trade in goods and services, bilateral investment, and institutional mechanisms for enhancing bilateral trade and investment. The FTA follows the 'Early Harvest Program' between the two countries under

which tariff reductions have been implemented on Chinese and Pakistani products in over 3,000 tax items since January 1st 2006. A key feature of the agreement is the establishment of China-specific investment zones in Pakistan in which Chinese investors shall enjoy fiscal and other incentives. Moreover, both countries are negotiating an Agreement on Trade in Services.

183. Furthermore, both countries have formulated a Joint Program for Comprehensive Economic and Trade Cooperation. The Joint Plan envisages moving economic cooperation between the two countries beyond trade to such fields as energy, water conservation and power, transportation, petrochemicals, automobiles, textiles and telecommunications.

184. Using the gravity model to measure the impact of trade policy issues such as preferential trade agreements, Ghani et al. (2009) argue that there is a large potential for expansion of bilateral trade between the two countries as a result of the FTA, though it is likely to be heavily tilted in favor of China at least in the short term. In the long term, however, the FTA is likely to cause a change in the production structures that may support a more balanced level of bilateral trade between the two Asian countries.

Chapter 5: Promoting Inclusive Growth

5.1. Preamble

185. This section of the report proposes a medium-term (3-5 year) strategy for reviving inclusive growth and identifies the development priorities and the potential sources of growth within the context of, and limitations imposed by, the IMF stabilization programme, the difficult economic situation within the country and the uncertainties in the global markets for goods, services and capital in general and the domestic political and security environment in particular. It estimates the minimum growth necessary to reduce poverty and accommodate the bulge in the labour force now increasing at more than 3% per annum.

5.2. Identification of Sectors and Activities to Support Inclusive Growth

5.2.1. Introduction

186. There is no single standard formula that any country can simply adopt for launching a self-sustaining growth process (World Bank 2004). Of this observation there is enough evidence in the shape of just a handful of nations that have managed to achieve uninterrupted growth over long periods. The universal elements of success have been high rates of domestic savings, an educated labour force with ability to acquire new skills, access to and diffusion of rapidly developing modern technologies say through the medium of FDI, trading links with the global markets (which facilitates specialization and efficiency) a committed, focused and evenhanded political leadership and government that ensure availability of global knowledge as a public good (given its spillovers and externalities), sets up effective institutional frameworks that ensure competition and functioning of markets (since economic activity flourishes in open competitive markets) and is fiscally responsible (maintains macroeconomic stability), particularly by not borrowing excessively, especially in foreign currency.

5.2.2. Sectors and Activities to be targeted

187. The young working age population of more than 80 million can provide a huge demographic dividend only if it can be harnessed into productive employment by stimulating economic activities that are relatively labour intensive.

188. Sectors like agriculture (particularly horticulture) and livestock, housing and construction[74], information technology (especially in the form of BPO services) and communications, wholesale and retail, our range of merchandise exports and SMEs are essentially labor intensive, with relatively higher employment elasticities[75] (Table 21). Therefore, these sectors offer a promising potential to

[74] Pakistan's construction sector contributes less than 2% to GDP compared with 9%-10% in other regional countries like India and China and 7% in Bangladesh.

[75] Barring agriculture, this presently has a lower labour elasticity because of the high degree of underemployment. Our agriculture being focused on cereals is less labour intensive and has low labour elasticity compared with horticulture and livestock.

generate fairly large and diversified job opportunities, both directly and indirectly, because of their strong forward and backward linkages with other sectors of the economy. Even sub-sectors of industries like consumer appliances, auto assemblers, engineering, and communications which are relatively capital intensive, generate large employment opportunities through their backward and forward linkages- especially through the development of the vendor industry and related service sector for the sale and after sale maintenance of these products.

189. In our view, however, inclusive, robust and sustainable pro-poor growth has to be anchored in agriculture and livestock, from which 44% of the workforce (72% in the case of females) directly earns its livelihood. The sector requires support not only for poverty reduction and more equitable development of regions but also to bring more stability in growth in a manner that ensures that the gains that accrue from this process are safeguarded. Growth biased in favour of the lowest income households will, apart from directly creating employment opportunities, through increased demand for goods and services that are produced domestically are less import intensive and more labour-intensive.

Table 21
Employment Elasticities

Sector	1961 to 1971-72	1971-72 to 1977-78	1977-78 to 1986-87	1990s to 2000s**
Overall Elasticity	0.45	0.64	0.36	0.41
Agriculture	0.48	0.91	0.41	0.37
Large Scale Manufacturing	0.28	1.10	0.21	0.02
Small Scale Manufacturing				0.85
Construction	0.47	0.81	0.61	0.87
Transport & Communication	1.26	0.45	0.48	0.45
Trade	0.92	0.51	0.45	0.57
Electricity & Gas				0.54
Others including Services				0.68

Source: Government of Pakistan (2003b) Poverty Reduction Strategy Paper: Accelerating Economic Growth and Reducing Poverty: The Road Ahead.

190. The goal of inclusive growth, and stimulating economic activity in the medium-term during which the growth suppressing IMF stabilizing progamme is being implemented, would also be well served by undertaking reforms in housing and domestic commerce, by launching special initiatives to develop skills and by developing and strengthening SME clusters.

191. Skill enhancement of the rapidly growing young workforce has become obligatory on an emergency basis because agriculture with its underemployment will not only be unable to accommodate it but also must shed labour for absorption by the more productive sectors of the economy like industry, telecommunications and some sub-sectors of services. We could achieve the objective of inclusive growth, in which the benefits flowing from industrialization, globalization and modernization of the economy are shared equitably by focusing on the quality of job opportunities in terms of earnings, productivity and better working conditions.

192. The issues pertaining to these proposed interventions are discussed and related recommendations developed in detail below.

5.3. Agriculture and Livestock

5.3.1. INTRODUCTION

193. Agriculture and livestock are the backbone of the country since they directly employ 44% of the labour force while two-thirds of the population living in rural areas directly or indirectly depends on these sectors for its livelihood. They go hand in hand since rearing livestock complements as well as integrates into existing cropping patterns, given its dependence on agriculture for its feed on crop residues and fallow land after harvesting. Both sectors have a huge unexploited potential.

5.3.2. AGRICULTURE

194. Since almost all possible arable land is now under cultivation, enhancement in agricultural production will have to come from the increase in yields per acre, which are presently low by international standards. The potential for raising yields and diversifying agricultural production to enhance incomes and even employment (in the case of horticulture) will require a variety of interventions, including better extension services, are discussed below

Table 22
Mt. Tons/ hectare, 2004-06

	Highest	China	USA	India	Pakistan
Rice (Egypt)	10.1	6.3	7.6	3.1	2.4
Wheat (UK)	8.0	4.4	2.9	2.7	2.4
Sugarcane (Egypt)	121.0	70.6	70.3	60.0	48.0
Cotton (Egypt)	2.8	3.5	2.4	1.2	1.85

Source: FAO Database and Agricultural Statistics of Pakistan, 2006/07

195. The performance of agriculture is heavily dependent on the weather, water availability[76] and the continued focus on traditional crops like wheat, cotton, rice and sugar-cane, partly because of the large base of subsistence farmers. The sharp rise in international prices for food crops and the opportunities arising for Pakistani farmers to trade in other cash crops and enhance their earnings (especially with the gradual removal of subsidies in OECD countries and the resulting increases in prices of such crops) could contribute significantly to the rapid enlargement of the middle class even in the rural areas. Furthermore, to augment farmer prosperity there is a need to narrow

[76] There is also a need to promote water use efficiency, through micro-irrigation technology involving drip and sprinkler irrigation systems, land-leveling, etc.

the gap between the yields of the progressive farmers and the large population of the small farmers, and shift cropping patterns in favor of value-added horticulture[77] which presently suffers on account of marketing system.

5.3.2.1. Issues with Extension Services

196. Extension services can play a critical role in assisting inadequately resourced and poorly educated small farmers to raise their productivity in an effective and cost efficient manner on a sustainable basis. However, the quality of these services has deteriorated overtime because of a) a weak commitment to the sector; b) lack of funding for non-salary components (especially since the formation of local governments under the devolution); c) de-motivated and ill-equipped staff whose capability has not been upgraded periodically to enable them to satisfy expectations and requirements in an increasingly complex production environment; and d) the low priority attached by provincial governments to the potential offered by the revolution in the media and the advancements in telecommunications technology to advise and inform farmers on best practices.

5.3.2.2. Issues with Market Committees

197. For maximising the returns to farmers for their agricultural produce factors related to the infrastructure, framework and institutional arrangements for the marketing of these products are important. The agriculture marketing acts govern the regulation of the purchase and sale of agricultural produce (including livestock and poultry) through the institution of market committees. A licence is required from the provincial government to establish a market within a notified area and once the notification of the market committee has been issued no other market can be established in that area without prior approval from government. The government nominates the members of the market's oversight committee and maintains significant control over the inflow of resources and assets owned by the market committee. This arrangement also results in the lack of accountability of the committee to market users and key stakeholders.

198. Whereas a farmer can only sell his produce through a licensed commission agent or the arthi (in most markets the arthi also acts as the commission agent) anyone can participate in the auction as a buyer, i.e. buyers do not require a license to operate in a market. The commission agent gets a commission of 5% (on fruits) to 8% (on vegetables) on the produce sold in the auction.

199. The Committees have monopolistic power and control over the bulk/wholesale purchase and sale of farmer produce in the area that is traded in these markets. This is detrimental to the interests of growers, most of whom tend to be middle farmers- with the small landowner largely resigned to selling his

[77] According to the World Development Report, 2008, relative to cereals returns on horticulture are 10 fold with substantial-150%-increase in direct employment apart from off-farm job creation in processing, packaging and marketing.

entire produce to the "beopari" (contractor/middlemen/trader) who picks it up from the farm gate (see below) or to the arthi in the market[78].

200. Over the years, however, a) commodities like wheat, rice, maize, cotton, sugar cane and oil seeds are no longer being traded in these markets and are being sold directly to processors like ginners, rice husking mills, flour mills and sugar mills[79]. Similarly, fruits and vegetables grown are being bought directly by middlemen/trader/contractor from the farms of the small farmers[80] and brought for sale in the markets under discussion or sold directly to large wholesalers who in turn either export the produce or sell directly to large retailers; and b) poultry is not being traded in these markets while local governments (largely since the devolution in 2001) and private entrepreneurs in complete contravention of the law (reflecting on its poor enforcement) have set up markets for livestock[81]. In other words, only fruits and vegetables (contributing 10%-13% of Sindh's crop produce, valuing around Rs.30 billion at 2006/07 prices), but making up 40%-45%[82] of the total production of these commodities, find their way into the government controlled markets. If livestock is included as agricultural produce that has to be traded through these markets, then in the case of Sindh the provincial government exercises control over the trade of almost Rs.70 billion of value added in agriculture[83].

201. There are too many intermediaries in the marketing chain (as illustrated in Figure I below). As explained above the beopari/trader and the arthi provide the link between the farmer (and the commission agent in some instances) and the wholesaler. The wholesaler serves as the link between the mandi/market and the retailer. At each step the intermediary marks up the price to factor in his profit/ "cost of service" making the supply chain inefficient. It is estimated that in Sindh the wholesaler marks up the auction price at which he bought the produce by 10%-15% (depending upon the commodity and the supply and demand situation) when he sells to the small wholesaler or retailer[84], who in turn, when selling to the final consumer, mark up the produce by an overall 20%-40% depending upon the commodity and its quality to account for spoilage, especially of perishable items and the consumer markets in which they are sold, the more up-market the locality the higher the mark up for quality and the cost of operations. In other words, the intermediaries pocket two-thirds to three-fourths of the price paid by the final

[78] A significant proportion of the input costs of a small farmer are financed by loans from the arthi/commission agent on the condition that the entire crop would be sold through him in the market.

[79] However, the market committees try and collect market fees from the ginners, rice and sugar mills for the produce that they buy directly.

[80] It is widely believed that the small farmers neither have storage facilities nor the financial resources to transport their produce to the market. The arthi or the middleman/beopari is well positioned to exploit this weakness. Moreover, the price received by a farmer for his produce is influenced by prices for the crop in the government controlled markets-they serve as a reference point for price formation.

[81] However, there are no legal bars on the private sector setting up slaughter houses. Local governments are empowered to regulate the establishment and operations of these slaughter houses-essentially to ensure compliance with environmental considerations.

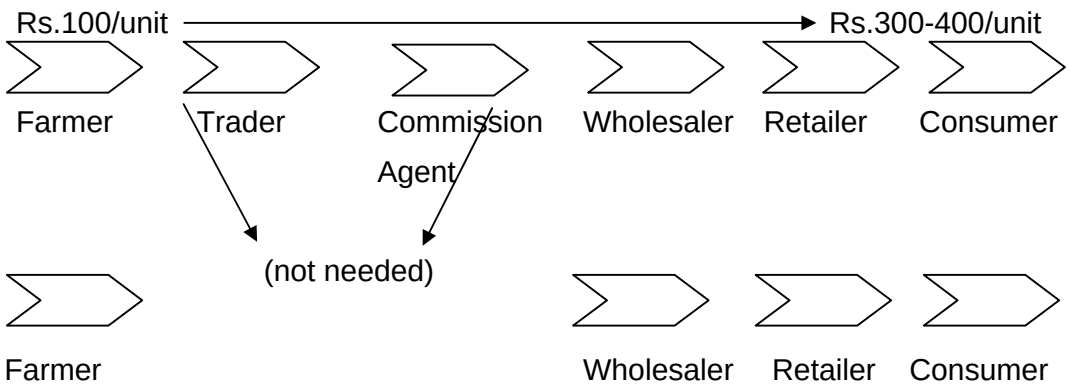
[82] Sindh Government officials, however, challenge this claim. They argue that the volume traded through these markets is larger-in their opinion sales of 60% to 70% of fruits and vegetables are transacted in these markets. Smaller quantities are being reported by market administrators simply to justify the total market fees of Rs.70 million being accounted for officially- leakage being a major issue. However, Arthis and traders claim that more than 80% of the fruits and vegetables cultivated in Sindh find their way into these markets.

[83] Assuming 25% of the stock of buffaloes, cows, sheep and goats is slaughtered every year.

[84] While 30% of the produce is sold by the wholesaler on cash the balance is traded on a 10-15 day credit.

consumer. The process of price discovery is opaque and places the grower at a disadvantage. The number of intermediaries also contributes to overall wastage-the spoilage in this lengthy chain can be as high as 40% of the total supplies of the farmer. The farmer and the consumer pay for these inefficiencies.

Figure I



Source: Khan, Mahmood Hasan (2008). Agricultural Growth in Irrigated Punjab: Some Issues and Policies. Centre for Research in Economics and Business, Lahore School of Economics.

202. In Karachi the provincial government has recently granted a specific permission to Metro Cash and Carry Company to buy agricultural produce from farmers directly and sell it as wholesalers instead of the produce being brought to the already notified Market Committee in the same area.

5.3.2.3. Recommendations for Enhancing Agricultural Productivity and Growth

203. To enhance agricultural productivity and growth government intervention in agriculture must move away from aimless subsidization of outputs (like production of wheat this year) and inputs (fertilizer and under-recovery of the cost of provision of irrigation services)[85] to: a) introduction of BT cotton learning from the experience of India where production of cotton increased 2.6 times from 10 million bales in 2001/02 to almost 26 million bales in 2007/08 while yields rose from 186 kgs per hectare to 466 kgs per hectare over the same period compared with Pakistan where there has been no significant upward trend in yields since 1990[86] (Appendix V); b) integrated pest management and testing facilities and regulatory oversight for quality of pesticides cotton; c) improved availability of good quality certified seed[87] (through the approval of the draft Seed Act, improvements to enhance the efficiency and effectiveness of the process and institutional framework for

[85] Meeting at best 35% of the cost of operating and maintaining irrigation networks-the latter maintaining the cropping pattern in favour of heavy consumers of water, a commodity fast becoming scarce.

And this is important since almost half of the cotton-producing households own less than 5 hectares accounting for nearly 20% of cotton production

[87] Certified seed is available for 45% of the cotton crop and in the case of rice and wheat 24% and 18% respectively.

seed certification and public private partnerships for sharing foundation seed and multiplication); d) more efficient utilization of water[88] (largely through better pricing and conservation of this scarce resource, including precision land leveling[89]); e) speedy implementation of projects relating to cold storages and additional support for development of such storages[90] say through period based tax exemptions; f) investment in, and dissemination of, research to increase yields; g) improved extension services (in part by incentivizing private sector provision of extension services); h) establishing a futures market for crops and a system of crop insurance so that pricing signals can work; i) constructing and maintaining farm-to-market roads; and j) rural electrification. Other interventions should include a) addressing of the issue of asymmetric prices for inputs and outputs[91]; b) allowing farmers opportunities to export[92] say through provision of export re-finance (thereby improving the terms of trade in favour of agriculture); and c) strengthening agricultural marketing, partly through public-private partnerships in the development of agricultural markets, and through revisions in the regulatory framework for market committees.

204. Finally, to address the issue of small, fragmented and uneconomic holdings and to provide liquidity to the assets held by subsistence growers the provincial governments should consider corporate farming as an alternative model for enhancing efficiencies and yields per acre, supplemented by a reliable system for land titling.

5.3.2.4. Recommendations on Extension Services

205. The provincial governments should use modern, effective and cost efficient instruments like the audio and electronic media and communication technology (by abandoning the present strategy to employ thousands of extension workers and opting for awareness and education campaigns using the media and new communication technologies, for example toll-free call centers manned by well paid experts and knowledgeable professionals) for disseminating best production practices.

206. The provincial governments need to strategize their interventions for greater effectiveness of its objectives associated with extension services. They should reprioritize and re-align budgetary allocations to support farmer efforts to augment yields by exploiting the opportunities provided by modern communication technologies (including web-based systems) to transmit

[88] Pakistan's cereal production of 0.13kgs per cubic meter of irrigation water compares unfavorably with 0.39, 0.82 and 1.56 in India, China and USA respectively, Report of the Task Force on Food Security, Ministry of Food, Agriculture and Livestock, January 2009.

[89] Laser land leveling saves water usage by 30% while increasing productivity.

[90] Post harvest losses of fruits and vegetables range from 12-40 percent of output valuing Rs.50 billion annually, partly because of lack of farm to market roads. Factors like non-availability of disease free seeds, poor management practices, and lack of grading standards, poor quality packaging and limited cold storage facilities affect exports of horticultural products and the prices they fetch.

[91] As a result of which small farmers pay relatively higher prices for their inputs and get paid relatively lower prices for their produce. See Akmal Hussain (2003).

[92] Because of the low elasticity of demand, prices in agricultural markets tend to be unstable and volatile.

powerful messages and production enhancement techniques to large, relatively less educated audiences in a cost efficient manner.

5.3.2.5. Recommendations on Market Committees

207. There is no reason why trade in fruits and vegetables and livestock cannot be deregulated by allowing private parties to set up and operate bulk/wholesale markets and manage product-grading and standardization processes. There is, therefore, a need for an enabling policy environment for trade in agricultural produce and market access by reducing trade barriers through the creation of more competitive, non-monopolistic, structures that will ensure better returns to farmers.

208. Introduction of greater competition at the wholesale level will not only reduce congestion in markets but also enable farmers to increase their earnings with declining opportunities for extracting rent presently available to traders who have captured these government regulated market committees that have the sole right to conduct wholesale trade in the area and also only through government-appointed commission agents.

209. Although the legislation governs the orderly flow of farm produce to the consumer with price discovery through the auction process the farmer, especially the small landowner, is exploited by the arthi and the commission agent a) because of the monopoly they enjoy since the produce can only be sold in that particular market[93]; and b) through unfair grading and weighing of the produce. An amendment in the legislation or its repeal will open up opportunities for improving the farm produce supply chain- permitting retailers to buy directly from the farmer by-passing the markets and the intermediaries. Such an arrangement will enable organized retailing (e.g. Metro type organized retailers/wholesalers) directly sourcing from the farmer-eliminating at least two intermediaries from among the arthi, commission agent and the wholesaler, with the need for central storage and reliance on wholesalers also being eliminated in the process.

210. We estimate that the overall economies from the shortening of the supply chain-with the reduction in the number of intermediaries would be 20%-25% of the consumer price in the case of farm produce. These economies would be a mixed blessing with varying impact on the different stakeholders, creating winners and losers. In case of farm supplies the share of each would be a function of their relative power and the situation with respect to competition, the greater the competition the higher the benefits that would accrue to the farmer and the consumer. Farmers will get higher prices and if warehouses and cold storages are constructed, spoilage of farm produce would be reduced significantly and provide an incentive to increase farm productivity through improved technology. The wholesalers would no longer have to buy from mandis/markets thereby lowering their purchase costs. The procurement costs of retailers would also be lowered with margins depending upon the competition between wholesalers and retailers. While some arthis and commission agents would be driven out of business they could harness

[93] Since the function of the markets is price discovery and if farmers only get a third of the retail price in government markets that sets the base for all transactions.

their unique competency about market knowledge and contacts to reorient their businesses by for example becoming wholesalers.

211. Our estimates suggest that just for onions, chillies, bananas and mangoes, whose traded value in these markets at their June 2008 retail prices in Karachi was respectively Rs.6 billion, Rs.2.5 billion, Rs.5 billion and Rs.1 billion the overall annual economic savings from the shortening of the supply chain (including reduced wastage/spoilage) could be Rs.1.5 to Rs.2 billion at today's consumer price in Karachi.

212. The reforms in the area of agriculture marketing should also aim to strengthen market related information systems. There is a need to tackle information asymmetry on prices to enable farmers to maximize their returns without being exploited by middle men on this account. To this end, there is a need to improve the information providing network comprising websites and electronic boards in markets to make data real time.

5.3.3. Livestock

5.3.3.1. Issues with the Livestock Sector

213. The livestock sector which contributes 52% of value-added in agriculture and around 11% to the GDP has experienced an annual growth of 3-4%. Livestock is a major, if not the only asset of the rural poor, with 30-35 million engaged in livestock husbandry. Livestock apart from serving as draught power is an important source of essential nutrients. It also provides a regular stream of income and of employment (the latter particularly for women). Between 30-40 percent of incomes of such households is derived from the sales of related products, milk, meat and eggs, with nearly three-fourths of the milk either consumed by the households themselves or sold locally.

214. The estimated livestock population is in excess of 151 million[94] with an average of 3.2 milch animals per livestock holding household, with one-half to two thirds having a herd size ranging from 4 to 6 milch animals. However, despite the size of the animal population, its outputs are well below the potential in terms of yields of milk and meat because of traditional and poor farm management practices with regard to the nutrition and management of animals, the inadequate cover and quality of animal health, the inferior genetics of the breeding stock, long calving intervals, the weak quality product controls with respect to milk and meat, the lack of availability of credit and lack of access to, and weak, marketing networks. The small herds that are largely dependent upon local fodder, open/communal grazing areas and farm and household waste are also factors underlying the poor yields.

215. Therefore, the primary focus of interventions in the livestock sector should be to enhance yields of milk and meat and improve access to markets through assistance in the adoption of modern farming practices, development of effective insemination centres to upgrade the genetic base of the animals, better quality animal feed, training in animal care and disease prevention and better access to animal health services through social mobilization of farmers.

[94] Census of Livestock, 2006

However, although milk sales provide a daily income, less than 8% is processed and marketed through formal channels and an estimated 20% is lost during transportation and storage[95]. It is generally accepted that the sector is failing to reach its potential due to poor nutrition and management of stock, lack of access to services, weak market linkages and lack of availability of credit

5.3.3.2. Recommendations on Livestock

216. There is a diversity of views on the strategies to adopt and the interventions needed to improve the productivity of the most important commodity of the sector, milk, and through such initiatives, help in reducing poverty. These range from the proponents of commercial farming to those who advocate community development. The essence of the debate centres upon improving returns that accrue to the livestock farmers through better marketing, technical advisory and extension services, while also giving them better access to finance.

217. In our view, the existing Insemination Centres (ICs) suffer from multiple inefficiencies arising from staff absenteeism, mainly because of weak monitoring, supervision and accountability structures and systems. To ensure the sustainable development of cost-effective good quality fresh semen producing centres, the existing insemination centres should be run under a public-private partnership arrangement. The veterinarians and para-vets trained under such a partnership arrangement over a 3-5 year period should be able to sell their services directly to the community after trust has been built and their advice has contributed to higher household incomes.

218. The complementary pillars of the ICs should be the provision of animal health care and nutrition through trained workers (para-vets) based in the village, focusing on prevention (which represents 90% of the animal health cases requiring attention) through dressing of wounds, de-worming, seasonal vaccination and administering basic medicines, activities that qualified vets are reluctant to perform.

219. Due to a favourable climate, the nutritional value of fodder in Pakistan is 3 times that of the feed available in New Zealand. A proper feed mix for maximum nourishment can improve yields dramatically.

220. Therefore, through a package of interventions along the lines proposed above, milk yields of beneficiary households could increase by 35%-40% over a 3 year period. This is likely to be the maximum improvement in yields due to limitations imposed by the genetics of the livestock breed. Currently, the average yield is about 1,100 litres/ year. An increase of 40% in milk yields, assuming each household has 3.5 animals on average, and taking a conservative price estimate of Rs. 20/litre[96], would raise the annual household income by Rs.31,000. The marketing of this milk should not pose any serious

[95] Employment and Income Generation through Livestock and Dairying, Paper prepared for DFID

[96] This is a conservative estimate of income since the price of milk has risen from Rs.14/liter to Rs.27.50 per litre in just 3 years.

problems because of the healthy competition between milk processors. If the marketing of the milk is viewed as a major constraint facing livestock-rearing households, then through a PPP arrangement an organization could be established to either create or manage (for a nominal fees) a central milk collection facility, buying the product and storing it in chillers for onward sale to other milk processors, thereby ensuring better returns and timely payments to these households.

221. A related intervention to enhance farmer incomes could be an initiative to increase livestock yields of meat (both in terms of quantity and quality), which requires effective and efficiently functioning marketing chains. At present there is a weak relationship between the quality of the meat and its price. Moreover, since the male calf drinks milk and is not a milk producing animal and there is a cost of maintaining it, the male is slaughtered before it reaches 6 months of age (now that tractors are replacing animals for draught power). Also, during transportation to livestock markets or slaughter houses animals undergo trauma, losing weight in the process. For these reasons the incentive to invest in the fattening of the animals is poor. Through an appropriate package of interventions (such as the provision of interest free loans) household incomes could be raised by Rs.100/day at 2008 prices. Additional income from keeping the animal and not slaughtering the male at an early age should provide an adequate incentive for others to adopt such a course.

222. Furthermore, animals are sold in the unregulated, if not illegal, market fetching lower prices. Presently, markets for trading livestock can only be set up under the auspices of local governments. If the private sector were to be permitted to set up local bulk markets for the sale of livestock and also encouraged to set up abattoirs (some privately owned ones are unauthorized)[97] with direct links to such markets, greater competition and fewer intermediaries between the livestock holder and the end consumer will reduce margins, thereby benefiting both producers and final consumers. The establishment of slaughter houses locally would stimulate economic activity in backward areas like Southern Punjab, lower Sindh and Balochistan.

5.4. Housing and Domestic Commerce

5.4.1. INTRODUCTION

223. The construction sector is a major source of employment, especially for those with limited skills. It also has numerous forward and backward linkages with different sub-sectors on industries and providers of associated services-e.g cement, stell, electrical appliances, sanitary ware, etc. A major sub-sector is housing, being a major determinant of savings. Therefore, encouraging the development of this sector can bring a host of benefits to the domestic economy in general and to the objective of inclusive growth in particular.

224. With the sharp escalation in prices of land in recent years, even improved availability of housing finance will not enable the vast majority of the less affluent segments of society and those among the low to middle income households, whose primary source of earnings is salaries from employment,

[97] Abattoirs can only be owned by local governments and these are generally controlled by private wholesalers and abattoir contractors.

to buy residential property. For such households, especially with the rise in nuclear families, the only option to escape from high land prices, low housing affordability, over-crowded dwellings and congested surroundings would be the move away from horizontal to vertical development in major cities and availability of housing on rent. For the latter, the structure of property taxation and the pro-tenant bias of the rent related legislation serve as principal disincentives.

225. Similarly, small and medium-sized enterprises do not have adequate investible equity sources for funding property acquisition and need a dynamic and efficient rental property market for office and other business space. The growth of small businesses is stunted because they are priced out of the land market and because of the limited supply of commercial and office rental space owing largely to overregulation and by the poor incentive, if not positively discouraging, structure for developing property for rental purposes and issues of contractual enforcement and tenancy favouring legal and judicial systems.

5.4.2. Key Constraints to Development of Housing and Domestic Commerce

226. The key legal, fiscal and administrative constraints to the development of housing and domestic commerce within the purview of provincial governments are:

a) Poor reliability of the Records of Rights resulting in unclear title to property.

b) High rates of stamp duty and other levies.

c) Outdated and non-uniform building and zoning regulations.

d) Contract enforcement.

e) High property tax rates on rented properties.

f) Rent restriction legislation, especially sections relating to rights of tenants.

5.4.2.1. Unclear Land Titles

227. The lack of an adequate land information, access, and retrieval and verification system underlies the poor quality, poor reliability and inaccuracy of the records of ownership rights, which has resulted in the dysfunctional nexus between land management and housing markets. These factors, combined with weak protection of property rights, are major impediments to the development of efficient and more liquid land markets.

228. Pakistani law does not view registration or any other record of rights in land as a guarantee from the government or its agencies that the person mentioned in the records of any agency is the rightful owner, so that if the records turn out to be incorrect, the government cannot be held liable for the inaccuracy of the record and the loss if any incurred by the buyer of the property on the basis of

the information contained in the records. In transactions involving property transfers, the documents of 'title' provided by the seller to the buyer do not certify title. These are private documents that confirm one of the transactions in the entire chain of transactions. By entering the transaction in respect of any property in the official records, the Registrar only confirms that the transaction has been recorded and does not provide any guarantee for either the validity or the accuracy of the document. Erroneous documentation and multiple registrations of the same lot in the names of different transactors and poor recording of plot size and boundaries encourage overlapping claims on ownership.

5.4.2.2. High Rates of Stamp Duties

229. An important factor hindering the growth of housing is the high cost of registering property transfers. All related instruments are either wielded by or within the control of the provincial and local governments. In Punjab and Sindh the costs in urban areas include a 1% registration fees, a 3% provincial stamp duty and local government property transfer fees on the value of the property[98] (plus a 2% Capital Value Tax levied by the FBR), compared with a nominal transfer fee of Rs.150 per sq. yard (and no stamp duty) payable to the Capital Development Authority in Islamabad[99]. In the case of a loan, there is a 0.25% charge for registering mortgage documents.

5.4.2.3. Out-dated and Non-uniform Building Laws

230. The building by-laws are outdated and do not reflect realties or the needs of major urban centres and leave discretion in the hands of officials. For instance, residential zones only cover single family homes and not greater urban density through apartment blocks for constructing, which developers are liable for commercialization charges[100].

231. Moreover, there are multiple agencies, Development Authorities, Cantonment Boards, Tehsil Municipal Administrations, each administering its own, non-uniform, zoning and building by-laws (e.g., those relating to heights of buildings, ratio of floor area to plot area) and building approval criteria within a city, with little coordination between them on these matters.). In Karachi the ceilings on the height of buildings operate through the permissible floor to plot area ratio and the construction industry in the city is of the opinion that at the allowable density of floor to plot area ratio, it is not financially viable to acquire land in prime commercial locations at the current price of Rs.80,000 to Rs.100,000 per sq. yard.

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[98] The government loses revenue since individual parties to a transaction avoid payment of stamp duty by giving a general power of attorney to the buyer, until a buyer in the long chain of transactions decides to take possession of the property to either hold it for a longer period or carry out on construction on it. Only then does a sale deed get drawn up for registration purposes.

[99] On average, roughly 1% of the value of the plot of land.

[100] Considering that the two provinces with the largest populations face scarcity of land the only way to accommodate the growing population would be vertical construction, which would also require reliable supply of power

5.4.2.4. Land Regulation-Commercialization Charges

232. Some local government taxes and fees overly load the cost of investment for the construction sector. For instance, the Lahore Development Authority (LDA) levies a commercialization fees equivalent to 20% of the value of the plot in case of change of use of property, even in areas declared as commercial zones[101]. In Karachi, the flat rate commercialization fee of Rs.8,000 per sq. yd. is approximately equivalent to 10% of the value of the plot in case of change of use of property in prime commercial areas of the city. Moreover, commercial space in residential sites and services schemes tends to be limited and also restrictive in nature in terms of plot sizes for warehousing and retail outlets. As a result, commercially zoned property is inadequate, explaining the lack of warehouses, hotels, large departmental stores and shopping malls in major urban centres.

233. We understand that the rationale underlying these rates is the wide gap between revenues from property tax[102] and receipts from the provision of other services (for example, water tariffs in the case of WASAs) and the requirements to finance capital expenditures and recurring obligations of these agencies. In our view, the deficits faced by these agencies to satisfy their mandates should not be bridged by taxing investment but addressed through a combination of measures involving the re-structuring of property tax, rationalization of user charges, appropriate strengthening of the collection machinery, enhancements in the efficiency of expenditures and better financial management.

234. Moreover, commercialization is generally restricted in the form of strip development. For example, in Karachi strip development has occurred along 17 roads of the city (where commercialization had already taken deep roots) instead of the promotion and development of commercial and business districts in the city, highlighting both the weaknesses and reactive nature of the planning process and the lack of an integrated strategic approach towards the city's growth, resulting in an inefficient spatial structure (uneven density and ribbon development) and in the uneconomical utilization of scarce land.

5.4.2.5. Restrictions on the Height of Buildings

235. As indicated above, one constraint to the development of the construction sector arises from ceilings on the height of buildings and floor-area ratios. These height restrictions have been imposed because local governments and their agencies entrusted with the responsibility to provide essential municipal services, such as water and fire fighting capabilities, are ill-equipped to perform these functions effectively.

[101] In areas not categorized as commercial, LDA allows temporary commercialization for which it imposes charges on an annual basis.

[102] 50% of the property tax receipts are handed over to WASA, 25% are distributed to LDA and the remainder are passed on to the City District Government Lahore (CDGL)

5.4.2.6. Other Building Regulations

236. The current building regulations require the provision of parking space on the basis of one car for every 1000 square feet of covered area. In our view, there is a need to re-examine this requirement for mandatory provision of parking space in commercial plazas since it is the responsibility of the government to enforce traffic laws and ensure the free flow of traffic.

237. A major issue is the slow colonization of the housing schemes, even when all associated infrastructure has been provided. As a result, not only is the investment on the roads and the electricity, gas and water supply and sanitation systems being under-utilized, the assets created through the provision of infrastructure to these housing societies deteriorate because of long periods of non-use. The levies/charges on leaving plots vacant do not serve as effective instruments for deterring speculation in land, ensuring better utilization of installed infrastructure in the sites and services schemes and facilitating a more efficient functioning of land markets.

5.4.3. PRIVATE SECTOR DEVELOPMENT OF HOUSING

238. Private developers of housing and related schemes require a host of separate approvals from a variety of agencies, rather than have access to a one-stop processing facility. Approvals are required from different agencies and departments dealing with town planning, zoning variations, plumbing plans, architectural plans, site plans, environmental plans, electrical plans, building permits and completion certificates. They also need to get relevant NOCs from another set of agencies and neighbours, apart from having to deal with WAPDA/KESC, gas and water providing utility companies, a time consuming exercise.

239. An overarching, and formidable, constraint to the bulk development of property by the private sector for eventual sale [103]is the 'legality or white' aspect of the source of money tied up in land. The antecedents of the bulk of the wealth invested in land are dubious, being 'black' in character.

240. Since money is not white it is in the interest of both parties to the transaction – the buyer and the vendor – not to document the correct amount of consideration at which the property exchanges hands. Hence, the sale deed only declares the value on which stamp duty is levied and collected by the Registrar of Properties (as per the valuation table applicable to the area, which in many cases significantly under-states land values). Therefore, unless the valuation table reflects the market value of land, and is revised frequently enough to ensure its currency, the white portion of the transaction can be grossly understated, resulting in a large taxable 'paper gain' on which the developer has to pay a high rate, 41%, of income tax.

241. Developers also complain: (a) of the high charges or rates of penalties for modifying building plans, even when the variations do not result in any increase in the covered area of the building; and (b) the demands of the

[103] Other than high rates of stamp duty and registration fees on property transfers and on financial mortgage deeds.

Employees Old Age Benefit Institution (EOBI) and the Provincial Employees Social Security Institutions for contributions at 5% and 7% of wages respectively even for casual workers, which make up most of the labour force in the construction industry. The latter is a particularly contentious issue in NWFP where the bulk of the labour force in the sector comprises Afghan refugees.

5.4.4. Rent Control Legislation and other Factors Influencing Property Development for Rental Purposes

242. A key factor constraining the expansion of the housing sector is the rent control legislations of the provinces that are biased in favour of the tenant, creating a disincentive for construction of property for rental purposes.

243. In Sindh and NWFP the legislation empowers a Rent Controller to determine a fair rent for the residential premises and disallow the increase of rent of residential buildings over a 3 year period, while the rent of non-residential buildings can be raised by 25% every three years. It appears that even when there is a suitably framed, and legally binding, lease/contract the tenant can still apply to the Controller for assessing a fair rent.[104]

244. Moreover, despite a fixed period lease the tenant has an automatic right to retain possession of the property and stay on, an exception being made only in the case of landlord establishing that his "bonafide personal need" for the return of property, a matter that generally becomes the subject of litigation right up to the Supreme Court, where rent related cases make up in excess of 8% of the cases that it adjudicates.

245. The most important provisions of the legislation relate to conditions governing the eviction of tenants. For getting the tenant to vacate his property not only is the landlord required to establish his bonafides of need he also has to demonstrate that the premises are more suitable for his needs than the one he is currently occupying. The process of eviction is slowed down appreciably (and may even take several years) over disputed questions of fact that require submission of evidence and accounts of witnesses before they can be resolved.

246. The legislative bias in favour of the tenant is reinforced by provisions that:

a) empower the Controller to restore to the evicted tenant the possession of the property if the landlord does not inhabit the vacated premises or puts it to any use other than personal or re-lets it to a third party within one year of re-possession.

b) in the event that the landlord has been given possession of the property for new construction or renovation and the old building has not been demolished within six months or the new building has not been constructed within two years after this six month period, in Sindh the

[104] We understand that there are conflicting judgments of the Supreme Court of Pakistan on whether the law of contract overrides the provisions of the Rent Restriction Ordinance.

Controller can fine the landlord up to a maximum of one year's rent. In the NWFP he can even be sentenced for a period of 6 months!; and

c) endow the evicted tenant with the first right to rental space of the same size in the new building.

247. In Sindh if the Controller finds the application filed by the landlord for re-possession of property to be frivolous he can direct him to pay the tenant a compensation that could be as high as ten months.

248. Moreover, the law makes the tenancy relationship even more complicated by allowing tenancy rights to automatically pass onto the legal heirs of the dead tenant.

249. Other major factors that serve as disincentives for renting out properties are:

a) The high rate of stamp duty (e.g. in Sindh 3% of value of contract) and registration fee (1% of contract value) on the compulsory registration of lease documents covering a period of 1 year and above;[105] and

b) The structure of property tax in Punjab under which rented-out properties pay ten times the tax paid by similar owner-occupied properties, even though they have similar access to facilities like roads and street lights and to services like solid waste disposal. This differential is much higher than in Karachi where the ratio is 1:2 and in Islamabad where both categories pay the same rate of property tax. The NWFP government on the other hand has put in place a better policy for taxing commercial properties. Both owner-occupied and rented commercial properties pay the same rate of property tax.

250. Moreover, property tax paid is treated as an expense against taxable income and not as a tax credit, thereby effectively raising the tax on rental income (already a high 41%) in a system that does not tax wealth. As a result not only has a whole potentially vibrant service sector been lost to the economy, it has also contributed to the entrenchment of dysfunctional land markets, characterized by rather high prices and lack of supply and opportunities for development.

5.4.5. Recommendations on Housing and Domestic Commerce

251. The housing and construction sector with its high employment elasticity, strong forward and backward linkages with a number of sectors and sub-sectors[106] and large direct and indirect employment and income generating impacts is most affected by the tax regime and regulatory structures within provincial control. For these reasons the following reforms are proposed to exploit the huge untapped potential of the sector.

a) Reducing the cost of investment by:

i) Rationalizing the stamp duty on property related transactions.

[105] To avoid these charges leases tend to be signed for an eleven month period.

[106] For India, it has been estimated that: (a) every Rs. 100 invested in housing adds Rs. 78 to the GDP; and (b) housing has backward and forward linkages with more than 269 ancillary indicators.

ii) Further pruning property change of use charges levied by local development authorities in areas categorized as ‘commercial’ under zoning regulations;

iii) Making zoning and building regulations uniform across authorities operating within a city, basing them on modern technologies of construction and quality of related materials and the pattern and availability of infrastructure of access roads and parking spaces and public transportation systems and capacity of of utility facilities and distribution networks;

iv) Removing arbitrary restrictions on heights of buildings and making insulation of buildings mandatory and introducing modern safety precautions requiring high-rise buildings used for commercial purposes to be both insured against hazards and equipped with basic fire fighting facilities.

v) Rationalizing development charges imposed by local water and sanitation agencies for change of use of property from residential to commercial purposes, collections from which are ostensibly earmarked for upgrading trunk infrastructure to handle the resulting increased volumes of sewage; and

vi) Imposing or raising the land non-utilization fee and enacting legislation to abolish benami holding of property. This will create a disincentive for speculation in real estate, help release land for construction, thereby also bringing down the price of land and generate resources that would enable utilities to earn a return on the assets tied up in the infrastructure (such as the trunk sewerage system, roads and utility distribution systems).

b) There is also a need to improve the incentives for construction of property for rental purposes by:

i) further narrowing the differential in property tax paid by rented and owner-occupied properties; and

ii) revising and reorienting the Rent Restriction Ordinance to reduce the pro-tenant bias, and more importantly its provisions relating to the eviction of tenants, particularly in cases where there is rental contract/agreement that governs the relationship between the landlord and the tenant.

252. The potential loss of revenue from the reduction in the property tax rate of rented properties would be more than recovered from a reduction in the evasion of property tax on rented properties, increased development of properties for rental purposes and a slight revision in the tax of owner-occupied properties.

253. The measures proposed above should be combined with disposal of land owned by government in prime commercial locations and being used for less productive purposes. The divestment of this land or that leased out to the

private sector at a nominal rent[107], will help exploit the potential of this scarce asset, thereby stimulating private construction activity, improving utilization of land, mobilizing revenues for all levels of government and generating resources for utility agencies from sunk investments in completed sites and services schemes not fully colonized.

5.4.6. Other Recommendations

254. A cost effective, reliable and effective system and an improved administrative mechanism for recording and transferring ownership or rights in urban land will facilitate the functioning of land markets, thereby lowering costs of transactions in property. The benefits will also include more effective instruments of fiscal policy, higher revenues through better administration of these records and improved efficiency in tax assessment and collection.

255. There is a need to establish a centralized land registry system in the form of a central register of land title and, in our opinion the provincial governments should give the responsibility of determining title to the Excise and Taxation Department (E&T). This department has the most complete and accurate record of urban properties in the province and hence best suited to shoulder this burden. For it to be able to perform such a function efficiently and effectively it will have to be mandated by law and provided the necessary resources in terms of finances, trained manpower and essential hardware and software facilities. Moreover, the Registration Department should be bifurcated and the wing dealing with urban properties should be placed under the E&T department.

256. Alternatively, the institutional arrangement proposed above can be placed under the Board of Revenue by establishing a Revenue Authority.

257. A system of registering deeds can provide the platform on which a system of registering titles can eventually be built. Hence, there should be a requirement for the compulsory registration of all property related documents that include sale agreements, declarations of gift and powers of attorney.

5.5. SME Clusters

5.5.1. Preamble

258. SMEs bring numerous advantages to regions of their location. They provide employment opportunities, encourage entrepreneurial activities and innovation and can lead to basic technological capacity building and skill development. Furthermore, a dynamic SME sector, especially when such enterprises are located in clusters, serves as an important complement to a more open economy. In most of the countries which appear to have reaped major benefits from export orientation the SME sector has been an important player in that process (Berry, 1998).

[107] The Lahore Gymkhana golf course and the Royal Palm Club/golf course in the centre of city being the most prominent examples.

259. Pakistan's economy has a large presence of small and medium sized establishments, estimated at 3.3 million which contribute 30% of the GDP with 95%. They are highly labour-intensive in comparison with the large-sacle manufacturing sector with 95% employing less than 5 workers.. Presently, three are several SME manufacturing clusters in the country. For example, there is a sanitary-ware cluster located in Gujranwala, a cotton ginning cluster in Rahim Yar Khan, an electrical fittings cluster in Sargodha, a cluster of industries manufacturing light engineering products in Faisalabad, a wooden furniture cluster in Gujarat, a sports goods and surgical instruments cluster in Sialkot and the auto parts, PVC pipes and plastic products cluster in Lahore. This section defines clusters, highlights their needs in Pakistan and then proceeds to develop recommendations on their strengthening, especially from the point of view of their international competitiveness.

5.5.2. INTRODUCTION

260. Clusters can simply be defined as sectoral and spatial concentration of firms.[108] An industrial cluster is an agglomeration of companies, suppliers, service providers and related institutions producing a similar range of products. An example would be a country's auto industry, with its manufacturers and all their supporting services, like parts and equipment suppliers, transportation companies, retail distributors, educational institutions and R&D firms, public relations, advertising agencies, etc.[109]

261. Clusters keep transaction, inventory and transportation costs low, enhance productivity and operational efficiency via linkages, spillovers and synergies across firms and associated institutions and through efficient access to public goods, improved coordination, and the diffusion of technology and best practices all this being facilitated by the presence of specialized vendors of allied products, technologies and support services within the cluster.

262. In view of the increasing internationalization of production, distribution and marketing has created global community chains and business networks from supplying raw material to production, marketing and retail (retailer and brand merchandizing control chains) that are buyer driven (design and marketing intensive garments and leather sectors) or are producer driven, as is the case of capital and technology intensive products, automobiles and electronics, SMEs have to become part of a chain to access markets. And external actors such as global buyers and global lead firms not only link local producers to global markets but also provide a framework for understanding how clusters are inserted into global value chains to enable them to upgrade their technological and complementary capabilities[110].

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[108] Schmitz, H. and Nadvi, K. (1999) "Clustering and Industrialization: Introduction." Industrial Clusters in Developing Countries. *World Development*, Vol. 27, No. 9.

[109] International Trade Department (2009). "Clusters for Competitiveness: A Practical Guide and Policy Implications for Developing Cluster Initiatives." The World Bank.

[110] Nadvi, Khalid (1997) "The Cutting Edge: Collective Efficiency and International Competitiveness in Pakistan." IDS Discussion Paper 360.

263. There is, therefore, a need to identify sub-sectors of industry available to sub-contracting and then devise the strategy for providing the necessary support, including broadening of skills and substantial upgrading in the technological base, organizational structures and information systems for exploiting outsourcing opportunities (with environmental and labour standards pushing up cost of acquiring technology) and to meet standards of buyers with respect to price, quality and delivery schedules.

264. After they have been organised into clusters, enterprises have more incentives and ability to improve their individual performances than vertically integrated conglomeration of firms because of the pressure of competition. Also, compared to industrial policies which tend to be isolationist, and economy-wide approaches which tend to be generic, constraints to competition and development are often easier to spot at a cluster level.

5.5.3. Issues and Needs of Clusters in Pakistan

265. Some of the key issues and needs identified by international literature and similar work carried out in Pakistan, particularly pertaining to the clusters in Sialkot, include the following:

a) SMEs do not have the financial wherewithal for vertically integrating their production chain through investment in diversified equipment and technologies to enable them to secure their supplies of intermediate goods and services critical for manufacturing their products and manage their distribution nor is it economically and financially viable for them to do so given the scale of their production, the narrow scope of specialization based on their core competence and the market niche that they are targeting. Hence, they need common support facilities and technology support service centres located within the cluster.

b) The existence of a large pool of labour with specialized skills should reduce search and hiring costs for firms located within the cluster as well as reduce the risk and cost of re-location for labour looking for a better job opportunity. However, in the case of Pakistan a major constraint faced by those located in the cluster concerns the easier and rapid mobility of labour from one enterprise to another largely because of skill shortages, which pushes up the cost curve affecting the competitiveness of the cluster. Hence, the need to improve availability of relevant skills that can adapt quickly to changing technologies.

c) There is a need for effective engagement with global players, in particular between local cluster institutions and global brands, the costs of which are difficult for smaller individual enterprises to bear.

d) There is a need for regular flow of information on developments in products and process technologies, suitably supported by strengthening of capabilities to produce high quality products, which requires access to technology from global partners. Again the transaction costs of keeping themselves abreast with such developments are high for SMEs.

e) Another issue is that of the lack of, or restricted access to, working capital or long-term credit.

5.5.4. Recommendations on Policy Interventions for Strengthening Clusters And Regional Development

266. In terms of policy, a cluster-based approach enables the policy debate and actions to be more strategic and incremental. While industrial clusters generally evolve spontaneously over time, as has been demonstrated in the case of clusters in Sialkot, Gujranwala, Wazirabad, Daska, Gujrat and Faislabad, well-designed interventions to support existing clusters initiate development of new clusters and can speed up the process and provide a much-needed platform that can be used to excel in product output and sophistication.

267. In the light of the discussion above the following policy initiatives are proposed for the strengthening of clusters:

a) Collective action could be promoted by identifying the common needs of a particular cluster. SMEs generally lack modern design and production facilities and nor do they have the financial muscle to acquire these. To support their ability to compete and becoming efficient producers the government could consider setting up common facility centers[111] that would provide access to technology, machining facilities and market related information and other common services. For example, well-designed export processing zones (EPZ) with decent quality physical infrastructure can be developed with proper bonded warehousing capability and the above referred support facilities. In such export processing zones, the location of SMEs can be encouraged on the basis of transparent criteria such as a minimum number of workers, volume of exports and share of total turnover, etc.

b) Proper training facilities could be set up under a public-private partnership agreement with certification by some internationally recognized body for workers in such clusters. To facilitate development in relevant skills industries located in the cluster would identify the skills needing creation or upgrading.

c) Public information and knowledge of buyer needs, markets and production mechanisms are more effectively accumulated and disseminated within clusters Organizations can be established to develop linkages, for example, between buyers and sellers by acting as repositories of information of potential venture capitalists, potential buyers of products, potential trainers and to act as repository of information for market research reports which have already been conducted on various clusters.. The public sector say through SMEDA can play a key role in this area[112] .

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[111] Akmal Hussain, An Institutional Framework for Inclusive Growth, Draft, April, 2009

[112] International Trade Department (2009). "Clusters for Competitiveness: A Practical Guide and Policy Implications for Developing Cluster Initiatives." The World Bank. Also refer to the following for a similar initiative launched in India Cluster Pulse India. Accessed on: April 6, 2009.

d) The flow of sector-specific and technical information within the cluster generates important knowledge spillover gains for local firms. Widespread subcontracting allows for economies of scale and scope, leading to savings on costs, skills and space.[113] The flow of such technical information could be facilitated by the government, for example by arranging seminars and workshops within clusters thereby reducing transaction costs while generating high returns through wider and more effective participation of the key stakeholders.

e) The government can fund and facilitate market research to support innovation, tapping of new markets and identification of new products. Cluster associations and related chambers can identify credible consultants (both local and foreign) to conduct such studies and carry out capacity building exercises for improving among other skills managerial capabilities.

f) The government can finance study tours for cluster members to target markets or clusters which are centers of excellence and leading clusters in their industries. In addition, the visa regime for foreign buyers needs to be relaxed to enable them to travel to Pakistan freely, especially businessman visiting the region wanting to make a stopover in Pakistan.

g) The government can help improve the legal environment to support technology transfer by facilitating international adjudication for foreign patent holders and technology providers instead of insisting on dispute resolution in the poorly functioning domestic judicial systems.

h) To facilitate the growth of SMEs and SME clusters there is a need for a carefully designed programme to develop secondary/intermediate cities/towns[114] by adopting a cluster based approach (with the cities/towns to be connected, if necessary, through expressways) on the basis of economic potential (in terms of available markets and commercial centers), returns to the economy and payback period, instead of selecting individual cities in different parts of a province. Initially, for instance in Punjab, this may result in the selection of clusters in the central districts of the province with basic infrastructure (supplemented/upgraded by infrastructure to be provided under this project/programme), with markets having strong forward and backward linkages, because of readily available supply chains, skills, population concentrations with purchasing power and entrepreneurial talent.

Such an approach will keep the additional investment costs low for both the government and the private sector. For foreign investors in particular the costs of investment or doing business and locating assets

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<http://www.clusterpulse.org/index.htm>

[113] Nadvi, Khalid and Halder, Gerhard. (2005). "Local Clusters in Global Value Chains: Exploring Dynamic Linkages between Germany and Pakistan."Entrepreneurship and Regional Development. Pp. 339-363.

[114]The design will have to ensure that these towns/cities will have the revenues/resources to maintain this newly installed or rehabilitated infrastructure

will become lower for each new venture as more clusters are developed in other geographical areas of the province. These investments could attract large multinational retail chains like Metro, Makro, Carrefour, etc. (some of whom have already arrived) to locate in these areas creating opportunities for the development of high quality supply chains and related skills, especially for agro-processed products. There would be a huge multiplier effect associated with the operations of such retailers. The experience and expertise gained by those supplying goods to such franchises, those providing services of warehousing and transportation and by those trained by such branded outlets in managing the entire range of services linked to retailing and timely delivery of goods and services would enable them to improve the standards of their products so that they can market their products and services internationally throughout the global networks of such companies, especially their stores operating in the Middle East.

i) Promotion of entrepreneurship in new activities needs to be supported in view of high social returns but low private returns on investments, especially if the activities can spawn scale or agglomeration economies in new areas of specialization by expanding the range of capabilities in the economy. It is not a question of innovation and R & D but recognition that something already being produced internationally can also be produced domestically competitively. Rodrik (2004) calls this 'Discovery'. For Pakistan, the cases in point are the production of surgical instruments and sports in general and, until very recently, footballs in particular, in the city of Sialkot.

268. Therefore, over and above the above suggested interventions and initiatives that the government should consider to strengthen existing clusters, it may also support investment in technology and equipment in some new areas or sub-sectors of industry that it may wish to promote on grounds of their products being primarily exported or general value added and future potential for export. To this end it can provide incentives in terms of time based subsidized credit for all new entrants setting up new industry or opting for upgrading existing operations in the same industry through acquisition of specialized equipment and technology or/and accelerated depreciation allowances on investment in new plant and machinery. In addition, there is a need to continuously revisit the incentive structures for upgrading technology and products in response to changing market demands. The government can help develop foreign partnerships through tax incentives which can be period-specific incentives or linked to exports. Quasi public goods like specialized infrastructure, specialized educational programs, foreign direct investment (FDI) attraction, information and technology pools, quality centers and so on can be better handled by the government at the cluster level than either the macro or sector levels[115].

[115] International Trade Department (2009). "Clusters for Competitiveness: A Practical Guide and Policy Implications for Developing Cluster Initiatives." The World Bank.

269. Balochistan has peculiar features as compare to others provinces of Pakistan, We have to adopt a different model for the development of Balochistan e-g Horticulture is the base of agriculture in Balochistan and tons of fresh fruit has been spoil every year if these will be converted into by-product through Fresh Fruit Development Board (FFDB), which will also provide the agricultural extension services to farmers.

270. Onion and Potato are the high quality crops in Balochistan, but no provision of market for sale of these crop are available and ultimately farmers blocks roads and burns their produce on the roads There may be some system for the sale in domestic market as well as for export.

Chapter 6: Conclusions

271. The purpose of this report was to propose strategies and development priorities for broad-based sustainable growth. Pakistan's growth experience suggests while it has been able to achieve fairly decent rates of economic growth, the outcome has neither been inclusive in ensuring a fairer distribution of the benefits of growth nor has the process been sustainable. The reasons have included neglect of social indicators, a skewed distribution of assets, weak institutions of governance, inward looking economic policies and structures, poor levels and rates of savings and investments (largely owing to inequitable tax structures and the reluctance of the elite to contribute to the financing of economic growth on the basis of capacity to bear such a burden) resulting in the heavy dependence on external assistance (in turn helped by fortuitous events internationally) and the accumulation and continued growth of domestic and external debt. In addition, the requirements of a security state, further complicated by the recent surge in extremism and militancy in some parts of the country, have resulted in scarce resources being diverted from critical investments in human development.

272. Since some of these factors are likely to continue to serve as binding constraints in the foreseeable future, and given the uncertain international environment for significant inflows of private capital as FDI and portfolio investment or remittances of overseas migrants and markets for Pakistani exports in these recessionary global conditions, there is a need to identify sectors and activities that can help revive growth domestically, while ensuring that it is inclusive and sustainable.

273. Given the pattern of growth over the last 20 years, our estimates suggest that on the basis of the average ICOR of 3.65, taking the annual growth in the labour force of 2.95% and an average employment elasticity of 0.465, assuming a historical current account deficit of 3.06% of GDP and a national savings rate of 16.86% of GDP, the sustainable annual growth rate will be under 5.46% resulting in 14% of the annual increment to the labour force being added to the stock of the unemployed. However, if all annual additions to the labour force are to be accommodated the country will have to achieve an annual growth rate of 6.35% but financing this will require additional resources of 3.26% of the GDP. By raising the ICOR to the more realistic 4.00, keeping the rest of the assumptions the same, the achievable annual growth rate from available resources is estimated at 4.98% but this will result in the annual increment to the unemployed of 21% of the addition to the labour force. For the entire annual addition of the labour force to be absorbed will require an annual growth rate of 6.35% but this will mean a financing gap of 5.48% of the GDP.

274. A two-fold approach is recommended to address this fundamental problem. On the one side, it proposes emphasis on certain sectors which have the capacity to enhance the employment generating ability of the economy. On the other, it focuses on relaxing the growth constraints by enhancing competiveness and encouraging savings. In all this the provincial perspective is missing, which we hope to correct once the provincial reports are available.

275. To keep the ICOR low and spur growth through a shift in the pattern of development we propose strategies and public spending priorities that focus on sectors and activities with higher employment elasticities so as to accommodate the young labour force of 80 million presently endowed with limited education and skills or of indifferent quality. To this end we recommend interventions in agriculture and livestock which provide direct employment to 44%, in housing and domestic commerce and for promotion of SME clusters.

276. For the agriculture sector we recommend an early introduction of BT Cotton, greater reliance on technology for delivering extension services and improved marketing laws to benefit both farmers and consumers. The primary focus of interventions in the livestock sector should be to enhance yields of milk and meat and improve access to markets through assistance in the adoption of modern farming practices, development of effective insemination centres to upgrade the genetic base of the animals, better quality animal feed, training in animal care and disease prevention and better access to animal health services.

277. To improve housing and commerce, we recommend rationalization of stamp duties and development and commercialization charges, reforms in zoning and building regulations and property taxation of rented properties, revisions in rent control legislation, especially its pro-tenant bias, better contract enforcement and secure land titling systems.

278. The strengthening and creation of SME clusters requires facilitation of market research to assist innovation, better public information and knowledge of buyer needs, markets and production mechanisms, export processing zones (EPZ) with decent quality physical infrastructure and proper bonded warehousing capability, improvement in the legal environment for protecting foreign patent holders, promotion of entrepreneurship in new ventures and public-private partnerships in setting up common facility centers that would provide access to technology, machining facilities and market related information and other common services.

279. To ease the constraints to growth, especially the financing of the current account deficit, and to enhance the efficiency and competitiveness of the Pakistani economy in general and the heavily protected industrial sector in particular requires continuous and sustainable improvements in total factor productivity and a variety of policy, procedural, institutional, regulatory and legal reforms. Policy suggestions include interventions like reduction in the anti-export bias via an undervalued exchange rate regime, ensuring availability of imported raw materials to exporters at world prices and increasing market access for Pakistani products, particularly in EU markets. Other initiatives to support exports would include development of skills to assist upgrading of industry to enable export of value-added products.

280. To facilitate trade there is also a need to further simplify custom procedures, develop an integrated supply chain management service with real-time cargo monitoring and internet-based transactions, invest in infrastructure through better port facilities, create an efficient rail and air freight service and

introduce new and less polluting trucks for freight service. There is also a need to exploit the huge potential offered by regional trade, and thereby build strong constituencies for peace, through first granting India MFN basis and abandoning the positive list approach, easing visa processing to facilitate freer movement of people, an institutional arrangement for banks to participate freely in transactions relating to L/Cs and payments, opening up of new transportation routes, better information exchange, reduction in NTBs and creating an enabling environment for investment in joint ventures.

281. In addition, cost of doing business can be reduced through rationalization of administrative regulation, rationalization of labour levies and instituting a rule-based system for tax refunds.

282. To enhance the competiveness of the economy it is also necessary to improve the productivity of the young labour force. For this we recommend skill development initiatives through public-private partnerships and a quality approval process accepted by the key economic players in the domestic economy in the case of youth with limited education and a system for international certification for the better educated to be provided higher level skills. The labour force with such skills will attain mobility, domestically and overseas, thereby enhancing its earning capabilities.

283. Finally, to move to a higher sustainable growth rate it is necessary to tackle the lack of domestic savings. For this we propose improving financial intermediation by ensuring real and increased returns on financial savings, development of long-term saving vehicles like pension schemes and life insurance, examining the possibility of new instruments and institutions like portable and mandatory savings/pension schemes and Housing Societies/Credit Unions. To encourage savings on broad scale, particularly in the form that can be used to finance productive investment it is necessary to address the issue of financial exclusion of bulk of the population. This can be done by exploiting opportunities offered by technology in the form of “mobile phone banking”.

PART-III: INSTITUTIONAL FRAMEWORK FOR DEVELOPMENT

Chapter 7: Introduction: An Alternative Policy Paradigm

284. The present balance of payments crisis and slow down in GDP growth brings out in sharp relief the historical pattern of Pakistan's growth process. Periods of high growth end due to mounting balance of payments pressures such as at the end of the Ayub period in the 1960s, the Zia period in the 1980s and the recent Musharraf period: High growth has been critically dependent on concessional foreign capital inflows. An equally important feature is persistent mass poverty and the inability of the trend rate of GDP growth (about 5 percent) to substantially reduce poverty[116].

285. The twin features of instability and constrained poverty reduction are located at one level in the structural characteristics of the growth process itself: (i) An export structure that prevents an export growth high enough to finance the import requirements of a high growth trajectory. (ii) A domestic savings rate that given Pakistan's existing ICOR is inadequate to finance the investment rate required for a sustained GDP growth of 7 percent. (iii) A highly unequal distribution of productive assets and hence the exclusion of the majority of the people from participation in productive enterprise, results in increasing inequality during the high growth episodes and low poverty reduction if any.

286. At another level it can be argued that if sustained growth and rapid poverty reduction is to be achieved a shift in the paradigm for understanding both the determinants of growth as well as the nature of poverty is required. The literature of the New Institutional Economics (NIE) shows that the most important determinant of sustained growth is the institutional structure within which it occurs[117].

287. Applied research on Pakistan in the perspective of the NIE shows that Pakistan's stop-go pattern of economic growth is located in the limited access nature of its social order. Limited access social orders are characterized by rent creation, privileged access over economic and political power for the elite, and the exclusion of a large proportion of citizens from equal access over markets, resources and governance. Such limited access social orders as North, et.al have argued "preclude thriving markets and long term economic development"[118]. By contrast open access social orders provide

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[116] For a more detailed discussion of this phenomenon, see: Akmal Hussain, Institutions, Economic Structure and Poverty in Pakistan, South Asia Economic Journal, Volume 5, Number 1, January-June 2004, SAGE Publications, New Delhi.

[117] (i) Douglass C. North, Institutions, Institutional Change and Economic Performance, Cambridge University Press, Cambridge, England, 2004.
(ii) Douglass C. North, Understanding the Process of Economic Change, Princeton University Press, 2005.

[118] Douglass C. North, John Joseph Wallis, Barry R. Weingast, A Conceptual Framework for Interpreting Recorded Human History, National Bureau of Economic Research, Working Paper Series, Cambridge (Mimeo), 2006.

equality of economic opportunity on the basis of systematic competition, innovation, merit and mobility. Consequently, the institutional framework of open access social orders constitutes the basis of efficient markets and sustained economic growth.

288. If Pakistan is to embark on a path of sustained growth it would be necessary to establish an institutional structure for inclusive growth. Such a growth process would enable a transition to economic democracy which would sustain political democracy[119]. The institutional structure of inclusive growth would enable all of the citizens of Pakistan rather than only a small elite to participate as subjects of economic growth as well as the recipients of its fruits.

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[119] For a discussion on Economic Democracy and case studies of action, See: Ponna Wignaraja, Susil Sirivardana, Akmal Hussain (eds), Economic Democracy through Pro Poor Growth, SAGE Publications, Delhi, 2009.

Chapter 8: Policy Design Elements for Inclusive Growth

289. Successful prosecution of the battle for survival that Pakistan is currently engaged in, requires initiating the necessary structural changes and establish the institutional framework for inclusive growth.

290. A new approach to inclusive growth could be adopted by establishing an institutional framework for the provision of productive assets to the poor as well as the capacity to utilize these assets efficiently. In this way the poor by engaging in the process of investment, innovation and productivity increase could become the active subjects of economic growth rather than being merely recipients of a "trickle down" effect: Thus a sustained high growth could be achieved *through* equity. Inclusive growth so defined can become both the means and the end of GDP growth[120].

291. The institutional framework of such an inclusive growth could have four broad dimensions[121]:

    (a) A small and medium farmer strategy for accelerated agriculture growth through the provision of land ownership rights to the landless and institutional arrangements for yield increases.

    (b) An institutional framework for providing productive assets to the poor through equity stakes in large corporations owned by the poor and managed by professionals.

    (c) Accelerated growth of small and medium scale industrial enterprises through an institutional framework for increasing the production and export of high value added products in the light engineering and automotive sectors.

    (d) A process of localized capital accumulation through Participatory Development.

292. In this Report we will present the institutional framework and policy design which can achieve these strategic objectives. In so doing, Pakistan can embark on a path of development that has been called *economic democracy*[122]. It is a path of development which enables all the people, rather than only the elite to participate in the process of income generation, investment and innovation within competitive markets. Such a path of development would achieve sustained growth with equity.

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120 This paragraph is drawn from Akmal Hussain, An Institutional Framework for Inclusive Growth, 15 May 2009.

121 Ibid. page-4.

122 The term economic democracy has been developed in the book: Ponna Wignaraja, Susil Sirivardana and Akmal Hussain: Economic Democracy through Pro Poor Growth, SAGE Press (Forthcoming).

Chapter 9: Institutional Framework for a Small and Medium Farmer Agriculture Growth Strategy[123]

293. An important factor in the current economic crisis is the food deficit and the underlying stagnation in yield per acre of major crops. (In the year 2007-08 crop sector growth was negative). It can be argued that if the yield potential of the small and medium farm sector (less than 25 acres) is achieved, food shortages can be converted into food surpluses. In the existing high prices of food grain in the international market, such a shift can enable Pakistan to convert its weakness into its strength: The current crippling economic burden of food imports can be converted into a strength through food exports. To bring about this transformation a new policy framework is required to shift from the earlier elite farmer strategy to a new small farmer growth strategy.

294. When the 'Green Revolution' technology became available in the late 1960s it was possible to substantially accelerate agriculture growth through an elite farmer strategy which concentrated the new inputs on large farms. Now the crucial determinant in yield differences became not the labour input per acre in which small family farms had been at an advantage in earlier decades, but the application of the seed-water-fertilizer package to which the large landlords with their greater financial power had superior access. Thus the 'Green Revolution' had made it possible to accelerate agriculture growth without having to bring about any real change in the rural power structure. Today, after almost four decades of the elite farmer strategy, the imperative of land reform is re-emerging, albeit in a more complex form than before. As the large farms approach the maximum yield per acre with the available technology, further growth in agricultural output increasingly depends on raising the yield per acre of small farms and reversing the trend of land degradation brought about by improper agricultural practices.

295. The small and medium farm sector whose yield potential remains to be fully utilized, constitutes a substantial part of the agrarian economy. Farms below 25 acres constitute about 94 percent of the total number of farms and about 60 percent of the total farm area. From the viewpoint of raising the yield per acre of small and medium farms (i.e. farms of less than 25 acres) the critical consideration is that 15.7 percent of the total farm area in the less than 25 acre farm category is operated by landless tenants. Another 13.07 percent of the farm acreage in less than 25 acre farms is operated by owner cum tenant farmers. Since tenants lose half of any increase in output to the landlord, they lack the incentive to invest in technology which could raise yields per acre. Because of their weak financial and social position they also lack the ability to make such investments. Their ability to invest is further eroded by a nexus of social and economic dependence on the landlord which deprives the tenant of much of his investible surplus.

296. This problem is further exacerbated by the absence of an efficient land market where productive land can move to the more efficient operator. Institutional

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[123] This section is drawn from Akmal Hussain, An Institutional Framework for Inclusive Growth, 15 May 2009. pages 19 to 22.

changes are required to enable flexible and secure tenancy contracts, and a competitive land market which can allow efficient operation of farm land.

297. The objective of raising yields in the small farm sector is inseparable from removing the constraints to growth arising out of the institutional structure of tenancy. A policy initiative that enables the tenant to acquire land is therefore an essential first step in providing the small farmers with both the incentive and the ability to raise their yields/acre.

9.1. State Land for the Landless

298. An initial step in providing productive assets to the rural poor could be to allot the available 2.6 million acres of State owned land to the landless. This cannot be seen as a substitute for a land reform programme of 'land to the tiller'. According to the Census of Agriculture 2000, there are about 4.97 million acres of private farm area under pure tenant cultivation in farms below 25 acres. It is this acreage that would need to pass into peasant ownership for a genuine land reform to occur. Nevertheless 2.6 million acres (assuming that all of it is cultivable) could make a significant contribution to the reduction of rural poverty. For example if the 2.6 million acres of state owned land were to be transferred to landless farm households in holdings of 5 acres each, then as many as 520,000 tenant farmers would become owner operators. This means that out of the total number of tenant farmers (about 897,000) in the less than 25 acre category, as many as about 58% would become owner operators.

299. However, it is important to recognize that providing ownership of land to the landless is a necessary but not a sufficient condition for alleviating their poverty. Enabling the landless to make the transferred land cultivable, to actually settle on the new land and to achieve a sustainable increase in their income, productivity and savings are equally important factors in making the scheme successful. The institutional framework for achieving this objective could be to establish a Small Farmer Development Corporation (SFDC), whose equity is owned by small and medium farmers (less than 25 acres holdings), but managed by professionals.

300. The SFDC could provide extension services, equitable access over markets for the purchase of good quality inputs and marketing facilities for their products. The specific institutional framework for the SFDC as well as other corporate enterprises owned by the poor is proposed in the ensuing section.

Chapter 10: Institutional Initiatives for Inclusive Growth through Corporate Enterprises Owned by the Poor[124]

301. Apart from the considerable yield potential of the small farm crop sector, there are three non crop sectors in agriculture which have considerable potential for stimulating GDP growth, poverty reduction and increasing Pakistan's foreign exchange earnings: (i) Milk and dairy products, (ii) Livestock and the production of meat and meat products, (iii) Marine fisheries. In this section we will briefly discuss the institutional form that can be deployed for the development of small farms as well as milk and dairy products, on the basis of public private partnership. The purpose would be to establish corporate enterprises with equity stakes for the poor. Similar institutional structures can be established for livestock and production of meat, and for marine fisheries.

10.1 Milk Production Potential of Poor Peasants

302. With over 177 billion rupees worth of milk being produced annually in Pakistan, milk is Pakistan's largest product in the agriculture sector. Unlike agriculture crops the production of milk can be accelerated sharply within a couple of years. Currently Pakistan's milch cattle yield per animal is one fifth the European average. Demonstrable experience in the field has shown that the milk yield per animal in Pakistan can be doubled within two years through scientific feeding, breeding and marketing. What is required is an institutional framework for training the farmers in scientific feeding and breeding, and for establishing the logistics to collect milk from the farm door by means of refrigerated transport, domestic marketing as well as arrangements for refrigerated storage at airports and subsequent airfreight to export markets. Such an initiative could have a significant impact not only on the incomes of poor peasants but also on exports and overall GDP growth[125]. Pakistan lies at the hub of milk deficit regions such as Central Asia to the North, West Asia and South East Asia. Accordingly if milk output in Pakistan could be doubled, and the institutional structure established for milk and milk product exports, as proposed in this Report, Pakistan's export earnings could increase by US $ 4.5 billion annually.

10.2. Marine Fisheries Potential and Constraints

303. Marine Fisheries, also provide a significant potential for improving foreign exchange earnings although not as large as the potential for milk. Here again, what is required is improved institutional support and better management rather than huge investments by the Government. The expansion in the export of marine fisheries is constrained because the storage facilities for transportation do not match the international quality standards. Currently alternate layers of fish and hard sharp edged ice are placed in containers on

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124 This section is drawn from: Akmal Hussain, An Institutional Framework for Inclusive Growth, 15 May 2009, Section VI.

125 Akmal Hussain, A Policy for Pro Poor Growth, paper in Towards Pro Poor Growth Policies in Pakistan, Proceedings of the Pro-Poor Growth Policies Symposium, 17th March 2003, UNDP-PIDE, Islamabad. page 72.

the boats. Under the weight of upper layers of fish and the sharp edged ice, fish at the lower layers are crushed, and the resultant bleeding causes putrefaction. To avoid this, it is necessary to provide shelves for layered storage of fish in boats, topped by dry ice, with fiberglass covers to maintain the European Union standards of minus 7°C temperature during transportation. An export potential of 300 million dollars exists over the next three years if such improved management of the marine fisheries industry could be achieved[126].

10.3. Proposed Institutional Structure for Milk and Milk Products

304. It is proposed that the Pakistan Poverty Alleviation Fund (PPAF), its NGO partner organizations at the district level and provincial Dairy Development Boards be brought together into a consortium to establish a Pakistan Dairy Corporation (PDC). The principal elements of the institutional framework for the PDC could be as follows:

(a) This corporation should be a public limited company, run by a professional management with poor peasants as its shareholders.

(b) International donors, and the government of Pakistan can contribute to establishing a special fund within the PPAF which can be used to give either grants or loans to poor peasants to enable them to buy the equity in the PDC and also to acquire additional milch animals.

(c) The objective of the corporation should be to generate profits through establishing milk collection centers in each Union Council to collect milk, from its shareholders, arrange refrigerated transport, establish milk pasteurizing and packaging facilities at the provincial level.

(d) The corporation should invest in establishing an infrastructure for purchase, testing and marketing of milk at the village level on the basis of community organizations of village level share holders of the SFDC. On the basis of this infrastructure SFDC could invest in establishing village level milk chilling centres, milk testing facilities and directly paying the village level milk producers at a competitive market rate. This institutional framework could be used for marketing in both the domestic and export markets, including sales to other private sector corporations such as Nestle.

(e) On the basis of its network of village level community organizations of its shareholders, the SFDC should undertake marketing in both the domestic and export markets. Domestic marketing could include selling milk to large multi nationals such as Nestle in Pakistan.

(f) The PDC should also establish an infrastructure at the village level for directly collecting milk from poor peasant milk producer shareholders, testing the milk and immediate payment to the milk producers.

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126 Ibid. page 73.

(g) A computerized data base platform should be established at the Union Council level to keep a record of the profile of each milk producer with respect to the following data: percentage of milk that passes the quality test; payments for milk supplied; extension services provided; increases in yields per milch animal; changes in the stock of milch animal, initial level of and changes in household income resulting from increased milk sales.

(h) The profits of the corporation should be used partly for re-investment and growth and partly for disbursing dividends to the poor peasant shareholders.

(i) The PPAF should develop new partner organizations at the Union Council, Tehsil and District levels which would be exclusively devoted to forming special purpose community organizations (COs) of poor peasants. The objective of the COs would be to enable its members to increase production and sale of milk, access credit for increasing the stock of milk animals at the household level and undertake scientific feeding and breeding of milch animals for increasing milk yields.

(j) The PPAF could also be tasked to provide credit to the milk producer share holders of PDC, arrange for extension services to the community organizations of milk producers for testing and inoculating animals against disease, scientific feeding and breeding practices.

10.4. The Concrete Elements of the Small Farmer Development Corporation (SFDC)

305. The institutional framework for a small farmer led agriculture growth strategy could be to establish a Small Farmer Development Corporation (SFDC) in which farmers operating below 25 acres of land could have the opportunity of becoming shareholders. The following types of farmers could be eligible to become shareholders of such a corporation:

(a) All those who will receive state owned land or have in the past received state owned land.

(b) All owner farmers, owner-cum-tenant farmers and pure tenant farmers operating less than 25 acres of land could also be offered equity stakes in the SFDC.

10.4.1 How to float the SFDC

306. One way of floating the SFDC is for the PPAF to sponsor the establishment of the SFDC while ensuring that the ownership and control of the corporation lies with the small farmer shareholders.

10.4.2 How to Provide Equity to Small Farmers

- The PPAF out of its own resources or by accessing donor funds, provide to the recipients of the 2.6 million acres state owned land, a loan of Rs.65 billion to the 520,000 small farmers recipients of 5 acre packages of land. Each such small farmer would get Rs.125,000 as a loan to be invested in the SFDC.

- This loan should be deposited in the corporation as equity of Rs.25000 per acre of owned land by the recipients of State land, i.e. Rs.125,000 per five acre package.

- Small farmers who are not recipients of state land should also be enabled to become shareholders in the SFDC.

10.4.3 The Organizational Functions of the SFDC

307. The equity could be leveraged to acquire loans from the domestic commercial banking sector as well as from the World Bank and ADB to be used for:

(a) Land Development of the land operated by the shareholders.

(b) Provision of extension services to the shareholder farmers for:

(i) Improving the quality of top soils.

(ii) Efficient on-farm water management through laser based land leveling for accurate gradient, improved water channels and where required, drip irrigation.

(iii) Shifting to high value added crops through innovative techniques such as tunnel farming and also dairy farming and livestock development.

(c) Provision of loans to farmers for purchase of inputs, and investments in improving the on-farm water management.

(d) Recent research has shown that rural markets for agriculture outputs and inputs in Pakistan are asymmetric with respect to the large and small farmers[127]. The SFDC could serve to provide more equitable market access to small farmers by facilitating purchase of high quality inputs and arranging marketing of agriculture products.

(e) Investment on behalf of small farmers in agro processing industrial units such as grain milling, cotton gins and oil presses. These investments could be under written by organizations such as PPAF,

[127] Akmal Hussain, Poverty, Power and Economic Growth, Pakistan Country Study for the SACEPS Poverty Project, 2008. (Forthcoming)

Khushali Bank, Small Business Finance Corporation as well as aid donors[128].

10.4.4 Broad Basing Equity to include all Small Farmers

308. Those small farmers who are not recipients of State owned land and wish to become shareholders in the SFDC can be provided loans of upto Rs.25000 per owned acre which would be automatically deposited in the corporation as their equity. The loans would be paid back from the dividend earnings of the equity under the loan agreement.

10.4.5 The Structure and Functions of the Small Farmer Development Corporation

309. The company should have five divisions with branches in each district where shareholders reside. These divisions would be:

- Land Development and Irrigation.
- Provision of Access over input and output markets
- Extension services.
- Dairy farming and livestock development
- Finance Division to mange loans given to equity holders and also to provide new loans.

10.4.6 The Management System of the Small Farmer Development Corporation: The Management Structure

310. The Management Structure of the SFDC would have the following specific features:

(a) Each district level branch of the SFDC should be run by full time professional managers.

(b) Each of these branches should have Management Oversight Boards in which Union Council level organizations of shareholders in the particular district are represented.

(c) The Management Oversight Board should meet once a quarter.

(d) District level organizations of shareholders should be represented in the Board of Directors of the SFDC.

(e) The district level organizations of shareholders should be represented on the National Management Oversight Board of the corporation at the head office of the corporation.

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128 We are grateful to Professor Rehman Sobhan, President of Grameen Bank and Chairman, Centre for Policy Dialogue, Dhaka for this suggestion.

10.4.7 The Management System of the SFDC: MIS

311. The corporation should have Management Information Systems run by professional managers in each district level branch of the company.

312. The district level MIS should be integrated with the national level MIS to provide weekly performance reports for each operation of each Division.

10.4.8 The Management System of the SFDC: Financial Control

313. Financial Control Systems should be established at the district level and MIS reports provided to the head office at the national level on a weekly basis.

    (a) The Financial Control Systems at the district level should be run by young chartered accountants.

    (b) The Financial Control Systems at the head office should be run by Senior Chartered Accountants with a small team of financial experts operating a fully computerized accounting system that is linked up with district level financial control systems.

Chapter 11: Inclusive Growth Through Small Scale Enterprises: The Role, Constraints and Institutional Imperatives[129]

314. Since small scale industries have higher employment elasticities, smaller Incremental Capital Output Ratios (ICORs), and shorter gestation periods. Therefore an increased share of investment in this sector could enable both a higher GDP growth for given levels of investment as well as higher employment generation for given levels of growth. At the same time if the institutional conditions could be created for enabling small scale industries to move into high value added components for both import substitution in the domestic market and for exports, Pakistan's balance of payments pressures could be eased. The key strategic issue in accelerating the growth of SSEs is to enable them to shift to the high value added, high growth end of the product market. These SSE's. include high value added units in light engineering, automotive parts, moulds, dyes, machine tools and electronics and computer software.

315. Training of a large number of software experts with requisite support in credit and marketing could quickly induce a significant increase in software exports from Pakistan. Pakistan could build a pool of software experts for a large increase in export earnings. This would of course require a proactive government to establish joint ventures between large software companies such as Microsoft and Pakistan's private sector institutions such as LUMS and INFORMATICS. The Ministry of Science and Technology is already moving rapidly in facilitating the growth of information technology in Pakistan. In this sub-section however we will focus on small scale manufacturing enterprises.

316. A large number of small scale enterprises (SSEs) in the Punjab and the North Western Frontier Province (NWFP) have a considerable potential for growth and high value added production such as components for engineering goods or components of high quality farm implements for the large scale manufacturing sector.[130] Yet they are in many cases producing low value added items like steel shutters or car exhaust pipes resulting in low profitability, low savings and slow growth.

11.1. Constraints to the Rapid Growth of SSEs

317. Small scale enterprises in small towns of Pakistan face the following major constraints:

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129 This section has been drawn from Akmal Hussain: Poverty, Power and Economic Growth, Pakistan Country Study for the SACEPS Poverty Project, 30th September 2008. pages 115 to 119.

An earlier version of this section was published in: Akmal Hussain, Poverty Alleviation in Pakistan, Vanguard Books, Lahore, 1994.

130 Akmal Hussain: Labour Absorption in Pakistan's Rural Sector, Final Report, ILO/ARTEP (Mimeo), 20th September 1989, Pages 21 to 23.

(a) Inability of small units to get vending contracts for the manufacture of components from the large-scale manufacturing sector (LSM).

(b) Due to lack of expertise in production management and the frequent inability to achieve quality control it becomes difficult to meet tight delivery schedules.

(c) Lack of specific skills like advanced mill work, metal fabrication, precision welding, all of which are needed for producing quality products with low tolerances and precise dimensional control. In other cases accounting and management skills may be inadequate.

(d) Difficulty faced by small units in getting good quality raw materials, which often can only be ordered in bulk (for which the small entrepreneurs do not have the working capital), and from distant large cities.

(e) Lack of specialized equipment.

(e) Absence of fabrication facilities such as forging, heat treatment and surface treatment which are required for manufacture of high value added products, but are too expensive for any one small unit to set up.

(f) Lack of capital for investment and absence of credit facilities.

11.2. The Institutional Framework for Overcoming the Constraints to the Growth of SSEs

318. Overcoming the aforementioned constraints would involve providing institutional support in terms of credit, quality control management, skill training and marketing. This could be done by facilitating the establishment of Common Facilities Centers (CFCs) located in the specified growth nodes in selected towns where the entrepreneurial and technical potential as well as markets already exist. Such support institutions (CFCs) while being facilitated by the government and autonomous organizations such as SMEDA can and should be in the private sector and market driven.

319. The institutional features of CFCs are identified in the ensuing section. The specific technical facilities required for the CFCs, the product groups they could serve and the geographic locations of enterprise clusters are given in the Appendix-VI of this Report.

11.3. The Specific Institutional Features of CFCs

320. The concept of the Common Facilities Centers is based on the fact that small scale industrialists in Pakistan have already demonstrated a high degree of entrepreneurship, innovation and efficient utilization of capital. The CFCs would provide an opportunity for rapid growth to SSEs through local participation in extension services, prototype development, and diffusion of improved technologies, equipment, and management procedures.

321. Each of the CFCs would be designed to serve a cluster of products/process related enterprises. Each cluster of enterprises could be aggregated into a corporate entity which would jointly own the CFC, with each enterprise contributing equity to the CFC.

322. Each CFC would constitute a decentralized hub for the SSE cluster for ensuring continuous easy access to a comprehensive package of support services such as: (i) product development, (ii) technical services, (iii) skill training, (iv) quality control systems, (v) managerial advice, (vi) purchase of high quality raw materials, (vii) marketing, (viii) Institutional link up with large scale enterprises to supply them with outsourced products and components, (ix) The CFCs could also perform the role of financial intermediation with the banking system and enable individual SSEs to access credit.

323. The CFCs could also be linked up with national research centres, such as the PCSIR and donor, agencies for drawing upon technical expertise and financial resources of these agencies in the service of small scale industrial enterprises (SSEs). In this context it is advisable to establish institutional links between the research centres within Pakistan such as the PCSIR and Pakistan's manufacturing sector in general and small industries in particular[131]. It is important to translate science research into products, processes and technological change that is market driven and required by the small scale in the small scale sector. Of particular relevance is the need to re-orient the link between the PCSIR and industry to enable certification of products and quality standards for exportables.

11.4. Organizational Features and Functions of CFCs

324. The Common Facilities Centres could have the following functional dimensions:

(i) Marketing

325. Provision of orders from the large scale manufacturing sector for components, and from farmers for farm implements. These orders would then be sub-contracted to the cluster of SSI units that the CFC is supposed to serve. The individual order would be sub-contracted to the SSI on the basis of the skills and potential strengths of the unit concerned.

(ii) Monitoring and Quality Control

326. Having given the sub-contract, the CFC would then monitor the units closely and help pinpoint and overcome unit specific bottlenecks to ensure timely delivery and quality control of the manufactured products. These bottlenecks may be specialized skills, equipment, good quality raw material or credit.

[131] For a detailed discussion on the PCSIR as a Case Study of this issue see: Appendix-II.

(iii) Skill Training and Product Development

327. Skill training for technicians could be provided by the new good quality vocational training institutes (VTIs) established by the Vocational Training Council of Punjab. Similar VTIs could be established in other provinces. The CFC would provide specialized supplementary skill training on its premises to workers in the satellite SSI units when required. At the same time, it would provide advice on jigs, fixtures, special tools and product development where required.

(iv) Forging and Heat Treatment Facilities

328. The CFCs would establish at their premises plants for forging, heat treatment and surface treatment. The SSI units could come to the CFC to get such fabrication done on the products they are manufacturing on sub-contract, and pay a mutually agreed price for this job to the CFC.

(v) Credit

329. The CFC would provide credit to the SSE's for purchase of new equipment and raw materials. In cases where raw materials are available in bulk supply, the CFC could buy it from the source, stock it on its premises and sell at a reasonable price to units as and when they need them.

Chapter 12: Institutional Framework for Participatory Development[132]

330. Establishing the institutional basis for enabling the poor to increase their incomes, savings and investment, would not only constitute a direct attack on poverty but would also contribute to a faster and more equitable economic growth process. In this section we will begin by specifying the Participatory Development paradigm which has been formulated and put into practice successfully in a number of South Asian countries (including Pakistan) by a group of action researchers from South Asia[133]. We examine the issue of empowerment of the poor.

12.1. The Concept of Participatory Development[134]

331. Participatory Development in its broadest sense is a process which involves the participation of the poor at the village/mohalla levels to build their human, natural and economic resource base for breaking out of the poverty nexus. It specifically aims at achieving a localized capital accumulation process based on the progressive development of group identity, skill development, and local resource generation. (Akmal Hussain, 1994)[135].

332. At this level of generalization the concept has three key elements:

(a) Process: It is a process whose moving force is the growth of *consciousness*, of *group identity* and the realization in practice of the creative potential of the poor.

(b) Empowerment: The process of reconstructing a group identity, of raising consciousness, of acquiring new skills and upgrading, their knowledge base, progressively imparts to the poor a new power over the economic and social forces that fashion their daily lives.

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132 This section is drawn from:

(i) Akmal Hussain, Poverty Alleviation in Pakistan, Vanguard Books, Lahore, 1994, Chapter III.2.

(ii) Akmal Hussain, Pakistan: Poverty, Power and Economic Growth, South Asia Center for Policy Studies (Mimeo), 25 September 2008.

133 See, for example:

(i) Ponna Wignaraja, Akmal Hussain, Harsh Sethi and Ganeshan Wignaraja: Participatory Development, Learning from South Asia, United Nations Press, Tokyo and Oxford University Press, Karachi, 1991.

(ii) Akmal Hussain, Poverty Alleviation in Pakistan, Vanguard Books, 1994.

(iii) Akmal Hussain, Punjab Rural Support Programme (PRSP), The First Four Months, Report to the Board of Directors of PRSP, 1998.

134 Akmal Hussain, Poverty Alleviation in Pakistan, Vanguard Books, 1994, page-26 to 28.

135 Ibid.

It is through this 'power' that the poor shift out of the perception of being passive 'victims' of the process that reproduces their poverty. They become the vital subjects in initiating interventions that progressively improve their economic and social condition, and overcome poverty.

(c) Participation: The acquisition of the power to break the vicious circle of poverty is based on *participation* within an organization in a *series* of projects. This participation is not through 'representatives' who act on their behalf but rather, the actual, involvement of each member of the organization in project identification, formulation, implementation and evaluation. It is in open meetings of ordinary members at the village/mohalla level organization that decisions are collectively taken, and work responsibilities assigned on issues such as income generation projects, savings funds, conservation practices in land use, infrastructure construction and asset creation.

12.1.1 The Dynamics of Participatory Development

333. The process of Participatory Development proceeds through a dynamic interaction between the achievement of specific objectives for improving the resource position of the local community and the sense of community identity. Collective actions for specific objectives such as a small irrigation project, fertilizer manufacture through organic waste, clean drinking water provision, or production activities such as fruit processing, can be an entry point for a localized capital accumulation process, leading to group savings schemes, reinvestment and asset creation. The dynamics of Participatory Development are based on the possibility that with the achievement of such specific objectives for an improved resource position, the community would acquire greater self confidence and strengthen its group identity.

12.2. Empowerment and its Institutional Basis

12.2.1 The Meaning of Empowerment

334. Since the term empowerment has been loosely used in much of the literature on development it may be helpful to specify its meaning in the context of this section. Empowerment means enabling the poor to build their human capabilities and economic resource base for breaking out of the poverty nexus. It is a process of reconstructing a group identity, of raising consciousness, of acquiring new skills and of achieving better access over markets and institutions for a sustainable increase in incomes. Such a process progressively imparts to the poor a new *power* over the economic and social forces that fashion their daily lives. It is through this power that the poor shift out of the perception of being passive victims of the process that perpetuates their poverty. Thus they become active subjects in initiating

interventions that progressively improve their economic and social condition to overcome poverty[136].

12.2.2 Institutional Basis of Empowerment

335. The economic strategy requires a national campaign to empower the poor at the level of village/mohallah, Union Council, Tehsil and District. The idea is to facilitate the growth of autonomous community organizations of the poor at the village/mohallah level to be able to break out of the poverty. Through these COs the poor can identify income generating projects, initially at the household level, acquire skill training from a variety of sources such as government line departments, autonomous institutions, private sector firms, NGOs. and donors; and access credit for micro enterprise projects through apex organizations such as the PPAF, Khushali Bank, Small Business Finance Corporation (SBFC), and commercial banks. At the moment the scale of micro finance is inadequate, with only 1.5 million clients out of a total of 10 million being served with micro credit facility. Micro credit needs to be substantially enlarged. At the same time special institutional arrangements would need to be made in these apex organizations to take credit to poor women and women's COs, since poor women have even lesser access over institutional credit compared to poor men.

336. It is important that such village level community based organisations (CBOs) be autonomous and be permitted to form cluster apex organisations with other CBOs. Autonomous CBOs by means of social mobilisation, skill training, increased productivity, increased income, savings and investment would begin a process of localised capital accumulation. Such a process, which we have called Participatory Development[137] would be integrally linked with the emergence of a new consciousness of empowerment. The poor can begin to take autonomous initiatives to improve their material conditions of life. They would thus break out of the poverty nexus and shift from being victims to active subjects of social and economic change. Such a process of village level increases in productivity, incomes and savings would not only constitute a direct attack on the poverty problem but would also contribute to a faster and more equitable macro economic growth[138].

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136 For a case study based on implementing the Participatory Development approach in nine districts of the Punjab province, see, Akmal Hussain, Honourary Chief Executive Officer, Punjab Rural Support Programme (PRSP), The First Four Months Report to the Board of Directors, PRSP, 1998.

137 The concept of Participatory Development is formulated in: Akmal Hussain: Pakistan, A Strategy for Poverty Alleviation, Vanguard, Lahore, 1994, Pages 26 to 29.

Also see: P. Wignaraja, A. Hussain, H. Sethi & G. Wignaraja: Participatory Development: Learning from South Asia, O.U.P, 1991.

138 For a more detailed discussion of this issue, See: Akmal Hussain: Poverty, Growth and Governance, Chapter in, V.A. Pai Panandiker (ed.): Problems of Governance in South Asia, Centre for Policy Research, New Delhi, 2000.

337. Such autonomous organizations of the poor could not only become a framework for grassroots economic growth, but would also constitute countervailing power to that of the power structures of local elites. At the same time, these autonomous organizations of the poor would enable the individual poor household to get better access over input and output markets.

338. Facilitating the emergence of autonomous organizations of the poor particularly organizations of poor women, could enable the newly established local government institutions to function in a more equitable and effective manner. The equity would be with respect to class as well as gender. This would require establishing institutionalized links between autonomous organizations of the poor and local government bodies at the Village, Union Council, Tehsil and District levels. *These institutional links between organizations of the poor and elected local bodies would enable more participatory and equitable processes of project identification, design and implementation for local level development*.

Chapter 13: The Institutional Factors In Unstable Growth And Endemic Poverty[139]

339. We begin by identifying the major features of the crisis in the real economy that need to be addressed. These are:

13.1. Governance, Poverty and Unemployment

340. Poverty and inequality increased rapidly during the 1990s due to the decline in GDP growth, coupled with a decline in employment elasticities, labour productivity, and real wages in both the agriculture and the industrial sectors. In the subsequent period 1998-99 to 2004-05, while GDP growth accelerated sharply there was no significant poverty reduction. At the same time unemployment as well as inflation rates, particularly food inflation, increased sharply. The economic burden on the poor has intensified further due to inadequacies in three major aspects of governance:

    (a) Inefficient delivery mechanisms for translating development expenditure into improved health, sanitation, education, services and access over justice for the poor. Consequently, the disproportionate shortages of these services for the poor compared to the rich, have deprived them of an important redistributive mechanism in the economy.

    (b) During the 1990s there was a common perception that there was widespread corruption in government. To the extent it existed it had a significant adverse impact on economic growth and poverty[140]. During the period of the Musharraf government even though GDP growth accelerated widespread corruption persisted. In the Transparency International Corruption Perception Index, Pakistan's Country Rank increased from 87 in 1999 to 144 in 2005. In the Corruption Perception Index (CPI) which ranges from 10 (highly clean) to 0 (highly corrupt), Pakistan's CPI already at a low level in 1999 at 2.2 fell further to 2.1 in 2005[141].

341. The latest Global Corruption Barometer released by Transparency International (December 6, 2007) shows that corruption levels have increased even more sharply in the last two years. For example the percentage of people in the all Pakistan sample, who paid bribes for obtaining services doubled to over 30 percent compared to 15 percent in the year 2006. The

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139 This section is drawn from: (i) Akmal Hussain, A Policy for Pro Poor Growth, chapter in Towards Pro Poor Growth Policies in Pakistan, UNDP-PIDE, Islamabad 2003. (ii) Akmal Hussain, Pakistan: Poverty, Power and Economic Growth, South Asia Center for Policy Studies (Mimeo), 25 September 2008. pages 100 to 108.

140 Shahid Javed Burki, Pakistan: Fifty Years of Nationhood, Vanguard Books, Lahore, 2004, Page 174.

141 Transparency International, Perceptions Index 1999 and 2005, cited in Talat Anwar, Measurement of Absolute Poverty and Governance in Pakistan: 1998-99 and 2004-05, paper presented in the PIDE-PSDE, 22nd Annual General Meeting and Conference, 19-21 December 06, Table 4, page 15.

report places Pakistan among the top 10 countries which are most affected by bribery.

342. Widespread corruption in government contributes to constraining growth and increasing poverty in three ways: (a) the rising magnitude of corruption over time and at different levels of decision making in the government is a major factor in the uncertain policy environment and a constraint to estimating accurate project feasibilities. This would be expected to constrict investment, GDP growth and employment; (b) the transfer of resources from entrepreneurs to politicians and government officials results in a misallocation of national resources and a lower level of productive investment and hence GDP growth, than would be the case in the absence of such corruption. (c) the financial cost of individual projects increases, thereby simultaneously inducing slower GDP growth for given levels of investment and also reducing the employment elasticities with respect to investment. (d) To the extent that the poor are obliged to pay bribes for public services while in many cases the affluent with political influence may not have to pay bribes, means that the distribution of real income between the rich and the poor is worsened by the mode of provisioning of public services.

13.1.1 Institutions for Improved Governance for Pro Poor Growth

343. In this section we have argued that two of the most important governance factors that prevent sustained high growth and rapid poverty reduction are the persistent high levels of corruption and inefficient delivery mechanisms for the provision of public services. Addressing these issues requires establishing new institutions at different levels of governance.

344. The existence of corruption in government is a significant factor in constraining investment, allocative efficiency, GDP growth, employment and poverty reduction. The resource transfers associated with corruption are also a form of rent that is a structural feature of a rent based economy and polity that North, Joseph, Weingast call a “limited access social order” (North, Joseph, Weingast, 2006)[142]. The institutional structure that makes corruption endemic, also increases transaction costs and thereby constrains specialization, productivity and growth. Therefore, a policy of combating corruption through the establishment of institutions in state and civil society, would be important drivers of change on a development path to an advanced economy (open access social order). In this context six new institutions could help control corruption:

- An independent judiciary with adequate resources and judicial officers to provide access to justice at every tier of governance and in every region: national, provincial and district levels.

- An independent and constitutionally mandated structure of ombudsman’s offices at the district, tehsil and union council levels to listen to and rectify

[142] Douglass C. North, John Joseph Wallis, Barry R. Weingast, op.cit.

public complaints about the equitable provision of public services such as health, education, sanitation, and hygienic drinking water. At the same time the ombudsman's offices at each tier, would hear and rectify citizens' complaints about corruption and misuse of office by government functionaries.

- Citizens' Protection Committees at the mohallah and village levels where complaints about the provision of public services and against corrupt officials can be registered and systematically taken up. In the case of complaints about public services, these can be taken up at various tiers of the local government. In the case of complaints about corruption and misuse of power against citizens by government officials, these can either be taken up within the ombudsman structure or in more serious criminal cases, at various levels of the judiciary.

- An independent media equipped with adequate investigative reporting capabilities to independently report corruption cases and monitor the performance of government departments with respect to the provision of public services. A special public services and corruption monitoring page can be devoted on a monthly basis by newspapers. This would contain independent investigative reports on the performance of government departments with respect to their targets for the coverage and quality of public services. The monitoring page would also report on corruption cases and monitor the efficiency of ombudsman's offices at the district, tehsil and union council levels.

- An independent Federal Bureau Statistics (FBS) that directly reports to the Parliament and not to the government. The FBS would be tasked to conduct periodic surveys on the incidence of poverty, gender specific employment, inflation, productivity and real wages. The FBS would also be tasked to provide survey based data on the quality and coverage of services such as health, sanitation, hygienic drinking water, education and vocational training. The FBS could also be required to conduct regular surveys to provide data to the public about the extent of corruption and the performance of various government departments with respect to their performance targets.

- The bilateral as well as multilateral Donors in Pakistan could establish a Multi-donor Transparency Support Unit (MTSU) whose task would be to determine the extent to which donor funds have achieved the purposes for which they had been provided to both government as well as civil society organizations. In the case of funds provided for supporting strategic 'Drivers of Change' initiatives to government and civil society, the MTSU could apart from evaluating the functioning of the concerned departments and organizations, also conduct an independent Impact Assessment Survey on an annual basis.

13.2. Health and Poverty

345. Research for the National Human Development Report (NHDR), suggests that the high prevalence of disease amongst those who are slightly above the

poverty line is a major factor in pushing them into poverty. Those who are already poor get pushed into deeper poverty as the result of loss of income and high medical costs resulting from illness. The data show that on average 65% of the extremely poor were ill at the time of the survey, and they had on average suffered from their illness for 95 days. The survey data also show that the poor predominantly go to private allopathic practitioners rather than to basic health units or government hospitals. Private medical facilities in rural areas and small towns have grossly inadequate diagnostic facilities and there is wide spread prevalence of spurious drugs in private sector retail outlets. Consequently when the poor fall ill they suffer for a protracted period and get locked into a high cost source of medical treatment. This erodes whatever little asset base they have, and pushes them into indebtedness and deeper poverty[143].

346. The NHDR data on the widespread prevalence of disease in Pakistan is supported by evidence from the National Health Survey of Pakistan[144], which shows that in rural areas the prevalence of fair plus poor health for females above 25 years is as high as 75%, while that for the males in the same age group is 45%. The curative health care system has expanded substantially during the last decade (for example, the population per doctor has fallen from 2082 in 1990 to 1529 in the year 2000), yet the high incidence of disease points to both inadequate coverage and poor quality of the health care system in Pakistan.

13.2.1 Policy Implications

347. Since the UNDP, NHDR study shows that health is a major factor that pushes people into poverty, clearly improved nutrition and health conditions are important for poverty reduction. Improving the nutrition, preventive hygiene, provision of safe drinking water, improving the service delivery of basic health units, and improved diagnostic and treatment capabilities of Tehsil and District Hospitals are urgent imperatives to deal with the crisis of health and poverty.

13.3. Education and Poverty

348. Given the structure of the growth process, in spite of high GDP growth during the period a substantial reduction in poverty and unemployment could not be achieved. While livelihoods and income levels are critical to improving the economic conditions of people, yet the coverage and quality of health and education facilities are also important for improving the economic conditions of the people.

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143 Akmal Hussain, et.al, Poverty, Growth and Governance, UNDP, Pakistan National Human Development Report 2003, Oxford University Press, Karachi, 2003.

144 National Health Survey of Pakistan, Pakistan Medical Research Council, Federal Bureau of Statistics, Pakistan and the Department of Health and Human Services, USA, 1998, Page 127. Food note 5 appears to be three references, if so please give their dates and publication refer to, as well as the publishing agency.

13.3.1 School Education

349. Educational outcomes in Pakistan are measured using literacy and enrolment rates. The most commonly used nationally representative source are the PIHS data. For the most recent year (2004-2005) for which data are available the relevant source is the PSLM.

350. These data show a declining or stagnant trend for both male and female primary enrolment from 1991 till 2001-2002, and sharp increases in enrolment between 2001-2002 and 2004-2005. The PSLM sample for education data was some five times as large as the PIHS samples, and it is possible that the PSLM provides a more accurate picture of literacy and enrolment than the PIHS. A number of positive policy changes might be responsible for the increase in enrolment. Some of the provincial governments introduced incentives such as free textbooks and stipends (for female students) in order to encourage enrolment and retention. There has also been a rise in the availability of low-cost private schooling facilities over the last ten years or so.[145]

351. The increase in enrolment rates after a period of stagnation and decline is encouraging. For this increase to be sustainable there will be a need to give priority to the quality of schooling. There is wide acknowledgement that the quality of schooling has undergone a steady decline.[146]

352. Aspects of Pakistan's education system have attracted the interest and attention of the international community from a security point of view. Legislation in the United States, for example, links future assistance to Pakistan to reforms in the education sector. Although some religious and cleric-run educational establishments in Pakistan have been suspected of involvement in terrorist activities, the exclusive focus on the security angle is unwarranted. Cleric-run schools (*madrassah*s) account for less than 5 percent of total enrolment,[147] and a majority of these schools are not engaged in violent or unlawful activities. The key issue for *madrassah* reform is not that dissimilar for the reform of the broader educational system – namely quality and equity.

13.3.2 Education and Curricula

353. In pursuing improved quality of education it is necessary to review the curricula, particularly at the school and intermediate education level. There are reports that some elements of the existing curricula not only misinform

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145 National Education Census 2005, Federal Bureau of Statistics, Government of Pakistan (GOP), Islamabad, 2005.

146 This is acknowledged, for example, in the Ministry of Education's White Paper prepared by Javed Hassan Aly, as an approach to a new education policy (http://www.moe.gov.pk/nepr/WhitePaper.pdf).

147 National Education Census 2005, op.cit.

students about facts, but also inculcate prejudice against other religions, and incite militancy and violence. According to the findings of the recent SDPI study on education and curricula in Pakistan the following problems in the current curricula and text books were identified[148]:

(a) Inaccuracies of fact and omissions that serve to substantially distort the nature and significance of actual events in history.

(b) Insensitivity to the existing religion diversity of the nation.

(c) Incitement to militancy and violence, including encouragement of *Jehad* and *Shahadat.*

(d) Perspectives that encourage prejudice, bigotry and discrimination towards fellow citizens, especially women and religious minorities, and towards other nations.

(e) A glorification of war and the use of force.

(f) Omission of concepts, events and material that could encourage critical self-awareness among students.

(g) Outdated and incoherent pedagogical practices that hinder the development of interest and insight among students."[149]

354. According to the report, the military government of General Zia ul Haq after the coup in 1977 tried to guise its legitimacy problems in an overarching quest for Islamization of society. Education was among the first victims. In the educational sphere, this amounted to a distorted narration of history, factual inaccuracies, inclusion of hate material, gender bias, etc.

355. The report claims that over the last two or three decades, the curricula and the officially mandated textbooks have contained material that is directly contrary to the goals and values of a progressive, moderate and democratic Pakistan.

356. For example, in Social Studies, the books systematically misrepresent events that have happened throughout Pakistan's history. The history is narrated with distortions and omissions. The causes, effects and responsibility for key events are presented so as to leave a false understanding of our national experience. A large part of the history of South Asia is also omitted, making it difficult to properly interpret events, and narrowing the perspective that should be open to students. Worse, the material is presented in ways that encourage the student to marginalize and be hostile towards other social groups and people in the region. The curricula and textbook are insensitive to the religious

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148 *The Subtle Subversion: The State of Curricula and Textbooks in Pakistan,* ed. By A.H Nayyar and Ahmed Salim, (Islamabad: Sustainable Development Policy Institute), Pg v

149 Ibid.

diversity of the Pakistani society. On average over a quarter of the material in books to teach Urdu as a language are about Islam. The books on English have lessons with religious content. Thus the entire curriculum is heavily laden with Islamic religious teachings.

357. Pakistani nationalism is repeatedly defined in text books in a manner that excludes non-Muslim Pakistanis from either being Pakistani nationals or from even being good human beings. Much of this material runs counter to any efforts at national integration.

358. Many of the textbook problems have their origin in two sources. 1) curriculum documents and syllabi, and 2) the instructions to textbook authors issued from the Curricula Wing of the Ministry of Education. As long as the same institutions continue to devise curricula, the problem will persist. Repeated interventions from the post-1988 civilian governments failed to overcome the institutional resistance.

359. Curriculum documents include specific instructions for syllabus making and textbook writing that ask for material that glorifies war, militancy and the military. Some examples of this from curriculum document instructions are:

"A feeling be created among students they are the members of a Muslim nation. Therefore, in accordance with the Islamic tradition, they have to be truthful, honest, patriotic and life-sacrificing mujahids."[150]
"Suggested topics for lessons in textbooks:

Stories about the Pakistan movement, eminent personalities of Pakistan and martyrs of Pakistan"[151]

"Simple stories to incite Jehad."[152]

"Objectives, content and activities"

To make speeches on jehad and shahadat.

360. Discuss important personalities, such as Mohammad bin Qasim, Mahmood Ghaznavi."[153]

361. According to the report, the themes of Jehad and Shahadat clearly distinguish the pre- and post-1979 educational contents. There was no mention of these in the pre-Islamization period curricula and textbooks, and the post-1979 curricula and textbooks openly eulogize Jehad and Shahadat and urge students to become mujahids and martyrs.

362. It is clear that the current school curricula are inconsistent with building a pluralistic democratic society where education nurtures understanding and

[150] ibid, 86
[151] ibid
[152] ibid
[153] ibid

tolerance. It is advisable to set up a National School and Intermediate Education Curricula Commission with a view to correcting the distortion of facts and making them consistent with the objectives of developing a sense of objectivity, enlightenment and a humane sensibility amongst students.

13.3.3 Skill Training

363. The Planning Commission earlier this year has undertaken an imaginative initiative for a large scale district based national skill training programme in terms of the vision of its new Deputy Chairman[154]. The programme called the Human Resource Development (HRD) programme envisages a social transformation through new skill provision, and up-gradation of the skills of the existing trained work force with the aim of enhancing "the employability, productivity and competitiveness"[155] of the middle classes and the poor. This initiative is expected to provide the trained human resource base for placing the economy on the path of a diversified and broad based economic growth. The district level organizational structure for this promising initiative needs to be quickly established with a small a highly professional, highly motivated and appropriately incentivized team to actualize this programme.

13.4. Institutional Failure in the Delivery of Health and Education Services[156]

364. Health is a provincial subject and the responsibility of the province. However, after devolution, the provincial government's involvement in primary level health care financing has become virtually non-existent. The provincial government is primarily involved with maintaining hospitals that have more than 50 beds, teaching hospitals and picking up salary expenses for the handful of personnel at or above grade 17.

365. After devolution, the control of provincials government on basic health care and education has virtually ceased to exist. Fiscal transfers from the provincial to local governments are in lump sum. It is up to the district government to not only allocate resources across sectors but also in terms of the recurring and development budgets. Thus we are faced with the institutional paradox that while health and education are provincial subjects they have little control over basic provision apart from providing salaries of grade 17 and above officers.

366. At the district level then, the district assembly and the Nazim decide on sectoral allocations. Subsequently it is the Executive Development Officer (EDO) of health and education respectively who decides on the development and recurring budgets. The EDO health is the office in charge and has almost

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154 Sardar Aseff Ahmed Ali, Deputy Chairman, Planning Commission, Human Development for the 21st Century, Planning Commission, Islamabad, March 2009.

155 Ibid. page-1

156 The Chairman gratefully acknowledges the contribution of this sub-section by Dr. Asad Sayeed, Member, Working Group on Institutions for Development, Panel of Economists.

complete control over the district health budget. On the recurring side, the EDO is in charge of disbursal of salaries, miscellaneous expenses, and procurement of other non-salary items.

367. The perversity of the institutional structure of devolution is such that in principle all reform for these basic services must now originate from the district. The district in turn is headed by an indirectly elected Nazim whose electoral prospects are by definition not determined by their record on service delivery.

368. As an illustration, the health budget of a number of districts has remained the same over the years. Growth in current expenditure largely reflects the rate of inflation and incorporates increase in salaries. The share of salaries in the recurring budget is as high as 86% of the recurring budget. Since qualitative improvements generally take place in the non-salary budget even if there is an incentive at the level of the EDO to affect improvements they are constrained by the budgets. Increase in the share of the budget only takes place when new schemes are completed and their recurring expenditures are added to it, and since the district government has little or no incentive to launch new schemes, and the provincial government has little or no control to ensure they launch such schemes, there is no real development.

369. To improve health delivery at the basic level, The People's Primary Health Care Initiative (PPHI) was initiated by the previous government all over the country. PPHI is an arrangement between a quasi-government service provider and district governments. The agreement signed between district governments and PPHI entails that all BHU and dispensaries will be handed over to PPHI. The PPHI system works such that it attempts to deal with the problem of staff absenteeism by creating BHU clusters, which are served by one doctor and, depending on the number of BHUs in each cluster, the sanctioned salary for the doctor at each facility is provided to the one who is serving the cluster. Once more, just like in the case of the EDO health, the provincial government has no control over the PPHI program, only being involved to the extent that it gives the PPHI a one-off grant for repair and renovation. The funding for the PPHI program also comes from the federal government meaning, that the provincial government does not even have complete control over funding.

370. The PPHI program is responsible for all salary and non-salary expenditure on facilities, and has the flexibility of altering line items according to priorities that it sets for itself. The PPHI system, given this flexibility, tends to run in a very ad-hoc manner. Moreover, the single doctor serving a cluster of BHUs does not necessarily solve the absentee issue, as it means that a doctor is only available at each BHU for two days in a week, and there is no doctor available at that BHU for the remaining five days of the week. Finally, given that the provincial government has no control over the PPHI system, and there is no system of monitoring the performance of PPHI by any outside party, there is no way to really assess the success of the initiative, and no incentive to necessarily improve performance.

371. The lack of control and monitoring from above is the result of the weakening of the provincial government under the devolution plan, and has therefore reduced the incentive to establish and maintain an adequately functioning health sector.

13.5. Asymmetric Markets, Local Power Structures and Poverty

372. The NHDR/PIDE survey data[157] shows that the poor peasants face adverse input and output markets. They have to pay relatively higher prices for their inputs and get relatively lower prices for their outputs compared to the large farmers. At the same time, due to the lack of access to formal credit markets, the poor peasants often have to borrow from the landlord. As a consequence they are obliged to work on the landlord's farm at less than market wage rates. The NHDR study shows that the poor peasants could be losing one third of their income due to asymmetric markets for inputs and outputs.

373. In the urban and semi-urban areas where the poor households are predominantly involved in micro enterprises the data shows that low incomes are primarily due to low productivity and profitability of these micro enterprises.

13.5.1 Policy Implications

374. The evidence shows that asymmetric markets and local power structures constitute structural factors in persistent poverty. They siphon off as much as one third of the actual incomes of the poor, deprive them of their potential savings and keep their productivity and incomes at a low level. A pro poor policy must address these structural factors if poverty is to be overcome on a sustainable basis. Better access for the poor over the markets for labour, land, agricultural inputs and outputs, means changing the balance of power in favour of the poor at the local level. This requires facilitating the emergence of autonomous organizations of the poor, particularly poor women at the village, Union Council, Tehsil and district levels. It also means enabling the poor to access credit, training, and technical support for increased employment, productivity, and incomes.

13.6. Institutional Factors in Slow and Unstable Crop Sector Growth[158]

375. In agriculture the average annual growth rate of major crops has declined from 3.34% during the eighties to 2.38% in the nineties. At the same time, the frequency of negative growth years in some of the major crops has increased.

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157 This survey was part of the study embodied in the Pakistan National Human Development Report, UNDP. Published later: UNDP, Pakistan National Human Development Report 2003, Oxford University Press, Karachi, 2003.

158 This sub-section is based on research paper by Akmal Hussain: (Employment Generation, Poverty Alleviation and Growth in Pakistan's Rural Sector: Policies for Institutional Change, Report prepared for the ILO/CEPR, (Mimeo), March 1999.

This has accentuated the process of poverty creation: In a year of negative growth (i.e. bad harvest) the small farmers operating at the margin, have to borrow for consumption requirements and go into debt. In the following season, in the absence of an investible surplus, they are unable to reconstitute the production cycle and hence slip into poverty. Thus the instability of crop sector growth and the increased frequency of negative growth year becomes a structural factor in poverty creation. Underlying this phenomenon are five major institutional constraints:

(a) Reduced water availability at the farm gate due to poor maintenance of the irrigation system and low irrigation efficiencies of about 37 percent. While the availability of irrigation water has been reduced, the requirement of water at the farm level has increased due to increased deposits of salts on the top soil and the consequent need for leaching. About 33 million tons of salts are annually brought into the Indus Basin Irrigation System, out of which 24 million tons are being retained.[159] The consequent large water deficit means that the farmers even in the irrigated areas are dependent on rain fall. Given the vicissitudes of weather particularly due to global warming, (which has caused wide variation in the timing, location and quantum of rain fall) rain does not always fall in the right quantity at the right time for the water deficit farmers. Consequently, there is greater instability in crop sector output than before. (Akmal Hussain, 1999)[160].

(b) What makes improved efficiency of irrigation even more important is that the extensive margin of irrigated acreage has been reached, so the future agricultural growth will have to rely on improving the efficiency of water use and other inputs. Thus the rehabilitation of Pakistan's irrigation system for improving irrigation efficiency has become a crucial policy challenge for sustainable agriculture growth.

(c) It is well known that high yielding varieties of seeds gradually lose their potency through re-use, changing micro structure of soils, and changing ecology of micro organisms in the top soil. Therefore, breeding of more vigorous seed varieties adapted to local environmental conditions, and their diffusion amongst farmers through an effective research and extension programme is necessary. Yet there is no organized seed industry in Pakistan to meet the needs of farmers for the supply of vigorous varieties of seeds even in the major crops. In wheat, for example, the average age of seeds in Pakistan is 11 years compared to an average of 7 years for all developing countries. It has been shown that compared to India there was a sharp decline in growth of total factor productivity in Pakistan after 1975,

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159 Interim Poverty Reduction Strategy Paper, Government of Pakistan, November 2001, Page 23.

160 Akmal Hussain, ILO/CEPR, op.cit.

which can be attributed to the poorer level of research and extension in Pakistan compared for example to India.[161]

(d) A new dimension to the imperative of improving research capability in the crop sector is indicated by the possibility of declining yields per acre related with global warming. Given the sensitivity of wheat seed to temperature increase, even a 2-degree centigrade increase in average summer temperatures could mean an absolute yield decline of between 10 to 16 percent during the 21st century.[162] With a 2.8 percent population growth, even a decline of 5 percent in yield per acre associated with global warming, could mean serious food deficits and high food inflation rates for Pakistan, with relatively greater adverse consequences for the poor. It is, therefore, necessary to develop heat resistant varieties of food grains.

The current ineffectiveness of agriculture research and poor diffusion amongst farmers is a cause for concern. This is particularly so in a situation where future agriculture growth and labour absorption will have to depend more on input efficiency than on enlargement of irrigated acreage and input intensification, which were the major sources of agriculture growth in the past.

(e) One of the most important constraints to sustainable growth in the crop sector is the degradation of soils, resulting from improper agricultural practices such as: (i) lack of crop rotation and the resultant loss of humus in the top soil; (ii) stripping of top soil and resultant loss of fertility associated with over grazing; (iii) water erosion along hill sides and river banks due to cutting down of trees and depletion of natural vegetation. According to one estimate, over 11 million hectares have been affected by water erosion and 5 million hectares by wind erosion.[163]

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161 Mark W. Rosegrant and Robert Evenson: "Agricultural Productivity Growth in Pakistan and India: A comparative Analysis", presented at Pakistan Institute of Development Economists Ninth Annual General Meeting, Islamabad, 1993.

162 If atmospheric carbon is doubled, the average summer temperatures in Pakistan are expected to increase by 1.5 C to 4.5 C (base average of 2.5 C), over the next 70 years. This could lead to a decline in wheat yields from 10 percent to 60 percent, depending on the type of wheat seed, planting time, related atmospheric/weather conditions. See: Qureshi, Ata and Iglesias: Implications of Global Climate Change for Pakistan Agriculture: Impacts on Simulated Wheat Production, Climate Institute, Washington, D. C. USA, 1992.

163 Alim Mian and Yasin Mirza: Pakistan Soil Resources, National Conservation Strategy, Sector Paper IV, Environment and Urban Affairs Division, with IUCN, 1993.

Chapter 14: Institutional Change for Export Diversification and Accelerated Export Growth

376. Pakistan's slow export growth and the consequent perennial pressures on the balance of payments constitute a structural constraint to sustaining high GDP growth. In this sub-section we will briefly indicate Pakistan's position in the exports of developing countries, its export structure, new opportunities available for accelerating export growth and the institutional interventions required for actualizing these opportunities.

14.1. Pakistan's Poor Export Performance

377. The share of developing countries in the world's manufactured exports has increased sharply in the last quarter century: While manufactured exports for the world as a whole increased by 8 fold over the period 1980 to 2006 (from US $ 1.1 trillion to US $ 8.3 trillion), manufactured exports from the 16 major developing countries has increased 30 fold over the period (from US $ 94 billion to US $ 2.7 trillion). Within the developing countries the share of Asian countries in manufactured exports has risen even faster, with almost the entire market share lost by the developed countries going to Asian countries[164].

378. In contrast to the export performance of developing countries, Pakistan's share in world trade has not changed significantly and has remained at the low level of 0.15 percent. Even more dismal is the fact that Pakistan's share in world manufactured exports at 0.1 percent has fallen since the 1970s[165]. Furthermore Pakistan's share of manufactured exports amongst the developing countries has declined in the last two decades inspite of an 80 percent increase in manufactured exports during the period 2000-2006. The trend since 2006 has worsened with Pakistan's manufactured exports growing at half the world average. Even more serious is the fact that in the case of textiles, which is Pakistan's predominant export industry, the country's market share has declined as Pakistan's textile and garments industry was unable to respond to the new competitive environment after the phase out of the MFA[166].

14.2. Exports and Economic Policy

379. What are the major factors behind Pakistan's poor export performance which in turn has been a constraint on sustainability of GDP growth?

380. Historically Pakistan's economic policy has had an anti export bias with generally high duties on imported inputs creating disincentives for non traditional manufactured exports using such inputs. At the same time direct

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164 State of the Economy: Challenges and Opportunities, IPP's Annual Report 2008, Institute of Public Policy, Beaconhouse National University, Lahore, 2008. chapter 9.

165 Ibid.

166 Ibid.

and indirect subsidies, particularly to industries based on processing of domestic raw materials gave much larger profit margins from sales in the domestic market compared to exports, thereby creating strong incentives for inefficient, low quality production for the domestic market.

381. Over time some of the anti export bias in trade policy has been reduced, with export taxation of cotton ending after the decade of the 1980s, and imports greatly liberalized. The question is why has trade liberalization in Pakistan (which has gone further than India), not resulted in an increase in the share of manufactured exports? Perhaps the most important proximate reason for this is the failure to diversify Pakistan's export structure beyond textiles in a situation where the world trade in textiles is growing at a much slower rate than non traditional manufactured goods. For example, over 80 percent of Pakistan's manufactured exports consist of textiles and clothing compared to 12 percent for the developing country group and 6.5 percent for the world as a whole. India's non textile manufactured exports are 25 times that of Pakistan, while countries like Philippines, Indonesia and Turkey have non-textile manufactured export levels 15 times higher than Pakistan.

14.3. Institutions and the Failure to Diversify Exports

382. The failure to achieve export diversification is rooted in the current institutional structure relating to exports and the balance of trade. This institutional structure which is manifested in formal laws and their enforcement characteristics; tacit rules of business; and procedural mechanisms provides strong disincentives for export growth and export diversification on the one hand, while encouraging imports and restricting foreign exchange inflows through outsourced international trading on the other.

383. The current corpus of rules, regulations and their enforcement mechanisms are associated with high direct costs of doing business and substantial transaction costs stemming from uncertainties flowing from poor information flows on the one hand and graft in governmental departments on the other.

384. Specifically the current structure of rules is designed for traditional sectors such as textiles and agricultural products, and discriminates towards non traditional sectors such as high value added manufacturing, agricultural product processing, light engineering, and small scale enterprises including both manufactured and cottage industry items. The discrimination occurs in a number of ways including: (a) absence of standard concessions such as duty draw backs and meaningful rebates, (b) lengthy and complicated procedures for exports, (c) inadequate working capital support e.g. low interest export refinance, (d) under provision of public goods such as marketing support and international lobbying for market access, and (e) export documentation regulations which limit the scope of international, outsourced trading, (f) bureaucratic red tape, graft in governmental departments, weak contract enforcement and lack of protection of private property rights (such as protection of export consignments from bandits during road transportation to

the port) raises the costs of business across sectors and limits the development of new markets overseas[167].

14.4. Public Sector Investment and the Failure to Diversify Exports

385. Adverse public sector priorities over the last few decades has resulted in the following structural constraints to export diversification:

14.4.1 Inadequate Electricity Production and Distribution

386. Inadequate investment in electricity production and distribution facilities. The consequent high electricity tariffs are an important factor in making manufactured exports internationally uncompetitive. The poor distribution facilities which lead to sharp voltage fluctuations result in frequent burnout of expensive electronic equipment even in factories that use voltage stabilizers, further adding to costs. (electricity fluctuations and frequent stoppages associated with 'load shedding' oblige most manufacturers particularly in flow process industries to use high cost energy from private generators).

387. According to a recent study power outages in the year 2008-09 cost the industrial sector Rs.83 billion[168].

14.4.2 Inadequate Port and Transportation Facilities

388. Inadequate investment in port and transportation facilities resulting in a long time lag (typically three weeks) between arrival of a shipment of imported raw materials at the port and its arrival at the factory. There is a similar long time lag between dispatch of export consignments from the factory gate to dispatch of cargo from the port. These time lags oblige manufacturers in Pakistan to maintain much larger inventories than their competitors which places relatively high financial costs and a significant factor in lack of price competitiveness. Equally important the long delays in getting raw materials to the factory and dispatching export consignments from the port, often result in failure of timely delivery which is crucial to getting repeat export orders.

14.4.3 Poor Quality of Training

389. Lack of investment in the quality of professional university education, technical and vocational training and institutions for upgrading skills of in-service personnel. This adversely affects every aspect of production and sale: from the productivity of machine operators, the ability to conform to statistical quality control procedures, product design, production management, inventory control and marketing. Each of these aspects of production and sale which currently suffer from poor training of workers and management personnel are

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167 This sub-section IV.3 has been researched by Mr. Savail Hussain, Research Associate to the Working Group on Institutional Framework for Development.

168 Institute of Public Policy, BNU, State of the Economy: Emerging from the Crisis, Lahore 2009. page 69, Box 4.3.

crucial for achieving international competitiveness in terms of cost per unit, product quality and consistency, development of product design features, and timely delivery. It is hoped that the present severe shortages of high quality trained workers will be rectified through a fast track implementation programme for the HRD initiative involving district level vocational training centres across the country.

14.5. An Institutional Framework for Export Diversification[169]

390. In view of the above a number of changes in the institutional structure can be suggested which can lower the costs of business and facilitate export growth and diversification. These include:

14.5.1 Targeted Development

391. Selecting sectors and sub-sectors for targeted development over the next 5 years through rebates, tax relief, infrastructure development, marketing and R and D support, and removal of import restrictions. The selection and monitoring of these sectors can be managed through a bi-partisan committee comprising of members from the private sector, academics, and members of the bureaucracy.

14.5.2 Rebates

392. Rebates should be to the tune of 10-15% of invoice value. Furthermore the duties on imported raw materials for these sectors should be eliminated. It is important to note that elimination is distinct from refunds as the latter is cumbersome to claim and is rife with governmental graft. Removing rather than refunding duties paid on raw and semi-finished goods can also improve cash flows of non-traditional exports many of whom are working under working capital constraints. This policy intervention is inline with the one pursued successfully by the Chinese over the last decade.

14.5.3 Marketing Support Framework

393. Marketing support for the selected sectors. The support framework could have the following elements: (a) Subsidized warehousing facilities, (b) Appointment of effective commercial consular officers and free product road shows and sourcing of new buyers, (c) Private sector link up for outsourced production for exports to new markets, (d) Infrastructure support for export production.

(a) Warehousing is particularly important for Central Europe and Latin America where the market is fragmented and direct supplies can greatly aid growth.

(b) Appointment at Pakistan's foreign missions, of professionally qualified commercial consular officers with performance based remuneration

[169] This sub-section IV.5 has been contributed by Mr. Savail Hussain, Research Associate to the Working Group on Institutional Framework for Development.

and evaluation systems. Commercial consular officers can be used as effective agents of facilitating product road shows, sourcing for new buyers and providing the much needed legitimacy to Pakistani exports by providing a physical presence in an official capacity in as yet undeveloped export markets.

(c) Facilitate the private sector link up with sourcing agents based in India- many of whom represent large and medium sized importers in North America, Latin America and Europe. Rising costs and a stronger currency are pressuring many of these sourcing agents to look outside of India. Since proximity and the absence of language barriers lowers transaction costs, therefore Pakistan becomes particularly attractive for outsourced exports through such a private sector link up with India. The sourcing agents are also important since the law and order problems in Pakistan prevent many buyers from the Americas and Europe from traveling to Pakistan and to monitor the production of their goods and services. Sourcing agents act as the bridge thus enabling trade to continue.

Facilitation of a private sector link up with India for increased Pakistani exports, includes easing the visa regime for such companies and individuals and allowing them to open offices in major cities in Pakistan.

(d) Infrastructure support for export production. This includes the uninterrupted provision of essential utilities at subsidized rates; development of modern cold storage facilities and packaging solutions through a public private partnership; and the establishment of a one window export documentation board.

Cold storage facilities can substantially increase exports of high value added products such as dairy, livestock, seafood and flowers.

Export diversification can be further facilitated through the development of the packaging sector such that can it can cater to modern packing solutions: Acetate boxes, blister packing and PVC containers can provide manufacturers in non-traditional sectors an important advantage when competing internationally. Currently Pakistan lags behind in the type and volumes of packaging solutions it can offer especially to the international wholesale and retail chains thereby reducing its ability to win such contracts.

14.5.4 Export Documentation

394. Easing export documentation requirements by providing exporters a one stop, one window solution will increase the efficiency of existing exporters while providing incentives to small businesses to come into the exports arena. The current process is fragmented and is spread across the Chambers of Commerce, Trade Development Authority, State bank of Pakistan, private banks, port authorities, and shipping companies. Along the way are cumbersome forms and filing procedures.

14.5.5 Import of Raw Materials from India

395. Import of raw material from India (which is unavailable locally) should be allowed by expanding the negative list. The current DTRE scheme whereby quotas are fixed for raw material imports from India meant specifically for exports suffers from redtapism and graft. A better solution is to open up raw material imports across the board.

14.5.6 Capturing China's Export Markets

396. Finally Pakistan can quickly make use of the opportunities offered by international trading in the current global policy environment. The current policy especially in the Americas and increasingly in Europe is toward anti-dumping duties on Chinese products. This combined with the rising Yuan means that countries like Pakistan with a port and cheap, plentiful labor can pick up some of the business that has being routed out of China. This can be done by the following policy action:

Allow the tax and duty free import of semi finished goods into special Free Zones for value addition and then export. The key selection criteria for these goods should their labor intensity since Pakistan has a comparative advantage in unskilled labor cost compared to China. The Free Zones can be established in existing production areas where production units or parts of production units can be declared Free Zones for Exports. To ensure that these facilities are not misused quotas can be established together with regular book keeping to ensure that all imported items into these zones are processed/packaged for value addition and then exported out of the country.

14.6. Free Trade with and Investment Flows from India as a Means of Sustainable Growth with Equity in Pakistan[170]

397. An economic opening up with India would sharply accelerate GDP growth in Pakistan through increased investment by Indian entrepreneurs. Moreover, import of relatively cheaper capital and intermediate goods from India could reduce capital output ratios in Pakistan and thereby generate higher GDP growth for given levels of investment. At the same time import of food products during seasonal shortages could reduce food inflation and thereby improve the distribution of real income in Pakistan. Easing of travel restrictions would give a massive boost to Pakistan's tourism, services, and retail sectors, which could stimulate growth. At the same time it would increase employment elasticities with respect to GDP growth (since the tourism sector is labour intensive), and hence increase employment and improve income distribution. Thus free trade relations with India would enable Pakistan to achieve a higher and more equitable GDP growth.

[170] This section is based on: Akmal Hussain, Power Dynamics, Institutional Instability and Economic Growth: The Case of Pakistan, The Asia Foundation, Islamabad, 14th April 2008.

Chapter 15: 'Trust' as an Institution for Sustained Economic Growth[171]

398. During our research on SME growth we came across a number of instances where manufacturers, from different sectors complained that they could not enter into long term contracts with upstream or downstream players, or even with raw material suppliers, and providers of services (not necessarily upstream or downstream)[172]. The main reason they cited for the problem was that they could not 'trust' these players. In other words, they were saying that they could not do any long agreements with the players as they could not rely on these players not being opportunistic (in Williamson's sense of the word).

15.1. The Concept of Trust

399. This notion of 'trust' being invoked is a special one. It is saying that even if an agreement is reached between players, they cannot rely on the terms of the agreement being carried out in case their 'partner' gets even a small opportunity for gain. Usually an agreement has an expectation of being carried out. This expectation is based on either the enforcement that law provides, and redress as well, or the enforcement that social networks, norms and/or codes of the players provide. As market networks expand and transactions become impersonal, norms, social networks and small-group codes are not sufficient to provide the enforceability that is needed. We need the law to substitute for social systems of enforcement. The law ensures that the aggrieved will have access to speedy and fair redress and that, more than anything else, acts as a deterrent against breach of a contract. Once the law is well established and functions efficiently and in reasonable time, breach of contract happens less often as it becomes the costlier option. Without this 'trust' is legal recourse and redress, it is hard to see how economic transactions can take place even in time and specially across time.

15.2. Trust, Markets and Transactions

400. The problem is more general than just about long term contracting with suppliers and buyers. It transcends all markets. If employers and employees cannot go into long term contracts, employer's incentives to train labour, on the margin, will decrease[173]. If banks cannot be sure that they will get their

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171 The Chairman of the Group on Institutions for Development gratefully acknowledges the contribution of this section by Dr. Faisal Bari.

172 Retailers cannot get tailors to make clothes for them, sweet producers cannot get quality ghee producers, auto-vendors cannot find players that can make special sub-parts for them. In some cases small size of the market conspires against specialization, but in most of the cases we looked at, it was more the inability to 'trust' the buyer, supplier or provider of service that was the key issue.

173 In this case it can lead to low level equilibria in labour markets where lack of training hurts quality of product but due to the fear of labour switching to competitors employers are unwilling to invest in appropriate training. If all employers think the same way, being quite rational, the quality of labour in the particular area will be low and will hurt all producers, the industry and the country.

money back, they will not lend in the first place. If they expect that collateral cannot be alienated from the original owner who had pledged that asset, banks will not accept these assets as collateral, or they will have much larger margins, to pay for cost of retrieval, for accepting assets as collateral[174]. In cases where quality or quantity of the good or service being exchanged is not easily verifiable the contracting will impose high transaction costs in terms of inspections and monitoring. Can you 'trust' your contractor to build your house at the contracted quality without investing in quality check managers? But if his/her reputation was at stake or if he/she was concerned about legal redress, you could be more relaxed about quality checks and have them done at the end and not have people standing on the site at all times. Businesses tend to be small in Pakistan as many businessmen feel they cannot expand their business beyond a certain size since they do not have enough sons, brothers and 'trusted' relatives and/or friends. But why should businesses not be able to rely on professional managers to deliver in the same manner as 'trusted' sons, relatives and/or friends. The biggest gains in land markets accrue to those who can secure property rights over parcels of land. The 'developers' whether they be private developers or current/retired military personnel, profit from ensuring that property rights of eventual buyers are well established (DHA premiums are based on this issue). But if property rights were generally enforceable, we would see a much more even and larger development of land and/or housing markets and fewer occurrences of monopoly rents as well as creation of real estate bubbles. One can come up with such cases from any and all markets.

15.3. Market Efficiency, Contract Enforcement and Judicial Reforms

401. The cost of the not having a legal system that makes contracts enforceable cannot be over-estimated. It is causing business to expand inefficiently going into backward or forward integration or even horizontal integration when they should be focusing on growth in areas of their comparative or absolute advantage. It can force businesses to remain small or subdivide (between sons). It limits growth of credit and insurance markets as well as markets for contingencies and futures. It raises transaction costs for all parties and in most transactions.

402. One cannot move in the direction of creating enforceable property rights without serious judicial reform in the country. If the judiciary is not independent, free and accessible at reasonable cost, and if cannot deliver justice in reasonable time, property rights cannot be enforceable.

403. Judicial reforms are not seen as part of a 'economic' reforms agenda. Though they might actually be the most important reforms that need to be carried out even from an economic perspective. But this does not seem to be a priority for the government currently. If revealed preference is anything to go by the way government has gone about restoring the judges that were removed in the

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[174] Micro-credit works with reputation and possibility of ostracization as collateral. Loss of reputation or its threat can be thought of as alienation of collateral.

illegal actions of November 3rd 2007, the government has shown it does not have a strong preference for a free and independent judiciary. Furthermore, though there has been talk of judicial reforms for a long time now, actual reforms, attempted and completed, in the area of law and judiciary, have usually been quite unsatisfactory. The fate of programmes like Access to Justice, very well funded and supported by multilateral and bilateral donors, tell a rather sad story. In some cases whole programmes were shelved after the donors suspended payments due to lack of concrete progress. Attempts at reforms in the lower judiciary have been even weaker.

15.4. Institutional Change in Short and Medium Terms

404. Judicial reforms, reforms in related laws and changes in the relevant institutions would be based on a medium to long term engagement. However there are implications for institutional change policies even in the short term.

405. Short term: For the short term, a simpler but not an unimportant aspect of property rights issue could be looked at by the government. Expectations about the future are based on government policies and decisions. These expectations can become the basis for, among other things, important investment and related decisions by private players. If the government changes policies too often and changes it in ways that it leads to very different outcomes for investors, it is not only going to make some players lose money, the uncertainty created would makes investors risk averse and make them shy away from investing.

406. In the last decade or so the successive governments in Pakistan, and sometimes even the same governments, have taken contradictory positions on the same issue. The government had a major role in procurement of major crops like wheat and rice. Then it was decided, as a part of the de-regulation and liberalization drive, to reduce the role of government in procurement, storage, marketing and even export of major crops. The private sector was 'invited' to enter these areas. But as soon as supply or demand hiccups occurred, the policy was more or less completely reversed. And government entered into forced procurement, and every so often it even resorted to Section 144 to restrict inter-district and inter-province trade as well. Eventually a term 'hoarder' was coined for dealing with people who bought wheat cheap and stored it to sell when it was expensive[175]. And today we have different rates of subsidy across the provinces and strict controls on movement of wheat, especially on the provincial 'borders'. Would private sector invest under these conditions? Clearly not. Why should they invest when they cannot be sure about returns from their investments? It is true that the government cannot let monopoly rents be extracted from consumers, especially in sensitive markets like food items. But that is an argument for ensuring an efficient regulatory mechanism is in place and markets work

[175] If this is not what markets facilitate and exchange is supposed to do, what is? The idea is that as long as we are dealing with larger number of players, where each player is relatively small compared to the market, there should be no possibility of monopoly rents (called exploitation by some). If the wheat market does not qualify for a 'competitive' market, it is hard to see which market would be right for allowing unfettered competition to occur in.

under proper legal conditions. It is not an argument for arbitrary policies or arbitrary reversal in policies.

407. Expectations of consistency from government, continuation of policies and expectations against arbitrary behaviour, on the part of government, need to be ensured. Otherwise a number of markets can malfunction seriously. Should people believe the government when it says it will not nationalize or freeze foreign currency accounts and people should bring their money into Pakistan? Should people believe the government when it says that it will not exploit people once they have entered the tax net? Should they believe the government figures on inflation, poverty and so on? If the government can reverse policies, take arbitrary actions and change stated positions rapidly, the 'trust' in government policies and statements will be low, and the economy will suffer accordingly.

408. The government clearly needs to establish its credibility. Since the government is faced with an economic crisis right now, it is important for government, when thinking of institutions even in the short run, that it should establish its credibility, not renege on promises it made in the past or on expectations whose formation it encouraged in the private sector, and think of its policies in a longer term framework despite the short term emergent situation.

409. In the medium run it has two important tasks. It has to ensure that policies are consistent and do not contradict incentives for the private sector over time, and secondly it has to take on the agenda of reform for the judicial sector to ensure creation of laws needed for enforcement of property rights (broadly defined) and the efficient implementation of these laws.

Chapter 16: Institutional Framework for Social Development[176]

410. In this section we will propose the concept of social development, indicate the linkage between Pakistan's low performance on social indicators and persistent inequalities and finally outline an institutional approach to social development

16.1. Distinction between Social and Economic Development

411. Social development is defined to include qualitative and quantitative improvements in the physical and cultural conditions of the population, particularly those who are the weakest and most vulnerable in any given society, through the application of resources and institutional changes. Social development is the object rather than instrument of economic development, which is concerned with expanding the resource base and efficiency of resource use of an economy.

412. It has been customary in Pakistan for economists to ask how much social development – measured in terms of educational expansion, improvement in health, and demographic transition – might contribute to economic growth. Since fluctuations in economic growth have been dependent, however, on the nature and intensity of Pakistan's geo-strategic engagement with the rest of the world, a growth-centric approach has allowed policy-makers to ignore social development altogether. The appropriate question, in any case, is how and to what extent economic growth might contribute to social development and not the other way round.

16.2. Low Achievements and Persistent Inequalities

413. In Pakistan the social development gap can be thought of operationally along two dimensions. First, there are low achievements and slow progress in specific measures of social development such as mortality, morbidity, nutrition, public health, child welfare, violence against women, demographic change, education, scientific advancement, and cultural output. Second, there are persistent inequalities along the lines of gender, caste, kinship, ethnicity, class, urbanity and religious difference that are not incidental but institutionalized.

414. These two dimensions of the social development gap – i.e. low quantitative achievements and persistent inequalities – are inter-connected. Low overall literacy outcomes, for example, are directly related to gender and class inequalities. Poor mortality and morbidity outcomes are closely connected to restricted female autonomy and mobility in accessing health facilities. It is nevertheless important to see the issues of low achievement and persistent social inequality as being distinct ones, in order to recognize the potential synergy between improved resource allocations and pro-active political, administrative and legal measures for directly addressing social inequalities.

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[176] This section has been contributed by Dr. Haris Gazdar.

16.3. Institutional Approach to Social Development

415. In other words, an effective strategy for dealing with the social development gap must include higher resource allocations and better service delivery, in combination with direct interventions to counter patriarchy, caste discrimination, labour market inequalities and other forms of social marginalization.

416. An institutional approach to social development sees chronic backwardness and persistent inequalities not as merely incidental outcomes of low allocations or poor governance. Female enrolment or health access is low not simply because girls and women face disadvantage as individuals, but because of entrenched institutions of patriarchy that are sometimes even seen as social or cultural norms. Similarly, workers from particular castes and ethnic groups face unequal labour market conditions – and vulnerability to physical coercion and bondage – not merely as individuals but due to institutionalized discrimination against particular groups in accessing legal protection and contract enforcement.

417. The overarching institutional framework for social development must be citizenship – or the state-citizen relationship. This framework which is embedded in our constitution must take precedence over any other existing formal or informal institutional framework – such as patriarchal "norms", caste hierarchy, or coercive informal labour arrangements. This framework also presupposes that the wider community, as represented by the state, is interested in universal minimal outcomes with respect to citizens. This is simple to see with respect to the rule of law – the guiding principle here is that law must apply <u>equally</u> to <u>everyone</u>. The same is true, but less well appreciated with respect to other aspects of citizenship. Some minimal standard of education or health must be <u>equally</u> available to <u>everyone</u>.

418. It is manifest that in Pakistan the state-citizen relationship remains weak and mediated. The state's organizational and resource reach remains limited and uncertain for most purposes. Then there are numerous institutional layers, both formal and informal, that intervene in the state-citizen relationship thus limiting the entitlements and the agency of individual citizens. For a social development agenda to advance it is crucial that the administrative and institutional reach of the state must be extended and strengthened.

Chapter 17: Institutional Reforms for Strengthening Fiscal Federalism[177]

17.1. The Problem.

419. Pakistan's present inter governmental assignment of revenue and expenditure function is resulting in four main problems: (i) The vertical imbalance between provincial expenditures and revenues is large and has increased during the past seven years[178]. (ii) Pakistan's sub national (provincial) expenditure as a proportion of total expenditure is one of the lowest in a range of developing countries[179]. Furthermore Pakistan's sub national own source revenue as a percentage of GDP is also one of the lowest in a range of developing countries[180]. (iii) These imbalances result in either increasing provincial budget deficits or under funded provincial expenditure mandates. (iv) Rising provincial budget deficits have resulted in greater resort to borrowings in the last seven years and are adding to inflation and adversely impacting the deteriorating macro economic situation in the country.

17.2. The Solution

420. The institutional structure of fiscal federalism can be strengthened through the following four policy interventions to support macro economic stabilization in Pakistan:

17.2.1 Policy Proposal 1

421. Strengthen the own source revenue base of provinces and provide incentives to increase own source revenue effort. This will include:

- Devolving the CVT on immovable properties to the provinces.
- The GST on all Services needs to be made through a straight line transfer to the province even if it continues to be collected by the Federal Board of Revenue.

422. Design and introduce a system of performance transfers that make certain transfers conditional upon the province improving its own source revenue collection.

- *The Logic*. Strengthening provincial own source revenues will help to reduce vertical fiscal imbalances and to ensure that tax follows

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177 This section draws upon the contribution to the Working Group Report made by Dr. Ali Cheema, member of this Working Group. His contribution is gratefully acknowledged.

178 State of the Economy: Challenges and Opportunities, IPP's Annual Report 2008, Institute of Public Policy, Beaconhouse National University, Lahore, 2008.

179 Shahid Kardar, 2007.

180 Ibid.

function. It will also help reduce provincial fiscal deficits and the problem of under-funded provincial expenditure mandates.

423. Currently, the federal government is levying GST on services on electricity, telecommunications, gas, air travel etc. and retaining a proportion of these taxes even though constitutionally GST on Services is a provincial subject. The issue is somewhat different in the case of "Capital Value Tax on Immovable Properties" where a Supreme Court of Pakistan judgment has given the Federal government the right to levy and retain this tax. The latter limits the province's ability to utilize the full potential of a functional property tax, which the province with its much better developed capacity is in a more advantageous position to levy than the federal government.

424. At present, there are no incentives given by the federal government to the provinces for increasing own source revenues. Conditional transfers will ensure that provinces have incentives to increase own source revenue.

17.2.2 Policy Proposal 2

425. Stabilization must ensure that: (a) the federal government gives up its expenditure assignment with regard to all services that the Constitution suggests lie with the provinces; (b) provincial social sector expenditures are given priority during stabilization; (c) where the federal government has designed new programmes that encroach on constitutionally determined provincial expenditure mandates and/or there is duplication between federal and provincial government expenditures provincial projects and programmes should be given priority.

- *The Logic*. This will ensure that the size of the federal government is streamlined and long-run structural changes are made to the size, composition and efficiency of the federal bureaucracy. It will also make space for budget deficit reductions during the stabilization phase. Finally, it will ensure that social sector expenditures have priority during the stabilization period.

17.2.3 Policy Proposal 3

426. There is a need to seek buy-in during the stabilization policy phase from the provinces and to get them to commit to expenditure cuts and/or undertake complementary measures that support the stabilization. This can be achieved by creating provincial buy-ins for the stabilization and by bringing the policy for discussion and agreement in the Council of Common Interest.

- *The Logic*. This will ensure that adverse macroeconomic consequences are somewhat mitigated because of the improvement in the provincial budgetary situation. It is, however, imperative that a joint decision be taken to support the economy at this stage. However, prior to this decision the details of the stabilization package need to be shared with the provincial governments at the Council of Common Interest and a joint strategy be devised by all parties to see Pakistan through this economic crisis.

17.2.4 Policy Proposal 4

427. Setup a body of professionals that places ceiling on the size of the total credit plan and defines the process through which these funds are going to be divided between the province and the federal government. Furthermore, design a role for parliament in this process of approval.
    - *The Logic*. An important fact that has emerged during the last seven years is the issue of provincial budget deficits. There has been greater resort to borrowings to finance the rapidly increasing expenditure on development during the last seven years. IPP (2008) estimates that almost two-thirds of the development expenditure of provinces have been financed by borrowing. In this scenario it is important to work in a coordinated manner with provincial governments, especially during stabilization that is attempting cut aggregate demand.

Chapter 18: Conceptual Outline for Increased Domestic Resource Mobilization[181]

428. In this section we will flag some of the issues involved in enhancing tax revenues and outline in the case of NWFP some of the specific measures that can be undertaken to increase resource mobilization at the provincial level.

18.1. Enhancement of Tax Revenues

- The new government's economic stabilization program aims for reductions in both the fiscal deficit and the balance of payments deficit.
  As regards the fiscal deficit: Reduction in expenditure is contemplated with phasing out of subsidies, while enhanced government revenue is anticipated through higher taxes on imports.

- The tax to GDP ratio *(of less than 9%)* for Pakistan is *perceived to be low* when international comparisons are made. Hence, the *"over"* emphasis on finding avenues to boost revenue collection from taxation.

- The government also has *non-tax* revenue base through its engagement in a wide range of commercial activities: such as the production & distribution of electricity and gas, postal services, railways, commercial air travel and banking.

- Tackling the domestic deficit in prudent manner (that is, giving due consideration to its implications for social justice, economic efficiency and economic growth) necessities focusing on <u>comprehensive fiscal reform</u> – that is, on an examination of the potential for reduction in government expenditure through prioritization of expenditures and reduction in the delivery cost of government services *(fat trimming),* <u>coupled with</u> an examination of revenue enhancement options – including revenue from taxation, *nontax* revenues (i.e., the proceeds of government commercial activities), and public borrowing.

- The government ought to consider shifting its focus on raising revenues from indirect taxation with easy *"tax handles"*, such as import duties, since tax compliance and hence revenue collection tends to decrease with higher and higher rates of taxation, aside from the fact that indirect taxes tend to have adverse implications for social justice.

- The government ought to review the *burden sharing* of taxation. The well-off (the rural and urban elite) ought to be bearing a greater burden of taxation, than they historically have, since they tend to receive disproportionately higher benefits from government expenditures. Consequently, taxation of agricultural and urban land and property ought to receive serious consideration as an additional base for revenue enhancement – a source which has favorable implications for equity, and help to reduce the undesirable effect of land speculation which has driven property prices

[181] This section has been contributed by Dr. Nasser Ali Khan.

skyrocketing. A broadening of the tax base should have favorable consequences for the revenue enhancement.

- Raising revenues from *non-tax* sources ought to receive due consideration. The operations of government commercial entities ought to become an integral part of the government's revenue enhancement effort. The operations of some public entities, such as the railways and PIA, which defy commercial norms and persistently vie for classification as government expenditure, ought to receive due attention – ensuring such activities contribute to the budget and not drain it.

- The sources of fiscal measures (revenue collection and effective government spending) depend on the cooperation of the public and the discipline and integrity of civil servants.

- Compliance of taxpayers

Fiscal Federalism – delegation and decentralization of fiscal responsibility.

18.2. Provincial Resource Mobilization: The Case of NWFP

429. The N-WFP government depends on the federal government for 90% of its expenditures. The Province generates only 10% of its revenue from its own sources. The federal transfers are in the form of:
   - Net hydel profits,
   - Transfers from the federal divisible pool,
   - Subvention grants from the federal government
   - Foreign and federal government loans.

430. It is these rather vertical fiscal imbalances that need to be addressed since most of the revenue is collected at the federal level whereas the expenditures on service delivery are provincial and local.

431. For the Province to increase its share in revenue generation and stimulate growth in the longer term would require raising the provinces own revenues from 0.7 to 0.8 percent of GDP over the next 3 – 5 years. This increase works out to a 13 – 15.5 percent nominal increase in own revenues. In order to mobilize more of its own resources, the Government of the NWFP will have to improve its tax policy and tax administration. A number of recently completed policy studies indicate that there is considerable potential to generate higher own revenues over the medium term — by as much as 2.3 times the current level, in real terms.[182] There is even greater scope for increasing taxes such as Motor Vehicle Tax, Stamp Duty, Professional Tax and Urban Immovable Property Tax to 2.5–3.0 times. This entails a thorough review of tax structure and exemptions. For instance, although the NWFP government took a bold

[182] These included studies on Reforms of agriculture Income tax (AIT) and Land Tax in N-WFP (2003), Tax Potential in N-WFP (2004), and Reforms of tax administration in N-WFP (2004).

step of imposing the Agricultural Income Tax (AIT) on all farmers, irrespective of farm size, to-date AIT is levied in only 5 of the 24 districts in the province. This requires an immediate correction, as it not only reduces the base of the tax considerably, but also creates fiscal inequities within the province. Similarly, considerable UIPT revenue is lost due to the government's reluctance to declare additional rating areas despite considerable urban development and poor assessment of property values. Also, the ongoing conflict between the provincial government and the Cantonment Boards is adversely affecting revenue from the Profession and Calling Tax.[183] The province also needs to improve tax administration to increase collections within the existing tax statutes, adjust tax rates to remove exemptions and make them more equitable, expand the tax base by bringing in hitherto non-taxed areas under the tax base,70 create a better tax climate by opening Tax Facilitation Centers (with support from the private sector) in order to facilitate tax payments, abolishing taxes with little yield, likely to prove an effective way to invite new investment into the province. Experience from around the world has shown that the focus should be on having a sound tax policy and an effective and corruption free tax administration.

432. In addition to taxation measures, the provincial government should also find innovative ways to raise more resources for growth.

433. This could include:

- Relying on the private sector for many activities and leasing out/selling assets. This will not only contribute to private sector development but will also strengthen public finances by reducing spending and raising revenues. Examples of activities that could be better performed by the private sector include: tourism services (encouraged by leasing state-owned land to the private sector to develop the tourism industry); hydel electricity development (supported by a sound policy environment to take on Build-Own-Operate (BOO) options in this sector and in other areas of infrastructure development); and tertiary education, health services, and the provision of water and sanitation services.

- Moreover, the provincial government should find ways in which it can raise resources by auctioning/leasing high-value state-owned lands for urban development. It should make efforts to privatize public assets that have been on the privatization list for a long time; by making sure that the Privatization Committee plays a more active role and, if necessary, enlist the assistance of the federal privatization commission.

- Efforts of the Government of the NWFP to increase its own revenues will help, but will be insufficient to fund an accelerated development program.

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183 While the Profession and Calling tax is a provincial tax, the LGO specifies a profession and calling fee which could be levied by the local government. Levying a tax which is more or less similar in character not only creates the perception od double taxation, but can lead to significant collection inefficiencies.It would therefore be more appropriate if the profession fee could be subsumed in the profession tax (to be collected by the provincial E&T department) while revenue accruing from the fee be transferred to the local governments.

Increased resource transfers through a new NFC Award that devotes a higher share of the divisible pool to the provinces will also be necessary to complement the provincial government's own efforts. A higher award of the divisible pool to the provinces would reduce the stress on provincial finances and allow for a larger share of resources to be transferred to local governments.

- Quarterly payments of net hydel profits have often been irregular and the amount has been capped at Rs 6 billion since 1991/92. This implies that there has been an erosion in its real value by more than 60 percent between 1991/92 and 2004/05. As a minimum, the province should get timely payments of at least the capped amount.

Chapter 19: Conclusion

434. In this Report we have attempted to provide the analytical basis for a change in Pakistan's economic policy paradigm for achieving *economic democracy* in order to provide economic citizenship to all of the people rather than a few. This is an essential element in the prosecution of the ongoing battle for national survival.

435. We have argued that the observed failures to achieve sustained growth and to overcome mass poverty are both rooted in an institutional structure that excludes the majority of the population from the process of investment, access over high quality education, health and equitable access over markets. It is on the basis of this exclusion that a small elite is able to appropriate rents while leaving the majority of the population in a state of economic deprivation. Such an institutional structure not only generates mass poverty, acute inter personal and inter regional inequalities but also places severe stresses on both state and society.

436. The present multi faceted crisis of state, economy and society shows that the time has come to bring about structural changes in the institutional framework of Pakistan's economy to be able to achieve inclusive and sustained growth: A broad based economic growth process where the people would be both the subjects of development as well as the recipients of its fruits.

437. We have specified the major elements of a new institutional framework for inclusive growth. The central feature of the proposed institutional framework is to enable the small and medium farmers in the agriculture sector and small scale enterprises in the manufacturing sector to acquire productive assets and achieve equitable access over product and factor markets. The evidence shows that these markets are currently asymmetric with respect to the large and small farmers, as well as large and small manufacturers.

438. We have specified the concrete institutional mechanisms for enabling the deprived sections of society to acquire equity stakes in new large corporations that could provide services for land development, new technologies and marketing to small farmers: We have also specified similar initiatives that can be undertaken through public private partnership to set up corporations owned by the poor and landless owners of cattle for the development of the dairy and livestock sectors that could induce pro poor growth as well as substantially increase exports. Finally we have proposed the institutional framework for the establishment of Common Facilities Centres (CFCs) in specified industrial clusters through which a rapid acceleration in high value added, export oriented small scale industries could be achieved.

439. In this Report the institutional factors underlying unstable growth and persistent mass poverty have been identified and policy initiatives proposed for overcoming these structural constraints to sustained growth and rapid poverty reduction. The institutional constraints to achieving equity in the provision of health and education have been indicated to improve the quality and coverage.

440. The issues involved in the institution of trust as an underlying factor facilitating efficient markets and the institutional framework for social development as both a means as well as the aim of economic development have been examined and policies outlined for the necessary institutional changes.

441. Finally, a brief institutional analysis of fiscal federalism has been undertaken and specific proposals for institutional change have been specified to achieve economic efficiency, improved service delivery and strengthening the federation by empowering the provinces.

PART-IV: SOCIAL POLICY AND SOCIAL PROTECTION

Introduction

442. Pakistan finds itself at an important crossroads. The war against extremism has entered a decisive phase. While, the Government has so far managed internal displacements efficiently, the problem of displacements and loss of assets and livelihoods in areas affected by extremism will have to be addressed in the short to medium run. Conflict borne out of extremism is in addition to the increasing pool of the poor and vulnerable as a consequence of high inflation and the economic downturn in the country for the last few years. The role of social protection is paramount in addressing the present crisis and the previous reports of the Panel have made suggestion on instruments and scope of social protection.

443. Social protection can be broadly defined as provisions that "society provides to individuals and households through public and collective measures to guarantee them a minimum standard of living and to protect them against low or declining standards of living arising out of a number of basic risks and needs." Social protection is also increasingly seen as having a "transformative" role – creating entitlements that lead to the realization of citizenship rights and social equality. It is also explicitly mentioned as a citizenship right in Pakistan's constitution.

444. On paper Pakistan has a fairly elaborate network of direct and indirect social protection mechanisms. Direct provisions include employment based guarantees (such as the EOBI, WWF and provincial social security benefits), direct transfers (Zakat and Baitul Maal) and market based interventions (microfinance). Indirect provisions include the provision of the minimum wage, subsidy on petroleum products, electricity, subsidy on the price of flour and food subsidies through the Utility Stores Corporation. However, governmental commitment on direct subsidies has been minimal till recently and indirect subsidization has proven to be unsustainable and fiscally counterproductive. As such, the need for a rationalized and coherent social protection system in the country is self evident.

445. However if we take a medium to long run view, there are a number of structural inequalities in society and economy that require attention. Some of these need to be addressed through a pro active social policy of the state. Social policy as distinguished from social protection can ensure equitable and socio-politically sustainable development in the country. Thus, based on the principle that social policy and social protection are important elements of nation building and in creating a sense of belonging amongst the citizens to the state, the final report by this Panel will concentrate on these long term concerns. This report will also re-emphasize as to the manner in which the immediate response to the crises should be shaped.

Chapter 20: Social Policy Instruments

446. For the medium run, we address three specific issues in the realm of social policy. We have not addressed traditional 'social sectors' such as education, health, sanitation, etc. for two reasons. One, that policy making on these fronts is already taking place and two, a number of health and education initiatives are incorporated in social policy and social protection recommendations below.

447. Social policy areas that we highlight in this report are not only important in their own right but are also instrumental in improving labour market conditions which will have a positive impact on employment creation and productivity growth.

b) Residential Land Security for the Marginalized

448. Residential insecurity is a persistent feature of social marginalization at the local level. In rural areas this insecurity takes the form of dependent relations between landowners and the landless. Extreme forms of dependence result in bonded labour and other forms of coercion. Less extreme forms of dependence include the loss of political autonomy, vulnerability of services and provisioning to elite capture, restricted labour market opportunities, and chronic lack of tangible asset accumulation on the part of the poor.

449. Agrarian land reforms are no longer on the policy agenda for constitutional, political, administrative and economic reasons. There is a constitutional restraint following a Supreme Court ruling. Government can, however, make a significant differece to the position of the landless, poor and socially marginalized by ensuring secure tenure or title to residential or homestead land in rural areas. Such provision can be a significant non-fiscal measure for enhancing social protection, reducing inequality, and unleashing the productive potential of the poor. Past schemes for residential land security were responsible for dramatic changes in social relations in many regions of the country.

450. A key feature of rural residential insecurity is that the landless and socially marginalized groups are often resident on land that is actually owned by government, but is held under the influence of local landowners. The government has the responsibility for providing state land to the landless poor and the socially marginalized. In areas where state-owned land is not available in sufficient area, government can acquire land using the Land Acquisition Act 1894, or through market transactions, and allot it to specially designed schemes for the landless poor and the socially marginalized.

451. In urban areas successive rounds of regularization of Katchi Abadis have been very successful in increasing the social status and economic potential of the poor and the marginalized. Programs of regularization – which often relate to the regularization of existing settlements on land owned by the government or government-owned enterprises such as the Railways – should be reviewed, revived and expanded.

b) Forced and bonded labour

452. Pakistan is committed to the eradication of forced labour of all types. There are laws and regulations concerning the abolition of bonded labour. Persistence of coercive labour arrangements, particularly in many rural areas of the country is a dire failure on the part of state and society. Extreme forms of coercion are only the tip of the iceberg in a labour market that should ideally play the role of social emancipation. Eradicating bonded labour and forms of coercion in economic activities needs to be acknowledged as being integral to economic reforms, and not only seen as a concern for human rights policy. Progressively freeing up the labour market will make a significant contribution to improvements in economic opportunities for the weakest segments of the population, while at the same time enhancing overall economic efficiency.

453. Democratic governments have a strong record in acknowledging the curse of bonded labour, and in taking pro-active measures for its eradication. The Sindh provincial government, for example, has notified a separate ministerial portfolio for dealing specifically with the issue of bonded labour. There has also been a manifold increase in the number of police actions against landlords suspected of keeping workers in bondage. There are, however, some serious gaps in the implementation of bonded labour eradication strategies.

454. Although specific laws are now available for dealing with bonded labour, it is found that there is very little litigation on this issue. Most of the police action for freeing bonded labourers is done under habeas corpus laws.

455. While the issue of debt bondage has been widely debated, there is little recognition of the fact the most of the people who are vulnerable to bondage or coercive labour arrangements are from socially marginalized groups – such as traditional “low” castes and religious minorities.

456. While the legal definition of bonded labour has not been much used (as evidenced by the absence of litigation), no operational definition has been provided by the government to guide the work of the relevant ministries, law enforcement agencies, courts and civil society organizations. In the ensuing confusion actions against bonded or coerced labour provide only ad hoc relief to individual victims without effecting more structural changes in labour markets. What is *not* needed is further legislation. What *is needed* is guidance on making existing laws and policies operational, and creating benchmarks for measuring success.

457. Given the constitutional guarantees of freedom from slavery, forced labour and other forms of economic coercion, it is the duty of the federal government to take the lead in this regard, and set the parameters for initiatives at the provincial and local levels.

458. It is strongly recommended:

- Federal government set up a commission which will be charged with a plan for the eradication of bonded labour and other coercive forms of labour from Pakistan. The commission must complete its work and make its recommendations within a six-month period.
- The commission should consult with stakeholders in communities, legal experts, economists, social scientists, law enforcement officials, and activists, in order to:
- Propose an operational definition of bonded labour in Pakistan.
    - Agree the methodology for conducting a baseline quantitative and qualitative survey of forced labour in the country.
    - Pay attention to social dimensions of forced and bonded labour – such as caste, racial and religious discrimination.
    - Propose an action plan including a range of law enforcement as well as social policy interventions, with measurable indicators for the eradication of forced labour.
    - Propose easily accessible labour adjudication processes at the local level for redressal and equitable contracting in the labour markets.

c) Gender Mainstreaming

459. Perhaps the most important social policy initiatives required in Pakistan is gender mainstreaming. Pakistan has one of the lowest labour force participation rates for women. Moreover, access of women to productive activities is limited because of limited access to resources, low investment in human capital, and discrimination in the labour market. In addition malnutrition, limited asset ownership and lack of access to technology limit the participation of women in productive activities. In order to reduce gender disparities multidimensional efforts are required.

460. Access to education and health is the key to reduce gender inequalities while the gender parity index (GPI) for literacy increased from 0.62 in 2004/05 to 0.63 in 2006/07 whereas for primary school enrolment it remained constant at 0.82. Given the equal share of males and females in the population and initial low literacy and enrolment of girls, the gender disparity will not decline without policy intervention. Furthermore the GPI varies across provinces, from 0.72 in Punjab to 0.38 in Balochistan. Thus, the pool of illiterate is expected to rise, with a higher share of females and of Balochistan. The reason is lower availability and accessibility of females to educational facilities, particularly in Balochistan.

461. Similarly, the health status of the population, measured by rise in life expectancy, improved by 1-year and infant mortality rate has decline somewhat in the recent past. The maternal mortality rate, however, increased during 1995-2005. The reasons include low percentage of birth attended by trained staff and lack of availability of facilities to meet the needs of pregnant women, particularly in rural areas. Less than 30 percent births are attended by professionally trained health workers.

462. Low female labour force participation rate and underestimation of female contribution in household income has resulted in labour market gender disparities. The key indicators of labour market show an improvement over time as the female labour force participation rate increased by 5.4 points, female employment-to-population ratio increased by 6.2 points and unemployment rate declined by 8.9 points during 1999/2000 and 2006/07. However, gender disparities in the labour market are still prominent as male labour force participation rate is 70 percent and female LFPR is a mere 19.1 percent. The unemployment rate among female workers (8.4 percent) is higher than the unemployment rate for males (4.2 percent). In addition the share of women employed for wage and as a share of total employment declined by 8.5 points. As such there is an increase in the share of women working as unpaid family helpers. This has resulted in rise in vulnerable employment for females by 9.5 percent compared to 1.5 percent for males. Female earnings are also only one third of male earning and a significant part of this differential

463. Disparities in education and labour market discrimination, coupled with intra-household inequalities result in disproportionately higher burden of poverty on women. In addition, evidence also suggests that incidence of poverty is higher among the female headed (working) households. Vulnerability of females also increases due to lack of access to resources, assets and social discrimination based on socio-cultural norms. Thus, focused efforts are needed to improve status of women in society. This requires increasing the access to education, health, resources and creating an enabling environment.

464. Recommendations for gender mainstreaming will have to be multidimensional:

- *Allocative:* Improve the supply side of education and health specifically to improve access. This will not only entail constructing more girls' schools but also to target an increase in female teachers and medical practitioners. The indicative goal should be to increase the number of female teachers and female medical staff by 50% in the next 5 years.
- *Administrative:* Federal and provincial governments will have to ensure that female staff is recruited locally to the extent possible. Where women from other areas are posted, their living arrangements, protection and mobility will have to provided on a priority basis.

465. This of course is easier said than done in a predominantly patriarchal society. Measurable indicators for this purpose will have to be devised to track progress of provincial departments and governments over time. Such indicators can provide the basis for credible incentives and sanctions for compliance.

- *Positive Discrimination:* BISP has already focused on providing the cash transfer as well as the benefits from waseela-e-haq to women. Such positive discrimination should also be extended in education, asset creation, vocational training and micro credit.
- *Incentives:* Incentivize private employers to provide transport to women workers and cresh facilities for children. Make cash transfers through

BISP conditional on sending children to school as well as for seeking health care for pregnancy and maternal health related matters from approved service providers.

- *Legislate:*The government has recently legislated against sexual harassment and violence at the work place. This legislation was long overdue and is praiseworthy. Further legislation is, however, also required for informal sector and home based woman workers. This will entail administering the minimum wage and regulating working hours and working conditions in the informal sector.

466. Legislation by itself may not alter working conditions and improve returns from labour for woman workers given the nature of the informal industry, but it will create a right that women can seek through collective and legal action.

Chapter 21: Social Protection for Nation Building

467. Conflict in NWFP, FATA and Balochistan has severely challenged the ability of the state as well as the legitimacy of the idea of a functioning state in Pakistan. Social protection must be part of the strategy to reclaim the space and legitimacy for the state in Pakistan, through protection to the basic entitlements of people in the conflict-affected areas.

468. The challenge in NWFP and FATA comes from groups that seek to impose their own vision of society on the majority. They violate democratic norms, actively and violently oppose social policy and development initiatives such as girls' schooling, immunization campaigns, and even income transfers to women. The armed activities of militants and the state's armed response has led to large-scale loss of life, displacement, and destruction of infrastructure, particularly social infrastructure. There has been massive disruption to livelihoods and economic activity.

469. Expanded social protection programmes, particularly directed at the conflict-affected areas are essential to protect innocent victims of conflict, and to regain legitimacy for the idea of a functioning state through creating, expanding and ensuring the delivery of citizenship-based entitlements.

470. Besides the conflict areas there are other regions that have suffered extreme deprivation through decades of neglect, and will be potential breeding grounds of alienation and conflict. In the high population provinces of Punjab and Sindh there are deep pockets of deprivation (e.g. southern Punjab, and rural Sindh) where alienation from the state and its institutions can be used to launch further security challenges. The list of those districts is given in Appendix VIII. The needs of the population in these regions must be recognized on an urgent basis, and social protection delivery must be used to assure the people that the state does regard them as worthy citizens. Apart from NWFP, FATA and Balochistan the most deprived 20 per cent districts of Punjab and Sindh should also receive special attention in social protection programmes.

471. These regions should be designated as NATION-BUILDING REGIONS of Pakistan, which must receive priority support in social protection programmes and policies.

472. We recommend that social protection be seen as nation-building interventions in conflict-related and particularly deprived regions of the country. In this regard all social protection programmes advocated in this report must be prioritized for these areas. In particular, in the coming fiscal year, there should be provision for "nation-building districts" outlined above.

Chapter 22: Instruments of Social Protection

473. The group decided to persist with social protection instruments that were suggested in the first interim report, i.e. the Benazir Income Support Program (BISP), the Employment Guarantee Scheme and the School Nutrition Program. Keeping in view the priority to be given to the NBRs the schemes are costed accordingly. In this report, we will provide actual costing required for initiating the Employment Guarantee and the Food Nutrition Programs. We will also provide an institutional assessment of the BISP with the view of institutionalizing the program in the coming fiscal year. Similar institutional pre requisites for the Employment Guarantee and Food Nutrition will also be discussed.

BISP

474. BISP has evolved in the right direction since its inception. In the second year of the program (FY 10), allocation was doubled from Rs. 34 billion to Rs. 70 billion. The number of beneficiary families was also increased from 3.4 million to 5 million. While the target for the first year (of 3.4 million families) was not achieved, the fact that benefits reached 2 million plus in the first year is no less impressive. Also benefits were also targeted, in lump sum (of Rs. 25000 as a one off grant) to IDPs.

475. More important than the roll out is evolution in the targeting mechanism. From a simple NADRA approved list to MNA nomination to a poverty scorecard demonstrates the learning capacity of the BISP organization. It is also demonstrative of the commitment of the government to create a transparent and verifiable system for cash transfers. It is hoped that by FY 11 the entire roll out will be done on the basis of the poverty scorecard.

476. Once the roll out on the poverty scorecard is completed, BISP should move towards introducing conditional cash transfers. This will essentially mean that transfers are linked to the families sending their children to school, availing adult literacy facilities where available and applicable and women and children seek formal health services. This will enable BISP to move from a mere income transfer to one which contributes to human capital formation for the chronically poor. This will create conditions for the families to come out of the intergenerational poverty trap that is characteristic of the chronically poor.

BISP and Nation Building Regions

477. As mentioned above, BISP funds have been distributed to IDPs as a lump sum. Since BISP is the flagship scheme of the Federal Government, we propose that in addition to the target population, special emphasis is paid to the NBR. Presently the number of beneficiaries is roughly 20% of the population. The government can increase the number of beneficiaries in the NBR from 25% to 40% (given in Appendix IX), depending on the fiscal space available. Depending on which is fiscally possible, BISP will dedicate a large share of its allocation on NBRs.

Employment Guarantee Scheme

478. An employment scheme through workfare has been implemented successfully in other developing countries – most notably in India. It was also mentioned by the Prime Minister in his 100 days Programme unveiled in March, 2008. Moreover, at a time when employment opportunities in the economy have shrunk and low growth is expected to persist, EGS has the virtue of employment creation linked with asset creation. In fact, EGS can be one vehicle through which a growth impulse in the economy can be created by boosting aggregate demand in the coming years.

479. We recommend that the EGS for the medium run should be limited to the NBR and that also should be staggered in three phases. Both for fiscal reasons as well as reasons for economic distress in the wake of conflict the scheme is recommended to the limited to the NBR. Moreover, we also recommend that the launch of the program is staggered in three phases. In the first phase, the program should be launched in the conflict zones of FATA and Malakand. In the second phase, it should cover the rest of the NWFP province and all of the Balochistan province and in the third phase the poorest 20% of the population in Sindh and Punjab will be covered.

480. The virtue of an employment program if benefits are kept on or around a regionally determined minimum wage, it becomes self targeting. It is also recommended that it should only be administered on small infrastructure schemes that are outside the remit of Federal and Provincial PSDPs. Since the emphasis is on maximizing employment, the schemes are envisaged to have a lower capital labour ratio than typical PSDP schemes.

481. Apart from the low wage, there are two other criteria used to ensure benefits to remain within the realm of fiscal feasibility as well to ensure that the poorest households benefit. As such we have made the cut off for selection to 30% of the illiterate population and to limit the program to one household per family for 100 days of employment in the year. The capital labour ratio is kept at 40:60 (the same as NREGA in India).

482. Based on the above criteria, the cost for Phase 1 (FATA and Malakand Division) comes to Rs. 16.17 Billion. For Phase 2 for Rest of NWFP and Balochistan it comes to Rs.42.28 billion and Rs. 40.66 Billion for the 20% of the poorest districts of Sindh and Punjab. Detailed costing is given in Appendix X.

483. Since the program is outside the remit of the traditional PSDP, it will require a different implementation mechanism. While details of the mechanism can be worked out once it is decided in principle that EGS is to be implemented. Further details on implementation mechanisms are presented in Chapter 23.

Nutrition Program for Primary School Going Children

484. High food inflation has increased the risk of malnutrition amongst the poor. International and domestic evidence suggests that at highest risk on the nutrition status are school going children and particularly the girl child. This situation is particularly acute amongst IDPs. Since there are a number of design issues associated with the nutritional program – given its controversial pilot done earlier through the *Tawana Pakistan* Program – we recommend that an initial pilot is launched in the NBR. The total cost for this is Rs.5.32 billion (Appendix XI).

Chapter 23: Social Protection Platform

485. The absence of an *integrated* institutional mechanism for implementing and monitoring targeted social protection programs can be seen from the fact that virtually every sub-system dealing with the population has its own way of counting people. We have good data – from the Population Census, the Agricultural Census, and various surveys of the Federal Bureau of Statistics. The problem is not the dearth of good social sector data. It is about having mechanisms on the ground at the local level, that are linked upwards to the district, province or national levels, and that continuously generate and update actionable information on a range of social policy and social protection goals and objectives.

486. Moreover, the local school sometimes conducts a survey of children in its catchment. The LHW is supposed to maintain her own list of families. Zakat and Bait-ul-Maal lists emerge from other methodologies altogether. Electoral rolls record people in yet other ways. The NADRA system has its own definitions, and its not linked explicitly to territorial units.

487. The absence of a *comprehensive* institutional mechanism for implementing and monitoring social policy can be seen from the fact that apart from the decennial Population Census there is no system of keeping an account of the population that can claim to even attempt complete and comprehensive coverage. The NADRA system requires mandatory registration, yet acknowledges incomplete coverage. Other systems are even less complete, because they rely on voluntary registration. This problem is starkly illustrated by the failure of successive polio immunization campaigns to cover everyone, or even record those who might have been missed.

488. A Social Protection 'Platform' is an essential institutional intervention if Pakistan is to make any serious attempt at targeted social protection. For example, if the above discussed EGS is to be implemented then we have to know which heads of families are illiterate and we also need to monitor that each family does not take up more than a hundred days of work. Similarly, there can be a debate between school vouchers and noon-meals as alternative ways of ensuring universal enrolment. But neither of the two alternatives can be implemented or monitored to scale in the absence of reliable and regularly updated information and monitoring at the local level and its integration in a vertical chain.

489. Operational details of a Social Policy Platform including the cost of setting it up and maintaining it need further elaboration. Some basic points are:

- Presence at UC level
- Linked to district level upwards vertically
- Population registration
- Updating basic socio-economic data down to household/individual level
- Use across social sectors and programs
- Participatory methods of data verification
- Systems of monitoring and validation

- Synergy with existing, ongoing, proposed projects and programs
- Distinct from but synergy with local government
- Linked with NADRA

490. The social protection platform will need to be based at the federal level but linked up with other tiers of government so that the entire range of social protection and social policy initiative initiated at different tiers of government can benefit from the registry created.

APPENDICES

Appendix-I: Growth and Poverty

I.1. Introduction

Pakistan has experienced fairly large fluctuations in its growth rates in its history (Table I.1), which has also demonstrated that while growth may be a necessary condition for reducing poverty it may not be a sufficient condition. Periods of high growth like in the 1960s have coincided with high levels of poverty levels while periods of slow growth (1970s) have accompanied low incidence of poverty, the reasons ranging from skewed asset distribution to specific government policies. (Background Paper: 1 Poverty, Economic Growth, and Inequality: A Review of Pakistan's Poverty Literature (ADB)).

Table I.1

ECONOMIC AND SOCIAL INDICATORS

Indicators	1960's	1970's	1980's	1990's	1980-81	1984-85	1990-91	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 P
	Average (Annual)																				
GROWTH RATE (%) (Constant fc)																					
➔ GDP	6.8	4.8	6.5	4.6	6.4	8.7	5.6	5.1	6.6	1.7	3.5	4.2	3.9	2.0	3.1	4.7	7.5	9.0	5.8	6.8	5.8
· Agriculture	5.1	2.4	5.4	4.4	3.7	10.9	5.0	6.6	11.7	0.1	4.5	1.9	6.1	-2.2	0.1	4.1	2.4	6.5	6.3	3.7	1.5
· Manufacturing	9.9	5.5	8.2	4.8	10.6	8.1	6.3	2.5	3.7	-0.1	6.9	4.1	1.5	9.3	4.5	6.9	14.0	15.5	8.7	8.2	5.4
· Commodity Producing Sector	6.8	3.9	6.5	4.6	6.3	9.5	5.9	5.7	8.5	0.4	5.3	3.4	3.0	0.8	1.4	4.3	9.2	9.5	5.1	6.0	3.2
· Services Sector	6.7	6.3	6.7	4.6	6.6	8.2	5.2	4.8	5.0	3.6	1.6	5.0	4.8	3.1	4.8	5.2	5.9	8.5	6.5	7.6	8.2
GROWTH RATES (%)(Current MP)																					
➔ Total Investment	-	21.8	4.2	8.1	9.8	12.8	19.4	13.4	16.4	8.0	9.0	-3.6	10.2	8.6	3.2	10.7	14.4	32.6	36.1	18.3	13.1
· Fixed Investment	14.8	20.5	3.7	7.8	4.8	12.6	20.0	13.3	16.9	7.7	1.5	1.6	10.5	8.5	3.2	8.2	14.7	34.3	38.0	18.6	12.5
· Public Investment:	14.0	25.3	2.6	7.3	-1.2	11.4	20.9	18.8	13.0	-5.3	-14.9	25.8	5.5	11.1	-22.2	4.0	19.3	23.7	30.3	36.1	20.2
· Private Investment	20.9	17.0	5.1	8.8	13.1	14.1	19.2	8.5	18.7	19.6	13.3	-11.4	14.3	7.2	17.3	9.8	13.1	38.3	40.5	13.3	9.7
As % of Totall Investment																					
· National Savings	-	67.5	22.6	57.6	80.6	70.6	74.8	77.9	61.9	65.7	82.7	75.2	91.0	95.8	110.7	123.1	108.0	91.5	82.3	77.7	64.5
· Foreign Savings	-	32.5	7.4	20.1	19.4	29.4	25.2	22.1	38.1	34.3	17.3	24.8	9.0	4.2	-10.7	-23.1	-8.0	8.5	17.7	22.3	35.5
As % of GDP (Current MP)																					
Total Investment	-	17.1	18.7	18.3	18.8	18.3	19.0	18.4	18.8	17.7	17.3	15.6	17.4	17.2	16.8	16.9	16.6	19.1	22.1	22.9	21.6
- Fixed Investment	-	15.9	17.0	16.6	17.2	16.5	17.4	16.9	17.2	16.2	14.7	13.9	16.0	15.8	15.5	15.3	15.0	17.5	20.5	21.3	20.0
- Public Investmnet	-	10.3	9.2	7.5	9.4	8.9	8.5	8.2	8.2	6.8	5.2	6.1	5.6	5.7	4.2	4.0	4.0	4.3	4.8	5.7	5.7
- Private Investment	-	5.6	7.8	9.1	7.8	7.6	8.5	8.7	9.0	9.4	9.6	7.9	10.4	10.2	11.3	11.3	10.9	13.1	15.7	15.6	14.2
National Savings	-	11.2	14.8	13.8	15.1	12.9	14.2	14.3	11.6	11.6	14.3	11.7	15.8	16.5	18.6	20.8	17.9	17.5	18.2	17.8	13.2
Foreign Savings	-	5.8	3.9	4.5	3.6	5.4	4.8	4.1	7.2	6.1	3.0	3.9	1.6	0.7	-1.9	-3.8	-1.3	1.6	4.5	5.1	8.4
Domestic Savings	-	7.4	7.7	14.0	7.0	4.8	9.9	13.6	12.0	12.8	15.7	12.9	17.1	17.8	18.1	17.6	15.7	15.4	16.3	16.0	11.7
GDP DEFLATOR (GROWTH %)	-	-	2.3	0.3	10.4	4.5	13.1	13.8	8.3	14.6	6.6	5.9	2.8	8.0	2.5	4.4	7.7	7.0	10.5	7.9	13.4
CONSUMER PRICE INDEX (CPI)																					
(Growth %)	3.2	12.5	7.2	9.7	13.9	5.7	12.7	13.0	10.8	11.8	7.8	5.7	3.6	4.4	3.5	3.1	4.6	9.3	7.9	7.8	12.0
FISCAL POLICY																					
As % of GDP (MP)																					
➔ Total Revenue	13.1	16.8	17.3	17.1	16.9	16.4	16.9	17.3	17.9	15.8	16.0	15.9	13.5	13.3	14.2	14.9	14.3	13.8	14.2	14.9	14.3
· Tax Revenue	-	-	13.8	13.4	14.0	11.9	12.7	13.8	14.4	13.4	13.2	13.2	10.7	10.6	10.9	11.5	11.0	10.1	10.6	10.2	10.0
· Non-Tax Revenue	-	-	3.5	3.7	2.9	4.5	4.2	3.5	3.5	2.4	2.8	2.6	2.8	2.7	3.3	3.4	3.3	3.7	3.6	4.7	4.3
➔ Total Expenditure	11.6	21.5	24.9	24.1	22.9	24.7	25.7	22.9	24.4	22.3	23.7	22.0	18.8	17.4	18.3	18.5	16.7	17.2	18.5	19.1	21.7
· Current Expenditure	-	-	17.6	19.4	13.6	17.7	19.3	18.5	20.0	18.8	19.8	18.6	16.5	15.5	15.9	16.3	13.5	13.3	13.6	14.9	17.7
Defence	-	-	6.5	5.6	5.5	6.7	6.4	5.6	5.6	5.2	5.1	4.9	4.0	3.2	3.4	3.3	3.3	3.3	3.2	2.8	2.7
Interest Payment	-	-	3.8	6.8	2.1	3.5	4.9	5.2	6.3	6.6	7.6	7.5	6.9	6.0	6.2	4.8	4.0	3.4	3.4	4.4	4.7
· Development Expenditure (#)	-	-	7.3	4.7	9.3	7.0	6.4	4.4	4.4	3.5	3.9	3.3	2.5	2.1	2.8	2.2	3.1	3.9	4.8	4.9	4.0
➔ Overall Deficit	2.1	5.3	7.1	6.9	5.3	7.8	8.8	5.6	6.5	6.4	7.7	6.1	5.4	4.3	4.3	3.7	2.4	3.3	4.3	4.3	7.4
MONEY & CREDIT (GROWTH %)																					
· Monetary Assets (M2)	16.3	21.0	13.2	16.8	13.2	12.6	17.4	17.2	13.8	12.2	14.5	6.2	9.4	9.0	15.4	18.0	19.6	19.3	15.2	19.3	15.3
· Domestic Assets	15.0	20.5	15.4	12.2	16.5	25.0	16.8	13.1	18.8	15.3	15.0	3.5	9.0	3.7	2.2	0.5	23.7	22.4	15.8	14.2	23.1
STOCK EXCHANGE MARKET (GROWTH %)																					
· General Index for Share Prices	-	-	0.1	4.1	-1.0	-3.3	42.6	-35.6	-8.9	-15.9	-30.5	5.8	22.4	5.3	-30.9	91.2	53.2	15.1	18.6	28.2	-16.8
· Aggregate Market Capitalization	-	-	2.5	13.4	-1.9	11.7	40.7	-27.5	24.5	28.5	-44.7	10.4	36.9	-13.4	20.2	88.1	81.9	48.3	37.4	43.9	-5.9

- Not available

(Contd.)

\# From 1998-99 onward also include net lending to PSEs.

Source: Economic Survey of Pakistan (2006-07)

In excess of 44% of Pakistan's population is poor or vulnerable, reflected in the bunching around the poverty line. A slight shock at the macro level or at the level of the household (e.g. the death or illness of the main bread-earner) can throw large numbers of people into poverty (Table I.2).

Table I.2
Population Quartiles over Population Bands

	2000-01	Poverty Band (2003-04)	2003-04 (%)	2004-05 (%)
Non Poor	13.0%	Rs. 1,497	15.3%	20.5%
Quasi Non-Poor	30.1%	Rs. 936	32.2%	35.0%
Vulnerable	22.5%	Rs. 749	20.4%	20.5%
Poor	22.5%	Rs. 561	20.1%	16.4%
Ultra Poor	10.8%	Rs. 374	10.4%	6.5%
Extremely Poor	1.1%		1.6%	1.0%
Total Below Poverty Line	34.4%		32.1%	23.9%

Source: CPRID/Planning Commission, Pakistan Economic Survey 2003-04 and 2005-06

I.2. Trends in growth and poverty

During the 1970s, the average GDP growth fell to 4.8% from 6.8% in the 1960s while poverty head count declined from 47% to 31% of the population during 1969-1979. The reasons for these outcomes include larger volumes of public investment that created job opportunities for those with limited skills combined with laws that strengthened labour rights[184] especially following the state takeover of private enterprises (Arif, 2006). Therefore, despite a slowing down in the rate of economic growth, employment increased along with earnings of workers for the same level of effort. However, rural poverty continued to be higher than urban poverty largely owing to poor agricultural growth, 2.4%, as against the growth of 5.5% and 6.3% witnessed in manufacturing and services respectively.

The 1980s experienced a higher GDP growth rate of 6.6% driven mostly by external assistance as a result of the Afghan War and an upsurge of remittances from Pakistanis working in the Middle East. They averaged $2,355m annually (11.0 % of GDP) in the 1980s compared with their average of $713m (4.2 % of GDP) in the 1970s (Tables I.8-11 Appendix I). This increased GDP growth was also accompanied by a further reduction in the proportion of population below the poverty line, from 31% in 1979 to 17.32% in 1987-88. Rural poverty also fell as a result of remittances and the improvement in rate of growth of agriculture to 5.4% from an average of 2.4% in the 1970s, mainly as a result of good weather. The reduction in overall poverty is likely to also have been positively impacted upon by higher levels of private investment, to 16.8% of GDP compared with 15.5% in the 1970s (Table

[184] Improvement in Minimum Wages introduced in 1969; Workers' Welfare Fund (1971); Fair Price Shops Ordinance (Factories Ordinance in 1971-72); Workers' Children's Education Ordinance (1972); Workers' Profit Participation Fund; Employees Old-Age Benefit (EOAB) introduced in 1976

I.3), which would have spurred employment opportunities. However, for a variety of reasons the growth rate and the trend in poverty reduction could not be maintained (Arif, 2006), which principally include a decline in external aid at the end of the Afghan war. This led to a cutback in public expenditure and a diminution in employment opportunities (Table I.4). The deteriorating conditions of growth and poverty were also adversely affected by frequent changes in government policies; a weakening in the bargaining position of trade unions (owing to the presence of a military dictatorship) reflected in fewer worker stoppages; bans on strikes of labour, growing casualization of job markets and increasing pro-employer attitude of governments. See Table I.3 for period averages of Gross Investment as percentage of GDP.

Table I.3- GFCF

Average During	GFCF (Total) as % of GDP (Current Prices)	GFCF (Private) as % of GDP (Current Prices)	GFCF (Public) as % of GDP (Current Prices)
1960-1973	15.28	8.21	7.26
1973-1978	15.50	4.79	10.71
1978-1988	16.77	7.10	9.66
1988-1993	17.95	9.22	8.73
1993-1998	16.31	9.32	7.36
1998-2000	13.26	8.10	5.31

Source: Economic Survey, GOP, Economic Advisor's Wing, Finance Division, various Issues.

Table I.4
Development Expenditure as percentage of GDP

Average During	ADP as a % of GDP
1972/73 to 1976/77	7.4
1977/78 to 1986/87	6.24
1987/88 to 1996/97	4.26
1997/98 to 1999/2000	3.5

Source: Economic Survey, GOP, Economic Advisor's Wing, Finance Division, Various Issues.

All these factors combined with a decline in agricultural growth from 5.4% in 1980s to 4.4% in 1990s as well as slackening of external assistance led to a fall in employment opportunities and incomes, contributing to a rise in headcount poverty. By the 1990s the proportion of population living below the poverty line increased from 17.3% in 1987-88 to 32.6% in 1998-99 and once again rural poverty exceeded urban poverty. Among other factors, the poor generation of employment opportunities during the 1990s was on account of weak rates of GDP growth and low PSDP allocations for development of physical and social infrastructure and public sector recruitment bans for almost 5 years, even for hiring personnel for social service delivery.

I.3. Agriculture and non-farm sources income

The end of the 1990s suffered from an acute drought in 2000 which had negative spill-over effects on agriculture and consequently on farmer incomes <http://www.un.org.pk/drought/rcreport11.htm>. Overall poverty rose further to 34.5% in 2000-01 from 32.6% in 1998-99 while rural poverty increased from 34.8% in 1998-99 to 39.3% in 2000-01. Since 44% of Pakistan's labour is employed in agriculture, there were bad tidings for the rural population.

Another factor was the continued skewness inland distribution. A report by the World Bank shows that with only 37% of rural households owning land (of which 61% households own less than 5 acres and 2% own 50 acres or more) the Gini coefficient of land ownership is 0.66 (and if rural landless households are included, the Gini coefficient is 0.86). The link between landlessness and poverty has further been discussed by Anwar et al who carry out a province-wise analysis to reveal that the poorest landless households are in Balochistan where the poverty incidence of 69.6% followed by NWFP with poverty at 65.9%and Sindh at 58.6%. Anwar et al. emphasizing the role of unequal land distribution in worsening poverty show that only 0.1% of the households in Sindh and NWFP own 55 acres and above of land compared with Punjab and 0.3% in Balochistan. A high Gini coefficient of 0.6339 in Punjab shows how unequal the land ownership is here while it is 0.5893 in NWFP and 0.5072 in Sindh (Anwar et al). Studies also provide evidence that **'land productivity of large farms in Pakistan is lower than that of small farms" suggesting that** 'increases in the share of land cultivated by small-holders would help increase overall farm productivity in Pakistan' (World Bank, 2007).

However, data post-2000 shows that both rural and urban poverty have declined (Table I.7 and Table I.7a, Appendix I). The primary reason for this development has been improvement in agricultural growth that had dropped to 0.1% in 2001-02 but started climbing, reaching 6.5% in 2004-05 (Table I.1 Appendix I). During this period that remittances also rose as did development expenditure rising from 3.8% of GDP in 2001-02 to 5.7% in 2006-07 (Table I.15 Appendix I).

Although 44% of the total labour force is engaged in agriculture non-farm sources of income for rural households also play an important role in poverty reduction. Non-farm incomes as well as remittances together comprise 49% of overall rural income (World Bank, 2007). Also, agriculture credit lending which started growing after 2000 (Table I.16) should have also contributed to poverty reduction. The 'Khushhal Pakistan Programme' which aims at creating employment opportunities specifically for those in rural areas via micro-credit, skill enhancement and agriculture development was also initiated in this period benefiting almost 3.2 million households in 2,000 rural union councils in Pakistan (Economic Survey 07-08). This period also coincided with rapid growth in manufacturing, trade and services (Table I.17 Appendix I).

I.4. Sectoral growth (agriculture and construction) and employment elasticities

The root cause for the prevalence of rural poverty, despite decreasing levels of overall poverty, can be traced to the conditions in the agriculture sector. Agricultural

growth in Pakistan has been erratic (Figure I.2 Appendix I) and (Table I.18 Appendix 1) shows how the share of agriculture in GDP has declined over time. A good year followed by another bad one may keep a household trapped in poverty (Malik, 2005). Another important factor in affecting headcount poverty has been the employment elasticities of different sectors Anwar (2004) (Table I.5 Appendix I) provides the employment elasticity of each sector, the highest, 0.87, being that of construction. Secondly, although agriculture has low employment elasticity, since a large proportion of the labour force is employed in this sector, focus on agriculture would address the issue of underemployment and increase earnings of the work force of this sector. There is much higher under-employment in the agriculture sector (including livestock), followed by services (which absorbs 35% of the labour force) with close to 24% and just over 13% of their respective work force is employed for less than 35 hours a week. Such a strategy would not only help achieve inclusive growth but would have a multiplier effect by putting money in the hands of those segments of the population that are more likely to consume goods and services produced domestically, thereby encouraging domestic production and helping achieve a more sustainable growth rate while also bringing stability into it the latter because the consumption patterns of such households also tend to be stable.

Table I.5
Employment Elasticities

Sector of activity	Elasticities
Overall Elasticity	0.41
Agriculture	0.37
Large Scale Manufacturing	0.02
Small Scale Manufacturing	0.85
Construction	0.87
Transport & Communication	0.45
Trade	0.57
Electricity & Gas	0.54
Others	0.68

Source: Anwar, Talat (2004) Recent Macroeconomic Developments and Implications for Poverty and Employment in Pakistan: The Cost of Foreign Exchange Reserve Holdings in South Asia.

I.5. Poverty and inequality

Studies show that while poverty decreased during the 1970s and 1980s, inequality rose depicting how even if incomes rise as a result of more and better employment opportunities and large inflows of remittances, the distribution of the benefits of growth were not uniform; Table I.6 and Anwar (2004) shows how inequality has risen between 1998 and 2001-02 (Figure I.1 Appendix 1).

Table I.6

Trends in Inequality in Pakistan 1963-64 to 1998-99

Years	Rural	Urban	Overall
1963-64 to 1966-67	↓	↑	↓
1966-67 to 1968-69	↓	↓	↓
1968-69 to 1970-71	↓	↓	↓
1970-71 to 1971-72	↑	↑	↑
1971-72 to 1978-79	↑	↑	↑
1978-79 to 1984-85	↑	↓	↑
1984-85 to 1987-88	↑	↑	↑
1987-88 to 1992-93	↑	Stagnant	↑
1992-93 to 1998-99	↑	↑	↑

↑ : An increase in inequality between two years.
↓ : A decrease in inequality between two years.

Source: Various studies cited above.

The share of the poorest 40% households declined while that of of the richest 20% increased worsening income inequalities. Income disparity rose more because the poorest 20% as well as middle 40% lost their share.

Provincial disparities have also widened with NWFP experiencing the highest incidence of poverty (Figure I.3 Appendix I). There is also intra-provincial disparity for example between: “Northern Punjab (including Islamabad, Rawalpindi division, and the district of Mianwali), Central Punjab (including Sargodha, Faisalabad, Gujaranwala, and Lahore divisions), and Southern Punjab (including Multan, Dera Ghazi Khan, and Bahawalpur divisions)”. Northern Punjab has lower levels of poverty than Southern Punjab so that for example in 1999 “urban poverty was the highest in the country in Southern Punjab (35 percent), and almost three times more than was the case in Northern Punjab”. Also, while poverty was lowest in Pakistan in urban Northern Punjab, rural Northern Punjab had the lowest levels of poverty, 29%, in the rural areas of the country (ADB, 2002).

According to an ADB (2006) report, Jamal et al (2003) create indices of deprivation for education, health, housing and employment and their results show that Sindh faces the highest urban/rural inequality and stands out as the only province with the least deprived urban areas; whereas Punjab stands out as the only province with almost half

of its rural population living in districts which are least deprived. Tables I.21 and I.22 identify the ten least and most deprived districts of Pakistan reflecting disparities in income and social indicators.

These inter and intra provincial disparities, which have sharpened more over these past 5-6 years and which show better human development indicators in Punjab for instance, may possibly be because of better quality governance, a more competent bureaucracy, historical advantage in education and skill development, managerial and technical skill development in well-run private institutions for higher education, better public sector institutions of higher learning, agriculture sector gaining more in Punjab due to better irrigation system, more equitable land distribution especially in the central and northern parts of the province and better availability of credit to small farmers, etc.

I.6. Conclusion

The disparities between the rich and the poor have widened sharply. This, combined with growing poverty from 3 years of high inflation, is damaging social harmony. The benefits of economic development during the previous 5 to 6 years have largely accrued to the richer and more educated because the bulk of this growth was witnessed in the relatively skill-intensive sectors of finance, telecommunications, IT and oil and gas, and in the capital intensive industries of cement, motor vehicles and motorcycles, in which those with limited skills, the majority of the labour force, could not participate meaningfully. It is neither desirable nor feasible to separate economic growth from distributional outcomes since they are inextricably linked through employment growth.
The important lesson from this discussion is the need for the conscious adoption of a strategy for inclusive and sustainable growth, suggesting focus on agriculture, housing and domestic commerce, the latter being sectors with high employment elasticities and strong forward and backward linkages with several sub-sectors of industries. Such a strategy by creating a demand for unskilled and skilled labour will incentivize demand for education and skill acquisition, helping push the economy onto a higher and more stable growth path.

Table I.7
Trends in Poverty: Consistent estimates of Head Count

Year	Total	Rural	Urban
1963-64	40.24	38.94	44.53
1966-67	44.50	45.62	40.96
1969-70	46.53	49.11	38.76
1979	3-.68	32.51	25.94
1984-85	24.47	25.87	21.17
1987-88	17.32	18.32	14.99
1990-91	22.11	23.59	18.64
1992-93	22.40	23.35	15.50
1996-97	31.00	32.00	27.00
`998-99	32.60	34.80	25.90

Source: Kemal, A.R. “State of Poverty in Pakistan: Overview and Trends.”Presentation <http://siteresources.worldbank.org/PAKISTANEXTN/Resources/pdf-Files-in-Events/Briefing-on-PRSP/OverviewAndTrends.pdf>

Table I.7a

	2000-01	2004-05	2005-06
	Headcount		
Pakistan	34.46	23.9	22.3
Urban	22.69	14.9	13.1
Rural	39.26	28.1	27

Source: State Bank of Pakistan Annual Report (2007-08).

Table I.8-11

WORKERS REMITTANCES

(US $ million)

COUNTRY	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82
Total Middle East	34.74	43.90	83.63	214.05	437.20	938.39	1100.91	1361.47	1666.44	1848.58
Abu-Dhabi	0.00	0.00	10.54	26.24	46.68	81.79	92.68	105.00	131.90	113.07
Bahrain	2.46	3.39	4.56	13.84	24.27	43.43	37.21	33.04	42.43	43.39
Dubai	0.00	0.00	9.92	28.87	55.19	96.55	88.13	86.87	102.04	83.29
Iran	0.66	1.33	2.39	7.26	14.40	26.40	26.85	16.49	11.18	5.05
Iraq	0.12	0.13	0.49	0.78	2.96	5.46	5.00	0.00	0.00	12.82
Kuwait	7.04	6.93	10.28	17.23	27.37	53.97	75.11	111.64	133.23	151.69
Libya	2.22	3.03	4.95	7.83	12.15	21.90	42.59	51.27	75.09	97.11
Qatar	2.17	2.63	5.46	10.85	24.41	50.93	52.24	63.20	62.55	65.67
Saudi Arabia	7.87	10.52	17.26	46.36	158.82	464.10	594.38	795.46	984.27	1129.45
Sharjah	0.00	0.00	1.88	7.31	15.90	29.93	24.94	24.93	31.49	28.52
Sultanat-e-Oman	12.20	15.94	15.90	47.48	55.05	63.93	61.78	73.57	92.26	118.52
Germany	1.32	2.73	3.49	5.27	9.04	16.95	37.36	57.38	59.14	51.90
Norway	0.67	1.65	2.58	4.68	6.49	9.26	10.37	14.46	16.54	14.86
United Kingdom	72.13	55.38	74.11	54.38	49.29	76.69	119.12	149.72	184.92	121.31
Canada	2.12	3.16	3.62	5.53	7.87	6.69	6.95	7.33	7.85	7.43
USA	9.98	14.41	19.18	25.77	29.32	51.53	53.64	61.47	70.97	72.11
Others	15.04	17.91	24.49	29.34	38.51	56.82	69.58	92.31	110.02	108.70
Total	136.00	139.14	211.10	339.02	577.72	1156.33	1397.93	1744.14	2115.88	2224.89

(Contd.)

WORKERS REMITTANCES

(US $ million)

COUNTRY	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
Total Middle East	2408.44	2344.28	2069.29	2021.51	1673.61	1418.51	1356.51	1322.56
Abu-Dhabi	163.68	169.92	144.70	145.07	101.41	75.83	66.06	67.20
Bahrain	46.80	52.48	51.07	61.92	51.58	41.10	42.40	46.00
Dubai	143.49	110.28	112.06	114.78	126.80	112.25	97.12	83.74
Iran	3.40	2.37	2.50	0.00	0.00	0.00	1.34	0.83
Iraq	22.22	13.67	6.06	0.00	0.00	0.00	1.10	1.08
Kuwait	210.88	239.35	205.39	225.18	208.21	193.90	172.00	167.25
Libya	99.27	50.11	31.65	10.57	3.16	2.71	2.46	3.47
Qatar	92.18	67.38	59.05	63.65	52.92	34.00	34.80	30.65
Saudi Arabia	1441.96	1441.08	1245.23	1162.87	945.52	827.75	819.95	792.19
Sharjah	37.51	28.78	45.17	51.62	49.95	28.25	28.19	30.18
Sultanat-e-Oman	147.05	168.86	166.41	185.85	134.06	102.72	91.09	99.97
Germany	49.87	36.18	36.43	35.27	34.77	35.75	27.92	31.54
Norway	14.30	13.85	13.47	21.51	24.77	29.16	22.27	19.75
United Kingdom	161.72	141.79	135.98	223.27	204.93	215.06	171.06	178.16
Canada	6.99	7.76	6.49	7.71	8.63	9.88	11.19	13.98
USA	133.52	105.82	105.35	194.46	191.94	178.33	174.78	209.24
Others	110.83	87.76	78.91	91.58	139.91	125.91	133.26	167.12
Total	2885.67	2737.44	2445.92	2595.31	2278.56	2012.60	1896.99	1942.35

(Contd.)

WORKERS REMITTANCES

(US$ Million)

COUNTRY	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
I. Cash Flow	1,626.92	1,252.45	1,238.51	1,093.36	1,317.73	1,227.28	1,078.05	1,237.68	875.55
Bahrain	37.20	27.75	25.42	25.92	35.90	33.23	29.16	34.31	33.31
Canada	11.26	9.86	7.54	5.65	4.91	5.67	3.59	4.14	3.46
Germany	32.62	33.12	40.64	28.88	27.71	26.06	18.98	16.62	11.93
Japan	26.84	12.96	11.62	7.13	6.90	3.65	3.05	2.65	3.09
Kuwait	15.12	44.24	60.22	47.85	57.86	45.43	38.38	52.40	106.36
Norway	21.28	16.25	15.18	11.85	13.40	11.72	7.97	7.16	5.26
Qatar	24.27	12.87	10.91	7.57	11.52	14.08	9.68	12.17	12.94
Saudi Arabia	681.97	516.16	525.94	493.65	554.08	503.22	418.44	474.86	318.49
Sultanat-e-Oman	74.98	60.35	51.67	46.07	61.49	64.44	46.11	61.97	44.67
U.A.E.	172.03	105.07	97.76	99.36	178.26	161.93	164.39	207.70	125.09
Abu Dhabi	75.71	38.74	32.47	29.32	51.99	48.98	44.91	75.13	38.07
Dubai	68.72	49.07	47.79	51.12	90.09	81.19	93.07	101.01	70.57
Sharjah	27.60	17.26	17.50	16.73	28.96	28.95	22.90	28.54	14.69
Others	-	-	-	2.19	7.22	2.81	3.51	3.02	1.76
U.K.	180.05	137.02	114.02	101.19	109.96	109.74	97.94	98.83	73.59
U.S.A	190.23	150.34	157.80	122.49	141.09	141.92	146.25	166.29	81.95
Other Countries	159.07	126.46	119.79	95.75	114.65	106.19	94.11	98.58	55.41
II. Encashment*	221.37	215.03	323.73	352.20	548.37	233.89	331.42	251.87	184.64
Total (I+II)	1,848.29	1,467.48	1,562.24	1,445.56	1,866.10	1,461.17	1,409.47	1,489.55	1,060.19

* Encashment and Profit in Pak Rs. of Foreign Exchange Bearer Certificates (FEBCs) & Foreign Currency Bearer Certificates (FCBCs)

(Contd.)

WORKERS REMITTANCES

(US $ Million)

COUNTRY	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
I. Cash Flow	913.49	1,021.59	2,340.79	4,190.73	3,826.16	4,152.29	4,588.03	5,490.97	6,448.84
Bahrain	29.36	23.87	39.58	71.46	80.55	91.22	100.57	136.28	140.51
Canada	3.86	4.90	20.52	15.19	22.90	48.49	81.71	87.20	100.62
Germany	10.47	9.20	13.44	26.87	46.52	53.84	59.03	76.87	73.33
Japan	1.58	3.93	5.97	8.14	5.28	6.51	6.63	4.26	4.75
Kuwait	135.25	123.39	89.66	221.23	177.01	214.78	246.75	288.71	384.58
Norway	5.60	5.74	6.55	8.89	10.19	18.30	16.82	22.04	28.78
Qatar	13.29	13.38	31.87	87.68	88.69	86.86	118.69	170.65	233.36
Saudi Arabia	309.85	304.43	376.34	580.76	565.29	627.19	750.44	1,023.56	1,251.32
Sultanat-e-Oman	46.42	38.11	63.18	93.65	105.29	119.28	130.45	161.69	224.94
U.A.E.	147.79	190.04	469.49	837.87	597.48	712.61	716.30	866.49	1,090.30
Abu Dhabi	47.30	48.11	103.72	212.37	114.92	152.51	147.89	200.40	298.80
Dubai	87.04	129.69	331.47	581.09	447.49	532.93	540.24	635.60	761.24
Sharjah	12.80	12.21	34.05	42.60	34.61	26.17	26.87	28.86	28.58
Others	0.65	0.03	0.25	1.81	0.46	1.00	1.30	1.63	1.68
U.K.	73.27	81.39	151.93	273.83	333.94	371.86	438.65	430.04	458.87
U.S.A	79.96	134.81	778.98	1,237.52	1,225.09	1,294.08	1,242.49	1,459.64	1,762.03
Other Countries	56.79	88.40	293.28	727.64	567.93	507.27	679.50	763.54	695.45
II. Encashment*	70.24	64.98	48.26	46.12	45.42	16.50	12.09	2.68	2.40
Total (I+II)	983.73	1,086.57	2,389.05	4,236.85	3,871.58	4,168.79	4,600.12	5,493.65	6,451.24

* Encashment and Profit in Pak Rs. of Foreign Exchange Bearer Certificates (FEBCs) & Foreign Currency Bearer Certificates (FCBCs)

Source: State Bank of Pakistan

Source: State Bank of Pakistan (2007-08).

Table I.12

Percentage Share of Expenditure between 1998-99 and 2001-02 in Pakistan

Population Income Groups	Percentage Share of Expenditure 1998-99	2001-02	% Change in Expenditure Share
Lowest 20%	9.45	9.12	–3.4921
Lower Middle 20% to 40%	13.17	13.16	–0.0759
Middle 40% to 60%	16.34	16.46	0.7344
Upper Middle 60% to 80%	20.88	20.98	0.4789
Highest 20%	40.16	40.28	0.2988

Table I.13

Percentage Share of Expenditure between 1998-99 and 2001-02 in Rural and Urban Areas

Population Income Groups	Percentage Share of Expenditure Rural 1998-99	Percentage Share of Expenditure Rural 2001	% Change in Expenditure Share between 1998-99 and 2001-02	Percentage Share of Expenditure Urban 1998-99	Percentage Share of Expenditure Urban 2001	% Change in Expenditure Share between 1998-99 and 2001-02
Lowest 20%	10.38	10.26	–1.1560	8.17	7.7	–5.7527
Lower Middle 20% to 40%	14.33	14.35	0.1395	11.63	12.02	3.3533
Middle 40% to 60%	17.54	17.53	–0.0570	14.92	15.37	3.0160
Upper Middle 60% to 80%	21.95	21.99	0.1822	20.24	20.6	1.7786
Highest 20%	35.80	35.87	0.1955	45.04	44.31	–.6207

Source: Anwar, Talat (2003).

Table I.14

Gini Coefficient for 1998–99 and 2001–02

Region	1998-99	2001-02
Pakistan		
Overall	0.3019	0.3067
Rural	0.2521	0.2534
Urban	0.3596	0.3581
Rural		
Punjab	0.2575	0.2699
Sindh	0.2477	0.2228
NWFP	0.2390	0.2359
Balochistan	0.2274	0.2040
Urban		
Punjab	0.3777	0.3475
Sindh	0.3352	0.3763
NWFP	0.3535	0.3207
Balochistan	0.2583	0.2519
Overall		
Punjab	0.3099	0.3059
Sindh	0.3082	0.3434
NWFP	0.2684	0.2555
Balochistan	0.2314	0.2179

Source: Author's computation from PIHS, 1998-99 and 2001.

Table I.15
Social Sector and Poverty Related Expenditure (Rs. Billion)

	2001-02 Actual	2002-03 Actual	2003-04 Actual	2004-05 Actual	2005-06 Actual	2006-07 Actual	2007-08 Projected
Community Services	**11.0**	**16.6**	**28.5**	**41.7**	**63.6**	**76.6**	**82.5**
i. Roads, Highways & Buildings	6.3	13.2	22.8	35.2	53.3	60.0	69.1
ii. Water Supply and Sanitation	4.6	3.4	5.8	6.5	10.3	16.6	13.4
Human Development	**90.7**	**105.8**	**134.1**	**155.8**	**217.9**	**231.8**	**316.3**
i. Education	66.3	78.6	97.7	116.9	141.7	162.1	224.7
ii. Health	19.2	22.4	27.0	31.4	39.2	53.2	62.3
iii. Population Planning	1.3	3.1	4.7	4.6	10.2	7.0	13.3
iv. Social Security & welfare	3.7	1.3	4.1	2.0	7.6	4.5	9.8
v. Natural Calamities	0.2	0.4	0.5	0.9	19.2	5.0	6.2
Rural Development	**24.3**	**34.2**	**44.5**	**59.7**	**78.5**	**101.8**	**101.9**
i. Irrigation	10.1	15.5	22.5	37.9	59.8	74.8	77.6
ii. Land Reclamation	1.8	1.8	2.0	2.1	2.7	2.3	3.5
iii. Rural Development	12.3	16.9	18.6	15.4	15.0	22.2	19.5
iv. Rural Electrification			1.4	4.4	1.0	2.5	1.3
Safety Nets	**8.3**	**13.8**	**12.3**	**8.4**	**9.4**	**9.2**	**12.2**
i. Food Subsidies	5.5	10.9	8.5	5.4	6.0	5.5	7.8
ii. Food Support Program	2.0	2.2	2.8	2.7	3.1	3.5	4.0
iii. Tawwana Pakistan	0.8	0.6	0.6	0.1	0.0	0.0	0.0
iv. Low Cost Housing		0.1	0.4	0.3	0.3	0.3	0.4
Governance	**33.0**	**38.5**	**41.8**	**50.5**	**65.2**	**78.1**	**84.6**
i. Administration of Justice	2.0	2.3	2.4	3.1	5.6	5.1	7.3
ii. Law and order	31.0	36.3	39.4	47.4	59.6	73.0	77.3
Total	**167.3**	**208.8**	**261.3**	**316.2**	**434.6**	**497.5**	**597.5**
As % of GDP	**3.8**	**4.32**	**4.6**	**4.8**	**5.6**	**5.7**	**6.0**

Source: Economic Survey of Pakistan (2007-08)

Table I.16

CREDIT DISBURSED BY AGENCIES

(Rs million)

Fiscal Year	ZTBL a	Taccavi	Domestic Private Banks	PPCBL b	Commercial Banks	Total
1990-91	8,323.95	56.30		3,017.45	3,517.59	14,915.29
1991-92	6,996.44	56.80		3,247.01	4,179.56	14,479.31
1992-93	8,643.40	50.80		2,978.00	4,525.91	16,198.11
1993-94	8,989.26	..		2,621.49	4,063.30	15,674.05
1994-95	14,575.74	..		3,756.74	4,040.79	22,373.27
1995-96	10,339.27	..		3,803.38	5,044.66	19,187.31
1996-97	11,687.11	..		3,431.13	4,429.43	19,547.67
1997-98	22,353.60	..		4,928.93	6,109.70	33,392.30
1998-99	30,175.96	..		5,439.97	7,236.00	42,852.00
1999-00	24,423.89	..		5,951.23	9,312.50	39,687.60
2000-01	27,610.20	..		5,124.20	12,056.00	44,790.40
2001-02	29,108.01	..	592.82	5,127.54	17,486.12	52,314.49
2002-03	29,270.17	..	1,421.11	5,485.39	22,738.60	58,915.27
2003-04	29,933.07	..	2,701.80	7,563.54	33,247.45	73,445.86
2004-05	37,408.84	..	12,406.82	7,607.47	51,309.78	108,732.91
2005-06	47,594.14	..	16,023.38	5,889.40	67,967.40	137,474.31
2006-07	56,473.05	..	23,976.16	7,988.06	80,393.19	168,830.46
2007-08 P	39,561.17	..	29,975.57	3,935.16	65,124.83	138,596.72

.. not Available

P: Provisional(Jul-Mar)

b: Punjab Provincial Corperative Bank Ltd.

a: Zarai Taraqiate Bank Limited, formerly Agriculture Development Bank of Pakistan

Source : i) State Bank of Pakistan

ii) Ministry of Food, Agriculture & Livestock

Table I.17
Employed Labour Force by Sectors (%)

Sector	2003-04			2005-06		
	Total	Rural	Urban	Total	Rural	Urban
Agriculture	43.05	60.03	5.94	43.37	59.87	6.32
Manufacturing	13.73	9.05	23.97	13.84	9.00	24.71
Construction	5.82	6.02	5.39	6.13	6.23	5.91
Trade	14.80	9.39	26.62	14.67	9.30	26.71
Transport	5.73	4.33	8.80	5.74	4.64	8.22
Services	15.01	10.36	25.17	14.35	10.06	24.00
Others	1.85	0.82	4.12	1.89	0.89	4.13
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Labor Force Surveys, 2003-04 & 2005-06

Table 1.18
Sectoral Share In Gross Domestic Product (At Constant Factor Cost Of 1999-2000)

	Sectors	99-00	00-01	01-02	02-03	03-04	04-05	05-06	06-07	07-08
A.	**Agriculture Sector (1 to 5)**	**25.9**	**24.9**	**24.1**	**24.0**	**22.9**	**22.4**	**22.5**	**21.8**	**20.9**
	Crops	13.1	11.8	11.2	11.2	10.7	11.1	10.1	10.0	-
	1. Major Crops	9.6	8.5	8.0	8.2	7.8	8.4	7.6	7.7	7.1
	2. Minor Crops	3.5	3.3	3.1	3.0	2.9	2.7	2.6	2.4	2.4
	3. Livestock	11.7	11.9	12.0	11.7	11.2	10.6	11.6	11.1	10.9
	4. Fishing	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
	5. Forestry	0.7	0.7	0.7	0.7	0.6	0.4	0.4	0.2	0.2
B.	**Industrial Sector (1 to 4)**	**23.3**	**23.8**	**23.7**	**23.6**	**25.5**	**26.3**	**25.9**	**26.1**	**25.9**
	1. Mining & Quarrying	2.3	2.4	2.4	2.5	2.6	2.7	2.6	2.5	2.5
	2. Manufacturing (i+ii+iii)	14.7	15.7	15.9	16.3	17.3	18.3	18.8	19.0	18.9
	i) Large Scale	9.5	10.3	10.4	10.6	11.7	12.9	13.2	13.4	13.3
	ii) Small & Household	3.7	3.9	4.1	5.6	4.2	4.1	4.3	4.3	4.4
	iii) Slaughtering	1.5	1.5	1.5	0.0	1.4	1.3	1.4	1.3	1.3
	3. Construction	2.5	2.4	2.4	2.4	2.0	2.1	2.2	2.5	2.7
	4. Electricity and Gas & Water Supply	3.9	3.3	3.0	2.5	3.7	3.2	2.2	2.1	1.7
	Commodity Producing Sector (A+B)	49.3	48.7	47.9	47.6	48.4	48.7	48.3	47.9	46.8
C.	**Services Sector (1 to 6)**	**50.7**	**51.3**	**52.1**	**52.4**	**51.6**	**51.3**	**51.7**	**52.1**	**53.2**
	1. Transport, Storage & Communications	11.3	11.6	11.4	11.4	10.9	10.4	10.4	10.2	10.0
	2. Wholesale & Retail Trade	17.5	17.9	17.8	18.0	18.2	18.7	17.2	17.0	17.1
	3. Finance & Insurance	3.7	3.1	3.5	3.3	3.4	4.0	5.5	5.9	6.5
	4. Ownership of Dwellings	3.1	3.2	3.2	3.1	3.0	2.9	2.8	2.7	2.6
	5. Public Administration & Defence	6.2	6.2	6.4	6.6	6.3	5.9	6.1	6.2	6.5
	6. Social, Community & P. Services	9.0	9.3	9.8	9.9	9.7	9.5	9.9	10.1	10.4
D.	Gross Domestic Product FC (A+B+C)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Economic Survey of Pakistan (2006-07).

Table I.19
Growth Performance of Components of Gross National Product (% Growth at Constant Factor Cost)

	1980's	1990's	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Commodity Producing Sector	**6.5**	**4.6**	**4.2**	**9.3**	**9.5**	**5.1**	**6.0**	**3.2**
1. Agriculture	5.4	4.4	4.1	2.4	6.5	6.3	3.7	1.5
- Major Crops	3.4	3.5	6.8	1.7	17.7	-3.9	8.3	-3.0
- Minor Crops	4.1	4.6	1.9	3.9	1.5	0.4	-1.3	4.9
- Livestock	5.3	6.4	2.6	2.9	2.3	15.8	2.8	3.8
- Fishing	7.3	3.6	3.4	2.0	0.6	20.8	0.4	11.0
- Forestry	6.4	-5.2	11.1	-3.2	-32.4	-1.1	-29.5	-8.5
2. Mining & Quarrying	9.5	2.7	6.6	15.6	10.0	4.6	3.1	4.9
3. Manufacturing	8.2	4.8	6.9	14.0	15.5	8.7	8.2	5.4
- Large Scale	8.2	3.6	7.2	18.1	19.9	8.3	8.6	4.8
- Small Scale *	8.4	7.8	6.3	-20.0	7.5	8.7	8.1	7.5
4. Construction	4.7	2.6	4.0	-10.7	18.6	10.2	17.9	15.2
5. Electricity & Gas Distribution	10.1	7.4	-11.7	56.8	-5.7	-26.6	2.5	-14.7
Services Sector	**6.6**	**4.6**	**5.2**	**5.8**	**8.5**	**6.5**	**7.6**	**8.2**
6. Transport, Storage and Comm.	6.2	5.1	4.3	3.5	3.4	4.0	6.5	4.4
7. Wholesale & Retail Trade	7.2	3.7	6.0	8.3	12.0	-2.4	5.4	6.4
8. Finance & Insurance	6.0	5.8	-1.3	9.0	30.8	42.9	15.0	17.0
9. Ownership of Dwellings	7.9	5.3	3.3	3.5	3.5	3.5	3.5	3.5
10.Public Administration & Defence	5.4	2.8	7.7	3.2	0.6	10.1	9.1	10.9
11.Services	6.5	6.5	6.2	5.4	6.6	9.9	8.8	9.4
12.GDP (Constant Factor Cost)	**6.1**	**4.6**	**4.7**	**7.5**	**9.0**	**5.8**	**6.8**	**5.8**
13.GNP (Constant Factor Cost)	5.5	4.0	**7.5**	**6.4**	**8.7**	**5.6**	**6.7**	**6.1**

** Slaughtering is included in small scale* *Source: FBS*

Table I.20
Trends in Gini Coefficents

Years	Pakistan	Rural	Urban
1963-64	0.3666	0.3543	0.3698
1966-67	0.3672	0.3416	0.4068
1968-69	0.3456	0.3005	0.3975
1969-70	0.3394	0.3122	0.3694
1970-71	0.3379	0.3061	0.3687
1971-72	0.3607	0.3546	0.3886
1979	0.3946	0.3450	0.4118
1984-85	0.3802	0.3526	0.3884
1985-86	0.3629	0.3410	0.3589
1986-87	0.3580	0.3289	0.3643
1987-88	0.3608	0.3227	0.3782
1990-91	0.4099	0.4218	0.3788
1992-93	0.3937	0.3668	0.3970
1993-94	0.3864	0.3647	0.3685
1996-97	0.3598	0.3517	0.3691
1998-99	0.4187	0.3796	0.4510
2001-02	0.4129	0.3762	0.4615

Source: Kemal, A.R. "Income Inequalities in Pakistan and a Strategy to Reduce income Inequality.

Table I.21
Ten Least Deprived Districts of Pakistan

	MID 2005	MID 1998	Annual Rate of change (%)
Karachi	20.9	24.6	-2.3
Lahore	29.2	34.3	-2.3
Gujranwala	38.5	45.1	-2.2
Sialkot	40.9	40.3	.2
Rawalpindi	41.4	41.0	.1
Gujrat	42.7	46.5	-1.2
Faisalabad	44.2	45.6	-.4
Peshawar	44.2	50.8	-2.0
Sukkur	44.5	58.0	-3.7
Quetta	46.0	46.0	.0

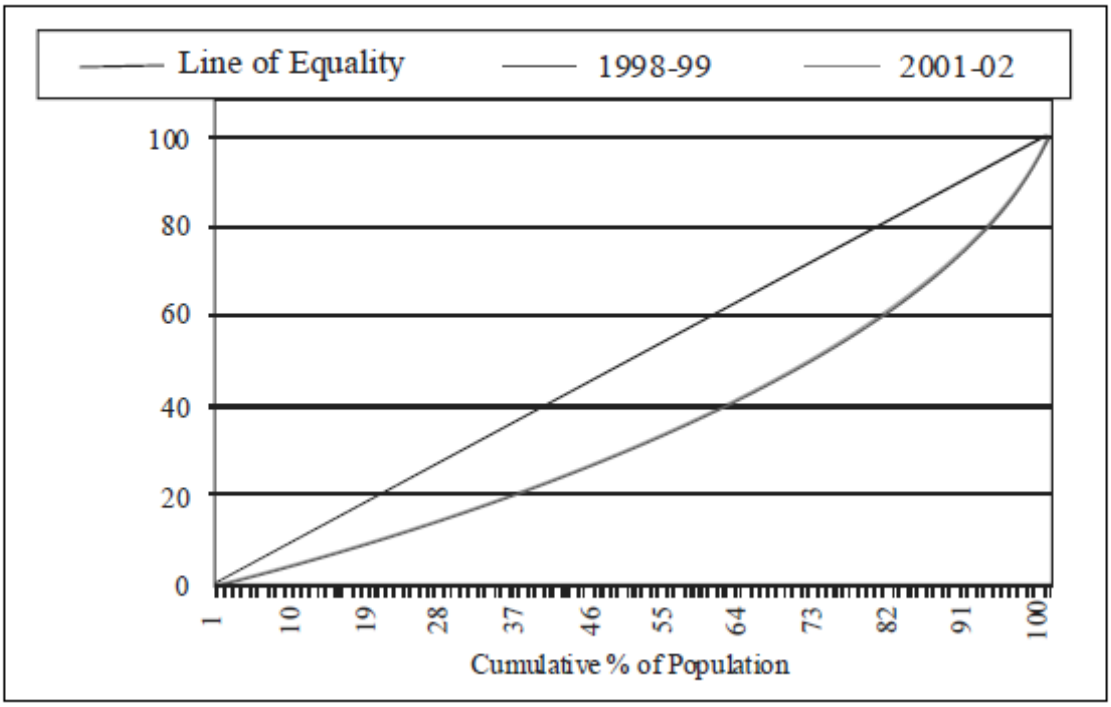
Source: Jamal, Haroon and Khan, J. Amir (2003). "The Changing Profile of Regional Inequality," The Pakistan Development Review, Pakistan Institute of Development Economics, vol. 42(2), pages 113-123.

Table I.22
Ten Highest Deprived Districts of Pakistan

	IMD 2005	IMD	Annual Rate of
Kohistan	71.7	83	-2.1
Khuzdar	72.8	79	-1.1
Qilla Abdullah	73.9	76.1	-.4
Jhal Magsi	74.7	79.2	-.8
Panjgur	75.6	79.2	-.7
Qilla Saifullah	76.8	76.2	.1
Zhob	77.1	79.3	-.4
Kharan	77.6	82.9	-.9
Awaran	79.8	80.4	-.1
Musakhel	82.8	89.1	-1.0

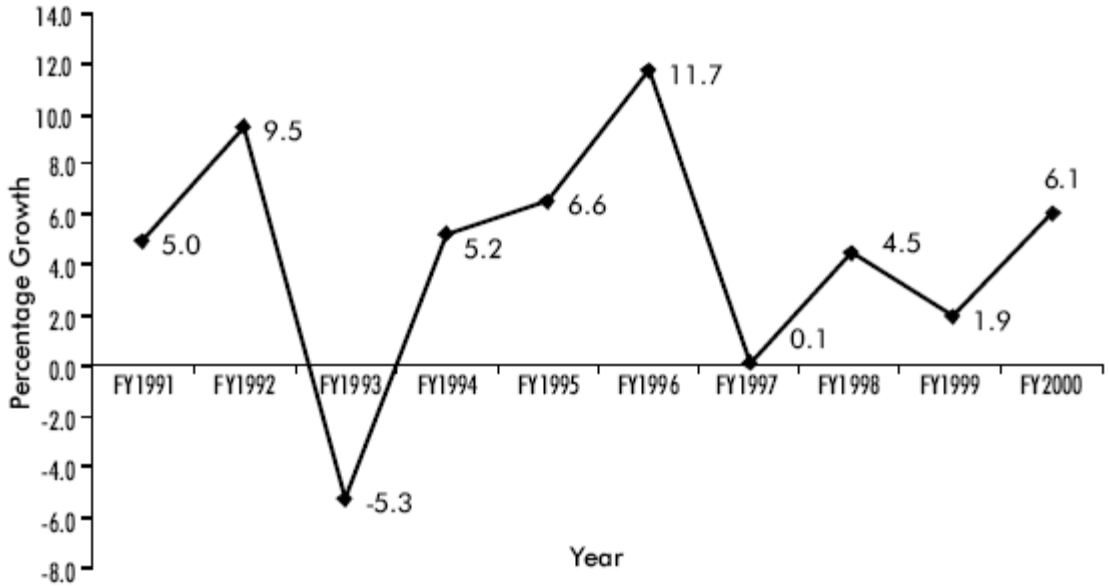
Source: Jamal, Haroon and Khan, J. Amir (2003). "The Changing Profile of Regional Inequality," The Pakistan Development Review, Pakistan Institute of Development Economics, vol. 42(2), pages 113-123.

Figure I.1: Lorenz Curve for Pakistan (1998-99 to 2001-02)



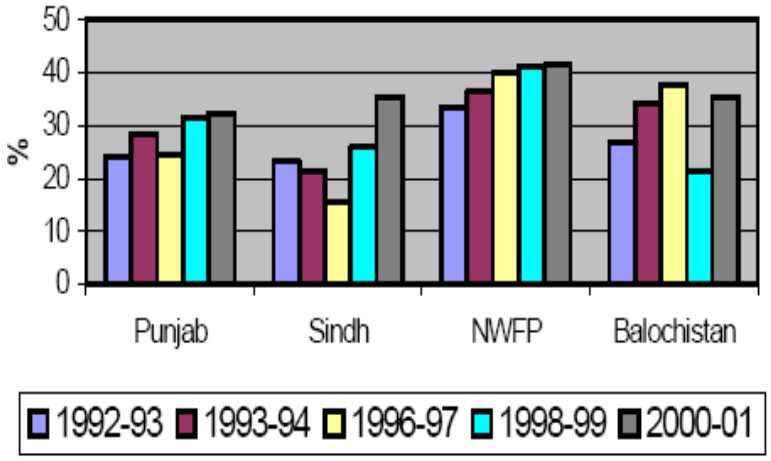
Source: Anwar, Talat (2003). "Trends in Inequality in Pakistan between 1998-99 and 2001-02." Pakistan Development Review 42:4, pp.809-821.

Figure I.2: Percentage agricultural growth



Source: Government of Pakistan. 2003. *Pakistan Economic Survey 2002–03*. Islamabad: Economic Advisor's Wing/Finance Division.

Figure I.3- Incidence of Poverty by Province.



Source: Kardar, Shahid (2008) "Regional Inequalities."

Appendix-II: Supporting Tables for the section on Sustainable Growth, Resource Gap and Employment Gap

Table II.1 shows data on national savings and current account deficit (as a percentage of GDP) between 1988-89 and 2007-08. Tables II.2A and 2B reveal sustainable levels of these two variables (as given by ten and twenty year averages). For the purposes of analysis entailed in this section of the report, the most optimistic scenario as given by a ten year national savings average and a twenty year current account balance average (both excluding 2007-08) have been employed. In tables II.3A and 3B growth in labor force and employment elasticity are shown. Finally, tables II.4A and 4B illustrate the investment capital output ratios for Pakistan between 1990-91 and 2007-08.

Table II.1
National Savings and Current Account Deficit over time*

Year	National Saving (% of GDP)	Current Account Deficit (% of GDP)
1988-89	14.1	-5.4
1989-90	14.2	-5.3
1990-91	14.2	-2.3
1991-92	17.1	-2.8
1992-93	13.6	-7.1
1993-94	15.7	-3.8
1994-95	14.7	-4.1
1995-96	13.7	-7.2
1996-97	11.8	-6.1
1997-98	14.7	-3.1
1998-99	11.7	-3.8
1999-00	15.8	-1.9
2000-01	16.5	-0.7
2001-02	18.4	1.8
2002-03	20.6	3.8
2003-04	17.9	1.3
2004-05	17.5	-1.4
2005-06	17.7	-4.0
2006-07	17.8	-4.8
2007-08	13.3	-8.4

Table II.2a
Sustainable Levels of Resources – Current Account Deficit*

Current Account Deficit	including 2007-08	excluding 2007-08
10 year average	-1.80	-1.27
20 year average	-3.26	-3.06

Table II.2b
Sustainable Levels of Resources – National Savings*

National Saving	(% of GDP)
10 year average (excluding 2007-08)	16.86
10 year average (including 2007-08)	16.72
20 year average (including 2007-08)	15.55

*Source: State Bank Annual Report (Various Issues), Pakistan Economic Surveys (various issues) and authors own calculations

Table II.3a
Labor Force*

Year	Labor Force (million)	Labor force (Growth rate)
1990	31.63	-
1991	31.50	-0.41
1992	32.48	3.11
1993	33.01	1.63
1994	33.87	2.61
1995	34.18	0.92
1996	35.01	2.43
1997	37.45	6.97
1998	39.26	4.83
1999	40.15	2.27
2000	40.49	0.85
2001	41.38	2.20
2002	43.21	4.42
2003	44.12	2.11
2004	45.95	4.15
2005	46.82	1.89
2006	50.50	7.86
2007	50.78	0.55

**Source:* Economic Surveys (various Issues)

The following regression is run to account for the possibility of a trend in labor force growth over time. The estimation results reveal that labor force has a statistically significant linear time trend[185]. The average annual growth rate of labor force is estimated to be 2.95%

Labor force(logs) = a + ß*t + µ

*Labor force (logs) =3.384 + 0.02954*t*

Table II.3b
Employment Elasticity over Time*

	1961 to 1971-72	1971-72 to 1977-78	1977-78 to 1986-87	1990s to 2000s
employment elasticity	0.45	0.64	0.36	0.41

Average employment elasticity: 0.465

**Source:* Economic Surveys (various Issues)

Table II.4a
Investment Capital Output Ratio (ICOR) over Time*

Year	ICOR
1990-91	3.38
1991-92	2.62
1992-93	9.12
1993-94	4.30
1994-95	3.56
1995-96	2.90
1996-97	9.27
1997-98	4.12
1998-99	4.95
1999-00	3.90
2000-01	8.60
2001-02	5.35
2002-03	3.57
2003-04	2.21
2004-05	2.12
2005-06	3.35
2006-07	3.27
2007-08	3.72

**Source:* State Bank Annual reports (various Issues) and own calculations

[185] T statistic → 32.22 with a p-value of 0.000

The following formula has been employed to estimate ICOR for each period:

ICOR = Average annual share of investment in GDP/Average annual growth rate of GDP

Table II.4b
Investment Capital Output Ratio (ICOR)
over different time periods*

Between 1987-88 and 2006-07	
average investment	18.57
average GDP growth	5.08
ICOR	3.65
Between 1989-90 and 1999-00	
average investment	18.61
average GDP growth	4.60
ICOR	4.05
Between 2000-01 and 2007-08	
average investment	19.11
average GDP growth	5.71
ICOR	3.35

**Source:* State Bank Annual reports (various Issues) and own calculations

Appendix-III

Table III.1 Investment and Savings Rates (as % of GDP)

	090	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07	08
Gross Total Investment	18.9	18.9	20.2	20.7	19.4	18.7	19.6	17.9	17.70	15.6	*17.4*	*17.2*	*16.6*	*16.8*	*16.6*	*19.1*	*22.1*	*22.9*	*21.6*
Changes in Stocks		1.6	1.5	1.6	1.6	1.5	1.6	1.6	2.70	1.6	*1.4*	*1.4*	*1.3*	*1.7*	*1.6*	*1.6*	*1.6*	*1.6*	*1.6*
Gross Fixed Investment	17.3	17.4	18.6	19.1	17.9	17.2	17.9	16.3	15.00	13.9	*16*	*15.8*	*15.3*	*15.1*	*15*	*17.5*	*20.5*	*21.3*	*20*
(a)Public Sector	80.4	8.5	8.8	9.1	8.3	8.3	8.1	6.8	5.30	6.1	*5.8*	*5.7*	*4.1*	*3.9*	*4.0*	*4.3*	*4.8*	*5.7*	*5.7*
(b)Private Sector	80.9	8.9	9.8	10.1	9.6	8.9	9.9	9.5	9.80	7.9	*10.4*	*10.2*	*11.1*	*11.2*	*10.9*	*13.1*	*15.7*	*15.6*	*14.2*
Net External Resource Inflow	40.7	4.8	3.1	7.1	3.8	3.9	5.8	6.1	3.10	3.9	*1.6*	*0.7*	*-1.8*	*-3.8*	*-1.3*	*1.6*	*4.4*	*5.1*	*8.3*
National Savings	14.2	14.2	17.1	13.6	15.7	14.7	13.7	11.8	14.70	11.7	*15.8*	*16.5*	*18.4*	*20.6*	*17.9*	*17.5*	*17.7*	*17.8*	*13.3*
(a)Public Savings	20.8	0.7	4.3	1.5	2.6	2.1	2.5	0.99	0.10	0.9	*-0.08*	*1.6*	*1.7*	*1.6*	*4.8*	*3.4*	*2.3*	*0.8*	*-1*
(i) General Government	1	-1.3	0.8	-1.1	-0.3	0.2	-0.3	-0.95	-1.50	-0.1	*-0.9*	*-0.1*	*0.2*	*-0.02*	*2.9*	*1.6*	*1.6*	*0.3*	*-1.4*
(ii) Others	10.8	2.0	3.5	2.6	2.8	1.8	2.8	1.9	1.70	0.9	*0.8*	*1.7*	*1.4*	*1.6*	*1.8*	*1.8*	*0.7*	*0.5*	*0.4*
(b)Private Savings	11.4	13.5	12.8	12.1	13.1	12.7	11.2	10.8	14.50	10.8	*15.9*	*14.9*	*16.8*	*19*	*13.2*	*14.1*	*15.4*	*17*	*14.3*
(i) House-hold	10.2	12	11.4	10.7	11.6	11.2	9.9	9.5	12.80	9.5	*14*	*13.1*	*14.8*	*16.8*	*13*	*13*	*13.7*	*15.1*	*12.6*
(ii) Corporate	10.2	1.5	1.4	1.4	1.6	1.5	1.3	1.3	1.70	1.3	*1.9*	*1.8*	*2.0*	*2.2*	*0.1*	*1.1*	*1.8*	*2.0*	*1.6*
Net Factor Income	20.5	1.6	0.4	0.1	-0.3	0.2	-0.7	1.2	-1.40	-1.2	*-1.3*	*-1.3*	*0.5*	*3.1*	*2.2*	*2.1*	*2.0*	*1.8*	*2.2*
Domestic Savings	11.8	12.7	16.7	13.4	15.9	14.5	14.5	12.9	16.00	12.9	*17.1*	*17.8*	*17.9*	*17.4*	*15.7*	*15.4*	*15.7*	*16*	*11*
GDP (at mkt prices)	856	1021	1211	1342	1573	1866	2175	2428	2678	2938	3793	4163	4453	4876	5641	6499	7623	8723	10478
GNP (at mkt prices)	893	1045	1224	1352	1577	1881	2188	2409	2653	2913	3746	4108	4476	5028	5765	6634	7773	8882	10712

Source: State Bank of Pakistan, Annual Reports, various

Appendix-IV: Productivity Growth in Pakistan: Significant But Not Sustained

IV.1. Introduction

One of the fundamental questions that arises across all economies is how much of economic growth is caused by growth in physical and human capital and how much is caused by factors such as technology and institutional change. Though there is little doubt about the positive impact of increased physical and human capital on growth, most economists feel that sustained high growth is dependent on sustained technological and institutional growth. Based on the assumptions of constant returns to scale and competitive factor markets, one can calculate the growth rate implied by the rates of change in physical and human capital and find the deviations of the actual growth rate from this implied growth rate. These deviations are the result of technological and institutional change and are called growth in total factor productivity (TFP).

This Appendix looks at the productivity growth rates for the Pakistani manufacturing sector, the Pakistani agricultural sector and the Pakistani economy as a whole. The reason why a disaggregated analysis is meaningful in the context of a developing country like Pakistan is because of the prevailing view that agricultural productivity growth is significantly lower than manufacturing productivity growth. This has extremely important policy implications: First, if agricultural productivity is perceived to be perpetually lower than manufacturing productivity, then policy makers will tend to bias policies and incentive structures towards manufacturing (which has generally been the case in Pakistan). Second, if agricultural productivity is perceived to be lower than manufacturing productivity, then research resources and technology adoption will be more heavily directed towards the manufacturing side.

IV.2. Manufacturing Sector Productivity

TFP growth over the period 1985 to 2005 average 2.48% per year in the manufacturing sector A detailed breakdown of the growth in the manufacturing sector is provided in Tables III.1 and III.2. As Table III.1 shows, the average growth rate of large scale manufacturing output is 7.8 percent between 1985 and 2005. During this same period, the capital stock grew at an average of 6.6 percent a year, the labour force grew at 3.5 percent per year and TFP grew at 2.4 percent per year. Table III.2 presents an interesting breakdown of the components of manufacturing sector growth[186]: 56 percent of total large scale manufacturing sector growth was due to growth in capital stock, 15 percent was due to growth in labour and 29 percent was due to growth in TFP. Thus, it can

[186] The shares of capital and labour were taken from the estimated Cobb-Douglas functional forms and are consistent with the shares used by other authors, including Martin and Mitra.

be clearly seen that manufacturing sector growth has been driven primarily by increases in capital and not increases in productivity.

Table IV.1: Average Growth Rates in the Pakistani Large Scale Manufacturing Sector, 1985-2005 (%)

Large Scale Manufacturing Output	*Large Scale Manufacturing Capital Stock*	*Large Scale Manufacturing Labour*	*Total Factor Productivity (TFP)*
7.8 %	6.6 %	3.53 %	2.4 %

Table IV.2: Components of Pakistani Large Scale Manufacturing Sector Growth, 1985-2005 (%)

Growth in Capital Stock	*Growth in Labour*	*Growth in Total Factor Productivity*
56 %	15 %	29 %

Figure VI.1: Pakistani Manufacturing Sector Output and Productivity Growth

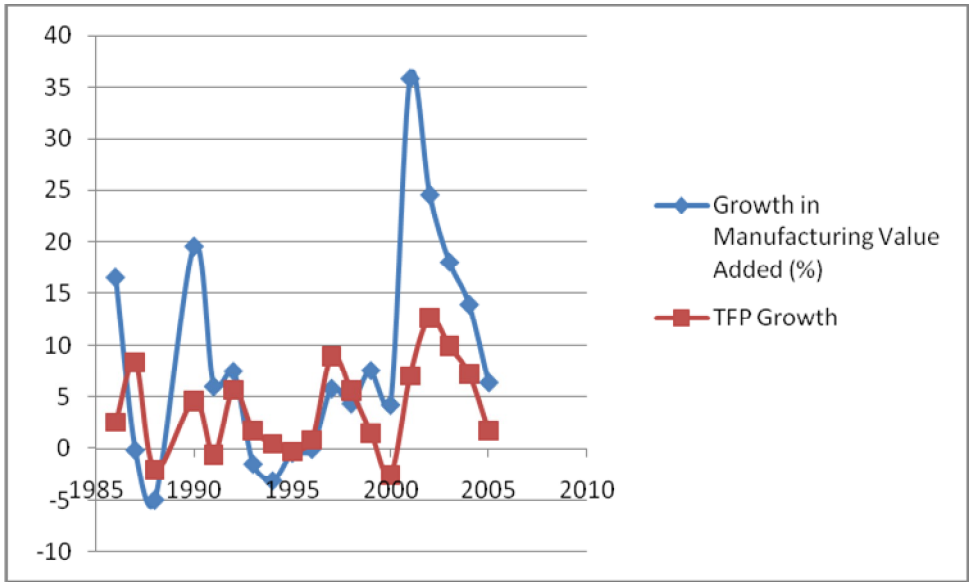


Figure VI.1 shows the high correlation of manufacturing sector growth with changes in productivity. As can be seen, periods of high productivity are accompanied by high growth and periods of low productivity are accompanied by low growth. Table IV.3 shows an international comparison manufacturing

productivity growth. As the numbers illustrate, the Pakistani manufacturing sector has experienced higher productivity growth than comparable sectors in other South Asian economies, but has grown significantly slower than the manufacturing sectors in the East Asian economies.

Table IV.3: Comparison of Manufacturing Sector TFP Growth[187] (%)

Country *(Time Period)*	*Growth in Manufacturing Total Factor Productivity (%)*
Pakistan (1985-2005	2.48
China (1967-1999)	3.86
India (1967-1999)	-0.33
South Asian Average (1967-1999)	0.31
East Asian Average (1967-1999)	3.81
Low Income Developing Countries Average (1967-1999)	0.22
All Developing Countries Average (1967-1999)	1.91

IV.3. AGRICULTURAL SECTOR PRODUCTIVITY

For the agricultural sector the estimated TFP growth rate over the period 1990 to 2005 was equal to 1.75 % per annum. A detailed breakdown of the growth in the agricultural sector is provided in Tables IV.4 and IV.5. As Table III.4 shows, the average growth rate of agricultural output is 3.57 percent between 1990 and 2005. During this same period, agricultural labour increased by 2.09 percent per year, agricultural land increased by 0.2 percent per year, the number of tubewells increased by 7.03 percent per year, the number of tractors increased by 9.1 percent per year, the amount of fertilizer used increased by 4.37 percent per year, water decreased by an average of 0.79 percent per year and TFP grew at 1.75 percent per year. Table III.5 presents an interesting breakdown of the components of agricultural sector growth[188]: 40 percent of total agricultural sector growth was due to growth in labour, 49 percent was due to growth in TFP

[187] Estimates for countries other than Pakistan are taken from Martin, Will and Mitra, Devashish (1999). "Productivity Growth and Convergence in Agriculture and Manufacturing." World Bank Working Paper Number 2171, World Bank, Washington DC.

[188] The shares of capital and labour were taken from the estimated Cobb-Douglas functional forms and are consistent with the shares used by other authors, including Martin and Mitra.

and 11 percent was due to growth in other factors of production. These results show that agricultural sector growth has been low and has been primarily driven by growth in labour and productivity. But these results have to be viewed more critically than the results obtained from the manufacturing sector, because the unreliability of agricultural input data may have led to an underestimation of the contribution of the other factors in agricultural sector growth and an overestimation of the TFP growth rate.

Table IV.4: Average Growth Rates in the Agricultural Sector, 1990-2005 (%)

Agricultural Output	*Agricultural Labour*	*Agricultural Land*	*Surface Water*	*Tubewells*	*Tractors*	*Fertilizer*	*Total Factor Productivity*
3.57 %	2.09 %	0.2 %	-0.79 %	7.03 %	9.1 %	4.37 %	1.75 %

Table IV.5: Components of Agricultural Sector Growth, 1990-2005 (%)

Growth in Labour	*Growth in Total Factor Productivity*	*Growth in Other Factors of Production*
40 %	49 %	11 %

Figure IV. 2: Pakistani Agricultural Sector Output and Productivity Growth

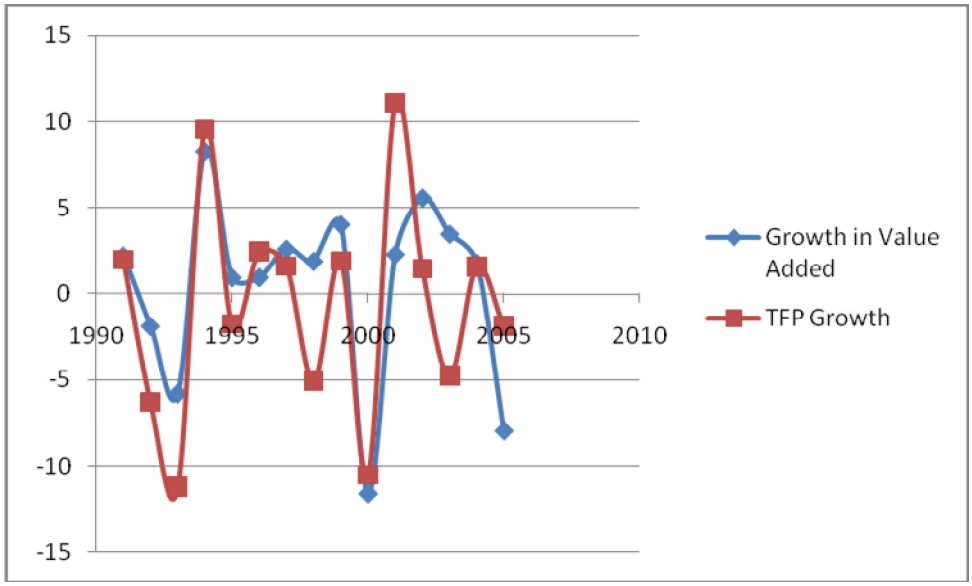


Table IV.6: Comparison of Agricultural Sector TFP Growth[189] (%)

Country *(Time Period)*	*Growth in Agricultural Total Factor Productivity (%)*
Pakistan (1985-2005	1.75
China (1967-1999)	2.49
India (1967-1999)	1.52
South Asian Average (1967-1999)	1.72
East Asian Average (1967-1999)	2.64
Low Income Developing Countries Average (1967-1995)	1.44
All Developing Countries Average (1967-1995)	3.35

[189] Estimates for countries other than Pakistan are taken from Martin, Will and Mitra, Devashish (1999). "Productivity Growth and Convergence in Agriculture and Manufacturing." World Bank Working Paper Number 2171, World Bank, Washington DC.

Similar to the manufacturing sector discussed above, Figure III.2 shows the high correlation of agricultural sector growth with changes in productivity. As can be seen, periods of high productivity are accompanied by high growth and periods of low productivity are accompanied by low growth and interestingly the volatility of agricultural sector productivity growth is comparable to the volatility of manufacturing sector productivity growth. Table III.6 shows an international comparison agricultural productivity growth. Again, the Pakistani agricultural sector has experienced higher productivity growth than comparable sectors in other South Asian economies, but has grown significantly slower than the agriculural sectors in the East Asian economies and has also grown more slowly than the average developing economy.

IV.4. Overall Productivity

The final analysis is done for the entire economy in order to compare TFP growth in agriculture and manufacturing with overall TFP growth. The results for the GDP growth are shown in Tables III.7 and III.8. As Table III.7 shows, the average growth rate of GDP is 4.1 percent between 1985 and 2005. During this same period, the capital stock grew at an average of 4.2 percent a year, the labour force grew at 2.4 percent per year and TFP grew at 1.1 percent per year. Table III.8 presents a breakdown of the components of GDP: 33 percent of GDP growth was due to growth in capital stock, 40 percent was due to growth in labour and 27 percent was due to growth in TFP. Thus, it can be clearly seen that overall growth in Pakistan has been driven primarily by increases in capital and labour and not increases in productivity.

Table IV. 7: Average Growth Rates in Pakistan, 1985-2005 (%)

GDP	*Capital Stock*	*Labour*	*Total Factor Productivity (TFP)*
4.1 %	4.2 %	2.4 %	1.1 %

Table IV.8: Components of GDP Growth, 1985-2005 (%)

Growth in Capital Stock	*Growth in Labour*	*Growth in Total Factor Productivity*
33 %	40 %	27 %

Figure IV.3: Pakistani Output and Productivity Growth

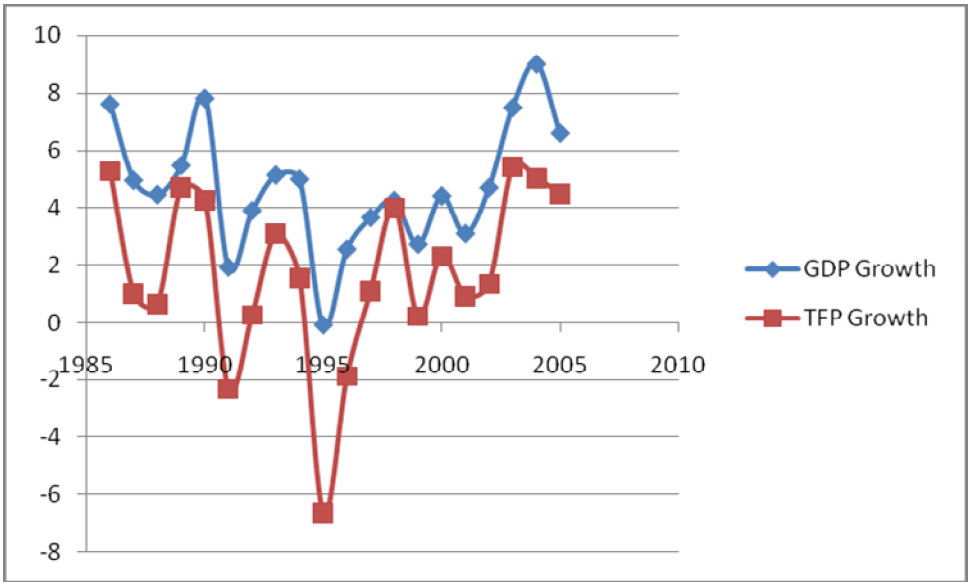


Figure IV.3 shows the high correlation of overall output growth with growth in productivity. For the economy as a whole, productivity and output growth in far more volatile than for the manufacturing and agricultural sectors. Table IV.9 shows an international comparison productivity growth. Here the numbers are extremely revealing: For the economy as a whole, productivity growth in Pakistan has fallen slightly behind the average South Asian economy and significantly behind the average East Asian economy.

Table IV.9: Comparison of TFP Growth [190] (%)

Country (Time Period)	*Growth in Total Factor Productivity (%)*
Pakistan (1985-2005	1.1
China (1960-2000)	3.3
India (1960-2000)	1.53
South Asian Average (1960-2000)	1.84
East Asian Average (1960-2000)	2.8

[190] Estimates for countries other than Pakistan are taken from Baier, Scott, Dwyer, Gerald and Tamura, Robert (2006). "How Important are Capital and Total Factor Productivity for Economic Growth?" *Economic Inquiry* 44 (1):23-49.

IV.5. CONCLUSION

The results of the analysis in this paper imply that total factor productivity in the manufacturing sector has grown at a higher rate than total factor productivity in the agricultural sector over the last two decades in Pakistan. On the manufacturing side, though productivity is increasing at an average of 2.4 percent per year, output growth is being driven by increases in capital. On the agricultural side, productivity is growing at an average rate of 1.75 percent per year (though this is probably overestimated due to data limitations). With the available data, the major drivers of agricultural sector growth are labour and TFP growth. For the economy as a whole, total factor productivity is increasing at an average rate of 1.1 percent a year, but almost three-quarters of GDP growth is caused by increases in labour and capital stock.

Cross-Country analyses find that high growth economies are driven both by growth in their inputs as well as sustained growth in their productivity. The interesting aspect of this conclusion is not that productivity growth has to be extremely high, but simply sustained over a long period of time. The results in this analysis show that productivity growth in Pakistan, at the sectoral level and at the aggregate level, has been slow and that growth has been input driven rather than productivity driven. Also, productivity growth has not been sustained in Pakistan. When looking at the TFP growth experiences of other countries, one finds that factors such as human capital development, physical capital development (including infrastructure), financial development, technology absorption and openness (especially in terms of openness to imports) have a significant impact of TFP growth and until Pakistan focuses on these issues, growth will remain unsustainable.

Appendix-V: The Impact on Cotton Production and Yields in India after Introduction of BT Cotton

India ranks third in global cotton production after the United States and China, and with 8-9 million hectares grown each year, India accounts for approximately 25% of the world's total cotton area and 16% of global cotton production producing almost three million tonnes.

Although quantity-wise, Indian cotton production is ranked third in the world, its productivity is substantially lower; and the primary cause for this low productivity is the damage caused by 'insect pests, notably *Helicoverpa armigera*, commonly referred to as American Bollworm'. Nearly Rs.12 billion worth of pesticides are used in India to control just the bollworm complex of cotton, which can be damaging to both the environment and human health. To overcome this issue, 'Mahyco (Maharashtra Hybrid Seed Company), in collaboration with Monsanto, introduced 'Bt cotton' technology in India. (Barwale et. Al 2004—Prospects for BT cotton tech in India) which has resistance to bollworm in six states.

The yields of Bt cotton have been observed to be higher than those of Non-Bt cotton (Gandhi and Namboodiri 2006, since Bt cotton requires a lesser amount of spraying as compared with Non-Bt cotton while the quality of BT cotton is also cleaner (Table V.1). Table V.2 also shows how overall cotton production and yield in India experienced a sharp growth post-2002. Total production rose from 10 million bales to almost 26 million bales in 2007/08 with yields growing from 186 kg per hectare to 466 kg per hectare over the same period, compared with irregular trends in earlier years but with lower production and yield outcomes (also refer to Figures V.1 and V.2).

Gandhi and Namboodiri (2006) conducted a study in 2004 in order to compare the effects of Bt versus non-Bt technology on the yield and value of cotton as well as the on use of pesticides across four Indian states, namely, Maharashtra, Andhra Pradesh, Gujarat and Tamil Nadu. Their results show how in all these four states pesticide spraying was reduced considerably along with the cost of spraying per hectare via Bt cotton (Table V.3) and how under both irrigated and non-irrigated conditions, Bt cotton yielded higher output with a greater value than non-Bt cotton (Table V.4).

While Pakistan's production of cotton is lower its yield per acre is higher than that of India (Tables V.2 and V.5). While India's production and yield of cotton were both rising post-commercialization of BT cotton, the trend beyond 2005 in Pakistan shows a decline in cotton production and yield even though absolute yields are still than those of India (Figures V.3 and V.4). Therefore, with India's visible success with BT cotton, adoption of this technology should ate least check the falling trend in Pakistan's cotton production and yield.

Table V.1: BT cotton results from Kharifa 2002 season, June-December (yield in quintals).

State	Non-Bt yield	Bt yield	Yield increase with Bt	Non-Bt sprays	Bt sprays	Spray reduction with Bt	Economic benefit per hectare[c]
Andhra Pradesh	14.42 (5–25)	20.52 (12.5–32.5)	6.10	4.81 (1–8)	2.08 (0–4)	2.73	Rs.16,747
Gujarat	19.80 (3.7–37.5)	28.35 (10–44)	8.55	3.42 (1–7)	2.09 (0–5)	1.33	Rs.18,430
Karnataka	10.50 (1.3–30)	17.82 (7.5–40)	7.32	2.53 (0–6)	1.00 (0–3)	1.53	Rs.16,170
Madhya Pradesh	15.00 (10–50)	25.82 (35–62.5)	10.82	3.29 (1–9)	0.93 (0–3)	2.36	Rs.24,000
Maharashtra	14.47 (2.5–45)	20.82 (2.5–62.5)	6.35	2.78 (0–7)	0.99 (0–4)	1.79	Rs.14,490
Tamil Nadu[d]	—	—	—	—	—	—	—
Total	13.25	21.35	8.10	3.10	1.17	1.93	Rs.18,130

Note. All figures given in the table are based on a survey conducted by Mahnyco in the six states where Bt cottonseed cotton was sold in the kharif 2002 season.[a] The total sample size was 1,069 farmers. Averages are on weighted average basis. Figures in parentheses represent the range for yield (quintals per hectare) and number of sprays.

[a] Kharif refers to a crop that is harvested at the beginning of winter.

[b] 1 quintal = 100 kg.

[c] Economic benefit per hectare was calculated on the basis of an average cotton rate of Rs.2,000/q and an average cost of each bollworm complex spray of Rs.1,000/ha.

[d] Cotton picking still in progress in Tamil Nadu at date of writing.

Source: Zehr, Usha et al. (2004) "Prospects for BT Cotton Technology in India." Agriculture Bio Forum 23-26.

Table V.2 : All-India Area, Production and Yield of Cotton

Year	Area (million hectares)	Production (million bales)	Yield (kg/hectare)	%age change in prod	%age change in yield
1980-81	7.82	7.01	152	-	-
1981-82	8.06	7.88	166	12.4	9.21%
1982-83	7.87	7.53	163	-4.4	-1.81%
1983-84	7.72	6.39	141	-15	-13.50%
1984-85	7.38	8.51	196	33	39.01%
1985-86	7.53	8.73	197	2.6	0.51%
1986-87	6.95	6.91	169	-21	-14.21%
1987-88	6.46	6.38	168	-7.7	-0.59%
1988-89	7.34	8.74	202	37	20.24%
1989-90	7.69	11.42	252	31	24.75%
1990-91	7.44	9.84	225	-13.835	-10.71%
1991-92	7.66	9.71	216	-1.3211	-4.00%
1992-93	7.54	11.40	257	17.4047	18.98%
1993-94	7.32	10.74	249	-5.7895	-3.11%
1994-95	7.87	11.89	257	10.7076	3.21%
1995-96	9.04	12.86	242	8.15812	-5.84%
1996-97	9.12	14.23	265	10.6532	9.50%
1997-98	8.87	10.85	208	-23.753	-21.51%
1998-99	9.34	12.29	224	13.2719	7.69%
1999-00	8.71	11.53	225	-6.1839	0.45%
2000-01	8.53	9.52	190	-17.433	-15.56%
2001-02	9.13	10.00	186	5.04202	-2.11%
2002-03	7.67	8.62	191	-13.8	2.69%
2003-04	7.60	13.73	307	59.2807	60.73%
2004-05	8.79	16.43	318	19.665	3.58%
2005-06	8.68	18.50	362	12.5989	13.84%
2006-07	9.14	22.63	421	22.3243	16.30%
2007-08	9.43	25.81	466	14.0521	10.69%

Source: DACNET(2009). AN EGOV4D INFRASTRUCTURE (AN APPROPRIATE ECONOMIC STRUCTURE) FOR GLOBALIZING INDIAN AGRICULTURE. <HTTP://WWW.DACNET.NIC.IN/>

Table V.3: Application of pesticides in BT and Non-BT cotton

State		Bt Cotton	Non-Bt Cotton
Maharashtra	Average Number of Sprays	3.37	5.28
	Cost per ha (Rs.)	3242	4120
Andhra Pradesh	Average Number of Sprays	4.27	8.11
	Cost per ha (Rs.)	7926	10675
Tamil Nadu	Average Number of Sprays	4	6
	Cost per ha (Rs.)	1910	4195

Source: Namboodiri, N.V. and Gandhi, P. Vasant (2006). "The Adoption and Economics of BT Cotton in India: Preliminary Results from a Study. Indian Institute of Management, Ahmedabad, India.

Table V.4: Yield and Value of output from BT and Non-BT cotton

State		Bt Cotton			Non-Bt Cotton		
		Irrigated	Unirrigated	Total	Irrigated	Unirrigated	Total
Gujarat	Yield (Kg/Ha.)	3176		3176	2345		2345
	Value of output (Rs.)	61848		61848	44720		44720
Maharashtra	Yield (Kg/Ha)	2755	2410	2605	1856	1747	1780
	Value of output (Rs.)	57262	50487	54313	39948	38973	39270
Andhra Pradesh	Yield (Kg/Ha.)	2933	2961	2962	2793	1607	2049
	Value of output (Rs.)	49437	52847	50970	48810	28372	35870
Tamil Nadu	Yield (Kg/Ha.)	2375	1335	1893	1697	1210	1473
	Value of output (Rs.)	45599	29797	38282	29307	23632	26032

Source: Namboodiri, N.V. and Gandhi, P. Vasant (2006). "The Adoption and Economics of BT Cotton in India: Preliminary Results from a Study. Indian Institute of Management, Ahmedabad, India.

Table V.5: Cotton in Pakistan

Year	Production(million bales)	Yield(kg/hectare)
1980-81	4.2	339.18
1981-82	4.4	337.85
1982-83	4.8	364.12
1983-84	2.9	222.87
1984-85	5.9	449.60
1985-86	7.2	511.00
1986-87	7.8	522.55
1987-88	8.6	571.65
1988-89	8.4	544.48
1989-90	8.6	560.22
1990-91	9.6	615
1991-92	12.8	769
1992-93	9	543
1993-94	8	488
1994-95	8.7	557
1995-96	10.6	601
1996-97	9.4	506
1997-98	9.2	528
1998-99	8.8	511
1999-00	11.2	641
2000-01	10.7	624
2001-02	10.6	579
2002-03	10.2	622
2003-04	10.1	572
2004-05	14.3	760
2005-06	13	714
2006-07	12.9	711
2007-08	11.7	649

Source: Agricultural Statistics of Pakistan (2006-07).

Figure V.1: Cotton in India

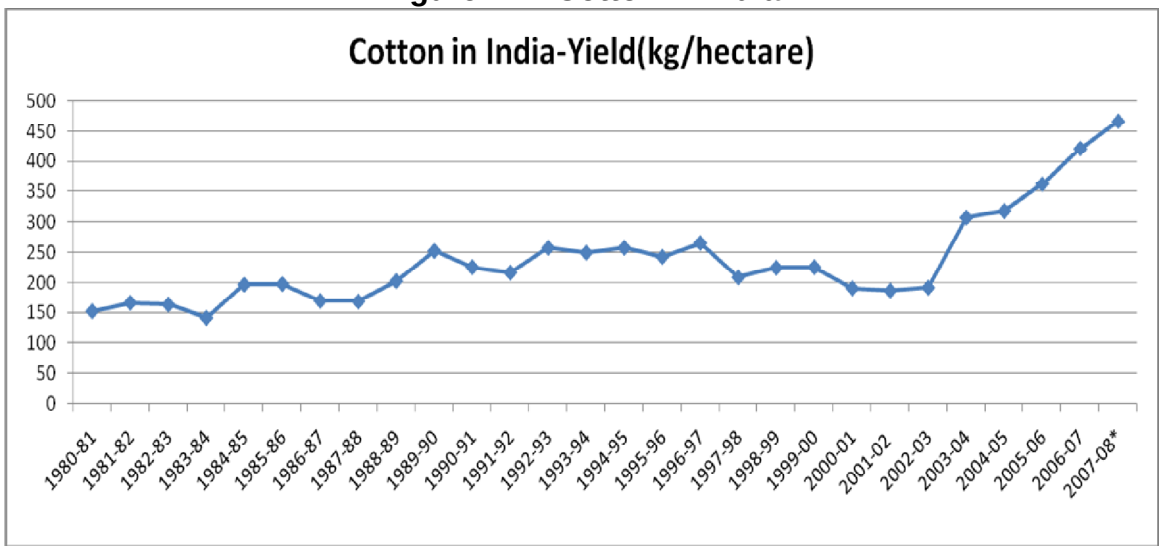


Figure V.2: Area and Production of Cotton in India

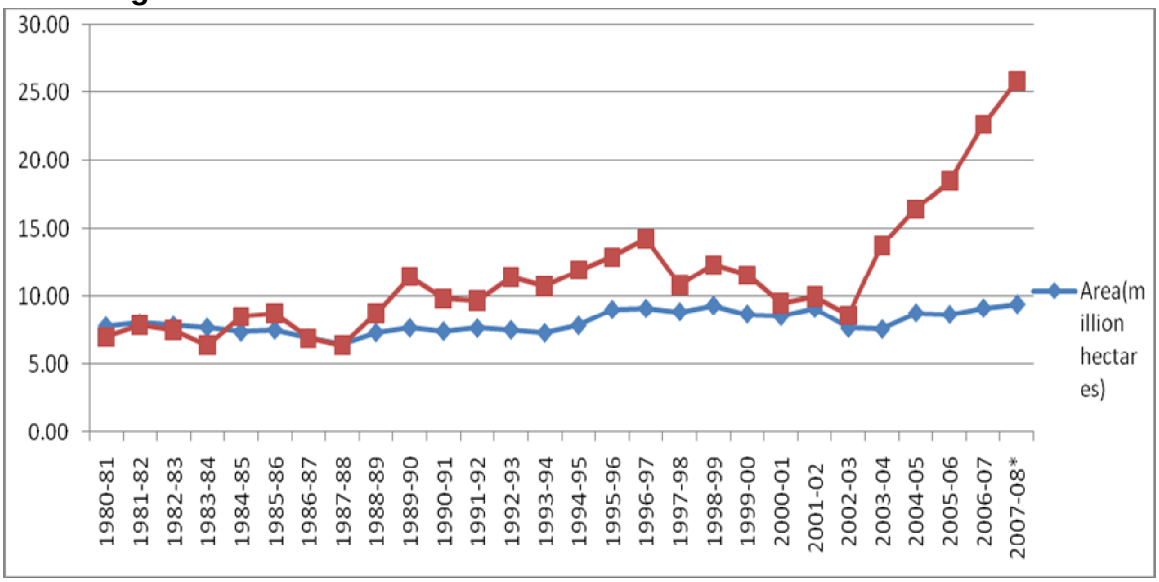


Figure V.3: Production of Cotton in Pakistan

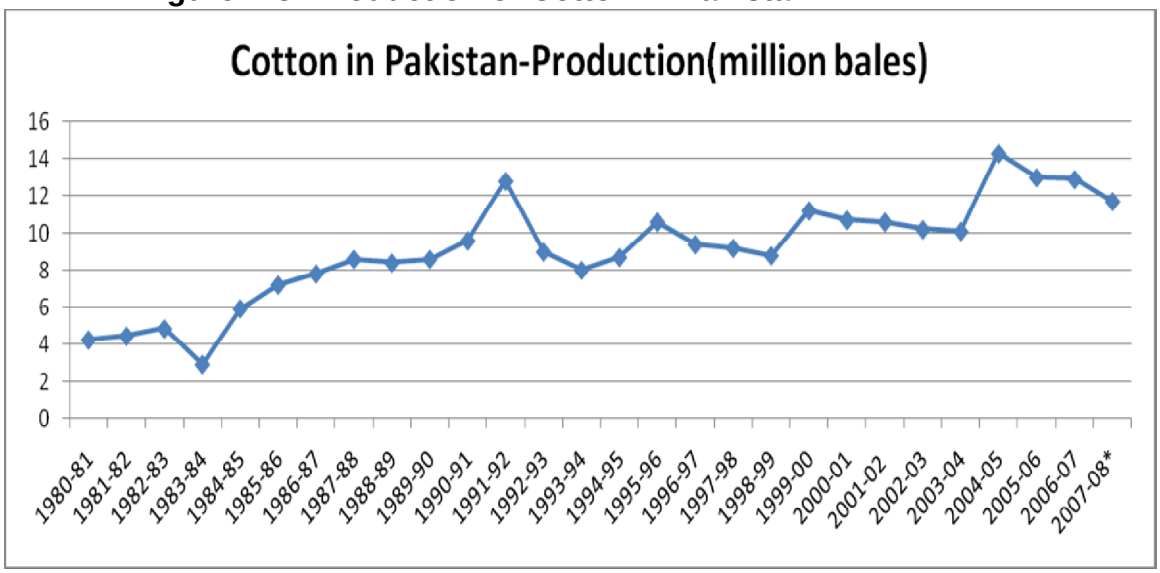
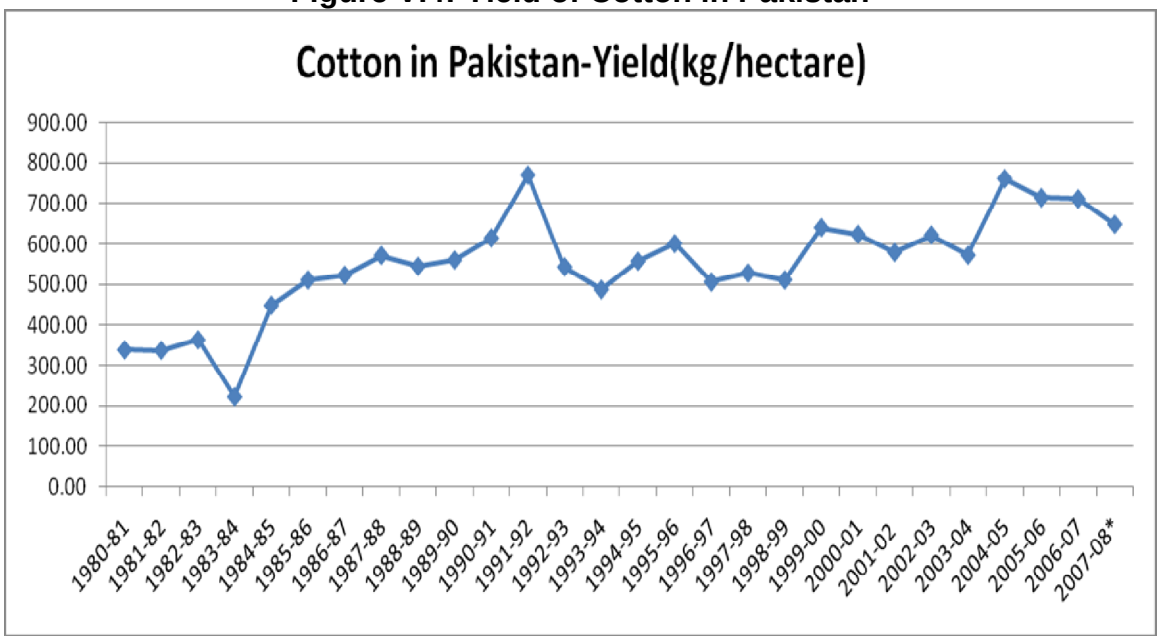


Figure V.4: Yield of Cotton in Pakistan



Appendix-VI

VI.1 SPECIFIC TECHNICAL FACILITIES FOR CFCs

The specific facilities that could be available at CFCs to fulfill their technology diffusion/fabrication functions are:

1. Materials testing laboratory.
2. Foundry.
3. Surface Treatment Plant:
   (a) Hot Dip Galvanizing Unit.
   (b) Paint Spray Installation.
4. Welding Workshop.
5. Sheet Metal Unit:
   (a) This metal sheet and pipe bending unit.
   (b) Thick metal sheet unit.
6. Heat Treatment Unit.
7. Tool and Die-making Shop.
8. Automotive Workshop/Garage.
9. Design and Information Centre.

VI.2 PRODUCT GROUPS

The product groups for which above facilities could provide support to SSEs are:

i) Agriculture

The CFCs could provide manufacturing support and marketing for SSEs in the following products:

a) Tools for manual work such as Hoes, Shovels, Rakes.
b) Animal traction equipment.

Inspite of rapid tractorization in Pakistan there remains a high demand for ox-drawn implements. The main technology here is the assembly of section irons and plates. Forging is essential in this field but there is also need for cast iron. The production of this equipment may consist of:

- Ploughs: (Forging and structural steel work).
- Rotary-blade harrows (Forging, casting and structural steel work).
- Bearings and other parts for animal drawn carts.

ii) Power Traction

Popular tractor drawn equipment contains cast as well as forged and machined parts. Welding is often necessary. Items to be produced may include:

- Spare parts for power cultivators (mainly forging);
- Ground graders (mainly plate assembly);
- Rollers (mainly plate assembly);
- Seeders, harrows and cultivators (Plate stamping, casting and structural steel work);
- Components for sprayers (aluminium casting).

iii) **Irrigation**

This equipment includes valves and pumps for industrial and household use. More complex technologies are involved in producing irrigation equipment. Among the technologies are the casting of non-ferrous metals and production of special cast iron. Typical products are:

- Components for centrifugal pumps (all CFC workshop technologies are involved);
- Connections and bends (mainly aluminum technologies);
- Components for hand pumps (casting, machining and welding);
- Components for sprayers (casting and machining);
- Panels for water reservoirs and roof tanks (welding and sheet metal technologies).

iv) **Off-Road Transportation**

Off-road transportation includes rail transportation. Products are:

- Parts for railway cars and rail transport (forging, castings, plate);
- Bushings and covers (nodular cast iron);
- Traction components (forged or shaped metalwork);
- Brake components (cast iron);
- Hooks, turnbuckles, clamps and other fastenings (mainly forged).

v) **Vehicle Components Industry**

Vehicle components include spare parts for motorcars, trucks, buses, tractors and industrial conveying and hoisting equipment. Particular vehicle components subject to frequent breakdown, such as pulley systems, fans and traction hooks, should be considered. The following are representative items:

- Brake discs and drums (pig iron);
- Oil-tight covers, oil pumps, pistons (aluminum alloys);
- Fans (aluminum alloy and stamped plate);
- Lights and tool kits (aluminum alloy and stamped plate);
- Trolley roofing (stamped plate and structural steel work);
- Hubs for tractor and trolley wheels (cast iron);

vi) **Metalworking**

The metalworking industries require metal containers, conveyors, gears, pulleys, electric motors castings, and supplies for trucks and cars. Typical products are:

- Plate bins (shaped plates);
- Components for rolling conveyors (plate or cast-iron castings);
- Pulleys and gears (iron castings and forging);
- Equipment for ingots moulds (iron castings);
- Blacksmith or smelter equipment (uses all ISC technologies);
- Miscellaneous tools (mostly forged).

vii) **Food and Related Industry**

The food processing industry in NWFP is still in its infant stage. However, the scope for the production of canned fruit, fruit juices and vegetables is quite favourable. The set-up of such industries require an approach on a case-to-case basis. Among the products are:

- Containers for food liquids (normally stainless-steel stamped parts);
- Stainless steel vats, tables, containers for food-processing plants;
- Wire products (baskets, shelves, dish drainers);
- Metal hanging panels;
- Cookers, water heaters, solar heaters;
- Components for seed-oil presses;

viii) **Construction**

Building yard machines are generally imported in whole or in part from abroad. Domestic production of simple castings may partly replace imports. The following are construction products:

- Building yard equipment (mostly forging);
- Scaffolding material (mostly forging);
- Mason tools (mostly forging);
- Components for building yard machines;
- Implements for rolling shutters or window screening (shaped plate, welding);
- Components for door framing and windows (cast or stamped plate);
- Drain covers, grates, road drain wells (cast iron);
- Piping elbows and unions for drains (cast iron);
- Components for valves, gate valves, unions, for portable or street and road signs, road fencing;
- Hinges and locks.

ix) **Household Appliances**

Household appliance products for the model workshops are:

- Bath tubs, showers and sanitary equipment (mostly cast iron);
- Taps (non-ferrous casting);
- Miscellaneous household fixtures and equipment (cast iron and aluminum castings and shaped sheets);
- Brassware for fittings, stop cocks, water taps.

x) **Power and Telephone Line Fittings**

Considering the ambitious plans in Pakistan for the increase in installed power capacity and electrification of rural areas, items in this category should be subject to market surveys and, if feasible, then produced. Possible ISC workshop items are:

- Connection, support and mooring clamps for power liens (cast iron and aluminum castings);
- Accessories for overhead line supports (aluminum castings and forging);
- Cable connection boxes (cast iron and aluminum castings);
- Waterproof feeder boxes (cast iron and aluminum castings).

xi) **Valves for Industrial Use**

Valves for industrial use include products that are almost exclusively nodular cast iron. Components include those of gate valves and fittings for gas and oil pipelines. Also included are components of small rotary compressors and radical fans, which mostly use shaped-plate castings. Cast-iron pipes, centrifugally or statically cast, must also be considered.

VI.3 **LOCATIONS OF SMALL SCALE INDUSTRIAL CLUSTERS**

The proposed growth nodes for rural industrialization where the new Common Facilities Centers (CFCs) could be located are as follows:

PUNJAB

(1) Lahore-Chunian Axis. Centre: Bhai Pheru.
(2) Lahore-Sheikhupura Axis. Centre: Sheikhupura
(3) Gujranwala-Sialkot Axis. Centre: Sialkot.
(4) Rawalpindi-Mianwali Axis. Centre: Mianwali.
(5) Bahawalpur-Bahawalnagar Axis. Centre: Bahawalnagar.

NWFP

(1) Haripur-Abbotabad Axis and Haripur-Havelian Axis. Centre: Haripur.
(2) Islamabad-Nowshera-Peshawar Axis. Centre: Peshawar.
(3) Peshawar-Kohat Axis. Centre: Kohat.

BALUCHISTAN

(1) Lesbela-Quetta Axis. Centre: Lesbela.
(2) Lesbela-Mekran Axis. Centre: Mekran.

SIND

(1) Hyderabad-Nawabshah Axis. Centre: Nawabshah.
(2) Nawabshah-Sanghar Axis. Centre: Sanghar.
(3) Nawabshah-Larkana Axis. Centre: Larkana.
(4) Larkana-Sukkur Axis. Centre: Sukkur.

Appendix-VII: An Institutional Analysis of the Pakistan Council for Scientific and Industrial Research

VII.1 INTRODUCTION

Given Pakistan's gloomy socio-economic situation and the challenges being faced by it, it is essential for the government to mobilize indigenous resources and capabilities so as to not only prevent Pakistan from collapsing in to a failed state but also to protect its sovereignty. This requires a coherent strategy as part of a medium-term framework to effectively pave way for industrial development as a vehicle for economic growth and societal transformation. History shows that countries that followed the path of industrialization have evolved in to strong economies and they not only enjoy better living standards but also social as well as economic stability.

For industrial development to take place it is absolutely imperative for the government to develop institutions that remove all the bottlenecks to growth and create a favorable environment for the local industries to flourish. What are these institutions? Institutions are defined as rules, enforcement mechanisms and organizations supporting market transactions. Extremely diverse across rich and poor communities and nations, they help transmit information, enforce property rights and contracts, and manage competition in markets. And in so doing, they give people opportunity and incentives to engage in fruitful market activity.[191] As Douglas North (2000) very aptly says "We must create incentives for people to invest in more efficient technology, increase their skills, and organize efficient markets. Such incentives are embodied in institutions."

Keeping in view the importance of industry-led economic growth especially in developing countries to enable them to attain parity with the developed world it is essential to define clearly the role of industrial development organizations and provide them with the support they require to act as agents of technical change in the industry. For this to happen, it is very important to analyze their performance and factors that can potentially prevent them from attaining their goals or performing at an optimum level.

This paper is concerned with an institutional analysis of the Pakistan Council for Scientific and Industrial Research (PCSIR) which is by far the largest industrial development organization in the country but has not been able to contribute significantly towards development of the local industry. We conduct a thorough analysis of the organization's functioning methodology and try to develop an understanding of the factors that might have prevented it from achieving its objectives.
The rest of this paper is organized as follows: Section 2 briefs upon PCSIR's background and its mandate since its inception, Section 3 provides an overview

[191] Building Institutions for Markets, World Development Report 2002

of the technical facilities available at PCSIR, Section 4 reiterates the motivation behind writing this paper, Section 5 summarizes the organizational structure of PCSIR, Section 6 lays down a framework for institutional analysis and employs this framework to identify some of the factors that have prevented PCSIR from achieving its objectives, Section 7 contains an analysis of the findings and recommendations for strengthening PCSIR and finally Section 8 concludes the paper with a brief summary of some of the major findings under the analysis.

VII.2 **BACKGROUND**

PCSIR was established in 1953 and since 1973 it has functioned under the Act of Parliament. According to Act XXX of 1973 the establishment of PCSIR is stated in the following words - “It is expedient to provide for a Pakistan Council for Scientific and Industrial Research to undertake, promote and guide scientific and technological research in respect of problems connected with the establishment and development of industries under conditions prevailing in Pakistan, and to encourage extension of the results of research to various sectors of the economic development of the country in the best possible manner.”

The primary objectives for the creation of this organization were to enable Pakistan to attain technological self-reliance based on indigenous capacity, provide basis for import substitution and export enhancement through development of new technologies, provide research and development (R&D) support and also a skilled pool of manpower to the local industry through targeted human resource development programs.

VII.3 **OVERVIEW OF THE FACILITIES**

PCSIR has a massive country-wide range of technical facilities including state-of-the-art digital libraries, research centres and laboratories. Besides Lahore, which is the biggest centre for research, PCSIR operates in almost all the major cities including Karachi, Peshawar, Islamabad and Quetta. In Lahore, facilities are available for a number of different industries including the auto industry, ceramics industry and the home appliances industry. Also available are state-of-the-art facilities for the metal industry including nano-technology equipment, material identification, heat treatment, foundry treatment and coating etc. Some of the other major industrial sectors that PCSIR caters to include minerals, glass, food technology and environment. All laboratories comply with international standards which means their data is accepted worldwide.

The Lahore unit of PCSIR has completed more than 500 processes. Out of these, 100 processes have been patented. Also it has 3500 research publications in journals of national and international standing. The laboratories are assisting the academic institutions by providing research / internship facilities to thousands of their M.Sc., M.Phil and Ph.D. students.

PCSIR Laboratories Complex, Karachi has the honor of being the first multidisciplinary unit in the whole Ministry of Science and Technology (MoST) to obtain the prestigious international award of being certified to ISO –9001 for the quality of its services to organizations of public and private sectors. Recently PCSIR Laboratories Complex, Karachi have also been accredited in ISO 17025 from Pakistan National Accreditation Council (PNAC), MoST.

The PCSIR Laboratories, Peshawar have over the years completed several adhoc projects referred by the industry and undertaken analyses of hundreds of samples of raw materials and products. Also about 500 research papers have been published in the national and international scientific journals of repute by the Peshawar staff.

All PCSIR centres and departments are manned by highly trained researchers. Necessary additional facilities such as workshops, libraries and pilot plants are adequately available to meet the requirements of research and development teams.

The following diagrams show the facilities available in the PCSIR Laboratories Complex at Lahore, Karachi and Peshawar all of which are headed by a Director General.

Figure VII.1: PCSIR Lahore

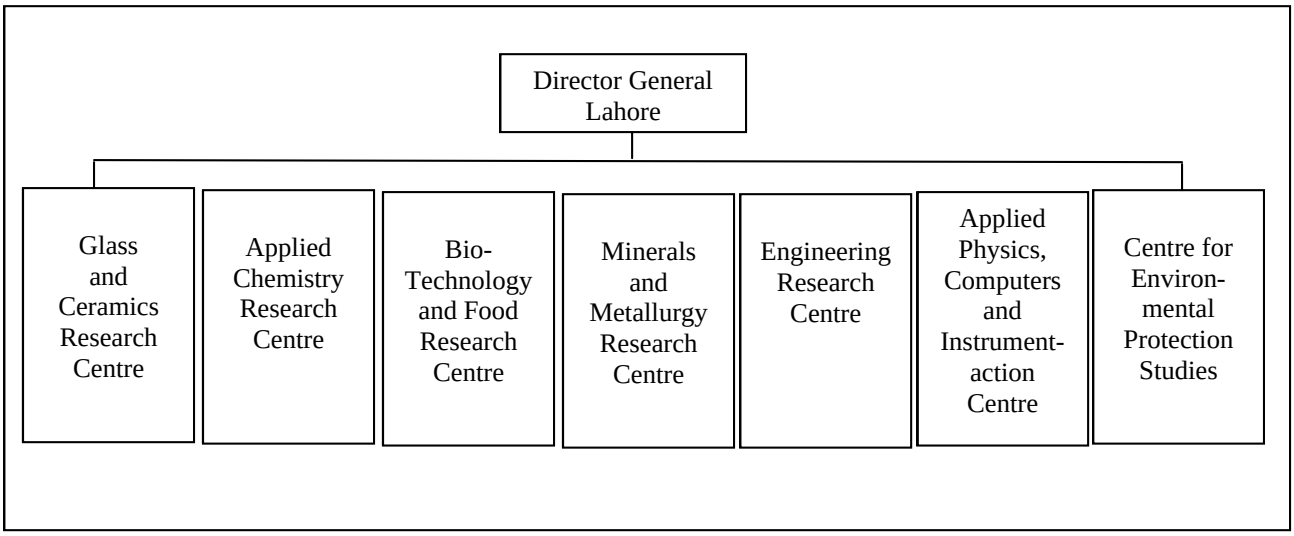


Figure VII.2: PCSIR Karachi

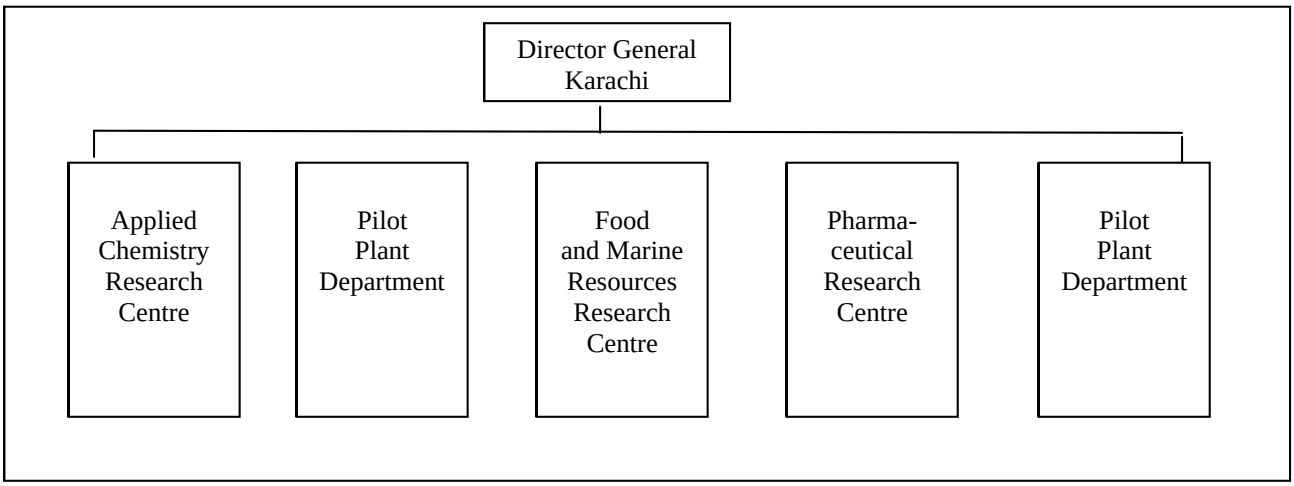
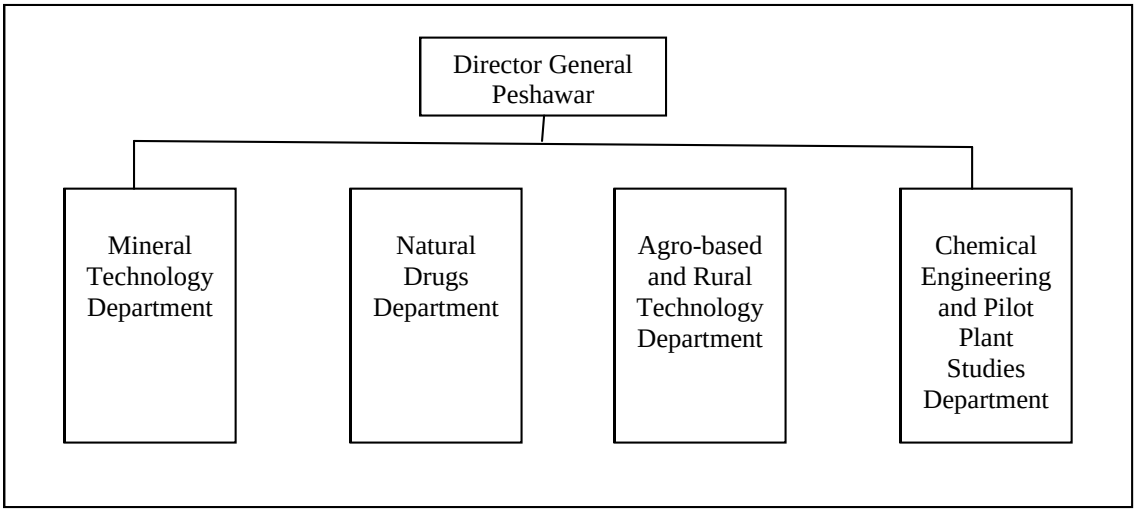


Figure VII.3: PCSIR Peshawar



Besides the laboratories complex in major cities PCSIR also has separate mono-functional centres which include: Fuel Research Centre, Leather Research Centre, Pak Swiss Training Centre and Institute for Industrial Electronics and Engineering in Karachi, Pak-Swiss Training Centre in Quetta, Solar Energy Research Centre in Hyderabad and National Physics and Standards Laboratory which is based in Islamabad.

VII.4 **PURPOSE OF THE CASE STUDY**

Keeping in view the research potential and all the facilities available for various industries at PCSIR, it would not be unreasonable to be critical of the poor performance of the industrial sector in Pakistan and question as to why has PCSIR not been effective as an industrial development organization. With a life span of almost six decades now, which is a long enough period to provide a solid platform for technological/industrial transformation in any economy, PCSIR has not been able to achieve its goals i.e. to facilitate economic development through industry led growth. Or it would be much safer to say that it has not been as effective an agent of technical change in the industry as desired.

Given its historical importance and also its mandate which highlighted the importance of industry-led socio-economic growth, it is very important to study the extent to which PCSIR has been successful in achieving its objectives and what could be done to strengthen this organization. It is essential to gain an understanding of the reasons as to why has such a strong organization with all its facilities, research potential and manpower not been able to make a significant difference towards development of the industry. An institutional approach will be adapted here for it would give insight not only in to the external factors but also the internal processes which could be improved to make PCSIR more effective. It will also enable us to get an idea of the degree to which PCSIR is actually contributing to industrial growth.

VII.5 **ORGANIZATIONAL STRUCTURE**

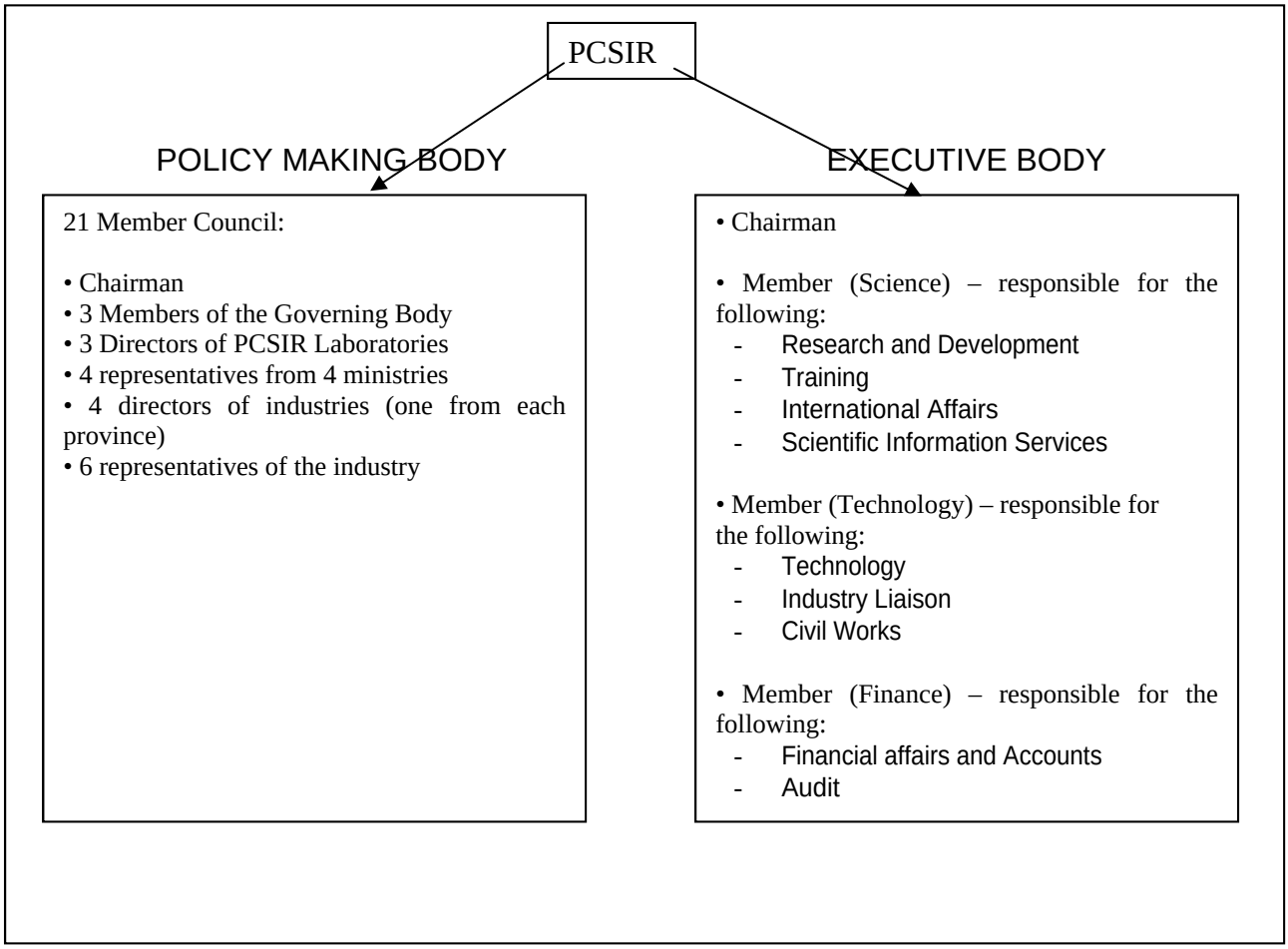
Before embarking on an analysis of the internal and external factors that have an impact on the effectiveness of PCSIR as an industrial development organization, it is important to discuss briefly its organizational structure. The Chief Executive of PCSIR is the Chairman who is appointed by the Federal Government. The 21-member Council is the policy making body of the PCSIR, which is composed of Chairman, three Members of the Governing Body, three Directors of PCSIR Laboratories, four representatives from four ministries, four Directors of Industries, one from each province and six representatives of the industry.

The Governing Body is the executive organ of the Council and comprises of the Chairman and three full-time members that are Member (Science), Member (Technology) and Member (Finance), nominated by the Government.

The Head Office of the PCSIR is functioning at Islamabad where offices of the Chairman, Member (Science), Member (Technology), Member (Finance) and Secretary PCSIR are located. The Science Wing is headed by Member (Science), who supervises matters relating to R&D, Training, International Affairs and Scientific Information Services. The Technology Wing is headed by the Member (Technology), who looks after the matters relating to Technology, Industrial Liaison and Civil Works. The Finance Wing is headed by the Member (Finance) who is in charge of activities in Finance and Audit and Accounts

Departments. The Chairman is assisted by the Secretary and Administration and Establishment Wings, working directly under him.

Figure VII.4



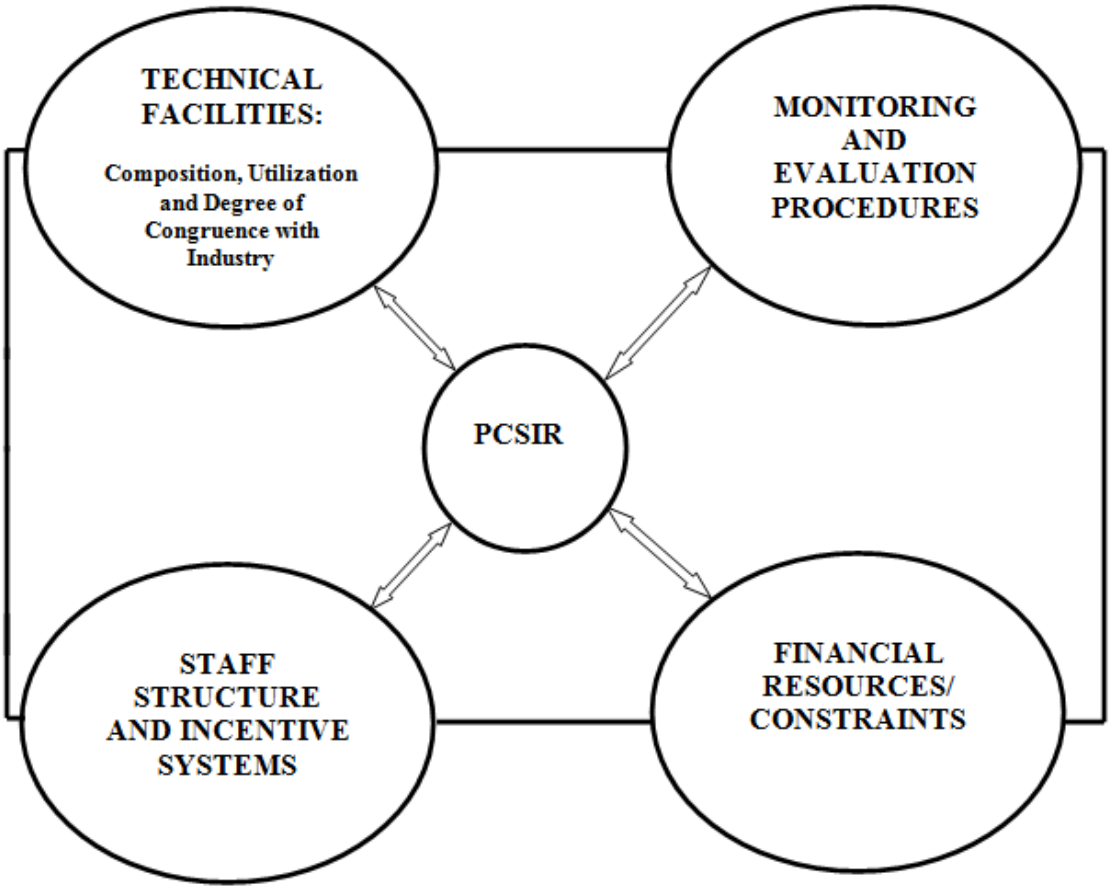
At present there are 11 Laboratories and 5 Human Resource Development Centres established throughout the country, headed by Director Generals / Directors who directly report to the Chairman. There are 681 Scientists / Engineers / Technologists working in different Laboratories out of which 80 are Ph.D.s and others have M.Sc./MS/M.Phil./B.E. degrees in multidisciplinary fields. These are supported by 1656 technical and skilled staff and 178 administrative staff. In Head Office 150 staff members including 7 Directors are working in different departments.

VII.6 **INSTITUTIONAL ANALYSIS**

The methodology employed for the analysis was to define four broad areas for investigation to gain insight in to the internal procedures, rules and processes of PCSIR as well as some of the external factors that inhibit its effectiveness. These four categories were: Technical Facilities (Composition, Utilization and Degree of

Congruence), Monitoring and Evaluation Procedures, Staff Structure and Incentive Systems, and Financial Resources/ Constraints. Series of questions were prepared for each of these categories which were then used during meetings / interviews with PCSIR officials at PCSIR Head Office in Islamabad and also its office in Lahore. Figure 6 illustrates these dimensions that were the focus of the analysis.

Figure VII.5: Framework for Institutional Analysis



A brief summary of some of the key information extracted from the meetings / interviews under each category follows:

VII.6.1 **Technical Facilities**

- ***The composition of technical facilities:***

Serving almost all the industries, PCSIR does not focus on any one particular sector and never has a specific methodology been employed to identify the sub-

sectors and industries that need to be focused on. The composition of the facilities is mainly inherited from the time when PCSIR was established. At that time a large number of bio-chemists started research specific to their own areas of interest (i.e. agriculture and bio-chemistry) and funding was also available only for projects pertaining to these fields. However, over time facilities were developed randomly based on demand and also foreign competition.

- ***Extent of utilization of facilities:***

The extent of utilization of facilities at PCSIR is only 30% whereas the remaining 70% of the facilities remain unutilized. Even though PCSIR is over-equipped with technical facilities pertaining to almost all industrial sectors, there is severe lack of demand.

- ***Linkages with the industry:***

Historically, PCSIR has never made any dedicated efforts to create a market for itself and increase demand / awareness among the industrialists. Up till now the major focus of PCSIR's staff has been on publishing its research in journal articles. Only recently an Industrial Linkage Program has been developed and some efforts have been made to create linkages with the industry. A number of MoUs have been signed over the last two months with different universities in Lahore (including F.C. College, Punjab University, Government College and also Sargodha University) to develop this program. PCSIR is aware of the importance of commercializing its technologies and therefore new marketing staff is being developed which will be responsible for diffusing previous and current technologies in the industry instead of generating new research which will remain underutilized. However, since dedicated efforts were not made in the past in this regard it will take considerable amount of time for PCSIR to build strong linkages with the industry.

- ***Determination of the agenda for research and development (R&D):***

R&D agenda is determined internally and is focused on producing new products which are 'expected' to have enormous demand. No standard methodology (dialogue with industry, stakeholders etc.) is adopted while determining research agenda.

VII.6.2 **Staff Structure and Incentive Systems**

- ***Staff structure:***

The sanctioned strength of BPS-20 level officers in Lahore and Karachi is 9 each while the sanctioned strength of BPS-19 level officers in Lahore and Karachi is 43 and 33 respectively. Sanctioned strength of BPS-18 officers in Lahore and

Karachi is 50 and 66 respectively. Details of the qualifications and department-wise break-up of these officers were not available.

However, an interesting observation made was that, as on 22 April, 2009, out of the total sanctioned strength of officers (across all cities); 25% of BPS-20 posts, 36% of the BPS-19 posts, and 22% of the BSP-18 posts were vacant which signifies a very high vacancy rate.

- ***Staff competency:***

Another major problem being faced by PCSIR is the dearth of experienced professionals with scientific background. There are a lot of young scientists and university students who come to PCSIR for research as part of their thesis but very few experienced people. The roots of this problem can be traced back to the period of 1965-1968 when around 70 foreign qualified PhDs returned from countries like Germany, USA and France but there were no facilities and funds to support their work at that time. Also most of them went in to retirement therefore causing significant depletion of manpower.

- ***Salary structure:***

As mentioned above, government pay scale applies at all levels which is considerably less than market rates.

- ***Employee Turnover:***

One of the major problems facing PCSIR is brain drain of the scholarship recipients and also loosing them out to academic institutions in Pakistan. PCSIR does not have the capacity to provide market salaries at par with companies like NESCOM, KRL and also universities wherein professors earn handsome monthly salaries. PCSIR's salary structure is based on government pay scale which is well below the market based rates.

- ***Incentive system for staff:***

A number of incentives are provided to staff members to improve their performance and efficiency. Of the revenue generated from a new product, 20% (now increased to 30%) is awarded to the research team (distributed among them in proportion to their current salaries and the amount of effort put in), 60% is recycled for research and the remaining 20% is given to the government. Another incentive being provided is that a full PhD scholarship is made available to young scientists after one year of work experience at PCSIR. At present PCSIR employs 3197 people and has 200 PhD scholarships available.

- Distribution/ Allocation of Overall Earnings:

All the departments send their cases of distribution of workers' share out of the earnings together with the cheque of the share of Head Office for obtaining approval of the Chairman. The Finance Wing is responsible for processing the case and seeking approval of the Chairman. The approval so obtained is conveyed to the concerned department and records are maintained by the Finance Wing. Only those employees are considered for distribution of worker's share whose attendance in that particular quarter remained 75% or more. Following mechanism is observed for utilization of self generated funds. The percentage of workers share for all categories of earnings is kept unchanged.

Figure VII.6: Distribution of Earnings

Nature of Activity/ Earning	Worker's Share	Head Office Share	Recycling by the department
Production Activity: i) Up to 1 million ii) Above 1 million	10% 7%	10% 7%	80% 86%
Contract/ Sponsored Activities	10%	10%	80%
Processes leased out	30%	30%	40%
Analytical/ Repair and Maintenance/ Calibration Services	20%	20%	60%
Consultancy Services	30%	30%	40%
Training Courses at Executive Centers	20%	20%	60%

- Distribution of the overall earnings among workers of the concerned department:

Head of the Department gets 3% and the Director gets 2% of the total amount earmarked for distribution as worker's share. The remaining 95% is distributed among two categories of workers as follows:

CATERGORY A (Working Scientists/ Actual Workers) 30%
CATEGORY B (All other employees) 70%

These amounts are distributed in proportion to each worker's full current basic pay for Category A workers and half of the current basic pay for Category B workers.

Category A workers' share may be reduced or increased by the Chairman upon recommendations of the concerned Head of Department concerning the worker's professional competence or the volume of contributions he has made. The Chairman also has the power to bar any employee from his due share as an outcome of any disciplinary complaint by the Head of Department.

VII.6.3 **Monitoring and Evaluation Procedures**

There are no proper mechanisms for internal monitoring and evaluation of different departments. Historically, the performance of departments has been judged on the basis of number of journal articles published but now it is planned to lay more emphasis on product development and marketing. The focus of employees so far has mainly been on earning research awards based on the amount of publications and that has been the primary criteria for success of the departments. The extent to which the industry has benefited from its research or the impact it has had on the industry is not taken in to account. There is no proper department for monitoring performance during the life-cycle of a project and also for enforcement of the rules and procedures. Further, there are no mechanisms for monitoring the overall organizational performance of PCSIR. There have been no efforts by the government to set targets for PCSIR and monitor / judge its performance on that basis.

VII.6.4 **Financial Resources/ Constraints:**

Although there is no lack of funds in terms of number of scholarships available for young scientists but the budget made available to PCSIR is not adequate for it to meet its objectives i.e. to make it more market based, link up with industry and do need oriented work. The budget allocated to PCSIR is only a fraction of what it proposes through PC-1s and even the disbursement of funds as part of this budget is a major issue. Funds are often delayed for two successive quarters and sometimes not disbursed completely.

The funds demanded by PCSIR under Non-Development Budget (for Pay & Allowance, Pension etc.) in the fiscal year 2008-09 were Rs. 973 million of which only Rs. 686 million (70%) were granted by the government. In 2009-10 Rs. 760 million (71%) were granted against a proposal of Rs. 1069 million.

Although figures for Development Budget were not available, it was learnt that they present an even more dismal picture.

VII.7 ANALYSIS AND RECOMMENDATIONS:

VII.7.1 Technical Facilities (Composition, Utilization and Degree of Congruence with the Industry):

Utilization:

The research revealed that approximately 70% of the enormous range of technical facilities including the research output and new technologies developed at PCSIR remain underutilized. This issue is of extreme importance to the Pakistan economy keeping in view the amount of investment made in setting up this huge organization. If 70% of that investment goes waste then it is a huge loss to our economy and this issue needs to be addressed immediately. Considered below are some of the factors that are potentially responsible for the current state of affairs and some of the ways in which they can be addressed.

- Lack of Awareness among Industrialists:

Despite the fact that PCSIR is over-equipped with technical facilities (ranging from product development, consultancy services, material testing, laboratory accreditation etc.) which can be utilized by any industrial sector, majority of the local industry is not even aware of these facilities. It is the government and its concerned departments who are mainly responsible for lack of promotion of the facilities on offer at PCSIR in the private sector. PCSIR is also to be blamed for not making dedicated efforts to create a market for itself. It would be interesting to research as to what are the factors that have prevented PCSIR from effective marketing of its technical facilities. Nonetheless, if all the concerned industries and sub-sectors become aware of the facilities they can avail at PCSIR, it is certainly predicted that demand for these facilities should rise if the quality of services is maintained and it is at par with those available internationally. Also important is the cost at which these services are provided. If PCSIR can provide the same quality of services as foreign firms at a lower cost to the local industry then demand will indeed rise. Therefore besides launching massive country-wide marketing campaigns PCSIR should also ensure the quality of its services, competency of its technical staff and improve its interface with the industry in order to ensure client satisfaction and increase the usage of its facilities.

- Lack of Confidence:

Besides a lack of awareness which is prevalent in the industry, there is also a lack of trust and confidence in PCSIR's capability and the quality of its services. A testimony to this very perception is the decline of textile industry's exports which can be attributed to lack of certification by an accredited lab. PCSIR has 16 laboratories focused on certification of product quality and these labs have also been accredited by a Norwegian Accreditation Body which means any

products certified by these labs are recognized globally. However, local exporters still prefer foreign laboratories (in countries like India) for accreditation of their products and also they are not ready to pay for any services provided by PCSIR labs.

Earning the confidence of the industry and image-building for an organization as big as PCSIR takes a lot of time. Reputation can only be developed by ensuring quality of services and client satisfaction. To build trust PCSIR must focus on making its interface with clients more efficient so as to improve the quality of their experience and also take regular feedback from them with a view to continuously keep evolving in to a high quality organization.

- Preference of Foreign Companies:

It is evident that local companies prefer to revert to foreign companies, from whom they procure their equipment, for troubleshooting instead of PCSIR. To tackle this problem, partnerships need to be developed with foreign companies. Such partnerships should entail agreements on sharing of knowledge, technology transfer, and research and development. Besides provision of services at a lower cost than international firms, again it must be stressed here that that quality of services must also be at par with those available abroad. This can be achieved by forging such partnerships with foreign companies.

- Bias Within the International Community:

Besides the lack of confidence among these potential customers, the low demand can also be attributed to a bias or lack of awareness among foreign buyers who prefer products tested from laboratories in Malaysia and India but not PCSIR. This would require a marketing/ promotional campaign at an international level.

- Degree of Congruence with the Industry:

Besides raising awareness, efforts need to be put in to ensure that research output and technologies developed by PCSIR do not go waste and are of relevance / significance to the local industry. The research agenda in all PCSIR departments is determined internally and is based primarily on expectations / predictions of success. No dialogue with potential clients is carried out while determining the research agenda. Also there is no involvement of the industry representatives during the research process. To ensure that there is not a mismatch between the research output and demands / needs of the industry, effective dialogue and a series of meetings must be conducted with representatives from the industry while determining the research agenda. Also a Need Assessment Survey must be conducted in the relevant industries to get feedback or the viewpoint of the industry and gauge their requirements. The research agenda must be based entirely on industrial demand to ensure better

utilization of facilities and reduce risk of failure. If efforts in this regard are not made, the only beneficiary of the research would be PCSIR employees themselves who get awards based on publishing their research in journals but that will obviously not help the industry. PCSIR needs to revisit and in fact focus a lot on developing its processes / methodology for determining research agendas. This methodology must incorporate all the above.

- Composition of Technical Facilities:

PCSIR has never utilized any scientific methodology to identify the sub-sectors and industries that it should be focusing on. This method fails to take in to account the fact that we are living in an era of ever-growing technological change and global conditions. In order to keep pace with rest of the world we need to invest in industries whose world market share is increasing and not waste our resources on declining industries. A proper scientific methodology needs to be utilized in determining the industries which need to be focused on.[192] A focused approach would not only improve performance and quality of service but also ensure that the country's limited resources are not being wasted.

VII.7.2 **Staff Structure and Incentive Systems**

There are 681 Scientists / Engineers / Technologists working in different Laboratories out of which 80 are Ph.D.s and others have M.Sc./MS/M.Phil./B.E. degrees in multidisciplinary fields. These are supported by 1656 technical and skilled staff and 178 administrative staff. In Head Office 150 officers / staff including 07 Directors are working in different departments / wings. Although the sanctioned strengths of Grade 18, 19 and 20 in all departments were provided but details of how staff is organized in each of these departments were not available. It is essential to study how staff in each department is structured and to see if the role of each staff member is defined clearly. Also a dedicated human resources department should be there to ensure that each department is functioning properly and contributing efficiently towards overall objectives of PCSIR. The high level of vacancies in each of the major departments and a high turnover rate can be attributed to low salaries. However other reasons also need to be investigated such as the working environment, rules, regulations, criteria for promotion / progression and incentives provided by PCSIR for improved performance. Staff policies need to be studied in detail e.g. the disciplinary actions in place for ensuring attendance, performance monitoring etc. Further, the incentive systems as detailed in the previous sections should be enforced to ensure no one is deprived of his / her due share in the total earnings. Also the share of the concerned staff members who directly contribute to revenue generation must be increased to ensure staff incentives are aligned with objectives of the organization.

[192] Bokhari, A.S et. al. (2008), 'Key Manufacturing Sectors for Technology Upgradation in Pakistan: Medium-Tech and High-Tech Manufactures'. *Journal of Quality and Technology Management*

Providing a PhD scholarship to young scientists (after one year of work experience) who do not even return to PCSIR is a waste of resources. The scholarships should be provided only to staff members with more experience or should be based on the extent to which they have contributed to PCSIR's success. The selection criteria for scholars need to be strengthened to mitigate the risk of loosing PhD scholars to other organizations. But even more important is the fact that until PCSIR will be able to abolish the government pay scale system in favor of market rates and provide salaries at par with those prevalent in the private sector it will keep on loosing out these young scholars to other companies and suffering from high turnover rate.

VII.7.3 **Monitoring and Evaluation Procedures:**

Unless strong measures are taken to enforce rules and regulations across all PCSIR departments in the country and to keep a check on the utilization of funds and the performance of each department – PCSIR will not be able to evolve in to a successful industrial development organization. Success criteria of each department should be clearly defined in terms of its impact on the industry for which indicators must be devised such as the ratio of the number of new technologies developed to the number of client contracts etc. If a department fails to deliver according to predefined criteria (based on the threshold level for different success indicators), a thorough analysis should be carried out to identify weaknesses and improve functioning of the department. The staff structure and competency level and also the liaison process with industry / stakeholders must be monitored regularly. There should be a monthly progress report and meeting of the directors of each department with the policy-making body and also the executive-body to ensure progress.

The performance of PCSIR should also be monitored at an aggregate level by the government. Keeping in view the amount of resources government has spent on this organization and the magnitude of the budget it allocates each year, it must also devise mechanisms to judge the cumulative performance of all the PCSIR departments, utilization of funds/ facilities allocated, and the impact on the economy. In other words a Cost-Benefit Analysis should be carried out regularly. If the organization as a whole is not delivering up to mark, then the departments that are functioning poorly must be identified and revamped. Also it must be ensured that there is greater coordination among different departments and the policy making body of PCSIR. The concerned government departments must also try to monitor all the internal procedures, rules and regulations and see how they can be improved to improve the overall functioning of the organization. Since no such mechanisms are in place at the moment and no performance indicators developed, the weak links within PCSIR continue to function and government resources wasted on such departments.

VII.7.4 **Financial Resources/Constraints**

The government must provide necessary financial support to PCSIR. Although there is no dearth of technical facilities available at PCSIR but the allocated development and non-development expenditures fall way below the requirements of the organization. The development expenditure, which is so crucial for growth of the industry and this economy, is very limited because of which developmental activities are curtailed and PCSIR is forced to adapt a passive stance i.e. it is not very progressive as far as identification and development of new / existing industries is concerned. In non-development expenditure PCSIR should be given resources to be able to provide market salaries to its employees. Efficient wages will not only improve performance but also reduce turnover rate. Further PCSIR can not even pay pensions at the moment to its former employees. The budget allocated to PCSIR is only a fraction of what it proposes through PC-1s and even the disbursement of funds as part of this budget is a major issue. Funds are often delayed for two successive quarters and sometimes not disbursed completely. This acts as a great obstacle towards the effectiveness of PCSIR and the measures it needs to take for industrial development in different sectors. These gaps need to be investigated thoroughly. Finally, besides increasing the amount allocated to PCSIR the government should also work closely with the Finance Wing to ensure effective utilization of these funds.

VII.8 **CONCLUSIONS**

In this paper we analyzed PCSIR's functioning methodology and some of the factors that have prevented it from achieving its objectives and acting as a major catalyst for industrial transformation in the country. Focus of analysis was based on four dimensions which were:

1) Technical Facilities (Extent of utilization, composition and degree of congruency with the industry), 2) Staff Structure and Incentive Systems, 3) Monitoring and Evaluation Procedures and 4) Financial Resources/ Constraints. The analysis revealed that the composition of technical facilities available at PCSIR is mainly inherited from the past, these facilities are greatly underutilized and have very low degree of congruence with the industry. PCSIR also faces a number of staff issues such as high turnover rate which can be attributed to low pay scales and dearth of experienced staff. Although a number of incentives are provided by PCSIR to improve efficiency of staff but there is no internal mechanism to oversee and enforce enactment of the internal rules, regulations and procedures. There are no internal monitoring and evaluation procedures. Success and performance criteria / indicators are non-existent / not properly defined. Finally, financial problems come in the form of low budget allocations and disbursements by the government.

Therefore, the above findings give us an insight in to some of the internal and external factors which have prevented PCSIR from making a significant contribution to the local industry. All of these issues need to be addressed immediately and rectified so as to provide PCSIR with the support it requires to effectively attain its goals and pave way for industrial growth and prosperity in the country.

Appendix-VIII: Nation Building Regions: 20% Poorest Districts of Sindh and Punjab

Distrcit	Index of Multiple Deprivation 2005	TOTAL			share	Cumulative share
		BOTH SEXES	MALE	FEMALE		
Districts of Punjab						
Lodhran	64.9	635073	326198	308875	1.52	1.52
Muzaffargarh	64.2	1373581	705424	668157	3.28	4.79
Rajanpur	61.8	571665	296160	275504	1.36	6.16
Layyah	60.1	604982	307564	297418	1.44	7.6
D.G. Khan	59.6	840903	430133	410769	2.01	9.61
Pak Pattan	59.5	718667	367349	351318	1.71	11.32
R.Y. Khan	58.4	1707342	877738	829604	4.07	15.39
Jhang	58.1	1602682	820878	781804	3.82	19.22
Vehari	58.1	1171450	600990	570460	2.79	22.01
Districts of Sindh						
Thatta	65.3	643,334	334,382	308,951	3.55	3.55
Tharparkar	64	446,393	233,139	213,254	2.47	6.02
Umerkot	64	359,193	187,588	171,605	1.98	8.01
Dadu	62.5	980,784	504,481	476,303	5.42	13.43
Larkana	61.2	1,062,704	532,483	530,221	5.87	19.3
Badin	61.1	636,427	332,181	304,246	3.52	22.81

Appendix-IX: BISP Costing for Nation Building Regions

Table IX.1: Costing at 25% of the Population

Enhanced package for "Nation-building regions"		**NBR Areas**
Population	Millions	61.0
Households	Millions	8.8
Target proportion	per cent	25.0
Number of beneficiaries	Million	2.2
Monthly transfer per beneficiary	Rupees	1000
Annual cost	Rs million	26400
Overheads	per cent	3
Total	Rs million	27,190

Table IX.2: Costing at 40% of the Population

Enhanced package for "Nation-building regions"		
Population	Millions	61.0
Households	Millions	8.8
Target proportion	per cent	40.0
Number of beneficiaries	Million	3.5
Monthly transfer per beneficiary	Rupees	1000
Annual cost	Rs million	42000
Overheads	per cent	3
Total	Rs million	43,260

Appendix-X: Employment Program Costing

Table X.1: Employment Program Costing Phase 1: FATA and Malakand Division

Phase- I		
FATA (30% of Illiterates)		
	Unit	**Cost**
Total Population	million	1.60
Population covered (30% of Illiterates)	million	0.38
Wage rate	Rupees	150
Number of days worked	Rupees	100
Total wage cost million	Million Rs.	5700
Material cost (40% of wage cost)	Million Rs.	2280
Administration cost (10% of material + wage cost)	Million Rs.	798
Total cost Billion	**Billion Rs.**	**8.778**
Malakand (30% of Illiterates)		
	Unit	**Cost**
Total Population	million	2.01
Population covered (30% of Illiterates)	million	0.32
Wage rate	Rupees	150
Number of days worked	Rupees	100
Total wage cost million	Million Rs.	4800
Material cost (40% of wage cost)	Million Rs.	1920
Administration cost (10% of material + wage cost)	Million Rs.	672
Total cost Billion	**Billion Rs.**	**7.392**

Table X.2: Employment Program Costing Phase 2: Rest of NWFP and Balochistan

NWFP (30% of Illiterates)		
	Unit	**Cost**
Total Population	million	7.46
Population covered (30% of Illiterates)	million	1.18
Wage rate	Rupees	150
Number of days worked	Rupees	100
Total wage cost	Million Rs.	17700
Material cost (40% of wage cost)	Million Rs.	7080
Administration cost (10% of material + wage cost)	Million Rs.	2478
Total cost	**Billion Rs.**	**27.26**
Balochistan (30% of Illiterates)		
	Unit	**Cost**
Total Population	million	3.65
Population covered (30% of Illiterates)	million	0.65
Wage rate	Rupees	150
Number of days worked	Rupees	100
Total wage cost	Million Rs.	9750
Material cost (40% of wage cost)	Million Rs.	3900
Administration cost (10% of material + wage cost)	Million Rs.	1365
Total cost	**Billion Rs.**	**15.02**

Table X.3: Employment Program Costing Phase 3: Poorest Districts of Sindh and Punjab

Punjab (30% illiterates of Cumulative 22% most deprived districts)		
	Unit	**Cost**
Total Population	million	41.91
Population covered (30% illiterate in most deprived districts having cumulative population = 22%)	million	1.17
Wage rate	Rupees	150
Number of days worked	Rupees	100
Total wage cost	Million Rs.	17550
Material cost (40% of wage cost)	Million Rs.	7020
Administration cost (10% of material + wage cost)	Million Rs.	2457
Total cost	**Billion Rs.**	**27.03**
Sindh (30% illiterates of Cumulative 23% most deprived districts)		
	Unit	**Cost**
Total Population	million	18.09
Population covered (30% illiterate in most deprived districts having cumulative population = 23%)	million	0.59
Wage rate	Rupees	150
Number of days worked	Rupees	100
Total wage cost	Million Rs.	8850
Material cost (40% of wage cost)	Million Rs.	3540
Administration cost (10% of material + wage cost)	Million Rs.	1239
Total cost	**Billion Rs.**	**13.63**

Appendix-XI: Nutrition Program Costing

Variable	Unit	Coverage for all children in Nation Building Districts only
Number of children aged 5-9	Million	.976
Cost per meal	Rupees	25.00
Total number of meal days	Days	218
Total cost	**Rs million**	**5,320**

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