DECEMBER 2020

PIDE P & R

PIDE's Guide to Policy and Research

Growth Diagnostic of Pakistan

An exclusive Interview with

Arshad Zaman

FRIEDRICH EBERT STIFTUNG

PAKISTAN INSTITUTE OF DEVELOPMENT ECONOMICS

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PIDE Policy & Research is a guide to policy making and research. Each issue focuses on a particular theme, but also provides a general insight into the Pakistani economy, identifies key areas of concern for policymakers, and suggests policy action. The publication offers a quick orbit of the country's economy and is a hands-on and precise go-to document for the policymaker, businessperson, academic, researcher, or student who seeks to remain updated and informed. This issue is themed around PIDE's recent research efforts regarding the diagnostic of growth. We welcome contributions from within PIDE as well as from any external contributors.

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For contributors and feedback, please reach us at policy@pide.org.pk

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Vice Chancellor's Message

Economic growth should be our single most important priority. Governments and people should dream of nothing else. This is the way followed by countries like China, Korea, and Vietnam when they wanted to grow. China even gave up ideology to seek practical solutions to growth including opening up their economy.

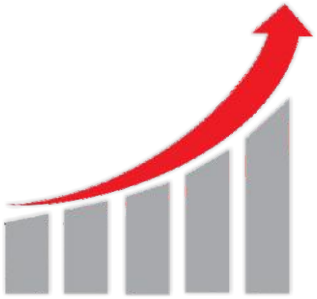
Pakistan lacks that single-minded determination for growth. Our leaders and their policies lack the fervor and depth of the policies that countries like China and Korea have shown. Besides we want the easy way out, looking for funding and easy policy suggestions from donors. Begging has never created success.

All countries that wanted sustained growth adopted a pragmatic approach allowing their populations to seize opportunity. Their policies were fine-tuned consistently, their markets nurtured, and even foreign and security policies adapted to the needs of economic growth. Such countries paid attention to research and development and monitoring and evaluation to erase barriers to investment and learning.

Growth is in human DNA. And growth is basically human learning and knowledge. Humanity yearns for knowledge and growth. Experience has shown that some societies preclude this learning because some extractive elite captures the state to benefit from the status quo. The extractive elite would like to suggest that knowledge is formal education which they will prescribe and serve within the extractive framework.

The knowledge that humanity requires is far broader than that which can be prescribed in hallowed halls. It is the knowledge that creators and innovators (e.g. Bill Gates, Steve Jobs) create regardless of their credentials. Such knowledge is created in a combination of a thoughtful government, efficient competitive markets and great dense commercial and youthful cities. The process has to be underpinned by a thoughtful government!

PIDE's major research theme is unlocking ideas for realizing Pakistan's growth potential. We offer you some food for thought from this research. We would love your feedback.



Editorial

Pakistan's elusive chase of growth

Yet again, Pakistan is passing through its familiar boom and bust cycle of growth. It was only appropriate to devote this issue of the PIDE P&R to the long term story of our growth, or the lack of it.

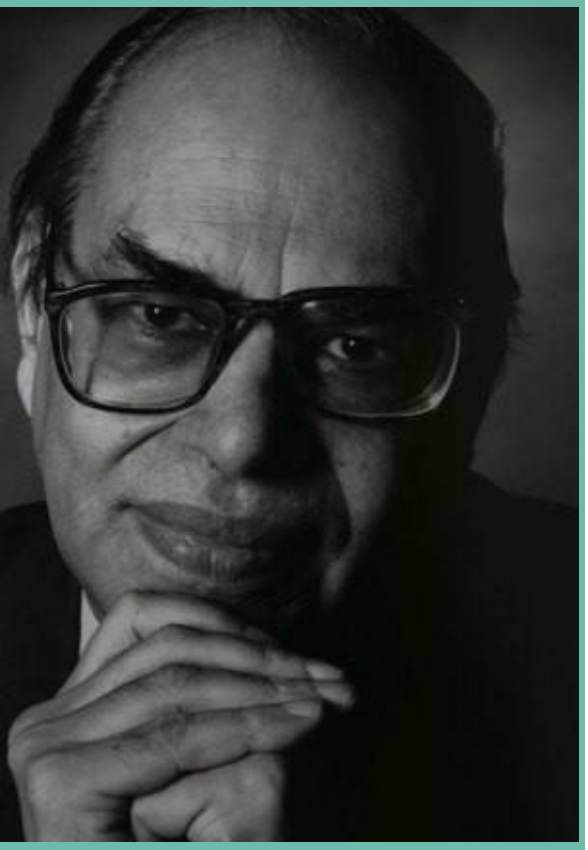
While Pakistan enters a deadlier phase of the incidence of Covid-19, officials are combing the economy for any signs of the revival of growth. There is growth in large scale manufacturing, exports and inputs of the construction sector. Private sector demand for credit has also risen. With all this activity in the negative territory last year, there could only be some positive improvement, i.e., the so-called base effect. With the IMF programme stalled due to Covid-19 emergency, there was a scramble for fiscal concessions, export rebates and refunds, tax amnesty for the construction sector, cheaper energy and credit incentives entailing an unprecedented liquidity backstop. With the likely resumption of the IMF programme, this joyride will come to an end. Agriculture, a handy cushion in such situations, was not in this train anyway. Outlook for cotton is quite bleak. Regardless, the State Bank's Annual Report published in November projects growth in the range of 1.5 – 2.5 per cent in the current year against minus 0.4 per cent in the previous year. The upper limit is above the Planning Commission's projection of 2.1 per cent and way above the donors' projections ranging between 0.5 – 1.0 per cent. After a long time, the usually optimistic Planning Commission and the conventionally pessimistic medium term budgetary framework of the Ministry of Finance projected the same outlook for growth. The mainstay of these projections was agricultural growth, while the State Bank's projection relies on services and revival of manufacturing.

These glaring contradictions betray the absence of a thoroughly considered framework for sustained economic growth over the long run. The analyses presented in the preset issue of the PIDE P&R point poignantly in this direction.


Poverty
Energy Crisis
Infra Structure
unemployment
Covid 19 crisis
Debt

Mahbub ul Haq: Pakistan's Growth Pioneer

Pervez Tahir



Pakistan's Second Five Year Plan 1960-65 was acclaimed the world over as a great growth story. The man behind it was Mahbub ul Haq. With impeccable academic credentials – GC, Lahore, Cambridge, Yale and Harvard – Dr Haq quickly rose to be the Chief Economist at the Planning Commission in the 1960s. In his first published book, he famously advanced a functional justification for inequality for take-off into high growth. “The road to eventual equalities may inevitably lie through initial inequalities. The time for a Keynesian type somersault is not just yet.” In making the case for a relentless pursuit of growth, he was supported by the Harvard Advisory Group (HAG) led by Gustav Papanek, who opined: “There is no obvious reason why Pakistan's growth should not continue to accelerate.” History recorded otherwise. Mahbub ul Haq was the first to admit the weak foundations of growth: “[I]n 1968, while the international world was still applauding Pakistan as a model of development, the system exploded not only for political reasons but for economic unrest.” The road ahead was clear to him, as he went on to pioneer the concept of human development. This writer cannot but repeat what he wrote in 2001: “There is no doubt that Mahbub was Pakistan's greatest and most innovative development policy thinker and the power of his ideas inevitably forms the major part of the intellectual subconscious of planners and economists here and elsewhere in the developing world... there is always this unacknowledged debt, as in the case of a very famous speech by Mrs. Indira Gandhi on Gharibi Hattao.”

Mahbub ul Haq moved on, as all great intellectual minds do, but our planners and policy makers have not. They are still following the growth framework of the 1960s, with some add-ons from the latest development fashions. The result is that there is neither growth, nor human development. Thinking for reform is left to the donors, while the relics of Papanek's “Gentlemen at Work” pick and choose monuments to development that their political masters can use to rally voters around.

COVER STORY

Economic Growth of Pakistan: Arbitrary Policies in the Past and a Bumpy Road Ahead

Abdul Jalil

Once Benjamin Franklin said, “Without continual growth and progress, such words as improvement, achievement, and success have no meaning”. The same is true in the case of economies. Economic growth expands the size of the economy and the living standard of a country's typical citizen. Generally, the word 'economic growth' is associated with growth in the gross domestic product (GDP), and the GDP is the market value of goods and services produced in a country. Therefore, it gives an opportunity to produce, consume and exchange more goods and services. The economic growth further leads to more job creations, industrial diversification, the retentions and expansions of businesses, the fortification of the economy, increased tax revenues, and improved quality of life of human beings. That's why economic growth is one of the most important indicators of the countries improvements.

In this backdrop, it is very safe to claim that economic growth is a delicate process and a subject of the utmost importance for politicians, policymakers, and economists. Notably, the economists had undertaken extensive historical and analytical research over the last two centuries (See Box 1). However, the interest in economic growth was renewed with new vigor after the Second World War. Almost all of the countries narrated their economic growth experiences through the literature produced in several books, scientific articles, and special reports of the recognized institutions. However, despite the availability of superior historical and statistical material combined with a sophisticated theoretical framework, new research contributions had been small, keeping the subject's importance in view. Moses Abramovitz, an economist who is well known for his research on macroeconomic fluctuations and economic growth, documents that this is mainly due to the complexity of the subject and the limitations of economics and other social sciences1.

Pakistan is not a different case. Like the Framework of Economic Growth, several essential documents suggest the roadmap for the economic growth of Pakistan. On the contrary, the growth path of Pakistan is shaky and moderate over the last four decades. The overall trend in economic growth is down due to several reasons. The graph shows that economic growth and total factor productivity are downward (see graph 1A). Within this context, this issue of the magazine attempts to present macro and sectoral perspectives on economic growth in Pakistan. The most important question that will be addressed is why the economic growth and total factor productivity of Pakistan are continuously declining over the past several years. These perspectives are based on the research, which is published under the patronage of the Pakistan Institute of Development Economics (PIDE). The main objectives of these viewpoints are to present narratives of what happened to the economy of Pakistan in the past, what were some of the possible the factors that restrained the economy from moving to a path of sustainable growth, how significant were various sectoral policies for the promotion of growth and what are the lessons to be learned for future policy?

Box 1: Old and New Growth Theories

Among the earliest exponents of economic growth, David Hume found a connection between the volume of international trade i.e., sum of exports plus imports and economic growth. The question of why the pace of growth differs between countries was first dealt by Adam Smith who took Hume's insight further and linked the division of labour, efficiency and the size of the market to wealth creation and growth of nations. Smith emphasized both direct and indirect connections between saving and investment and growth, former via accumulation of capital and letter through labour productivity and interaction with trade and exchange rate.

Later classical economists including Malthus, Ricardo, Mill and Marx expanded Smith's ideas on growth. However, Alfred Marshall added organization as the fourth factor of production and also emphasized the importance of distribution of income and wealth in the growth process. Joseph Schumpeter emphasized the importance of technology, invention, innovation and entrepreneurship. Harrod and Domar enunciated the dynamic relationship of economic growth with the rate of saving, capital output ratio and the rate of depreciation in a single equation.

The neo-classical growth model formulated by Solow (1956) differed significantly with earlier stance of the classical economists on the economic growth. Solow (1956) notes that the long run steady state of economic growth is determined by the growth rate of labour and the growth rate of the labour productivity. Solow (1956) also postulates that the rate of growth is independent of ratio of saving and investment to GDP. Solow (1957) estimated this residual for the US economy to be 87.5 percent of the growth in output per worker during 1909-1949. Consequently, factor accumulation explained only a minor part of growth, whereas the major chunk of growth was explained by the residual, which was labeled as total factor productivity.

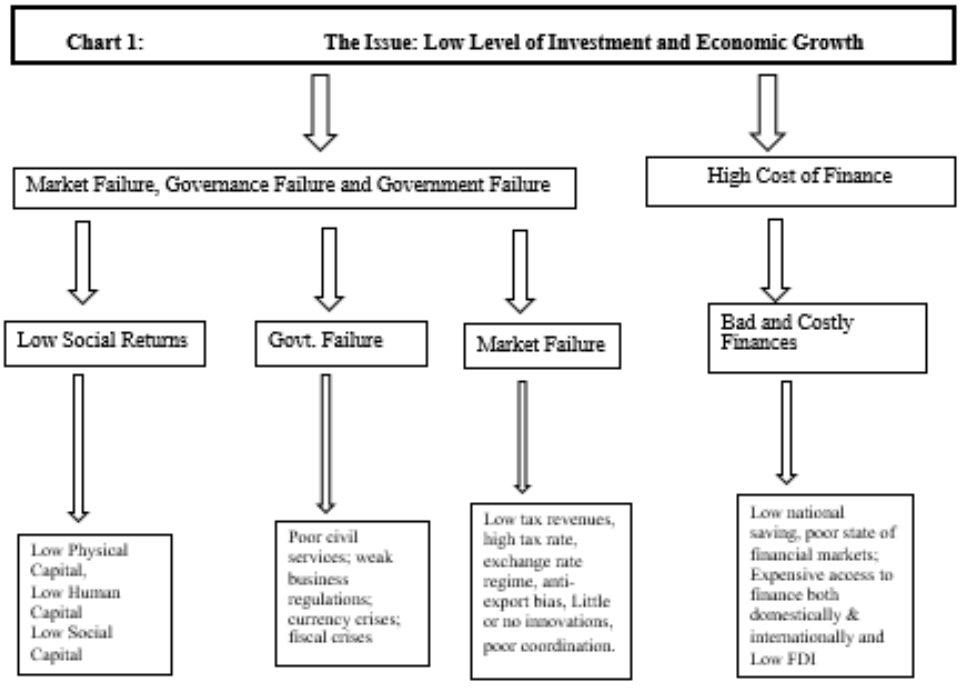
The “new growth” or the “endogenous growth” theories bring “factor productivity” inside the neoclassical model of growth along with “factor accumulation”, i.e., residual is endogenised. Romer (1986) first formalized this approach in a model in which per capita income can grow without bound, possibly at a rate that is increasing over time. Proponents of endogenous growth theory emphasize that unlike physical capital, human capital may be augmented by non-diminishing return, which leads the growth to continue indefinitely. Technological progress, rather than being exogenous, occurs with purposeful economic activity when entrepreneurs seek ways to make new and better products and generate new ideas. Economics of new ideas, or innovation have a positive externality that help raise the productivity of all subsequent innovators.

Indeed, despite the available potential, sustainable high economic growth remains a real challenge for Pakistan. The past decades have been seen as a declining trend in actual and potential long-run growth path in Pakistan despite a few growth accelerations. The more worrisome is, the potential growth has been a decline from 7 percent to around 4 percent (see Table 1 and Figure 1A).

The growth performance of Real GDP is summarized in a frequency distribution of growth rates over the past 70 years in Table 1. One is immediately struck by the high modal growth rate between 6 and 7 percent per annum achieved in 12 out of 70 years. The Table is evidence of the poor performance of Pakistan on the front of growth. It is well understood that Pakistan requires at least a 7 percent to 8 percent growth rate for a considerably long period, say for 30 years (Haque 2020). Nevertheless, unfortunately, Pakistan crosses only a 7 percent growth rate, only 10 out of 70 years. Sadly, none of them happened in the last 25 years. Some economists, especially in the corridors of the powers, argue that in 60 out of 70 years, the rate of growth remained considerably higher than the rate of growth of population; therefore, the growth performance is satisfactory in the case of Pakistan.

Sadly, the central focus of the growth policy in Pakistan was the public sector projects, subsidies, protection to industry, and other arbitrary incentives (see Box 2). The literature on economic growth and economic development post that the development is not the name of a few projects, but it is an integrated process that prevails over a more extended period. Therefore, the natural outcome of these random acts that the vibrant and robust markets never developed in the country. Furthermore, the infrastructure remains poor and inadequate.

It is well settled in the policy discussion that one of the major causes of the low economic growth is the lack of private investment in the case of Pakistan. If we consider that this is an issue, then Haque (2020) posts that there are two major constraints to the low level of private investment and then the economic growth.First, market development and second public sector management (See Chart 1).



The second major constrain to economic growth that Haque (2020) points out is the lack or inefficient public sector management. The inefficiencies can be witnessed in almost all core functions of the government. That is the core governance responsibilities like providing the security of property, contracts, transactions, and, most importantly, life. The government is also failed to provide the appropriate physical, human, and social capital, which is the core of economicgrowth.

The other meaningful discussion is related to finances. There is well-established literature that finances causes growth. Therefore, the availability and access to finance are some of the essential elements in the way of economic growth. In the case of Pakistan, the costly and mere access to finance is a common issue. The issue of access to finance is due to several reasons including, but not limited to, low national saving, the poor state of financial markets (see Shahid and Fraz 2020), expensive access to finance both domestically & internationally, and low foreign direct investment. The story of lack of finances ends with an approach to international institutions for the finances like the International monetary fund (IMF). Notably, the literature has a lack of consensus on the role of the IMF for economic growth (Box 3), and Pakistan approached several times to the IMF for the finances [Box 4].

BOX 3

IMF and Economic Growth: Studies Around the World

The IMF has a stance on the economic growth. Particularly, the Articles of Agreement state that the mission of the IMF is to "facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy."

However, the literature has a lack of consensus of the role of IMF in promoting the economic growth. For example, Reichmann and Stillson (1978), Connors (1979), Pastor (1987), and Gylfason (1987) reported no effect. While, Conway (1994) and Killick (1995), Dicks-Mireaux et al (2000), Evrensel (2002), Hutchison (2004), and Atoyan and Conway, (2006) found positive and mixed effects, Haque and Khan (1998) found mixed effect. On the other hand, Bordo and Schwartz (2000), Przeworski and Vreeland (2000), Hardoy (2003), Hutchison (2003, 2004), Hutchison and Noy (2003), Vreeland (2003), IEO (2002), Barro and Lee (2005), Butkiewicz and Yanikkaya (2005), Dreher (2006), Eichengreen eat al. (2008) and Marchesi and Sirtori (2011) argued that while growth declines in the first year of a program, the negative effects diminish after that. A useful recent systematic and useful review is done by Bal Gunduz et al. (2013) and Bird and Rowlands (2017)

There are several other reasons for low or costly access to finance, but the tax system and the developments of financial markets are the most important on the domestic front. The tax system and the tax collections are the long-debated issues in Pakistan. The tax to GDP ratio is consistently low according to the requirements of the IMF and, therefore, tax collection remains the central discussion point in the IMF-Led stabilization programs. It is argued that the low saving is due to low tax revenues and the high current (non-development) expenditures. The significant chunk of the expenditures is going to finance the salaries, subsidies, securities concerns, and other contingencies. All these things are crowding out public expenditures. It is also important to mention that the existing tax system is also deteriorating economic activities. Therefore, Nasir et al. (2020) document, Pakistan chasing the tax to GDP targets in arbitrary manners. Furthermore, the study of Nasir et al. (2020) also argues that the arbitrary tax policy is killing the transactions. Indeed, the low number of transactions implies that the low level of economic growth in the country.
The role of financial markets to get comfortable and less expensive access to finance is not appropriate in the case of Pakistan. Particularly, Mahmood, and Fraz (2020) argue that the state of financial markets in Pakistan should be of grave concern to the policymaker. Indeed, the financial sector of Pakistan is driven by the banking sector. Even the banks are not doing the 'banking.' The policy viewpoint of Mahmood and Fraz (2020) posts that out of the 33 banks, only 3 are investment banks, but they hardly issue anything. This serves as an indication of the lack of depth and maturity of the financial markets in Pakistan because leading investment banks have an essential role to perform in the economy.

What previous Literature Diagnosis for Pakistan?

A plethora of empirical research is produced to discover the reasons for the low growth of Pakistan's economy. As mentioned earlier, Pakistan's economic growth constraints are widely discussed in the literature over the last three decades. The most prominent constraints were a low investment in human capital (Ahmed 1991 and Fardoust 1998), inadequate investment in infrastructure (Fardoust 1998 and Burki 2007), weak institutions (Fardoust 1998), poor macroeconomic management (Fardoust 1998), political instability (Husain 2004), lousy governance (Husain 2004, Burki 2007 and Qayyum et al. 2008), and institutional shortcomings (Husain 2004); macroeconomic instability (World Bank 2006); trade imbalances due to trade protectionism (World bank 2006); budget deficit (Iqbal and Zahid 1998), low productivity in agriculture (Lopez-Calix and Touqeer 2013); inadequate investment in energy infrastructure investment (Qayyum et al. 2008 and Favaro and Koehler-Geib (2009), law and order (Favaro and Koehler-Geib (2009), tax collections (Favaro and Koehler-Geib (2009), Nasir et al. (2020) and balance of payments issue (Felipe et al. 2009) and Inadequate market development (Haque 2020).
All these overall results, spread over two decades, are taken into account in this paper. Two important studies attempt to diagnose the constraint to the economic growth of Pakistan. First, Qayyum et al. (2008) and second (Lopez-Calix and Touqeer 2013). Both of them follow Hausmann et al. (2005) methodology to systematically diagnose the constraint to economic growth in Pakistan's case. Lopez-Calix and Touqeer (2013) document that the significant issue with Pakistan's economy is the low level of investments. The low level of investment is fueled by low return on and then the economic activities. Sand the costly access to finance. Haque (2020) notes that Pakistan never learned from history in policymaking but merely repeating the old mistakes.

Regional Comparisons on Economic growth, Saving, and Investment

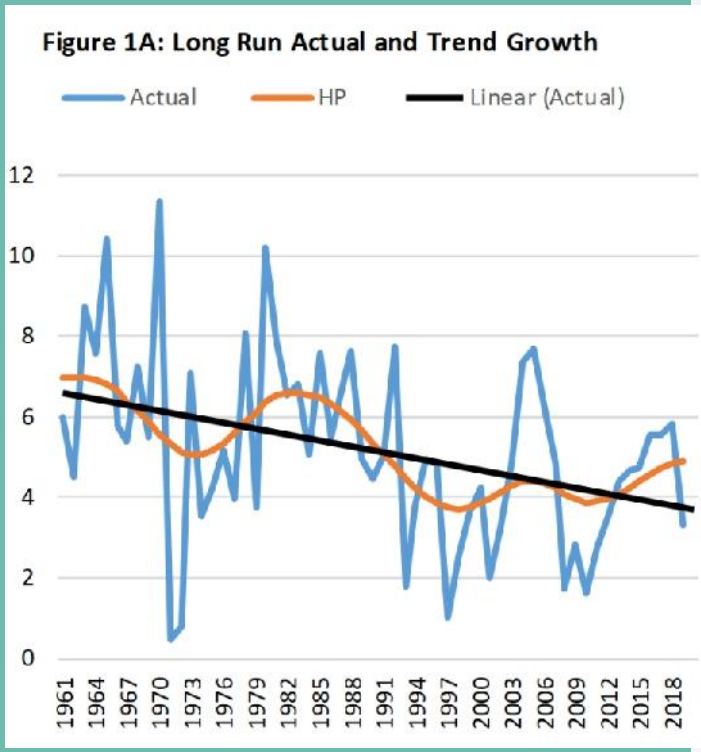
The most important factor for the production and then the economic growth is an investment, and the savings fuel the investment. It is also a well-known fact that the increasing global challenges and competitions also requires the catchup with, at least, regional competitors. Sadly, the economic growth of Pakistan is diverging from its main competitors. We plot the income ration in figure 1B (see Box 5). The per-capita income of Pakistan was almost double in the early 1990s as compared to China, Pakistan, and Bangladesh. That is, Pakistan was much more productive than the neighboring countries in the 1980s and 1990s. Since then, it is continuously decreasing. This development shows a continuous diverging pattern. This policy brief offers a diagnostic of structural issues of lowering economic growth and then the possible policy interventions in the case of Pakistan (See Figure 1Aand Figure 1B)

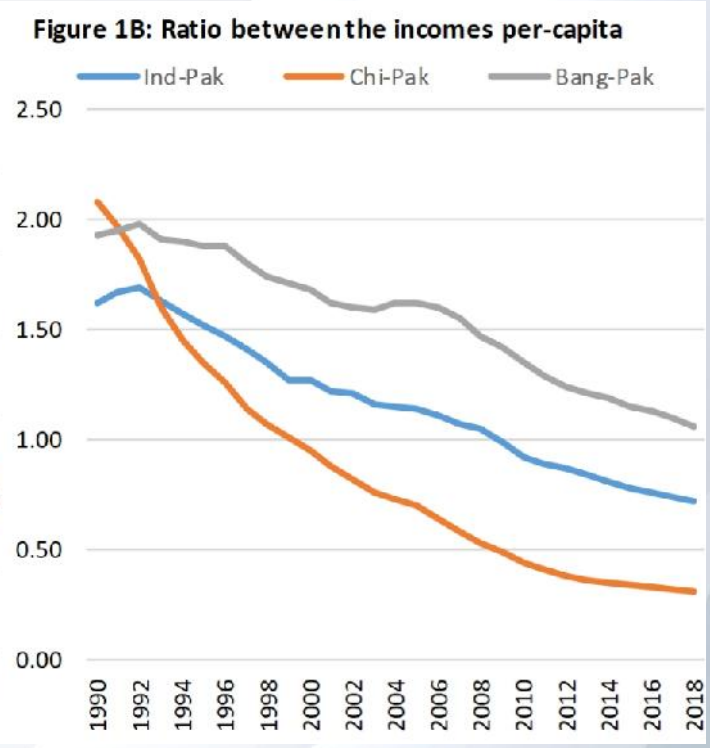
Box 5: Income Ratios (IR)

This ratio is calculated to analyse the relative per capita incomes of Pakistan to its competitor counties. *comppakyyIR*=That is:
Where ir= income ratio
ypak= per capita income of Pakistan at Purchasing Power Parity constant 2017 international dollars

ycomp= per capita income of competitor country at Purchasing Power Parity constant 2017 international dollars

There are three possible values.
1= the per capital income of both countries are same
>1= per capita income of Pakistan is greater than the competitor
<1+ per capital income of Pakistan is less than the competitor country.
A falling ratio implies that the per capita income of Pakistan is decreasing as compare to the competitor country.

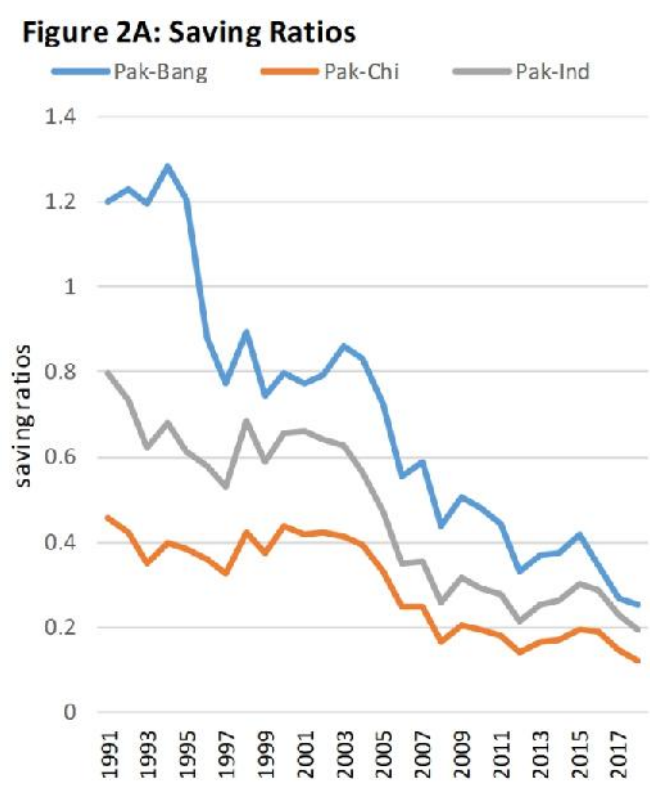


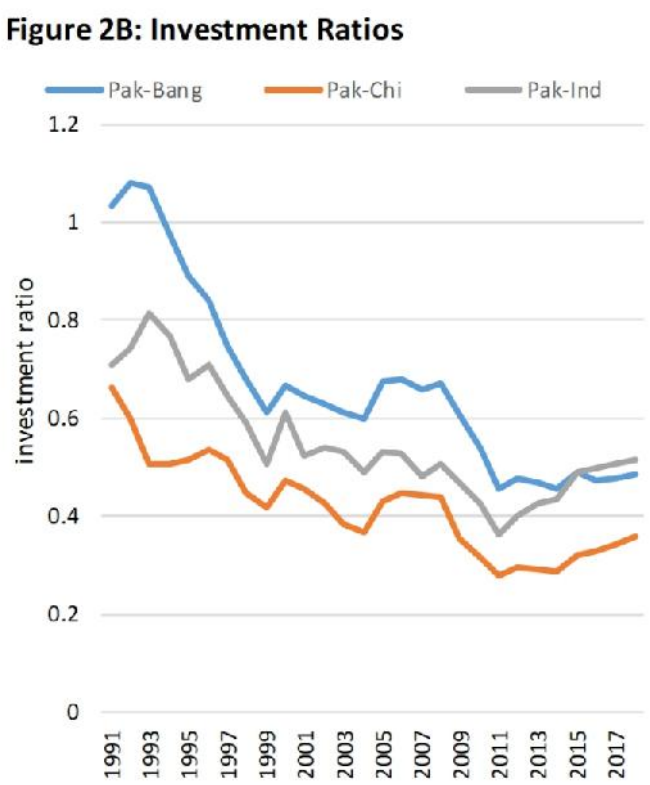


Saving and Investment

The neo-classical economic growth models and endogenous growth models have a consensus that the saving, which are assumed to be the source of an increase in investment and then economic growth, are vital for economic growth (see Klenow and Rodriquez-Clare 1997 and Howitt 2000). Unfortunately, both saving and investment are low and declining, as compared to neighboring countries, in the case of Pakistan.

The saving ratio and investment ratio [see box 1] in Figures 2A and 2B show that the saving and investment as a percent of GDP declined in Pakistan as compared to Bangladesh, India, and China over the last three decades. Interestingly, saving to GDP ratio of Pakistan was equal to the saving to GDP ratio of Bangladesh in the early 1990s, and now it dropped to 30 percent of Bangladesh. The same is true in the case of China and India. Similarly, the investment to GDP ratio is also continuously declining as compared to selected neighboring countries.





Conclusions and Further Readings

The discussion on the economic growth of Pakistan and the growth strategy remains the top agenda in PIDE. Therefore, PIDE published/suggest several pieces for the policymakers to pave the path of economic growth in Pakistan. Recently, Haque (2020) suggest some workable solutions for sustainable economic growth in the country. These may be total factor productivity (TFP) (Siddique 2020), better government (Haque 2020 and Hassan 2006), better governance (Haque 2020 and Qayyum et al.), more trade openness (Khan and Qayyum 2007), vibrant and robust competitive markets, smart and creative cities [Nayab (2007), (Haque and Nayab (2007a, 2007b)], and mobilizing the youth are the few engines of economic growth in the country. There are several other questions are as well. This issue of the magazine will give more details on the issues and solutions regarding the economic growth of Pakistan

Haque Survey on Role of Taxation in Economic Growth

Design a tax compliance system that will not discourage taxpayers from participating.
More important than the level of taxation is how revenue is used.

February 03, 2020

Nadeem Haque @nadeemhaque · Feb 3
To get growth and employment to accelerate, government must abandon the policy of arbitrary taxation and random documentation. Tax and documentation will follow development. Do u agree

Yes	**70.6%**
No	29.4%

235 votes · Final results

February 02, 2020

Nadeem Haque @nadeemhaque · Feb 2
What do you think is the bigger problem

Low tax GDP ratio	37%
Large wasteful government	**63%**

386 votes · Final results

July 09, 2020

Nadeem Haque @nadeemhaque · Jul 9
Pakistani Economists believe that taxation is the path to growth. Do you agree.

No taxes=waste	37.3%
Yes taxes=benefits	**62.7%**

426 votes · Final results

Did South Korea Copy-paste Pakistan's Growth Model?

Pervez Tahir

Among the many myths that we in Pakistan have lived with, there is one that simply refuses to die. Some economists and quite a number of politicians tell the believing listeners that Pakistan in the 1960s was recognized internationally as a model of high growth. So far, so good. My South Korean colleague from the doctoral days at Cambridge, Ha-Joon Chang finds it "Totally plausible. Pakistan was the golden boy of the World Bank… in the 1960s." Then the myth makers go on to claim that South Koreans copied Pakistan's growth model and persisted with it to achieve what came to be known as the Korean miracle. Pakistan departed from the model and her economy got derailed. Of the Korean adoption, there is no documentary evidence. Ha-Joon smiled when I narrated the story, saying that the "evidence is anecdotal."

There are many versions of the story. One is that Mahbub ul Haq gave a visiting delegation of planners from South Korea a copy of the Second Five year Plan. I have spent over three decades working in the Planning Commission. Despite some serious search, I did not find any record of this visit. Mahbub ul Haq himself never talked about it, nor even hinted at it in any of his long list of writings. There is some evidence that a few Korean bureaucrats were sponsored by the World Bank for training at a civil service training facility. This could hardly be termed as a source of transmission of economic knowledge.

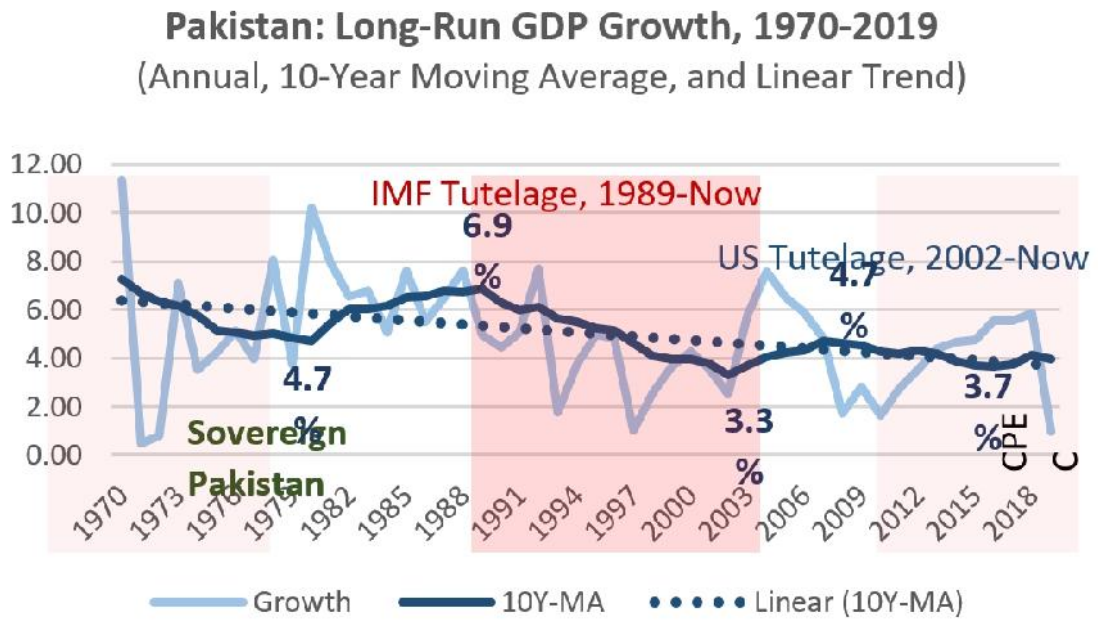
Mr Sartaj Aziz, who was in the Planning Commission in the 1960s, recalls that the delegation was from Korea Development Institute (KDI). The members of the delegation were given the documents prepared for the Aid to Pakistan Consortium, as the World Bank found them to be a good guide to other countries. Professor Jwa Sung Hee of KDI, while visiting Planning Commission in 2013, is reported to have talked about technical assistance from Pakistan in the 1960s. This is a newspaper report claiming too much. The long list of the writings of the learned professor contains nothing to the effect. Another report attributes replication of Pakistani plans to an address by a Korean diplomat to Pakistani businessmen. This was before Pakistan gave diplomatic recognition to South Korea. Again, it was no more than positioning for full diplomatic recognition.

The fact is that the two growth models were essentially different. Pakistan had focused on state-directed import substituting industrialization in view of a large consumption base. South Korea, then a small economy, eyed world consumption, with the state catalyzing competitive private sector export industries. That South Korea followed our plans and prospered and Pakistan lost the way and paid dearly for it is a myth that must die now. South Korea followed its own path and is now a member of the OECD, the club of the rich. Pakistan never departed from the HAG-Haq model and continues to be a sitting member of the club of the poor.

PIDE Interviews Arshad Zaman, Former Chief Economist, Government of Pakistan

PIDE: Pakistan's long-run growth rate has been declining for the last 3-4 decades. With your experience in planning, what in your view is the story here?

Arshad Zaman (AZ): It is true that as a linear trend Pakistan's long-run growth rate (the trailing 10-year moving average of annual rates of GDP growth) has been declining for several decades.



Source of data: World Bank, *World Development Indicators*, Online.

A closer look, however, shows three distinct phases in this decline: (1) accelerated growth (from 4.7% in 1980 to 6.9% in 1989; average: 6.2%); (2) precipitous decline (from 6.9% in 1989 to 3.3% in 2002; average: 5.0%); and (3) fluctuating low-level growth (between 3.7% and 4.7%; average: 4.1%), from 2002 to 2019. In short, after 10 years of average annual growth of 6.2%, the long-run growth rate fell by 3.6% points (from peak to trough) over 14 years, after which it has fluctuated at around 4.1%, for the last 18 years (counting 1989 and 2002 with both the preceding and the next period).

The story here, therefore, is not of 3-4 decades of decline. Instead, it relates mainly to the 14 years of what might be called "the long IMF-90s" (1989-2002), when long-run growth fell precipitously, with the implementation of neoliberal economic policies, under IMF tutelage. This was attended by the rise of crony capitalism, grand and petty corruption (including transnational bribery and kickbacks), capital flight, and deterioration in economic management capacity and a breakdown of social morals, law, and order, from which it hasn't recovered in 18 years.

Neoliberalism is an amorphous group of theories and practices. Nonetheless, it has a core ideology and policy component. In ideology, it advocates minimal government: relying on markets, and firmly opposing all government planning and regulation. In economics, it advocates liberalisation and monetarism: opening the economy to foreign imports and capital (globalisation) and liberalising domestic financial markets; and shifting the target of economic policy to controlling inflation by monetary and exchange rate policy, rather than promoting output growth, employment and equitable income distribution by fiscal measures. The last implies that the locus of economic management shift away from the ministries of planning and finance to a technocratic imperial central bank, "independent" from national political influence. This is what was implemented in Pakistan during the late 1980s and the IMF-90s, with disastrous results that were visible throughout the 14-year path downwards. The stubborn failure to correct course was a triumph of religious faith over growing adversity.

Without dwelling on the details, the key lesson of the last 50 years of our experience, in my view, is quite simple: sovereign states—who make their own decisions—grow and develop faster than what might be called subaltern ones, who outsource economic thinking and governance to foreigners. Ironically, the fact that the IMF programme would fail to achieve its objectives was clear enough to both government economists and the IMF Board and staff, when the government was induced to enter into the IMF agreement (signed on the last day of an outgoing government).

It isn't that sovereign alternatives weren't available. The agreement with the IMF scuttled a far superior and potentially more effective course of action outlined for the Eighth Five-Year Plan (1993-98), that was under preparation, which proposed to build on the high-growth path achieved in the previous decade. It addressed the social problems arising from "the existence of two parallel systems of education" and the problems of quality and lack of community participation in educational decision-making. It made "good governance" the centrepiece of its approach, proposing reforms in public administration (decentralisation, deregulation, and reforms in public service) and in local government, and in rural democratisation. It first introduced the term "governance" in public discourse in Pakistan, when the World Bank and the IMF weren't familiar with it (and they opposed it, as being contrary to their emphasis on the market). It proposed affirmative action for women, promotion of social justice, and popular well-being. Above all, it was evolved through two years of consultations and compromises within federal and provincial governments and civil society, involving literally thousands of people, and thus possessed the holy grail of "ownership" ostensibly sought by these institutions. Its fatal flaw was that it was ahead of IMF/WB thinking at the time, and a government short of confidence and money chose to go with its financiers.

In a retrospective review, the IMF, dogmatic in its neoliberal faith, found the superior performance of our sovereign years a "puzzle", and failed to attribute the subsequent fall in growth and the rise in the fiscal and external deficit, and eventually unsustainable debt, to the programme it forced upon the government, indirectly blaming its victim instead:

> "From 1970 to the late 1980s, Pakistan enjoyed an impressive growth performance (6–7 percent a year on average). Fiscal and external imbalances were large during most of that period, but unlike in many other developing countries, they did not lead to hyperinflation or to a debt crisis, which led Pakistan to be sometimes referred to as a "development puzzle." However, the picture deteriorated markedly from the late 1980s onward, as growth faltered and the continued failure to rein in the fiscal and current account deficits led the debt—which had been accumulating for over two decades—to become unsustainable. Pakistan made an intensive use of IMF resources during both periods [1970-1988 and 1988-2002], but became continuously dependent upon IMF-supported programs only in the second one."

There is, in fact, no puzzle: neoliberalism failed in Pakistan. When leadership and management was in our own hands, we pursued pragmatic strategies and policies based on ground realities, free of dogma, and did quite well. The surrender of economic sovereignty to the IMF led to persistence in the pursuit of neo-liberal dogma, despite accumulating evidence that it wasn't working. This resulted in multiple-system failure, which caused the secular decline in long-term growth, from which we have yet to recover some two decades later.

I estimate the cost of neoliberalism to Pakistan—the loss in GDP from 1990 to 2020, due to the slowdown in long-run growth during the long IMF-90s—at US$ 75.6 billion (at 2020 prices; current values capitalised by the US discount rate on January 1 of each year). This is roughly two-thirds of Pakistan's total external debt and liabilities as of end June 2020, of $112.8 billion.

PIDE: Amidst the pandemic, the global economy has come to a halt, and every aspect of human life has been affected. How do we even start reviving growth?

AZ: How, indeed! To begin with, let me separate the main question—how to revive growth—from what I fear may be a distraction, its linkage with the Corona Virus 2019 (Covid-19) pandemic. Also, the fact that the treatment, prevention and containment aspects of the pandemic are not yet fully understood by medical scientists, makes its economic impact harder to assess.

In my judgment, the pandemic may be a confounding variable that will only complicate analysis and provide an excuse for the policy failures currently underway. While it constitutes a serious public health crisis that has impacted and will impact growth in the short-term, the binding constraint to reviving future long-term growth, in my view, remains the government's persistent inability to move away from neoliberal policies and resume control over its own policies, despite the documented damage done to the economy during the long IMF-90s—and being done today.

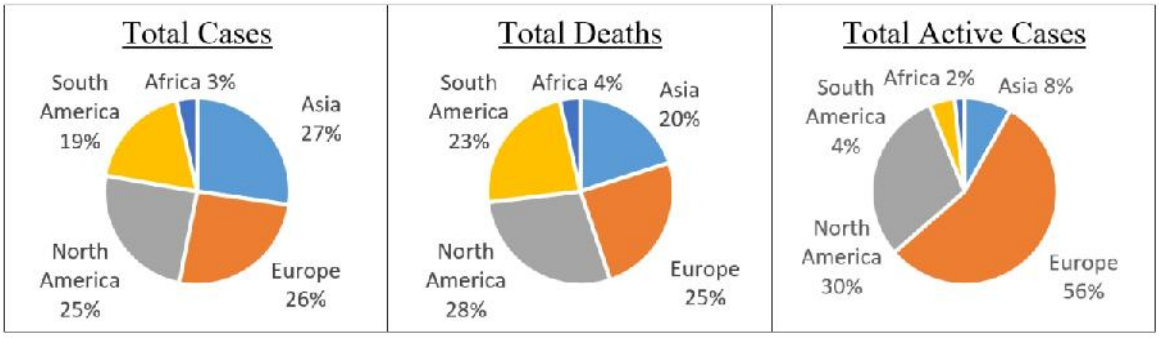
Due to the absence of quarterly or monthly estimates and the poor quality of the annual estimates of GDP, it is impossible to forecast future growth with any confidence. Still, the government's pre-budget estimates were for a fall in GDP growth in 2019-20 from 3.6% to 0.5%, and in investment from 14.0% to 13.8% of GDP. More recently, in October 2020, the IMF projected Pakistan's 2019-20 economic growth at negative 0.4%. For the future, the IMF forecasts a slow recovery in the next five years (growth rates, starting 2020-21, of 1%, 4%, 4.5%, 5%, and 5%). In November 2020, the State Bank reportedly forecasts a 2020-21 growth of 1.5-2.5%. The actual course, pace and shape of future recovery beyond 2020-21—especially, the distribution of its costs and benefits between the rich and the poor—remains to be seen.

To turn to the question of reviving growth, if and when a government that aspires to sovereignty takes office, the place to start would be to set aside the past and take stock of the situation at the time, assess the future outlook and opportunities, identify the constraints to action, formulate a strategic approach (not a static strategy), and proceed to implement an on-hands, properly sequenced, pragmatic strategy of balanced social and economic development—development, not just growth. To say more on reviving growth at this juncture would be pointless: nothing grows on saline ground.

On the pandemic, though, it is important to realise that Pakistan is a miniscule part of the global catastrophe—in terms of total cases and deaths, and currently active cases. Europe and the two Americas account for the overwhelming proportion of total and active cases and deaths. We must keep our eyes on our own situation, therefore, and avoid falling victim to vicarious fear and anxiety by an empathic response to the course of events and policy responses in the Americas and

Covid-19: Global Shares in Total Cases, Deaths, and Active Cases, as of November 17, 2020

(Pakistan's share of Asia: Cases 2.4%, Deaths 2.7%, and Active Cases 2.4%.)

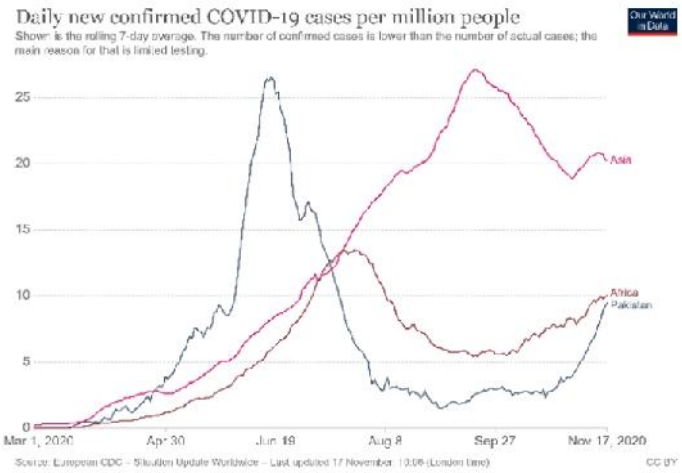


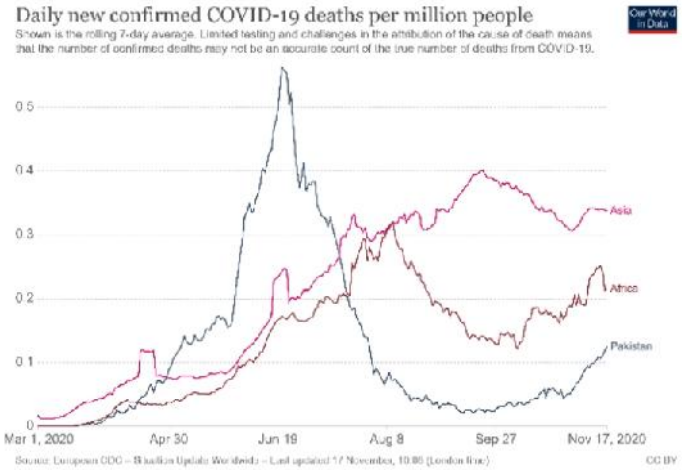
Note: Excluding Oceania (Cases 42,829, Deaths 1,002, Active Cases 8,908). Four countries (US, India, Brazil and France) account for over half the worldwide cases and deaths; the next six countries (Russia, Spain, UK, Argentina, Colombia and Italy) raise this share to around two-thirds.

Source of data: https://www.worldometers.info/coronavirus/#countries

Note: Excluding Oceania (Cases 42,829, Deaths 1,002, Active Cases 8,908). Four countries (US, India, Brazil and France) account for over half the worldwide cases and deaths; the next six countries (Russia, Spain, UK, Argentina, Colombia and Italy) raise this share to around two-thirds.

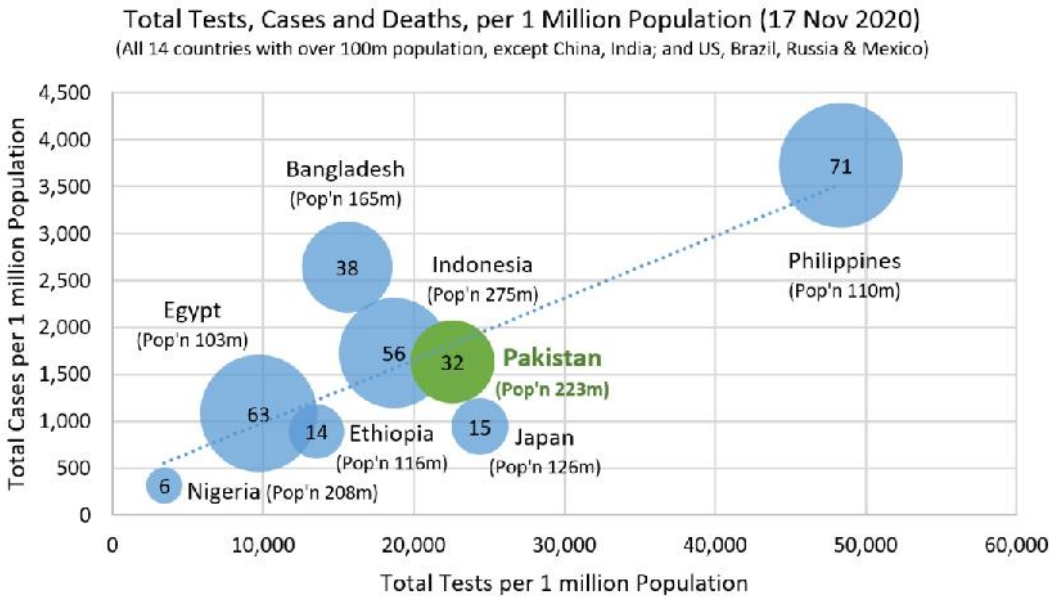
Source of data: https://www.worldometers.info/coronavirus/#countriesDespite our low shares, however, the total numbers of cases (368,665) and deaths (7,284) have been, and active cases (33, 839) today are, quite large and rising sharply, straining our health service capacities. Moreover, as this is written (20 November 2020) there has been a spike in new cases (+2,738, up from +2,298 two days ago) and in new deaths (+36, compared to +37 two days ago), that calls for renewed vigilance. This is especially true since in the summer (late April to mid-July) we failed to keep cases and deaths below Afro-Asian averages—which should be one of our prime policy target.Daily Cases and Deaths (per 1M population) in Pakistan, Asia and Africa, March 1 to





Source:
https://ourworldindata.org/coronavirus

Consequently, we should look at the progression of cases and death in Pakistan, in comparison to Africa and Asia (rather than Europe and the Americas, which are off the charts). The data suggest that the relevant comparator countries—in terms of population size, and key indices—for Pakistan are the seven large Afro-Asian countries shown in the chart below. Closer cooperation and sharing of experience among these countries may be helpful.



Notes: (1) Numbers in circles are Covid-19 deaths per 1M population. (2) China and India are excluded as outliers (both in terms of population and cases—cases in China too low, 60/1M, and in India too high, 6,434/1M). Four other countries, excluded due to much higher tests, cases and/or deaths (per 1M population) are: USA (517,544 tests, 35,255 cases and 766 deaths; Population 332m), Brazil (102,752, 27,737 and 782; Population 213m), Russia (476,510, 13,504 and 232; Population 146m), and Mexico (20,227, 7,811 and 765; Population 129m).
Source of data: https://www.worldometers.info/coronavirus/#countries.What this and other data show is that the number of confirmed cases is positively correlated with the numbers tested and is therefore a poor target for public policy. It is more important to look at the positivity rate—the share of tests that come out positive—both to see if we are testing enough (which we aren't) and to understand the spread of the virus. This rate stands at 6.2% in Pakistan today, down from 19.1% in mid-March, a sign of policy success. Nevertheless, it remains above the World Health Organisation target ceiling of 5%, but compares favourably with many of our comparators (Indonesia 14.8%, Bangladesh 12.2% and Ethiopia 8.7%; but not Philippines 5.9% or Japan 4.9%; no data for Egypt).
In sum, while serious in its health and short-term economic consequences, the pandemic is not likely to be the binding constraint to economic revival in the longer term, which is being held back by a number of other social and economic pre-existing conditions. Its most consequential short-term impact, however, is likely to be on distributional equity—on access of the poor to health facilities, the distribution of vaccines, and the sharing of gains and losses from the path of recovery chosen. In particular, the likelihood of malpractices by pharmaceutical companies to seize monopoly profits during the pandemic remains high.
If nothing else, the pandemic has exposed the poverty of the neoliberal policy outlook. Other than the few who advocated the path of herd immunity, no one in their right mind would argue today that the state should step aside and let the market handle the pandemic. Clearly, solutions lie in cooperation not competition. Also, since the impact on the global economy is distinct from that on national economies, the case for selective rather than dogmatic globalization is stronger today. Finally, the IMF itself has apostatised from the dogmas of austerity and rigid budget deficit targets. These insights should not be lost sight of in addressing other national goals.

PIDE: Demographics (a young population in need for a job) suggests that we require economic growth of 8% per annum over the next 30 years. Are there strategies to achieve and sustain such growth?

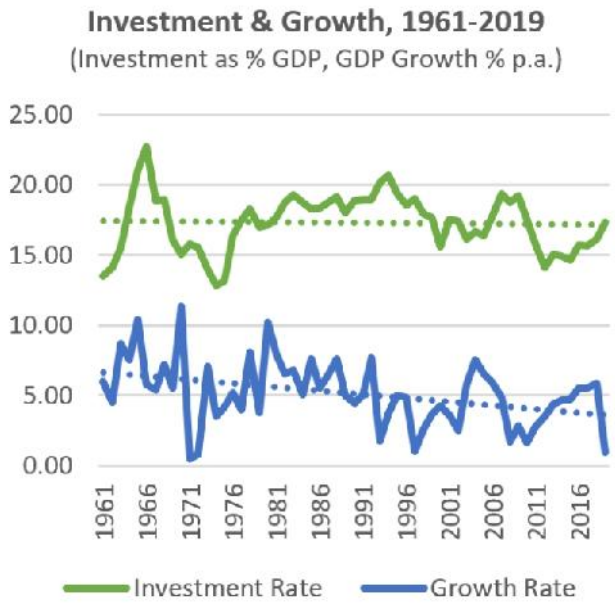
AZ:Yes, there are strategies but, again, there are no strategists. At present there are multiple bodies charged with formulating piecemeal strategies, but they are all actually engaged in managing tactical and logistical problems in their areas. In this vacuum, strategic national economic issues are settled indirectly as multilateral financial institutions led by the IMF supervise the implementation of a unified creditors' strategy—aimed only at keeping the government solvent and creditworthy (for further borrowing), so it can service its debt, without social unrest. Job creation doesn't feature in this framework; and inflation, not growth is its policy target.
Institutionally, there is no one concerned with achieving, say 'full-employment economic growth with price stability'. This neglect of employment (and real wages) in policy targets persists because the ruling class remains culturally, socially and politically alienated from the common people, in continuation of colonial traditions. Alienated rulers then are compelled to rely on foreign capital rather than domestic savings to finance themselves and their initiatives, leading among others to permanent fiscal and debt crises.
In this situation, a search for paths to 8% growth over the next 30 years is a purely academic exercise which leads to “agency-free” proposals that may shed some light on the problem but are of no practical guidance to a solution. That said, the need to create productive jobs for a growing youthful population—and an inclusive social safety net for those left behind—should be the highest priority of economic strategy and policy of any government—sovereign or servile. But the idea that GDP growth should be the main instrument—to some, the sole instrument—of job creation is theoretically and empirically unsound. What is needed instead is an integrated strategy for full-employment stable economic development, not just growth, like the one outlined for example in the Approach Paper for the Eighth Five-Year Plan (1993-98).

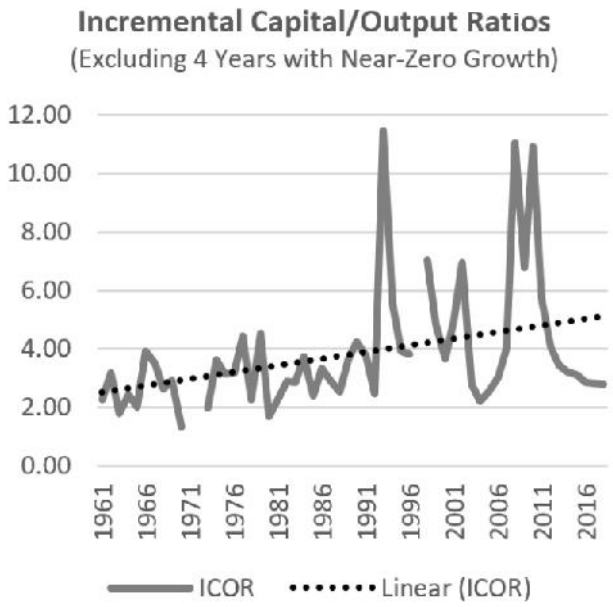
Briefly, in the area of employment, the Approach Paper had proposed a new set of categories of labour market segmentation: (1) a soft-jobs market; and (2) a hard-jobs market; the latter divided between (2.1.1) an urban formal, and (2.1.2) an urban informal sector, and (2.2.1) a rural farm, and (2.2.2) a rural non-farm sector. It had then proposed to look at the structure, conduct and performance of each of these segmented labour markets, and proposed differentiated interventions based on empirical evidence. It is this kind of innovative approach to employment policy that would be fruitful, even today. But, again, this would call for a restoration of planning and selective intervention in markets, and a move away from the neoliberal emphasis on money and finance (with neglect of output, employment and social policies) and on integration with the global economy and freedom for foreign capital. In short, it would call for sovereign development.

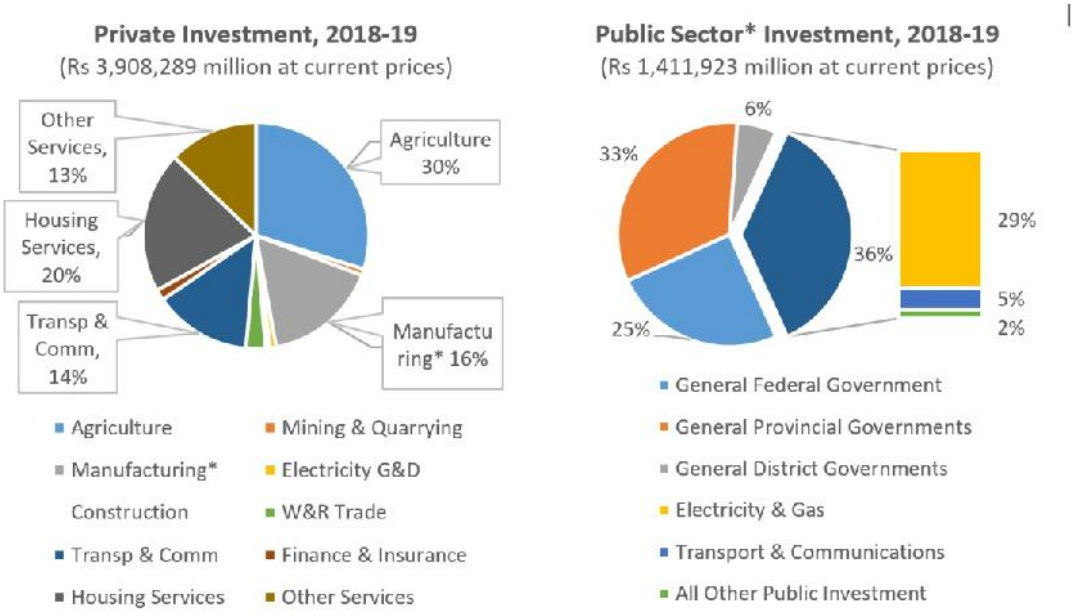
PIDE: Pakistan's investment has seldom gone to beyond 15% of GDP. Countries with sustained growth like China and India have sustained investment rates of more than 30% of GDP. Why is our investment rate so low, and what policies do you think are required to increase it to the desired level?

AZ: It is true that investment—and growth—rates in Pakistan have been lower than what we would like, but developing policy proposals to increase them requires three things: a clear theoretical perspective aligned with realities, a hard look at the data—for Pakistan, not for other countries being touted, and much pragmatic realism. Also, while convenient for policy-makers to think of investment as a key "driver" of growth, students of economics should be aware that this idea—derisively called "capital fundamentalism"—was never sound and was debunked over twenty-five years ago as theoretically simple-minded and empirically false.
Economic development—a wider concept than economic growth—is a historical process, in which numerous social, political and economic changes take place, of which a sustained rise in output per capita is only one inextricable phenomenon. From a theoretical perspective, therefore, it is sounder to think of and identify changes in a complex set of (instrumental) variables that lead to changes in another set of (target) variables, that include investment and growth.

This is just what the data for Pakistan—and elsewhere—show. Based, once again, on the World Bank's WDI data, the two charts below show rates of investment and growth, and the ratios between them (investment rate as a ratio of GDP growth, or the incremental capital/output ratio, or ICOR), over the last 49-48 years.







*Large-Scale is 93.2% of Manufacturing.

*Includes "General Government" (Rs 897,771 million)

Source of data: Federal Bureau of Statistics.

The bulk (64%) of public sector investment is capital expenditure by "general government" (federal, provincial and local) that contributes to value-added in public administration and defence. Of the remainder, "public" investment (36%), the overwhelming bulk (29%) consists of expenditure on fixed assets by autonomous and semi-autonomous bodies in the electricity and gas generation, and gas distribution sectors. The component of public investment that contributes to genuine growth, of non-service sectors, is miniscule, and public and private energy investments are bogged down under the twin burdens of structural irrationalities and grand corruption in old long-term contracts with sovereignly guaranteed, excessive returns that are burdening domestic industry and consumers. The suggestion, therefore, to review the PSDP is unexceptionable, but ways will have to be found to overcome resistance to changes from vested interests of lenders, provinces, federal agencies and state enterprises.

As for the private sector, misapplied neoliberalism during the long IMF-90s made a fetish of private investment, as a category, without attention to the nature, composition or quality of that investment. This was supported by propaganda masquerading as economics, which harmed policy-making. A good example, among others, was the Ease of Doing Business Index, which was so blatantly "manipulated to push neoliberal policies" that the World Bank, in the face of rising criticism, has now discontinued it. Policy-makers, increasingly professionals with a banking or corporate background since the 1990s, readily swallowed this propaganda. Naturally, the private sector made hay while the sun shined.

"The best way to achieve the goal of increased private sector participation," as the Approach Paper for the Eighth Plan had advised, "is not by baiting them with greater incentives and subsidies in protected niches but by reducing bureaucratic controls and interventions and replacing them by strategic and non-discretionary instruments of regulation." This advice is still relevant today. But, once again, the neoliberal stranglehold on our sovereign capacities allows no room for new ideas on investment promotion and industrial policy.

Clearly, investment and growth rates have not moved together in Pakistan. For instance, from 1980 to 1994, while investment as a ratio of GDP rose from 17.1% to 20.7%, the growth rate fell from 10.2% to 3.7%. Both before and after, the pattern has been erratic and when they do seem to move together it isn't clear whether investment precedes growth or growth, investment. The truth is that other, extraneous variables determine their joint movement.

Another way to look at the same data is to see whether the ratio of the investment rate to the growth rate (ICOR) has been stable. Again, the graph to the right shows that the ICOR has fluctuated widely, especially in the last two decades. The linear trend, for what it is worth, shows a steady rise (to over 4, in recent years: meaning, as an unsound but commonly used rule of thumb, that a 5% growth would be associated with—or, "would require"—a 20% investment rate). Obviously, the rising capital-intensity of investment and the increasing share of infrastructure in its composition is reflected in the data.

For the last four or five years, domestic investment has hovered around 14% of GDP, with the private sector, just over 10%, and the public sector, just under 4%. So, why have these rates been low and what can be done about it? This is an empirical question, on which I have only anecdotal evidence. I suspect, however, that private sector investment rates remain low because of extra-economic concerns about security of person and assets, about political stability and due to the lack of predictability of laws, government policies and the overall structure of investment incentives. As a result, the total risk-adjusted return (including normal commercial, and all other risks) on fixed investment is probably too low today in relation to the cost of capital, and alternative returns on short-term legal and extra-legal schemes in collusion with regulators are extremely high. On the other hand, public investment has been decimated and is constrained by ideological predispositions and a critical shortage of federal and provincial fiscal resources. Like much else, there are no purely economic solutions to the problem.

PIDE: Which sector should take the lead in achieving the desired investment level? Research at PIDE shows that Public Sector Development Programme (PSDP) needs to be seriously reviewed. Private sector has its own tales of business unfriendliness? Your thoughts.

AZ:The question of leading sectors—or in textbook terms, balanced vs. unbalanced growth—is relevant only for governments in a position to affect the sectoral composition of investment. In Pakistan, the government takes credit—and deflects blame—for growth that takes place, over which in reality it has very little direct control. During the long IMF-90s, public investment, regulation and control was rolled back to the point where the government has little to no ability to influence economic outcomes. Should a time come when a government has the confidence to be sovereign, unbalanced growth should be privileged, but leading sectors should be chosen as opportunities arise, as part of an overall strategy, and not on a doctrinaire basis.

For a closer look at where investment—private and public—is going, and why it isn't contributing to genuine growth, let us look at latest full-year data.

Obviously, this was and is a con job. There is no reason to believe that sustainable growth and investment can be engineered without undertaking the social and political changes required. Moreover, the initial conditions of Pakistan in the twenty-first century bear no resemblance to those of England in the nineteenth, so adaptive problem-solving rather than "isomorphic mimicry"—monkey-like imitation—would be required to go forward. Every economy has a natural rate of growth. Efforts to enhance this rate of growth, artificially, by recourse to foreign loans should be undertaken with extreme care if we are to rise from our present state of being a debt-colony to regaining economic sovereignty.

Box 4: IMF and Pakistan

Pakistan is one of the most frequent users of IMF resources. Unlike the regional competitors, it has been under IMF-supported programs almost continuously since the late 1980s (see table 2). Until now, Pakistan has approached 22 times to IMF for financial support since December 1958, that is, 22 programs in the last 62 years. It implies that there are some structural /fundamental issues in the economic growth model of Pakistan. Indeed, Pakistan was, in terms of income per capita, much richer than its neighboring countries, but unfortunately, the situation is opposite now. China is 500 times, India is 60 times, and Bangladesh is also more prosperous than Pakistan. Furthermore, these countries did not approach the IMF for the fund facilities for long.

Table 2: A Brief Summary of IMF Programs

	Pakistan	China	India	Bangladesh
No. of Program	22	02	07	10
Last Program	3-Jul-19	12-Nov-86	31-Oct-91	11-Apr-12
Total Amount (Thousand SDRs)	23,656,650	1,047,725	7,680,425	2,813,690
Ratios	1	22.58	3.08	8.41

The question of how much of the burden of this recovery should rest on the state's shoulders would depend on who emerges as the vanguard of this effort. Certainly, history demonstrates convincingly that rapid growth has occurred under both minimal and maximal roles of state and government—but I know of no case where a non-sovereign government has achieved sustainable long-term growth. Even where the role of government has been minimal, it has devised and enforced a system of laws and regulations ensuring competition in markets, and there has been a vibrant private sector willing to risk its own capital without (or with minimal) government support.

In Pakistan, today, there is neither a genuine private sector nor a sovereign government. Equally, competition is the exception rather than the rule in most markets, and oligopolies and monopolies abound. So, I don't believe that the size of the government's shoulders (or footprint), has any bearing on the rate of investment or growth that can be achieved. What matters is the quality of government, and of the private sector, rather than size. In the public sector, "The essential issue is to provide large enterprises with freedom from ministerial and bureaucratic control in setting their own prices, procuring their own materials, and awarding their own sub-contracts. The location of actual ownership is not of prime importance."

The question of the relative productivity of public and private enterprise is an empirical matter on which honest research is much needed. What evidence there is—some of the key papers were written at PIDE—finds no difference between the performance of public and private enterprise in the early IMF-90s. This is especially true if private financial profits are adjusted for distortions in domestic prices due to protection and subsidies. Evaluated at world prices, many financially profitable private industries would show negative value added. A study for the Asian.

Development Bank found that the performance of 78% of privatised enterprises remained the same (44%) or was worse (34%), while only 22% did better. For these and other reasons, I believe that there is room to enhance the productivity not only of government but also of the private sector in the economy. But this calls for more, not less government.

PIDE: Experience has also shown that the chief driver of growth is local investment. Here the policy preference seems to be for foreign investment. We give foreign investors tax breaks and many other advantages, while the locals are under suspicion on their source of funds, for tax evasion/avoidance and they have to seek all sorts of permissions and no objection certificates. How do we resolve this contradiction?

AZ:I see this less as a contradiction than as faulty theory and practice. The reliance on global rather than local capital is, of course, a key doctrine of neoliberalism. Also, as I have said, rather than seeing investment as driving growth, it is more fruitful to look at investment and growth as being jointly determined by other economic and extra-economic variables.
Experience shows conclusively that foreign direct investment (FDI) can accelerate the pace of growing local investment (or domestic fixed capital formation). But FDI has never been a source of igniting domestic investment. In this condition, efforts to attract FDI will always lead to demands from foreign investors for unreasonable sovereign guarantees. Where these guarantees can be secured by kickbacks and other corrupt practices, the foreign investor will be willing to pay for guarantees not only against political risk but also against normal commercial risk. By over-invoicing imported machinery and other shenanigans, the foreign investor will and does succeed in recouping his cash investment in months rather than years. This, as we know, is the story of independent power producers (IPPs) and some of the key projects dis-invested under the IMF-coerced privatisation programme. Finally, the beneficial ownership of foreign investment, routed usually through offshore companies, is seldom known, posing legitimate security risks.
So, yes, until we get domestic investment growing, we should not consider any special incentives to FDI. The only exception being projects involving technology transfer, to ensure which requires a vigilant government. In general, however, this kind of predatory foreign investment is best avoided.

PIDE: PIDE has estimated the state footprint (the amount of the regulatory space, land, and the government intervention in markets) is very large—as much as 70-80%. Can investment and growth happen without reducing the government footprint? Or, is there a way to make this footprint productive?

AZ:These are complex questions. They involve beliefs about the sources of investment and growth, the role of government and markets among these sources, the relative productivity of public and private enterprise, and the case for and against government regulation. Let us take each of them, in order.
Economic development is a historical process. In particular, it refers to the cultural, social, political and economic changes that occurred in England and Wales over the course of the long nineteenth century (1789-1914)—and similar changes later in some other countries. Until the birth of development economics—which bears the same relation to economics that astrology bears to astronomy—it was studied using historical methods. In the struggle between communism and capitalism during the Cold War (1947-91), an ideology was needed to combat the feared rise of socialism in the “third” world. This was the genesis of development economics which, for reasons of bureaucratic convenience, marketed economic development to governments as a mechanical process, in which loan-financed projects (and later, liberal policies) were sold as a magical potion to bring about the historical changes that had occurred in industrial England, and elsewhere.

We come, finally, to the case for and against government regulation. This is less a matter of economics than of political and economic philosophy. Let us review the case for deregulation, as set out in one of the holy books of neoliberalism (that Margaret Thatcher is said to have pulled out of her purse and slammed on the table during a meeting declaring, “this is what we believe”):
“The classical argument for freedom in economic affairs rests on the tacit postulate that the rule of law should govern policy in this as in all other spheres. We cannot understand the nature of the opposition of men like Adam Smith or John Stuart Mill to government 'intervention' unless we see it against this background. … Freedom of economic activity had meant freedom under the law, not the absence of all government action. The 'interference' or 'intervention' of government which those writers opposed as a matter of principle therefore meant only the infringement of that private sphere which the general rules of law were intended to protect. They did not mean that government should never concern itself with any economic matters. But they did mean that there were certain kinds of governmental measures which should be precluded on principle and which could not be justified on any grounds of expediency.”
In the UK (and the US), deregulation (and associated policies) met, arguably, with success largely because there was a vigilant legislature, enforceable laws, mechanisms for ensuring competition and inhibiting monopolistic behaviour in markets, public participation in legislation and governance, an independent judicial system to adjudicate disputes and curb legislative excesses, and a loyal and competent civil service. In Pakistan, it was precisely the absence of this infrastructure of governance that had led to the abuses that resulted in the breakup of Jinnah's Pakistan and to Bhutto's hugely popular socialism. While they weren't without faults, the structure of public control and regulation that had been put together during 1971-1988 in Bhutto's Pakistan—our Pakistan—was all that stood between the maintenance of good-enough governance and the rampant crony capitalism of the 1960s that had led to social and political disaster.
With the rollback of the state during the IMF-90s, a new crony capitalism, now combined with state capture, once again erupted with a vengeance. Accumulated economic and political grievances and the perceived short horizon of civil governments, led to grand corruption at an unimaginable scale. Having been burnt once, wealthy private businessmen and politicians transferred abroad the bulk of the capital they accumulated by fair or foul means, to forestall any future political or economic misfortune. The environment so created led to a pervasive and severe breakdown in social morals and public order.
So, yes, there is a way to make government intervention more efficacious. But until the rule of law (over all persons) is established, subjects become citizens, and together they are able to influence the acts of parliament passed, the next-best alternative is precisely to rely on rules and regulations to protect what a bureaucracy with limited independence can of private rights, ensure competition in markets, and break up monopoly power. This is not a happy situation, but to do away with good-enough regulations—because some can be bad—in a situation where the constitution is weak, laws ineffective, the judiciary not free from political influence, and legislation stymied by political differences, is to throw the baby out with the bath water. Once again, there is no substitute for sovereign action.

PIDE: Last, but not the least. Could you please sum up for our readers a growth path that, in your considered opinion, will likely take the economy out of the present stagflation and onto to sustained growth at the level necessary to achieve socio-economic goals?

AZ: Our present economic predicament does not arise from un-clarity on a growth path. It arises from the absence of leadership, and of a self-confident independent community of scholars to guide them. As a result, foreigners, with their own aims and interests, end up determining our goals, strategies and paths. In a word, our economic difficulties arise from the lack of “agency” of our scholars and of “sovereignty” of the state. In this situation, nothing can be done; because both leaders and scholars are incapable of anything more than isomorphic mimicry—mindless imitation—rather than intelligent adaptation.
This is a mouthful, so let me unpack the key terms. Individuals have 'agency' when they possess the capacity to act independently and to make their own free choices. A state is 'sovereign' “when persons in authority—those who mediate, or formulate, and enforce policies—are [1] indigenous .

and [2] can determine the content of their policies free from constraints imposed by foreigners." A study of forty countries, over 1870-1950, shows that there is a "quantitatively strong positive" relationship between economic growth and sovereignty ("the power of the state to advance, in the long run, the interests of indigenous factors in opposition to the interests of foreign factors")Also, there is a difference between leadership, management, and administration. Leaders lead people—human beings, not human 'resources'—toward shared goals. Managers manage processes—like plans, programmes, budgets, supply chains, etc.—designed to achieve leadership goals. Administrators administer tasks—adjudication of disputes, maintenance of order, collection of revenue, implementation of projects, controlling the spread of pandemics, etc.—assigned by managers. Sadly, for most of our history, the nation has been led by managers and managed by administrators. Consequently, the men who rule Pakistan have always looked to foreigners for leadership, in all areas. In this situation outlining growth paths and formulating strategies become academic exercises which, if taken by decision-makers as a serious representation of reality, can cause positive harm.

Nevertheless, to respond to the question, in the briefest of terms, let us recall that every economy is embedded in a political society. Again, to be clear, the 'economy' can refer to one or both of two things: arrangements for the provision of livelihood to people, or to enriching the treasury of the state. And 'political society' or polity, refers to a society 'constituted' by an ultimate shared collective objective (religious or secular) and an agreed distribution of power within rulers and between the rulers and the ruled—this, incidentally, is the sense of the term 'constitution' which need not be a written document.

In Pakistan, the written constitution bears no resemblance to the real constitution. As a result, Pakistan in fact is an un-constituted polity, or at best a "colonial" polity, in which rulers, alienated from the people, seek to extract revenue from them to enrich themselves, while providing them minimum livelihoods to keep them peaceful. Consequently, "the socio-economic goals" of the rulers are quite different from those of the people. As a result, there are three growth paths to achieve, respectively, three sets of socio-economic goals: those of the rulers; of the ruled; and of their joint goals, if any.

History teaches us that societies so divided either break up (pre-modern Europe, antebellum America, Jinnah's Pakistan), or are unified either by bloody democratic revolutions (England, USA, France, Russia) or peacefully by an authoritarian elite that unlike Pakistan is not culturally alien from the people (Germany, Italy, Spain, Japan). It is only when a cohesive, stable, law-abiding political society, with provisions for popular representation in making laws and resolving disputes, has been formed that sustainable economic growth can begin to take place. Until that happens in Pakistan, social and political development must be privileged over economic development and growth.

Contingent as it is on the emergence of self-confident leaders, the path of development that I have advocated for the last three decades is the path of self-reliant, sovereign development. "Sovereign development not only expands the conception of development to include security, but also in its economic component, it suggests that economic development be re-defined as the capacity to protect domestic markets and capture foreign markets, in aid of national security and power; rather than just the growth of production capacity." In this perspective, we should snap out of the 'borrow-invest-grow' pipedream and pursue pragmatic strategies rather than wooden-headed ideologies; selectively protect our exposure to the expected volatility ahead in the global economy; privilege employment and distribution over output growth; identify competitive (not comparative) advantages, especially in defence-related industries; rationalize the integrated management of all public assets, with sensible rather than dogmatic privatization and a role for better management of all state assets; and take a cold hard look at the discontents of financial sector liberalization—which has avoided scrutiny due to the rise of bankers in government. Implementing this would require a fundamental rethinking and reform of national economic and financial management, as part of comprehensive administrative reforms. In short, to roll back neoliberalism.

This, in a thumbnail sketch, is the path of social and economic development—not just growth—that in my considered opinion will take the economy out of our current predicament of a debt-colony toward the achievement of sovereign, joint socio-economic goals. It awaits leadership.

The Cost of Disinflation: The Sacrfice Ratio

Nadeem Ul Haque and Abdul Jalil

Price stability is imperative in economics. Independent central banks have, therefore, been encouraged by the IMF in all countries with a clear mandate to achieve a low inflation target. It is well accepted that long-run sustained growth requires a stable low inflation environment.

Curbing inflationary pressures is not costless. The tradeoff between growth and inflation is well known ever since the famous Phillips curve. The recessionary impact of IMF programs, at least in their early stages, is also well known.

One approach to measuring the tradeoff between growth and inflation is the Sacrifice Ratio (SR) which is defined by the ratio of accumulated loss in real GDP during a particular episode of disinflation to the overall fall in inflation during this particular episode.

It is well accepted that disinflation produces output losses. The quantification of these losses due to disinflation is termed as SR. More clearly, SR is used to gauge the cost of disinflation in term of accumulated loss in real gross domestic product (GDP) due to monetary policy1.

SR Around the World

Estimates of SR from many emerging markets are presented in Table 1. In understanding these estimates the following considerations should be borne in mind.

- Estimates may vary with specifications.
- The SR may vary with the level of inflation and its history.

We will also examine the determinants of the SR such as speed of disinflation, length of episode from inflation to disinflation, credibility and independence of monetary authority to pursue disinflation policy, initial level of inflation in later studies. This particular study discusses the size of SR.

Table 1 : Episode-Wise and Average SR by Using Ball(1994) Methodology

Country	Episode	SR	Average	Country	Episode	SR	Average	Country	Episode	SR	Average	Country	Episode	SR	Average
Australia	60–62	1.68	0.70	Denmark	62–64	0.94	0.60	Italy	63–67	2.41	1.39	Sweden	66–68	0.42	1.24
	74–78	0.54			67–69	-0.39			74–78	2.79			76–78	2.65	
	82–84	1.06			74–76	0.81			80–87	1.37			80–82	0.41	
	86–88	-0.20			80–86	1.18			90–93	0.19			83–86	-0.34	
	89–92	0.74			88–90	0.46			95–98	0.22			90–97	3.08	
	95–97	0.36		Finland	63–65	-0.78	1.44	Japan	62–64	3.01	1.14	Switzerland	66–68	1.35	0.89
Austria	64–66	0.02	1.03		67–69	0.95			65–66	-0.01			74–77	1.77	
	74–78	1.47			74–78	1.45			70–71	1.23			81–83	1.70	
	80–82	1.25			80–86	0.64			74–78	0.40			84–86	-1.16	
	84–86	-0.17			89–94	4.92			80–87	1.84			90–94	0.78	
	92–98	2.55			62–66	-0.83			90–95	0.38			61–63	2.03	
Belgium	65–67	0.52	0.90	France	74–77	1.54	0.00	The Netherlands	65–67	1.53	2.47	United Kingdom	74–78	0.69	1.07
	74–78	0.60			81–86	0.23			75–78	-1.19			80–83	0.60	
	82–87	1.59			89–94	-0.93			80–86	2.74			84–86	0.35	
	68–70	0.28			65–67	1.22			91–97	6.78			89–93	1.69	
Canada	74–76	0.41	1.23	Germany	73–78	3.86	2.33	New Zealand	75–78	1.79	0.51	United States	69–71	2.70	2.55
	81–85	1.90			80–86	1.91			80–83	0.54			74–76	1.41	
	90–93	2.34		Norway	75–78	-0.70	1.30		86–88	-0.91			79–83	1.98	
--	--	--	--		81–85	1.31			89–92	2.14			89–94	4.11	
--	--	--	--		87–93	3.28			94–98	-1.00			--	--	--

Table 1 reports 77 episodes of disinflation of 17 different countries. It is observed that the ratio is positive in 64 of 77 cases. This suggests that disinflation is usually costly.

More clearly, on average there is 0.7 percent accumulated loss in real GDP during a particular episode of disinflation to the overall 1 percent fall in inflation during in the case of Australia. It is also evident from the table 1 that there is a huge variation in the SR of different countries.

One can infer that the cost of disinflation may vary from country to country. However, it is also important to note that the direct comparison among countries is not sensible due to several reasons

.

Sacrifice Ratio in Pakistan

We calculate SR from period of 1973 to 2018 based on Laurence Ball. We find four episodes of inflation in the case of Pakistan (see table 2). It is evident that from the table that SR is different for all four episodes. It ranges from 0.458 to 0.903 and the average of all four episodes is 0.662.
It implies that on average 0.662 percent of the real GDP will be forgone for the permanent reduction of one percent of inflation. However, these findings are highly sensitive to measuring of SR and real output loss.

Table 2: Sacrifice Ratio for Pakistan

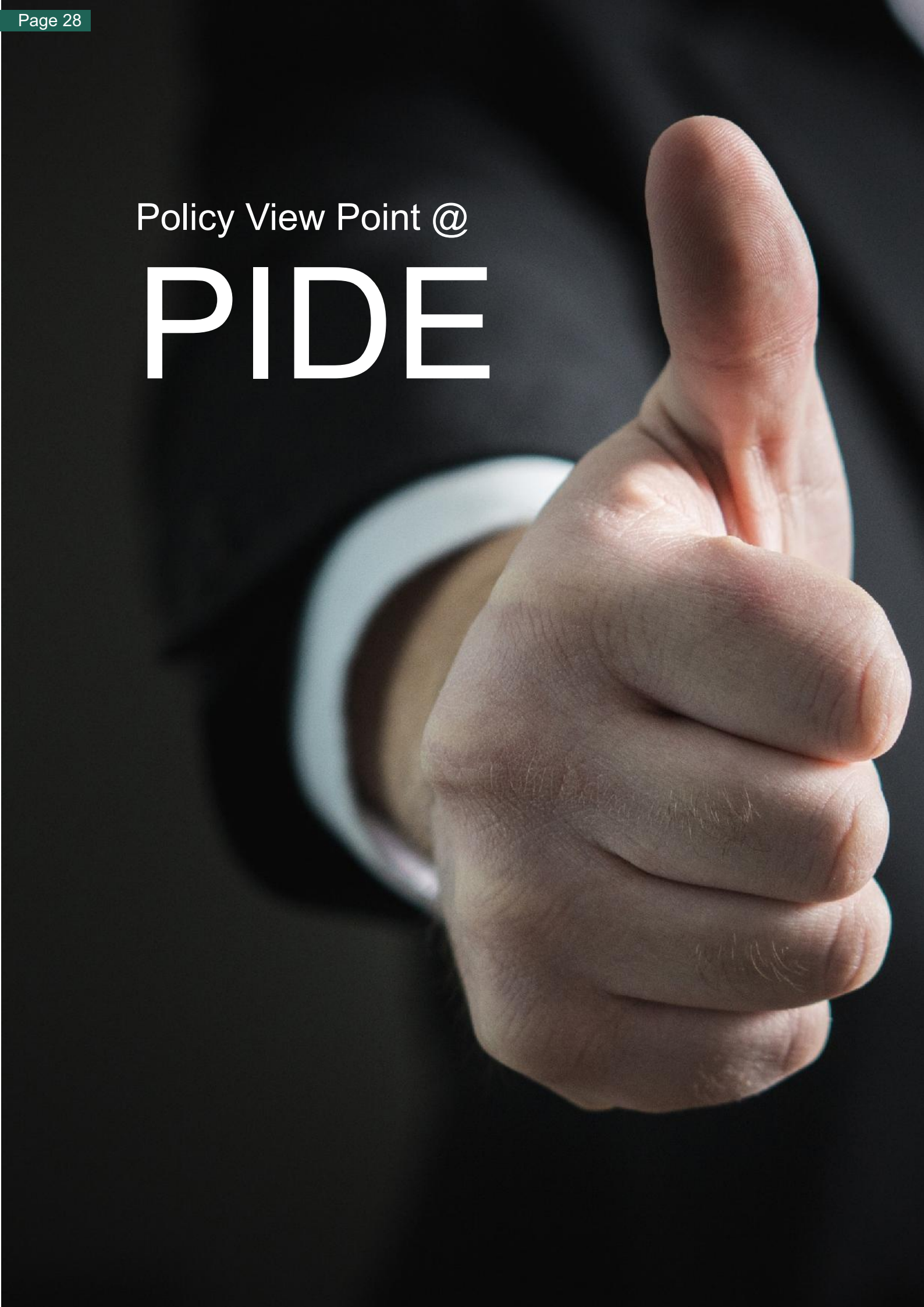
Episode	Sacrifice Ratio Ball (1994) Method
1974-78	0.797
1980-86	0.458
1995-02	0.903
1998-17	0.491
Average	**0.662**

Concluding Remarks

It must be noted that this estimate is not an argument against disinflation. This estimate merely informs policymakers of what to expect for growth and employment in an adjustment program. With an employment elasticity of 0.1, we can expect that employment will be reduced by 0.06%. Policy must seek structural reform in a disinflation episode (adjustment program) to generate some growth momentum in the economy, if costs of disinflation are to be mitigated.

Policy View Point @

PIDE



Doing Taxes Better: Simplify, Open and Grow Economy

Muhammad Nasir, Naseem Faraz & Saba Anwer

All experts agree on:
Simplifying taxes, reducing costs of excessive documentation, opening the economy for high growth and employment. Taxes too will then Increase.

Taxes have been the cornerstone of IMF-led adjustment programs for Pakistan for over four decades. During this period, long term growth and productivity have declined while the tax policy has become more contentious and fragmented. Measures multiply as unrealistic targets are chased with mini budgets every quarter. The following arose from a high-level conference arranged by PIDE to outline future directions in tax policy.

Illusive Targets: Chasing Tax GDP Ratio through Arbitrary Measures

For decades now, the policy has given priority to increasing the tax-to-GDP ratio leaving growth and employment to an outcome perhaps of some projects funded by the Public Sector Development Programs (PSDP). Expenditures are never reviewed or rationalised for efficiency. Public sector employment is guaranteed, and annual wage increases are held sacrosanct while operational expenditures are regularly cut. Arbitrary and frequent tax changes have created an environment of uncertainty while cuts in operational expenditure have led to "austerity."

Increasing the tax-to-GDP ratio regardless of how this has become the cornerstone of policy. The narrative that the government and donors have established is that Pakistan has a tax- to-GDP ratio lower than some other countries. Box 2 shows the tax-to-GDP ratio for a select group of countries. It clearly shows that even in advanced countries, this ratio can vary by as much as 15 percentage points. Pakistan's tax-to-GDP ratio of 14 percent is not very low as compared to other countries of the region: Sri Lanka (13 percent), India (18 percent), and Bangladesh (8.5 percent).

Box 1: The principles of tax policy

Transactions must be allowed to grow while collecting taxes. All taxes will create dead weight losses and market distortions. Good policy must seek to minimise these.

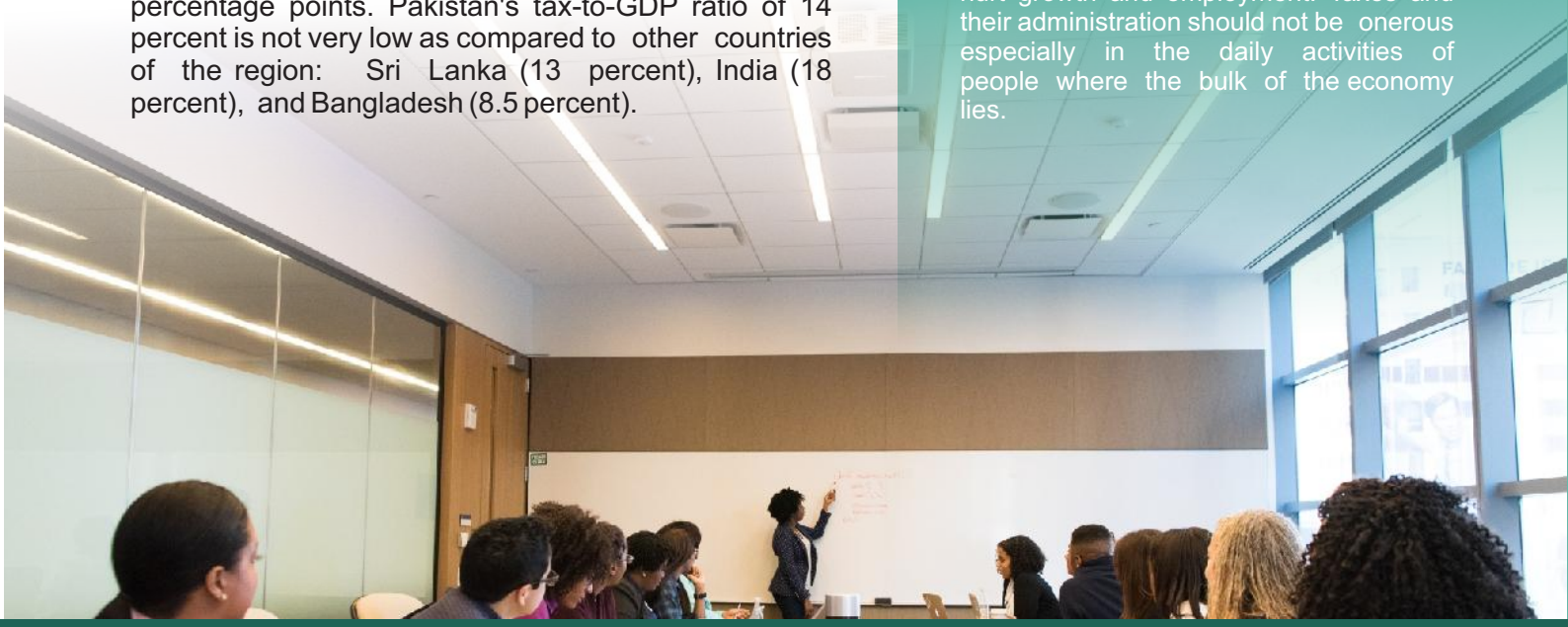
A tax effort that kills transactions is self-defeating. More transactions mean higher economic growth and employment, which in turn will generate sustainable streams of revenues.

Fairness: No one group should be seen to be bearing more taxes than others. This does not mean redistribution cannot be achieved through tax policy, but it must have an explicit and well thought out plan.

Certainty: Since taxes distort prices and market activity, there must be certainty in policy for people to build businesses. Frequent and arbitrary taxes are harmful for growth.

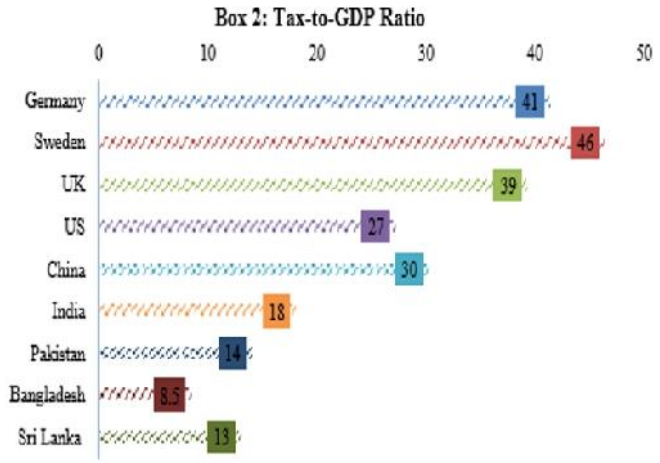
Efficiency: The process of collection should not involve further losses and transaction costs on economic agents. One inefficient manner in which government taxes people is through the use of excessive regulation such as curbing economic activity or state ownership of market resources and activities.

Convenience: Excessive documentation requirements also add to the tax burden to hurt growth and employment. Taxes and their administration should not be onerous especially in the daily activities of people where the bulk of the economy lies.



Tax Policy is Killing Transactions

Most experts are of the view that Pakistan's tax policy is not based on well-known and clear principles (See Box 1). Section 5 of the Federal Board of Revenue Act legitimises a Tax Policy Board/Committee to sketch tax policy independent of FBR. Unfortunately, that board convened only once after reconstitution. The finance bills that continually add ad-hoc tax measures in frequent mini-budgets have developed a complex tax system that confounds the principles of rational tax policy.



Box 3: Are we a tax cheating nation?

The gathering challenged the prevailing official narrative of tax cheating nation. In the current withholding tax regime, every mobile phone user (i.e. 90 percent of population) is paying income tax in withholding form. This narrative appears to be unique to Pakistan. Countries such as Indonesia with a lower tax-to-GDP ratio does not accuse its citizens of tax cheating. It is strange indeed that even as FATF and international community are breathing down our neck our officials are claiming that their policy and administration is not at fault; it is the people who are cheats.

Data shows that policy consistently pushes for an unrealistic tax-to-GDP ratio, setting FBR to chase the number with arbitrary measures that kill transactions. The current target of the IMF for a tax-to-GDP ratio of 16.7 percent by FY 2021-22 is unrealistic and cannot be achieved without enhancing the taxable capacity of the country. Yet curiously the design of the target and measures to achieve it have stifled economic activity. As in the rest of the world, for revenues to increase we need economic growth. Yet policy is killing transactions through arbitrary taxes and the costly documentation drive.

Arbitrary Minibudgets and Fragmented Sales Tax have Increased Uncertainty

Not only is our tax policy not based on conceptual clarity but it is also being changed continuously to meet unrealistic targets. The tax rates are high and keep changing several times a year through exemptions and SROs in mini budgets. The uncertainty due to continuous tax changes is a huge drag on investment which, as a percentage of GDP, is already among the lowest in the world.

Similarly, the sales tax base is fragmented with services subject to taxes at the provincial level and goods at the federal level. There is also a variation in rates (from 1 percent to 17 percent), in addition to several exemptions. The standard rates on services also vary between provinces. In Balochistan and KPK it is 15 percent, in Punjab it is 16 percent, and in Sindh it is 13 percent. Such fragmentation and exemptions also add to the existing uncertainty.

Tariff Policy has Strangled Competition and Growth

Openness has been seen to be important for growth. In the 1970s Pakistan adopted the local industry protection policy while Chile and Turkey liberalised their economies. The countries that adopted openness – Turkey and Chile — saw sustained growth and their manufacturing sectors developed. Turkey even joined the European Customs Union in 1995. These countries are now exporting value- added goods like machinery and automobiles. Similarly, Vietnam started liberalising in 1986. They started rationalising tariffs and went for privatisation. In 1995, their exports were equal to that of Pakistan, which are now ten times higher in 2020. Since we did not lower tariffs, we could not integrate into the global value chain.

There is a need for reforms in the regulatory framework on data sharing of public and private sector agencies with FBR. The availability and sharing of data could increase compliance by covering a variety of sources of income before filling of tax returns. For instance, banks maintain a registry of each customer and transaction. State Bank records this data. The government should sit together with public and private agencies to formulate a plan to configure this data with FBR. The data sharing between institutions would also provide a mechanism to bring in non-filers into the system, thereby paving the way to end the distinction between filers and non-filers.

Box 3: Regional Comparison of Effective Tariff Rates

Country	Average Effective Tariff Rate
Pakistan	11.2
Malaysia	4.5
China	5.2
Sri Lanka	7.0
India	7.5
Bangladesh	10.6

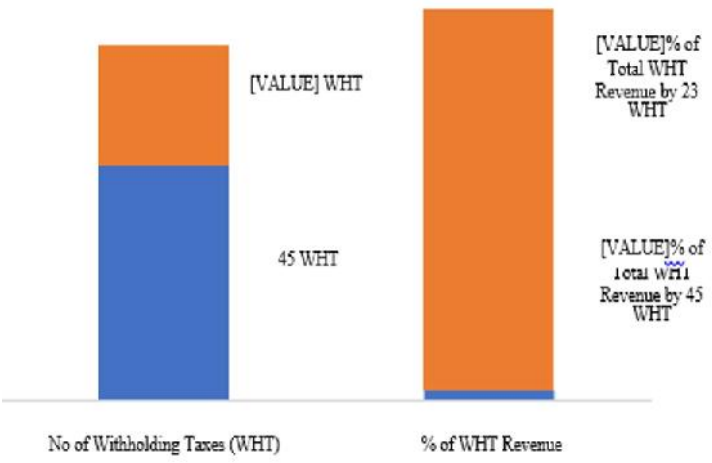
Source: World Tariff Profiles 2018 by World Trade Organization.

Excessive Documentation is Killing Economy

Not only is the tax system complex, but the cost of compliance is also high. Taxpayers are also discriminated based on being filer and non-filer. Higher taxes, narrow base, differential treatments, and exemptions become hurdles in achieving growth and employment and block the flow of revenue.

The withholding regime is imposing costs on business and individuals. 66 withholding taxes furnish almost 3/4th of direct tax revenues. However, 45 of these withholding taxes provide only 2 percent of the revenues (see Box 5). About 70 percent of tax revenue is collected through withholding tax agents such as banks, utilities, and telecos, placing the burden of collection on these businesses and increasing their costs. While these withholding taxes may provide an easy source of revenue collection for the Federal Board of Revenue (FBR), they make the tax system incredibly complex

Box 5: Withholding Tax and Revenue Earning



for the taxpayers. This also questions the role of FBR as a tax collecting authority.

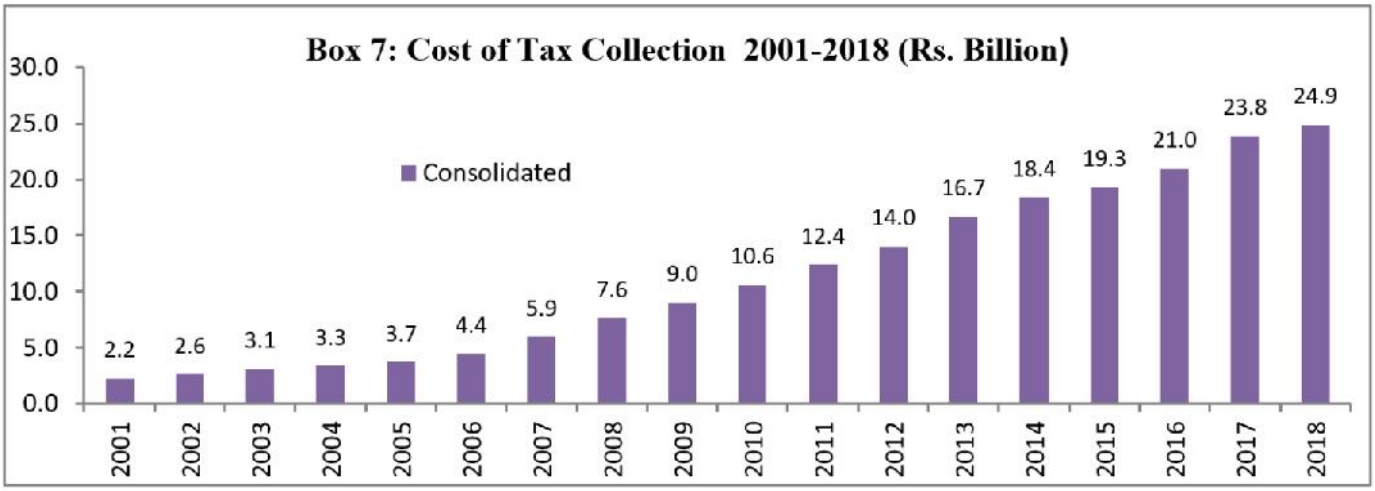
The current documentation drive would prove ineffective and rather counter productive in the presence of the high cost of compliance. This cost consists of the number of hours required for record-keeping, tax planning, and forms completion and submission. It takes around 577 hours (per year) to complete the tax payment process in Pakistan compared to the world average of 108 hours. Adding this to the high number of payments (47) tremendously increases the average tax burden in the country. The high compliance cost imposed on businesses being unpaid tax collectors for the government is the very reason for tax non-compliance. In such an unconducive environment, the current documentation drive would kill transactions—and with it any hopes of increasing economic growth and sustainable revenue streams.

Box 6: Cost of compliance to complete international transaction

	Pakistan	India	Korea
Imports			
No of Hours (TEU)	216	85	7
Days (TEU)	9	3.5	0.3
Cost (TEU)	400	366	342
Exports			
No of Hours (TEU)	113	64	14
Days (TEU)	5	3	0.6
Cost (TEU)	406	270	196

Note: The twenty-foot equivalent unit is an inexact unit of cargo capacity.

An intriguing example of a high compliance cost for meeting the documentary requirements can be observed in Customs. To complete an international trade transaction, we require more than 400 hours (17 days). India and Korea, on the other hand, require
270 and 194 hours, respectively (see Box 6 for details). Hence, reduction in transaction time should be an important objective.
The price of tax collection is also very high in Pakistan (see Box 7). The cost of collection (CoC) has sharply increased over time. It has increased from Rs. 16 billion in 2014 to Rs. 25 billion in 2018, representing a 36 per cent increase in cost during a short span of 5 five years. Higher CoC leads to lower benefit of revenue collection. Nearly 80 per cent of CoC is distributed in the form of wages of the tax collection staff. Tax expenditures have been estimated in a study by FBR to be about 1.2 trillion rupees, about 4 percent of GDP. There is an urgent need to reduce these for many



The tax administration model operates with outdated departmental manuals and outmoded information technology (IT) platform that relies on pirated systems and software. Advance countries are using business intelligence (BI) and artificial intelligence (AI) tax solution technologies for compliance and reducing human interaction in tax filing and tax analysis.

Making Policy Pro-Growth is the Way Forward

The policy should facilitate transactions to help grow the economy. Hence, it should be simple, efficient, and convenient, and help create a conducive environment for the economy to is still required.

(2) The existing tax system is a four-tiered appeal system which is hopelessly redundant, painfully unproductive, and marred with inefficiency and inordinate delays. There is a need for a complete restructuring of the tax justice system so that fiscal disputes between the state and taxpayers get settled within a year at most. The existing Inland Revenue and Customs Tribunals should be merged and renamed as the National Tax Court. If the National Tax Court is established, there will be a drastic reduction in litigation.

(1) The culture of SROs is unconstitutional and hence should be completely abolished. The 2013 ruling of the Supreme Court of Pakistan states that "Parliament/Legislature alone and not the Government/Executive is empowered to levy tax". The sectors supporting education and health can be exempted.

(2) The SRO's were ruled out in 2013 by law but they were "tariffied" or transformed into tariffs under Fifth Schedule. The Fifth Schedule has exemptions/concessions for importing plants, machinery, and inputs for pharma, poultry, dairy, home appliance, and textile sectors, and imports under Auto & Aviation policies. To become an active player in the global value chain, Pakistan should minimise the loops in the form of concessions and exemptions regime. SROs also maintain a distinction between commercial importers and local manufacturers.

(3) Unlike other countries, the tariff instrument has been used in Pakistan for revenue generation rather than growth and industrialisation. This short-sighted policy raises conflict of interests as tax collecting authority would always prefer high tax rates. There is a dire need for the tariff policy to be designed around "facilitation of transactions" or "growth". The rationalisation of tariffs should be a phased process.

(a) First phase—revise duty tariffs with more reliance on domestic taxes.

(b) Second phase—clear sectoral policies should be developed and tariffs be aligned with those sectoral policies. The exemptions should be merit-based only.

(c) Third phase—once the tariff policy is in place, all the exemption schemes to be phased out.

(1) The electronic declarations and documents submission, digital signature communications, and web-based Tracking and Audit Trails (TAT) are the necessary reforms that can serve the purpose of enhancing the efficiency of the tax administration.

(2) The digitisation of the tax system and one-window environment would lower the business cost. It must be online with imaging and digital signatures. Minimal human interaction would lead to a transparent system and maintain an efficient economic environment. In this regard, instead of having several agencies for documentation, a one-window operation can increase the efficiency of the tax administration. For working in an integrated environment, digitisation and data-driven system are inevitable.

(3) There is a need for reforms in the regulatory framework on data sharing of public and private sector agencies with FBR. The availability and sharing of data could increase compliance by covering a variety of sources of income before filling of tax returns. For instance, banks maintain a registry of each customer and transaction. State Bank records this data. The government should sit together with public and private agencies to formulate a plan to configure this data with FBR. The data sharing between institutions would also provide a mechanism to bring in non-filers into the system, thereby paving the way to end the distinction between filers and non-filers.


Research & Blogs
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PIDE

Enough " Bricks and Mortar"!

Nadeem ul Haque

https://www.investorslounge.com/

The novel corona virus has exposed the weakness of our development planning. We have plush roads for our cars, but our health industry remains stagnant. We have 200 universities with few accomplished professors to lead the research effort to fight the corona.

By design, the focus of the Public Sector Development Programme (PSDP) is on "Brick and Mortar" regardless of the consequences. We build purposelessly. Convention Centers, Stadiums, roads remain underutilized giving no returns to the funds spend to build them.

Avenues have been built where country roads were required, flyovers where a traffic light was required, expensive metros where buses were required, public money has been spent with little visible return.

In the name of education, our politicians want to build a university in every district, no matter the dearth of qualified professors. All departments want a huge residential training center to run at 25% of its capacity. Meanwhile, our education indicators are declining and the government lacks the capacity to make policy. It now regularly asks donors for even routine work such as making plans, inventorying stocks and monitoring our schools.

The public imagines that money went into corruption. The fact is that despite corruption, assets have been built. The questions to ask are, "were these the right assets to build?" and "could the money have been better utilized to increase our growth and productivity?"

Projects are creating assets but then they are managed for no return. We must recognize that the pressure to build more "brick and mortar" has led to a lot of waste.

No wonder, our research shows that public investment does not increase growth and productivity over the long run! We must ask, "why not?"

A new Pakistan Institute of Development Economics (PIDE) study, "Doing Development Better", suggests that our current development approach is based on the model given by Dr. Mahbub ul Haq and the Harvard Advisory Group (Haq/HAG). This was also suggested by the Planning Commission's Framework for Economic Growth (FEG) of 2011, which was approved

by the NEC, which suggested that our planning model needs to change.

Both reports note that Pakistan has been following the Haq/HAG development model since the First Five-Year Plan. Key features of this model are:

- A focus on building physical infrastructure through discrete projects in different sectors in the economy.
- Planning to develop medium term budget to finance the sectoral hardware.
- Seeking foreign projects for meeting financing gap in the plan given an expected shortfall in domestic savings.

At that time, we had no infrastructure. Haq/HAG therefore favored 'bricks and mortar' development without giving consideration to usage or the maintenance of assets. In other words, it merely created the hardware.

Times have changed. Modern policy suggests that growth happens because of the 'software' of society such as productivity, management, policy, innovation and institutions.

The PIDE study also shows the importance of developing a coordinated and well-researched national development strategy for economic growth and development. This will require detailed inquiries into developing strategies for enhancing productivity, developing markets and better asset creation and management.

system indigenously.

Pakistan must grow at 8% per annum for 30 years consistently if the growing youth population is to be employed. The PC Framework for Economic Growth of 2011 (FEG), which was approved by the NEC, suggested that this would only happen if policy moved from building "brick and mortar" to focus on "software" –reform and deregulation.

For this to happen, the PSDP approach must change. It is well known, the PSDP is overly politicized and wasteful. Politician push through pet projects that are not well-considered or analyzed and waste taxpayer funds. In any case, the PSDP merely measures the money spent on building but never learns anything on the return from the building.

It is time that the Haq/HAG approach that merely considered the money spent on projects with little regard for outcomes be discarded. It has served its purpose.

FEG as well as the PIDE study recommend that we should frame our growth policy to maximize returns and not only on measuring inputs (PSDP). In other words, assets should not be created without yielding a maximum return.

Agencies and ministries would get a budget—both investment and current—to let them build assets and make policies for results to people.

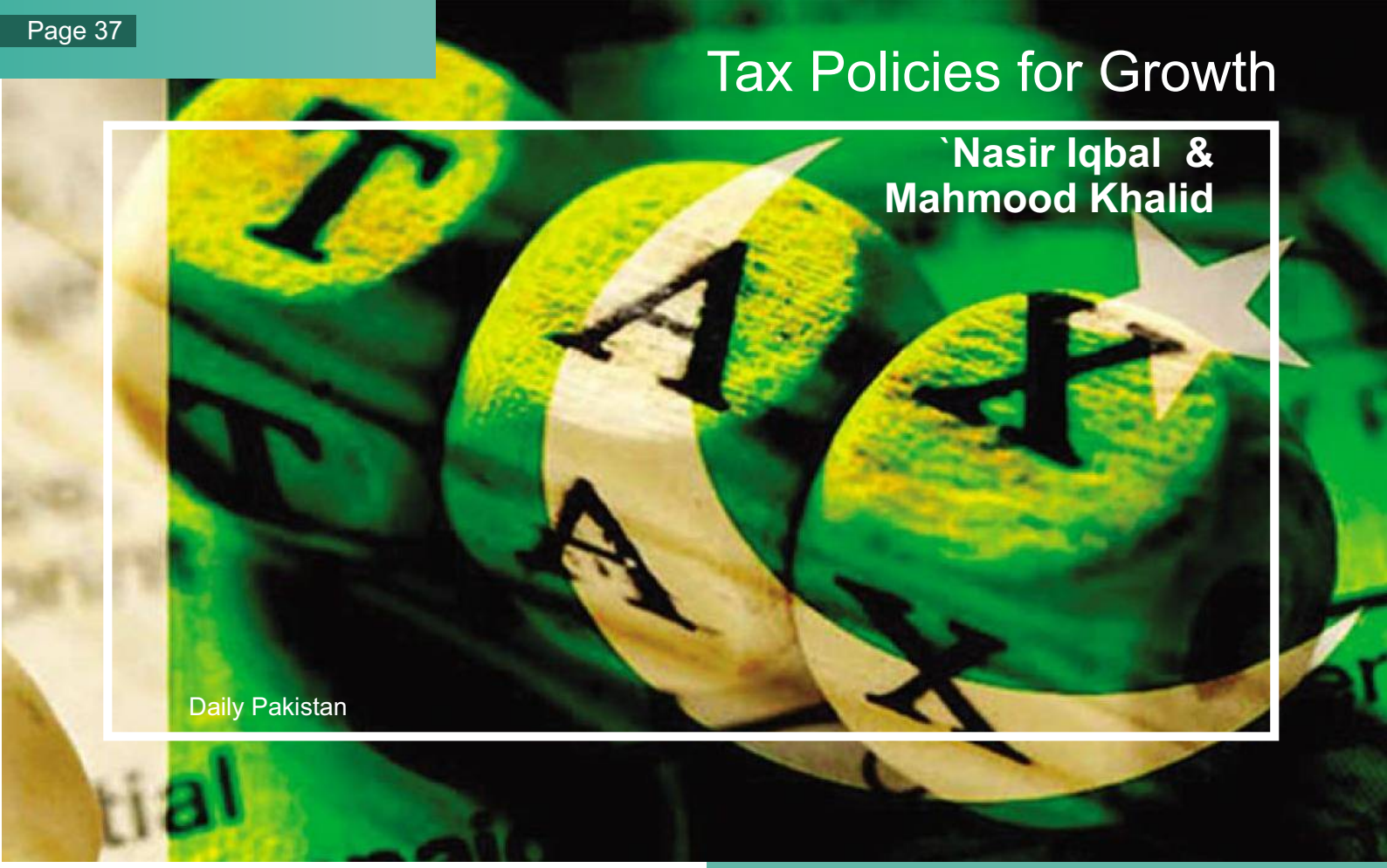
Both studies say that the PC must oversee the Medium-Term Budget Framework (MTBF) not the Ministry of Finance. The MTBF must be soundly based on well-thought out performance contracts that are also desired by the PM. The Planning Commission must then play a role in coordinating and leading with research to develop well-thought out initiatives for reform and deregulation.

Sustained growth will only happen with reform and deregulation to accelerate productivity, private investment and entrepreneurship. Policy can then focus on building a sports industry that rather than just empty stadiums. Universities can stop building buildings and campuses and focus on R&D and using existing capacity. Training academies can share resources to capacity rather than each department seeking buildings.

Potential growth and productivity have both been on the decline for the last four decades, even as we rushed to develop large "brick and mortar"—roads, buildings, metros etc. I urge policy to rethink the age old Haq/HAG model. Time to stop and modernize our growth policy: develop a modern Results Based Management

Tax Policies for Growth

`Nasir Iqbal &
Mahmood Khalid



Daily Pakistan

PIDE had organized a conference “Shifting the Paradigm on Tax Policy and Administration: A Policy for 21st Century” on March 11, 2020 in the Policy Capital of Pakistan. The conference aims to unbundle the taxation system of Pakistan for critical reforms by considering key questions: What is wrong with our Tax Policy? Why can't we fix it? Tariffs for Trade or Revenue? Technology, administration and documentation trio to improve tax collection and tax policy certainty? Renowned national and international experts will address these questions and put forth solutions.

As a prelude to the debate and answering these questions, we need to understand why taxes are needed in the first place. Certainly we don't like them. The simple answer is that taxes are the only way to generate revenues for financing public spending on goods and services. One can also question why do we need to spend in the first place, but let's put that aside for now. We know the government spends and taxes are needed to finance it since there are not many sources of finance other than that. An ideal taxation system would generate sufficient revenue to meet the needs of the government without discouraging economic activity.

Pakistan's government, on the one hand, is working hard to increase tax revenue to overcome budget deficit and finance fiscal needs. Official data (Economic Survey of Pakistan 2018-19) predicts total tax revenue will increase from 9.1% of GDP in FY 2009 to 13.9% in FY 2019 (budget estimates). A possible composition shows that 40% tax revenue is generated from direct taxes while 60% is generated from indirect taxes.

On the other hand, empirical literature has documented a negative impact of taxes, especially if taken as % of GDP, on economic activity. This implies that a simple tax increase to finance expenditures is not useful to promote economic growth or development. This would be particularly true if there are fissures in the economy and it faces a myriad of structural challenges. These challenges range from low productivity and economic growth, weak industrial base to rising poverty and inequality, stagnant exports and above all to climate change.

Apprehensions for the current tax regime and structural challenges in the economy present a daunting task for tax policy reforms. Some of these have been present since the beginning of Pakistan's economic life. So it has to have a perspective of efficiency, equity and be revenue

buyout. The ultimate question which remains is: how tax system could be best designed to promote inclusive growth? The decline in growth requires a debate on how tax policy can be used to bring back economic growth.

According to renowned public economics expert Vito Tanzi and Howell Zee; any proposed revision to tax policy should consider four key aspects of the economy, including

- the dominance of the informal sector (estimates of which range from 25% to 50% of the formal economy),
- inefficient tax administration (due to lack of well-educated and well-trained staff),
- lack of reliable data to assess potential impacts of major changes in the tax system, and
- skewed income distribution.

These are all very much grounded in our tax-economic issues, but often not rigorously considered while making a new policy.

Coming back to the conference; it should discuss "growth-oriented tax policy", but with several questions in mind which should be added to the debate. Had the tax systems supported long run inclusive growth in Pakistan? Research shows the need to shift the tax mix away from income tax towards taxes that have a less negative impact on economic growth, including property, wealth, inheritance and last but not the least the consumption taxes.

We are putting environmental taxes on the back burner for the time being, but these are also critical for internalization of external costs related to health, climate and the environment. Besides addressing the negative impact on economic growth, we also need to consider equity; or the equity and efficiency together.

Greater dependence on some taxes can reduce overall progressivity of the tax system (for example trade taxes). Therefore the fundamental and overarching question would be: how to move towards a tax design with shifts in the tax mix with minimal negative consequences on equity yet having desired growth.

Let us divulge into some of the recent issues in tax streams. To start with taxing the real estate is good as these are progressive. Despite huge potential, revenue from recurrent property taxes remains low and painful. There are looming questions on the role of political economy, the debate of 18th amendment related ownership of tax bases to name a few.

There is also an urgent need to reconsider inheritance taxes a sustainable source of resource growth and an equitable resource transfer among generations. An unfair resource redistribution across generations can reduce the competitive growth perspective. We used to, but can we again use wealth taxes as a tool to mitigate income and wealth inequality and promote social mobility with equal opportunities? Environmental taxes, such as carbon taxes, pollutant pay principle-based taxes and others offer a potential source of expanded revenue with equity across generation and across fiscal jurisdictions.

Let us propose a simple solution to maintain inclusiveness while shifting tax mix; that is to eliminate regressive tax expenditures (the tax concessions through SROs and lately through Schedules) and expand the tax base. We leave the conference to address it in more detail. But for growth it is imperative to recognize the role of small and medium enterprises (SMEs) and new businesses. So it is critical to increase competition (meaning let them have more transactions) that can promote dynamic and inclusive growth.

Although not all SMEs are innovative, new and small businesses tend to be the driving force behind important innovations for economic growth. Instead of reducing tax rates, these firms should be facilitated by reducing compliance and administrative burdens and create incentives for performance. All of these should be discussed keeping in view the objective of long run and inclusive higher growth. The conference will provide a platform to kick start a new debate on tax system reform in Pakistan by examining the country's prospects for inclusive growth while going through the demographic dividend phase. It will help policymakers and other stakeholders to connect the missing dots in tax policy not only to increase tax collection but also to promote growth and equity in the country.

What Our Textile Sector can Learn from Vietnam's Progress

Abdul Jalil

The Prime Minister's top advisors have reassured us the economy is improving. But jobs are not being created. The implication is that sectors typically linked with job creation, agriculture and industry, are neglected. This is a potentially alarming situation. If this is the case, Pakistan's economic improvements will be one-legged and shaky. Therefore the government must pay attention to the labour-intensive agricultural and industrial sectors. These sectors have long production chains, meaning that they have excellent job-creating potential.

Unfortunately, these sectors have struggled to perform over the last decade and lost their market share to regional competitors. Pakistan's textile and clothing exports dropped from USD 13.8 billion to USD 13.5 billion between 2011 and 2018. During the same period, Asian competitors gained significant market shares. Vietnam's textile exports increased from USD 15.2 billion to USD 33.5 billion (a 120 percent increase), while those of India, Bangladesh, and Sri Lanka increased by 36, 72 and 24 percent respectively.

Pakistan's negative growth in this sector mark it as an outlier in the region. A comparison between Vietnam and Pakistan highlights some significant areas where Pakistan can make changes to regain its competitive edge in the textile industry.

The economies of Pakistan and Vietnam were very different in the early 1980s. The Vietnamese economy faced multifaceted problems against the backdrop of the Vietnam-US war. The country heavily relied on its agriculture and primary goods production sectors. Almost all Vietnamese state-owned enterprises were inefficient, and no foreign direct investment was available. Vietnam depended on donors and foreign loans.

The situation in Pakistan was the opposite. In 1980, per capita income wise, Pakistan was 40 to 60 percent richer compared to India, China, and Bangladesh. So how did Vietnam acquire the title of 'new manufacturing powerhouse' over the last three decades? Simply put, the country took several holistic steps on several fronts, the most important of which was a 'rethinking' of policy.

The Doi Moi economic reforms of 1986 shifted the paradigm in Vietnam from 'political relations' to 'political-economic relations.' This changed the mindset of Vietnamese policymakers. For example, it

withdrew all troops from Cambodia and actively participated in resolving Cambodia's problems. It normalised relations with China and became an observer in the Association of Southeast Asian Nations (ASEAN). Most importantly, it improved relations with the US. Consequently, the US lifted the economic sanctions it had imposed on Vietnam. Afterwards, a bilateral trade agreement was signed between the two countries, further strengthening relations. During this time, political-economic relations with China were also improved.

establishment of special economic zones (SEZs); improvements in human capital; liberalisation of trade; rationalising of exchange rate regimes; improvement in overall business environment; and stabilisation at the macro-economic level. Notable improvements were made in terms of the electricity production of the country, which increased from 4,825 gigawatt hours in 1990 to 16,319 gigawatt hours in 2017. Furthermore, renewable energy sources in 2015 exceeded that of all other ASEAN countries. This was instrumental to Vietnam's ability to overcome its energy

The resultant industrial growth created a demand for a skilled labour force. Vietnam invested heavily in its educational sector. Trade liberalisation became the primary driving force behind Vietnam's structural transformation. Vietnam signed trade agreements with South Korea, the ASEAN, and the European Union, and it joined the Asia-Pacific Economic Cooperation, Eurasian Economic Union, and the World Trade Organization. A supportive exchange rate regime was adopted. The Vietnamese Dong depreciated considerably, which made

Country	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	% Change 2011-18
India	27.70	32.90	32.30	35.40	37.60	36.30	36.40	37.70	36.10
Bangladesh	19.00	21.40	24.60	28.40	30.70	31.80	31.00	32.70	72.11
Vietnam	15.20	16.70	18.10	21.50	25.20	28.40	31.50	33.50	120.39
Sri Lanka	4.10	4.20	4.00	4.50	4.93	4.82	4.90	5.10	24.39
Pakistan	13.80	12.40	13.10	13.70	13.50	12.50	12.50	13.50	-2.17

Vietnam's normalised relations with various countries sent a strong positive message to international investors. As a result their confidence was boosted and many foreign investments were made. The structure of the economy was geared towards improving absorptive capacity to handle increased domestic and foreign investments. These included improvements in energy supply; development of infrastructure;

shortage problem. In terms of Vietnam's infrastructure, a vast network of roads, high-speed railways, ports, and waterways was developed with the help of several foreign countries. Several Special Economic Zones were established to make use of new roads, railway stations, and ports. As a part of this effort, special facilities were offered to foreign enterprises and attracted a massive amount of investment.

Vietnam competitive in the international market. Importantly, all these efforts were backed by favourable macroeconomic stability and a business-conducive environment.

The case of Vietnam proves that a holistic development approach accompanied by dedicated resources can change the fate of the country. As such, this case provides important takeaways for Pakistan's struggling textile

sector. The textile industry of Pakistan is one of the country's essential industries – it comprises 64 percent of Pakistan's exports and directly employs 1.4 million people, contributing around 8.5 percent to GDP 16 percent to tax revenue.

If Pakistan adopts a holistic development approach similar to what was used in Vietnam, output can be doubled. Moving forward, the government needs to take notable steps to ensure Pakistan can outperform its regional competitors. The most crucial step towards achieving this goal is to ensure that all economic policies in Pakistan are backed by strong political will and are consistent. Efforts must be made to attract investments in export-oriented sectors. Last but not least, our available skilled personnel cannot be neglected.

War for Talent: The Skills Gap

Nadeem Khan

A talent shortage is affecting companies not only in Pakistan but also worldwide. According to the latest Manpower Talent Shortage Survey by Manpower Group, 45% of employers across the globe report that they cannot find the skills they need. The German Economic Institute recently estimated that a shortage of skilled labor, estimated at 440,000 skilled workers, would cost the German economy EUR 30 billion a year in GDP growth (to be precise 0.9 percentage points).

According to Manpower Group's "Talent Shortage Survey 2018", the working population of the world in declining and talent pools are shrinking. Technology is evolving faster than ever, changing the skills needed for jobs and shortening the life cycle of those skills. We are also seeing a bifurcation of the workforce — those with in-demand skills versus those with high-supply skills.

The immediate concern is not the number of potential candidates, it's a talent mismatch. There are not enough sufficiently skilled people in the right places at the right times. According to the report the top 10 jobs for which employers are having difficulty filling globally 1) Skilled Trade Workers (especially chefs/bakers/butchers, mechanics and electricians) 2) Sales Representative 3) Engineers (especially mechanical, electrical and civil engineers) 4) Drivers (especially truck/lorry/heavy goods drivers, delivery/courier drivers, heavy equipment/ construction drivers) 5) Technicians 6) IT (Cyber security experts, network administrator and technical supports) Management/Executives 7) Accounting & Finance Staff (especially book keepers, certified accountants and financial analysts) 8) professionals (Project Management, Lawyers and Researchers) 9) Office Support (Administrative Assistants, PAs and Receptionists) 10) Manufacturing (Production and Machine Operators).

The problem of talent shortage is severe in Japan where 89% employers are experiencing difficulty in filling jobs, while in China only 13% are experiencing the same issue.

Japanese employers face difficulties in hiring skilled and talented workers because Japanese industries are the most sophisticated industries in the world. Japanese manufacturing and services industries believe in innovations and high-performance technologies. They need high performing employees to produce quality products. It is difficult for academia and other related institutes to provide required skilled and talented manpower to industry because of the following reasons

:Academia and other institutes cannot adopt latest technologies immediately, It is difficult to develop capacity of academic staff immediately, financial constraints, and sharing of knowledge and innovation between academia and industry is not seamless.

Talent shortages are impacting organizations ability to meet their client needs; the most likely consequences are expected to be a reduction in ability to serve clients and reduced competitiveness/productivity An increase in employee turnover, lower employee engagement and morale, reduced innovation and creativity in their organization will all lead to higher compensation costs.

Employers are using following strategies to overcome the talent shortage:

- People Practices: employers are revising their people practices to provide more training and development for existing staff; 54% of employers now provide additional training and development.
- Talent Sources: employers are seeking to explore previously untapped sources, young people and candidates who have potential to learn and grow.
- Work Models: employers focus on their talent pipeline and redesigning existing work procedure by sharing work assignment between different employees. Unfortunately, a big percentage of employers are not pursuing any strategy to overcome talent shortages.

It is suggested that unskilled issue could be addressed to a large extent by imparting technical and skilled based education to the youth. No skilled person would be found unemployed, and companies would take benefits from these skilled persons and produce high quality products in Pakistan.

Now, the question is how we train our youth to face future changing environment of employment and reduce the unemployment rate. According to a report published by Dell Technologies and authored by the Institute For The Future (IFTF) and a panel of 20 tech, business and academic experts from around the world, 85 per cent of the jobs that will exist in 2030 haven't even been invented yet.

Least Difficulty	Below Average Difficulty	Above Average Difficulty	Most Difficulty
China: 13%	Australia: 34%	Finland: 45%	Argentina: 52%
Ireland: 18%	Brazil: 34%	Austria: 46%	Slovakia: 54%
UK: 19%	Belgium: 35%	USA: 46%	India: 56%
Netherlands: 24%	Costa Rica: 35%	Portugal: 46%	Singapore: 56%
Spain: 24%	Panama: 35%	Israel: 49%	Greece: 61%
Norway: 25%	Czech Republic: 36%	Mexico: 50%	Turkey: 66%
France: 29%	Italy: 37%	Germany: 51%	Bulgaria: 68%
South Africa: 32%	Guatemala: 38%	Hungary: 51%	Hong Kong: 76%
Switzerland: 33%	Slovenia: 40%	Poland: 51%	Taiwan: 78%
	Canada: 41%		Romania: 81%
	Colombia: 42%		Japan: 89%
	Sweden: 42%		
	Peru: 43%		
	New Zealand: 44%		

12 years ago, not even the experts could have imagined that jobs like Mobile App Developers, VDC Consultants, Cloud Computing Specialists and Block-chain Engineers would be in demand today. The following table below which lists some of the past, present and future positions and answer the question, how do we prepare for jobs that don't exist yet? Especially, when things are changing so fast.

Preparing for a job that doesn't exist yet is compounded by the fact that students entering a 4 year program in 2019 may not have the skills that industry is looking for when they graduate in 2023. For example, how many students who started in 2014 chose a career path that would train them to become a Blockchain Engineer today? The demand for Blockchain professionals, (Economist, Business and IT graduates and Engineers) has increased by 400 percent since late 2017.

Suggestions to address the shortage of talent issue

. **Say hello to the hybrid workforce**

The hybrid workforce is a combination of full-time employees and contractors, which allows service companies to take advantage of their contractors, as well as use their trusted full-time technicians, which increases when the workload is increased. Service companies are primarily moving from full-time dedicated staff to third-party independent contractor companies. Having this flexible workforce (i.e., contractors) gives companies a better chance of growing and increasing profitability than previously thought. We can easily create hybrid workforce environment by adding gig workers in organizations and human/machine partnerships.

· **Create an employee referral program**

It is no secret that some of the most successful hires are referred by existing team members. And this is true in almost every industry. In fact, according to Career Builder, 82% of employers' rate employee referrals as the top source of ROI when it comes to hiring. Which is why developing a well-structured employee referral program can make a big difference when it comes to building a robust talent pipeline. The best way to do it would be to offer clear incentives to both full-time and temporary employees, leverage social media whenever possible and keep track of where the best referrals are coming from.

· **Adopt 4Bs Model (Build, Buy, Borrow and Bridge)**

Build – Invest in learning and development to grow your talent pipeline Buy – Go to external market to find the best talent that cannot be built in-house in the timeframe required, Borrow – Cultivate communities of talent outside the organization, including part-time, freelance, contract and temporary workers to complement existing skills, Bridge – Help people move on and move up to new roles inside or outside the organization.

Current formal and informal educations system need revolutionary changes according to top fastest growing industries of the world. These industries are: Green energy, E commerce, Consulting, Virtual Reality and augmented VR, Bio-tech, Elder care, Cyber Security and Fin Tech.

Update

Cloud Skills demand is growing very fast and sufficient job opportunities in the IT industry is creating. In a recently published blog (How to Weather the Cloud Skills Shortage) by TOPTAL research, claims that cloud skills shortage is growing and employers cannot find skilled talent in this most demanding field. The blog has very interesting statistics regarding Cloud Skills Shortage and also identifies the seven most demanding cloud skills. https://www.toptal.com/insights/future-of-work/-aws-cloud-skills-shortage

[1] https://manpowergroup.com/ ; https://go.manpowergroup.com/talent-shortage

Haque Survey on Post Retirement Job

May 25, 2020

Nadeem Haque @nadeemhaque · May 25

our bureaucrats generals are retired too early. let us stop giving them post retirement jobs like in charge of PIA, PSEs, or regulatory bodies. Like in the west, why dot we send them to universities or think tanks to teach and research for 5 years?

yes	88.9%
no	11.1%

351 votes · Final results

Pakistan Socio Economic Monitor by Yasin J @pakistanm... · May 26

Replying to @nadeemhaque

They should teach applied skills as most academics don't have applied knowledge but alas they love power grab more than transferring knowledge to younger generation because all they have learned perhaps in those years of service is .... rule the ordinary children of lesser Gods

Shahid Razzaque @DrShahidRazzaq3 · May 26

Replying to @nadeemhaque

They hv nothing to do with research & teaching. They are very good at management & administration, so they must be placed in the most relevant places

tanweer @mtanweerk · May 25

Replying to @nadeemhaque

What competence do they have for any other job? And if they do qualify and get a govt job then pension should be stopped

Muhammad Hanif @M_Hanif173 · May 25

Replying to @nadeemhaque

Good question, great idea hope survey results form the basis of a future study on the proposal. BTW it should be made compulsory for top bosses to do social work for two years before political launching 🙏

Ihsan Khattak @Ihsan_Khattak7 · May 25

Replying to @nadeemhaque

Who select him for these posts???
I think they are selecter too....

Abedullah

Issues and Strategies to Revitalize the Agriculture Sector of Pakistan

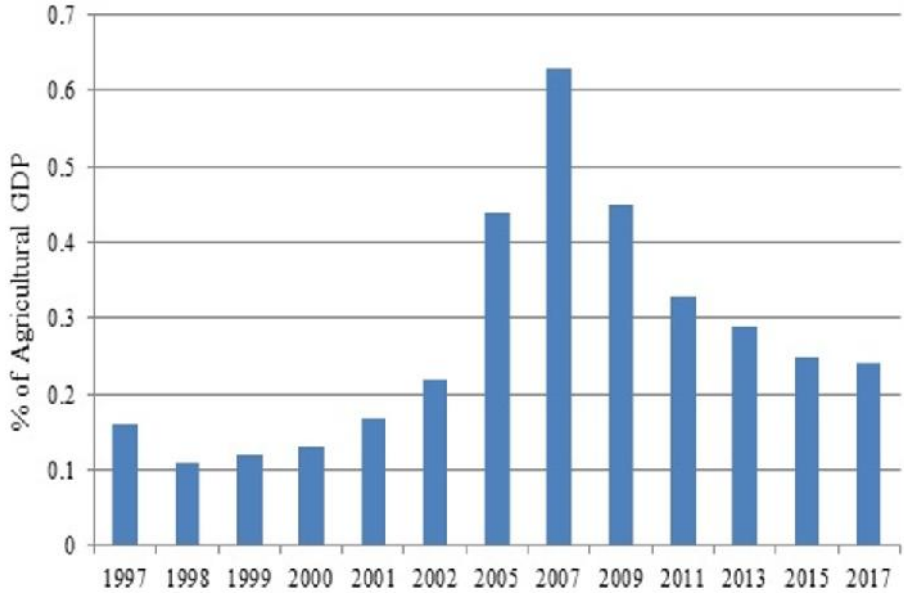
Agriculture is the lifeblood of Pakistan's economy because it contributes about 18.5% to GDP, provides livelihood to 64% rural inhabitants and employs 38.5% of the total national labor force. The sector has direct and indirect linkages with other sectors of the economy and plays a significant role in socio-economic development of the country. In contrast to high contribution of agriculture sector to Pakistan's GDP, a very meager amount of financial resources varying between 0.11 to 0.63% of agricultural GDP in last twenty year is spent on research and development (Figure 1). This has made Pakistan net food importing country since 2013 and put additional burden of US$4.261 billion in first nine months of fiscal year 2019. Yield gap between average and progressive farmers is about 40%, which is even higher between research stations and farming communities (40 to 80%). Although we proudly announced that we are food self-sufficient in wheat, rice and sugar but biased policies (input subsidy and support price etc) towards these crops discouraged farmers to shift from low value to high value crops.

Improvement in agriculture production is mainly driven by input intensification and area expansion but total factor productivity (TPF) is declining overtime. Injudicious use of chemical pesticide and fertilizer has adversely affected the natural resources like soil, water, air and quality and safety of food. High cost of production, low average yield and low quality produce are jointly providing space for imported products to occupy our local markets. These issues are making Pakistan uncompetitive in the international markets and also affecting the welfare of local consumers adversely. Water, being a critical input for agriculture sector is getting scarce but Pakistan's water use efficiency in the crop production system is extremely low. Empirical evidence indicates that some of the best and most fertile lands have gone out of cultivation but food demand is continuously rising due to increase in population and per capita income. Widening gap between supply and demand is posing serious threat to future food security and poverty alleviation strategies. It is warranted, if government does not address the aforementioned problems and challenges faced by

agriculture sector then not only food security of future generations is at risk but it may also slow down the development in manufacturing sector and increased trade deficit and balance of payments.

Lack of capacity in developing and adopting innovations at each node of value chains are further adding to the poor performance of agriculture sector. Stakeholders involved at different nodes of value chains are either not capable to adopt or they are unaware about the benefits of adoption of modern production, grading and processing techniques. Hence, poor adoption capacity and low return discourage stakeholders to invest in modern technologies, subsequently convincing them to operate at lower end of global production frontier. It increases the dependency on imported innovations, which are not only expensive but also risky in our environment. Moreover, it limits the adoption of innovation only to progressive farmers.

Macro and micro level structural changes may help to revitalize the agriculture sector. The low private investment in agriculture sector is mainly because of wider gap between social and economic returns on innovation in agriculture sector. Contract farming and development of agro-industrial clusters (AIC) could be a viable option but contract farming is not sustainable if different stakeholders in the value chain do not have the capacity to observe new technologies and innovations. Therefore, worldwide clusters have been considered potential drivers of agriculture development because cluster shifts



Source: UN (2017). https://www.theglobaleconomy.com/Pakistan/Research_and_development/

emphasis of firms from subsidies to competitiveness and differentiated products. Similarly, it also derive researcher from academic research to problem solving research and public funding to private funding research. Moreover, it helps to transfer government emphasis from broad-based subsidies to need-based support and general infrastructure to human resource development.

However, it is also well documented that subsidies appear to be the least effective option to raise agricultural incomes and poverty reduction, thus subsidies refers to inefficient allocation of resources. The development of agro-industrial cluster have potential to generate over US$19 billion additional income in the agriculture sector but private investments are not coming to harness these potentials. Unless innovations at different nodes of value chains and necessary infrastructure are developed through public investment, current situation is unlikely to change. Investment in agriculture sector needs to shift from subsidy to demand driven and problem solving research, establish incubators to transform subsistence agriculture into commercialization, and develop rural infrastructure to link rural economies with cities. Expansion of rural education network through agriculture based vocational training institutes could help to bridge the knowledge gap, improve productivity and efficiency of rural masses. These strategies will not only reduce dependence on

outdated extension system and imported innovations but also contribute to value addition by improving the agricultural value chains. Knowledge based innovations and interventions will lead to increase competitiveness, ensures future food security and reduce trade deficit. The process of uplifting agriculture sector can be summarized as below:

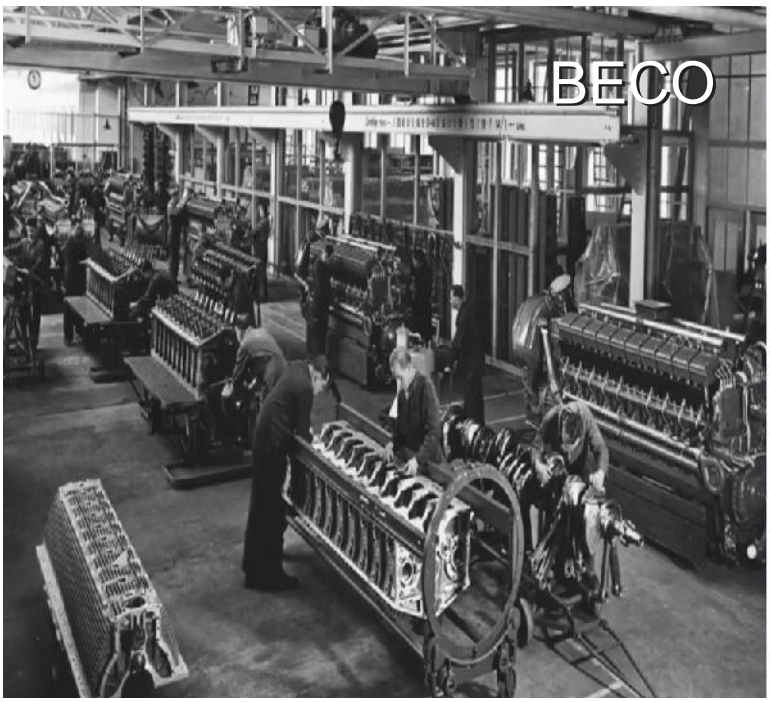
Policy reforms motivating vertical expansion in residential and commercial construction could help to slow down the process of moving agriculture from highly productive to marginal lands.

Shifting public investment from direct subsidies to problem solving research, towards developing production technologies (varieties and breeds), rural infrastructure, capacity building of stakeholders, establishing agriculture based vocational institutes and incubators, and strengthening public-private partnership could help to revitalize the agriculture sector.

· Identification of viable clusters for each crop could help to promote contract/cooperative/corporate farming to overcome the existing inefficient production and marketing system.

Economic Cost of Political Conflict

Nasir Iqbal



Economic development does not depend only on economic factors but also largely on non-economic aspects like institutions, political system and values. The political system plays a fundamental role to set the pace and direction of economic development.

A responsible political system is committed to creating a favourable environment, and facilitates investments to stimulate economic activities – hence, economic growth. In such a situation, citizens have less incentive to participate in political activities, since they engage in economic activities that are evident in the developed world.

However, in the developing world, citizens face numerous socioeconomic problems. Thus, they participate in political activities to solve their problems via political means. As a consequence, many political parties and interest groups come into existence in developing countries. These parties and activists normally present their demands through strikes, lockdown and blockades etc. These activities, in turn, generate economic and political uncertainty and therefore, can paralyze the entire production process.

Political protests remain very common in countries of the Subcontinent, including Pakistan. Pakistan has a long history of protests, strikes and sit-ins, with enormous media coverage of these activities. The right to protest / strike is considered a sign of a healthy democracy. Theoretically speaking, it allows people to raise their voices to decision-makers to obtain fundamental rights. But practically, these protests are associated with closure of economic activities and have often caused violence and loss to private and public goods.

Season II of protests and marches, in particular the 'Azadi March', began on October 27, 2019 from Karachi to Islamabad with new actors and old spectators. There are political and economic dimensions of the 'Azadi March'. From a political point of view, the key question is: what are the underlying objectives of the march? Geopolitical scientists can better answer this question. From the economic point of view, it is important to observe the economic consequences of these protests, marches and sit-downs. What are the economic costs, monetary and non-monetary, of the 'Azadi March'? What is the impact of this march on the local economy?

Literature has hinted at a significant impact of protests on the local economy. A study shows that the cost of production of manufacturing sector rises by about 1.17 percent due to the disruption

caused by strikes in Bangladesh. Another study reveals that the average direct cost of general strikes was 1.4 percent of gross domestic product (GDP) in Nepal and resulted in reduction of GDP growth rates from 0.6 percentage point to 2.2 percentage points.

In France, strikes caused a drop of around 0.17 percent of GDP and more than two-third loss in GDP was born by the private sector. Similarly, strike in Spain costs 0.1 percent of GDP, while in Austria, it costs around 0.46 percent of GDP. Another study shows that the protests caused an average decline in stock prices between 0.4 percent and one percent.

What would be the economic cost of strikes / marches and sit-ins to Pakistan's local economy. The monetary cost covers direct business losses, trade losses and increase spending on security services. Protests have a significant negative impact on the entire economy, such as increase in the price of necessary consumer goods translated into inflation, widening the fiscal deficit due to over-spending on security and trade deficit owing to low exports. Sectors such as transport are subject to significant revenue loss due to major service interruptions and considerable loss to vehicles.

Protests hit the manufacturing sector, albeit indirectly, owing to rise in production cost because of increase in input costs or decrease in total production. Therefore, protests eventually have long-term negative consequences throughout the business sector of the economy. About two-thirds of the workforce is engaged in the informal sector in Pakistan. These people get unemployed due to strikes and protests that contribute to huge production loss.

Considering global evidence, especially from neighbouring countries like Nepal, Bangladesh and India, we can assume that these strikes would cost up to 2 percent of GDP per year. This direct economic loss is three times greater than the total expenditure on social protection in the country (only 0.6 percent of GDP is earmarked for social protection). This highlights the consequences for the poor. If the same amount (loss in protests) is invested in the poor, Pakistan can easily alleviate poverty and hunger.

There are numerous non-monetary costs. These strikes hamper the general movement of citizens and are often associated with serious conflicts and violence that often cause injury. Due to these protests: companies lose valuable hours of work; factories lose working days; the poor lose income for days; patients fail to see doctors; shipments are delayed; meetings are cancelled, and overall the economy loses the desired goals. The biggest impact of such protests is violence, that causes loss of life and injuries. Although political parties often call protests on behalf of the people the protests directly and indirectly affect ordinary citizens, particularly those in the low or lower-middle income group of the economy.

Pakistan is a country with great prospects to develop. But today it is one of the lowest growing countries even in the South Asian region. If, somehow, we can restore political stability, the economic potentials ranging from human capital to natural resources can change the outlook of the country in a short period of time. Continuations of strikes, protests and sit-ins would further worsen the economy.

Political parties, therefore, should ponder on the costs of protests and strikes before initiating these activities. Pakistan faces chronic problems such as low economic growth with a high triple deficit, poverty, hunger, low quality human capital, terrorism and a weak governance structure. Unwanted strikes and other similar events have wasted the valuable time of politicians and other experts, including the media. The same amount of time could be spent discussing the real socioeconomic challenges to improve the country. They must invest energy to find some alternatives to strikes to lead the country towards prosperity and growth.

The government and relevant authorities should also correct their attitude of not hearing genuine voices until expensive strikes are organized. This requires the development of a culture to deal with a problem in a timely and honest manner. We should strike to end political conflict. We should move from trying to gain political power through protests to you engaging in a dialogue for strengthening of economic conditions of a nation.

Webinar @ PIDE

PIDE has initiated a series of webinars due to closure of in-house seminar in the wake of COVID – 19 Pandemic. These webinars are conducted on a bi weekly basis and are attended by students, researchers, academics and policymakers from different institutions around globe. The aim is to have debate among the students and academic community, create ideas, discuss new concepts for research, and get leaders to speak directly to the universities.

Report Prepared by
Hafsa Hina and Dilavar Khan

Managing Growth with Stabilization I

Masood Ahmad (President, Center for Global Development, USA)

- *How should Pakistan achieve durable adjustment without going through austerity of recnt years?*
- *What can be done to achieve growth accelation even when developing a stable economy?*
- *What are the major mistakes masde in the last 3 decades of adjustment programs in both design and implementation?*

Shaukat Tarin (Ex- Finance Minister of Pakistan)

Pakistan has been struggling hard for stabilization and strappingly relying on IMF programs for decades. Pakistan is extensively running after loans with the hidden conditions and now the state reflects that Pakistan is under pressure of approx. 53 billion debt. IMF internal evaluation report depicting that three things which lead towards austerity mainly include design failure, implementation failures related to government and institutional decay. Now the problem lies in the capacity issues especially in FBR, Ministry of Finance and Planning Division and finally the tax policy which is an absolute disaster of all. Considering the last program where offering a number of waivers, appreciated exchange rate, loss of reserves that built up debt during the program, increased energy prices and increased circular debt creating mess in the energy sector. Unfortunately, all these factors reflect the declining long run growth rate as well as investment rate i.e. Pakistan is lowest in Asia. Now the question arises that when and how we will be able to attain durable adjustments? What would be the ultimate objectives? Can our economic policy be able to refurbish all? Tax regime is happening at the cost of growth and employment. This is in fact a huge burden on the economy leading towards the declining GDP, killing investments and ultimately high fiscal deficit. While focusing on the austerity in Pakistan, there are no major rules for operational and maintenance, investment and capacity areas? Now shall Pakistan have to change the program design or will continue chasing

revenues at the cost of economy? As the growth is totally collapsed, so what will be the durable adjustment paths without growth escorting to the stabilization.

Mr. Masood Ahmad explained the story of stabilization of Pakistan divergent to international experience and highlighted the points on relationship between stabilization and growth. He explained that economic stabilization can have symmetric objectives but the current COVID 19 shock encountered an unanticipated collapse in demand and output and all related response programs are working hard to support to stabilize an economy. He further shared the figures on the current response to revive the aggregate demand. That rich countries have announced $8 trillion as a global rescue package and also offering the monetary easing policy in form of near-zero interest rates. Compared to that Pakistan also announced a PKR 1.2 trillion relief package and reduction in policy rate. But the issue is that there is a glaring difference between the fiscal stimulus and rescue packages that the rich countries have offered, with themselves compared with the kind of response, in terms of ability to respond, for the rest of the world. Traditional objective of economic stabilization is to restore macroeconomic stability by rebuilding foreign exchange reserves and reducing the current account as well as fiscal deficit. It can only be possible by enhancing the exports and reducing imports through change in exchange rate. Moreover, focus on fiscal and monetary adjustments to reduce the aggregate demand. Hence this will help to create conditions for resumption in sustainable growth and also slowing the economy down is built into the design.

He further reflects the outcomes of IMF programs in terms of current account outcomes, import compression, reserve accumulation and growth projections. Reasons for underperforming growth mainly includes under-estimation of fiscal/ monetary multipliers, over-estimation of growth impact of structural reforms and unimplemented planned reforms. In view of the structural reforms that targets to bolster the institutional and regulatory framework for all kinds of businesses and people's operations, is specially designated to ensure that the economy is able to realize the growth potential in a balanced way. The IMF record on bringing about n

successful and the same is true with the case of Pakistan.

The key points are that the IMF is effective in doing its job of inducing stabilization but the track record of laying the foundation of sustained structural growth is very vague. Stabilization is mostly being achieved through import compression resulting in well-restoring of foreign exchange reserves. Similarly, fiscal adjustment has heterogeneous impacts on growth depending on several other economic dimensions. Last of all, growth will come from structural reforms and a sense of ownership. In the case of Pakistan, there is a dire need to identify the constraints, stick to the fundamentals and chart a clear path with political willingness and accountability.

Mr. Shaukat Tarin, expressed that in all of these issues, the only thing where Pakistan progress is its well-thought strategic planning. The only delinquent fact relies with the road map and implementation design. All the stakeholders have a common consensus on Charter of Economy, not more than 6/7 points, as an economic way forward. It is acceptable that Pakistan has fiscal problems because of the reason of not generating money and expenses are at higher end. This would be the strategic objective for the government as well as for the opposition, because there is no time to redesign the program, just have to sequence the program by means of restructuring the machinery.

Coming up to the current account issue, it is equally true that Pakistan has not enough exports. The fundamental problem associated with exports is that it totally relies in the hands of the family businesses of Pakistan and they don't want to let go of control. There are no consolidation or bankruptcy laws in such cases. Moreover, Pakistan's export industry has no FDI and that industry is only commodity-based; not supporting the mega-orders exports. So, Pakistan has to seriously re-think on the exports, regenerate it and make our industry competitive. Third factor i.e., saving and investment rate which is also extremely very low. For this purpose the financial sector has to be revamped. This could only be possible to start with a good implementation plan, forward road map, good governance and good implementation.

In the end, Dr. Nadeem counter confirmed the saying of Mr. Masood that in Pakistan nobody is interested in growth and elite-captured people are the major hurdle hunters in the way of growth. The only point of concern is that when will the people of Pakistan start thinking and will demand growth. This is the only way that ensures Pakistan towards growth and stabilization.

Report Prepared by
Abdul Khaliq

Managing Growth with Stabilization II

Dr Adnan Mazarei (Senior Non-Resident Fellow, Peterson Institute for International Economics)

- How should Pakistan achieve durable adjustment without going through crushing austerity of recent years?
- What can be done to achieve growth acceleration even when developing a stable economy?
- What are the major mistakes made in the last 3 decades of adjustment programs in both design and implementation?

The growth pattern of Pakistan is not stable rather fluctuating from the last few decades. For the first time in history of Pakistan, a negative growth rate accounts for -1.5 is projected by the IMF, after the year 1952 when growth rate declined to 1.8% due to exogenous shock to agriculture. Moreover, the projections of the IMF for the year 2021 and further are optimistic. In the past, as compared to China and other developing Asia, Pakistan could have done a great job. For instance, the GDP per capita of Pakistan was twice as high as China in 1990, however, in 2018, the growth rate of both countries became closer as China moved faster.

In the case of the USA, our GDP per capita was 8 percent of that of the USA and in 2018, it moved to only 9 percent so the record is not satisfactory and as the people of Pakistan deserve.

There are a lot of factors which deteriorate the growth of Pakistan such as geopolitical, political and historical shocks, geography, governance and economic incentive structure. Further, Pakistan has not succeeded to control export diversification, except the

year 1984, after that the declining trend again started particularly in agriculture and textile. Contrary to other countries like India and China, we have not modernized our agriculture sector and are attaining low levels of agriculture yields. Other countries like Bangladesh have been focusing on growing exports.

Another factor contributing to the low rate of growth is the absence of Pakistan in global value chains. Although, Pakistan's participation in global chains has improved relatively to past years, as it was 22 percent during 1990-2015, while Vietnam was way ahead with 40% participation rate. The backward participation was negative as it stood at -2% indicating the decline in sophistication of Pakistan's exports. Whereas, the changes in forward participation was good but not significant as compared to other countries. Moreover, it also shows that other countries rely on inputs while Pakistan contributes in value-added.

Pakistan goes through repeated macroeconomic instability and adjustment cycles and the major reason for this is more emphasis on stabilization rather than growth. We often neglect the issue of growth because we repeatedly get confronted with cycles of stabilizing and lack of reforms to address the roots of that instability. One of the main factors behind it is the over-reliance on geopolitical rents and IMF financial safety nets. The reason behind focusing on stabilization rather than growth is the IMF programs that are more stabilization and crisis management oriented rather than growth oriented.

Unfortunately, whenever we have growth over 5%, we have gotten into macroeconomic instability or currency issues. We have been growing slowly because there are a lot of law and order issues in Pakistan and the state being weak has not been able to take care of the law and order situation. Similarly, in the past violence incidents of terror discouraged international businesses from coming to Pakistan.

Pakistan has not grown as fast as other countries. So, there is an overall need to understand the non-convergence puzzle and focus on growth. This requires balanced breathing space from stabilization. There is a dire need to identify the root cause of instability in growth. These instability cycles mainly, caused by excessive budgetary spending or other balance of payment problems. To overcome this problem, there is a need for a social contract that delivers shared economy prosperity, which focuses on building economic strength, and less reliance on geopolitics. Government should cut down the subsidies which were given to the elite such as the power and gas sector and put them into health, education and research & development for long term positive growth to achieve economic prosperity.

Report Prepared by
Nasim Akhter & Abdul Khaliq

Managing Growth with Stabilization III

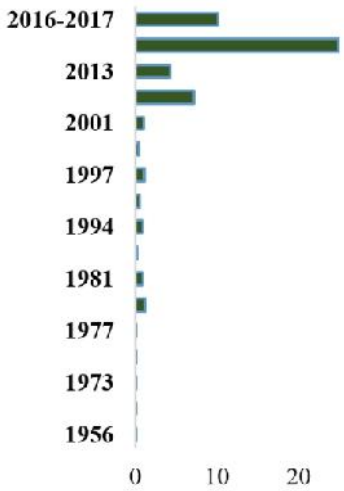
Dr. Salman Shah
(Advisor to the Chief Minister of Punjab on Economic Affairs and Planning & Development)

Dr. Hafeez Pasha
(Former Finance Minister, Govt of Pakistan)

- How should Pakistan achieve durable adjustment without joining through crushing austerity of recent years?
- What can be done to achieve growth acceleration even when developing a stable economy?
- What are the major mistakes made in the last 3 decades of adjustment program in both design and implementation?

As Pakistan's debt journey began in the year of 1956 with USAID and through massive loans Pakistan did not achieve the desired long-run growth with stabilization. Debt history of Pakistan clearly shows that Pakistan has two to three IMF programs in every decade, shows in Figure 1. Since, through massive loans instead of achieving long-term growth and stabilization Pakistan is facing deficits and a severe unemployment rate among young graduates which is around 33 percent estimated by the PIDE. This webinar enlightens us to understand what can be done to achieve the growth acceleration, what are the major mistakes made in the last three decades of adjustment programs in both designing and implementation by the policy makers. Further, how should Pakistan achieve durable adjustments without crushing austerity in recent years?

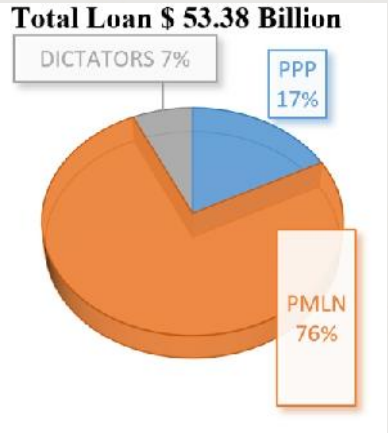
Figure 1: Amount of Loan (Billion $)



How we will move towards a stable long run path from an extraordinary set of difficult short run initial conditions?

To achieve the growth with stabilization we need to focus on the key prongs of long-term strategy to manage the growth with stabilization. The first is the whole area of progressive taxation reforms which has remained elusive last year and effort was made to broaden the tax base and remove some tax expenditures. But at the end unfortunately we were only able to achieve less than half of the initial growth rate that was anticipated. The second most crucial element in this regard is the rationalizing of

government size which is much embedded in the macroeconomic framework that has been presented by the IMF. Here the issue is how to be rationalized the size of government particularly of the federal government after following the 18th amendment. And funds have suggested a downward trend in the defense budget over the next five years, so, will we be in the position to do this? The Changes in expenditure priorities is the third most important area of impact to accelerate the



growth. It is truly tragic that the spending on water resources is reduced to the half level in terms of percentage to GDP ratio, when there is a need to focus more on water resources development. The absence of effective development spending can cause the constraints on growth potential. There is dire need to ensure enough financing in those priority areas to accelerate the long-term growth with stabilization.

The next element is the export-led growth in which Pakistan unfortunately has a big failure to promote its export. It is quite surprising that the exports of Pakistan remained unchanged from the last seven to eight years. To support the long-run growth with stabilization the policy makers must consider how we accelerate exports, how do we diversify our exports beyond the traditional dependence on low value-added textiles and how do we ensure balance in our current account.

Finally, in terms of individual and planning process and the strategy. It is extremely important that some key sectors should be identified, like agriculture, construction and so on. These sectors have strong backward and forward linkages and promote a measure of inclusiveness in the growth process. These are the few key issues which we need to focus to achieve the long-term strategy to manage the growth process with stabilization. Furthermore, there are two most critical elements in a strategy: mobilization of resources, revenues and exports.

Higher revenues and exports are very important factors for a medium to long-run strategy to achieve the higher rate of growth with stabilization.

In the context of macroeconomic framework there is always a question: how do we prepare our own macroeconomic framework instead of relying on the framework of the IMF. The other associated question is that should we change our program design or not as the program design has remained unchanged. If we look at the current situation the whole world turned upside down from the stabilization program. In the time of crisis talk about stabilization is not the right way as every sector of the economy including production, consumption and supply chain and so on, facing disruptions. This is the time to think about how we make the workplaces operational and how long it will take and what kind of strategy the government

should adopt to normalize the things instead of still focusing on austerity. The banking sector should have to gear up the economy in different areas such as SMEs, construction and so on as they have plenty of liquidity to boost the economy particularly in the period of COVID-19.

In addition to the above, our program design is based on very heavy taxation as our economy is tax led. The major focus of almost every government is to increase the revenues through excessive taxation. A plethora of taxes were imposed by every government not limited to the withholding taxes, presumptive taxes and full & final taxes. All our programs are tax led and growth is the second concern always and considered as residual by our policy makers. On the other side tax is a huge documentation cost, so, the question is should our program be tax led?

This is the one of the fundamental concerns in the context of current program design which relies heavily on a big increase in the tax to GDP ratio, resultantly, which provide the resources for expansion particularly in development spending which ultimately accelerate the process of growth.

According to the current program design, the expected tax to GDP ratio is 2.3 percent of the GDP in one next year. On the flip side, our tax system has been captured by the report on the sugar crisis and the price increase which happened for the first time in the history of Pakistan. The second issue in our tax system is that most of the taxes are collected from the trader. If we look at our neighbor India, only one city Bombay is collecting five times more property tax as compared to the total national property tax of Pakistan. Therefore, there is an urgent need for structural reforms in the current taxation system.

The Greece program is one of the successful programs led by growth not by austerity, so, the question is can we have the program led by growth instead of tax led. For long run growth and stability, we need a huge investment particularly in the infrastructure sector in every city. If we look on figures there is 50 percent public investment and only 15 percent is private investment. Therefore, there must be public private partnership at a higher level to stimulate the growth for a long term period. There are particularly two or three areas that can contribute in growth led strategy.

The first is the construction sector not in terms of infrastructure but in the context of development of water resources etc. and the private construction too. As now the government has introduced a construction package by providing a wide range of supply including a tax amnesty and free environment. The issue lies on the demand side which is what the builders will construct if there is no need for housing in the country. If we want to follow a growth led strategy then there is a need to focus the banking sector on developing housing finance which is very low around 0.6 percent. In the current system we have some issues like we don't have low cost housing relatively long-term, we didn't develop a proper foreclosure legal framework. As the government rightly identified the construction sector which has linkages and could become one of the focal points for growth strategy.

In the present era innovation and entrepreneurship are considered as major drivers of long run growth and stability. So, we need to focus on innovativeness

and dynamism; our SME sector contributes a lot in the growth but unfortunately this sector has been hopelessly starved for credit and one of the ignored sectors in terms of credit financing. Again, in terms of SMEs financing our banking sector is not promoting and investing in this sector of the economy which is almost counted for the 40 percent of the economy. What the banks are doing is they are just investing in PIBs for more money with zero risk. For a long-term growth strategy along with others we should develop an innovative SME sector.

Pakistan should have a growth led strategy but unfortunately Pakistan government didn't propose any growth led strategy. The International Monetary Fund (IMF) is looking for it but the Pakistan government didn't want a throat. Now, in this strategy what would be the key structural reforms? As already mentioned, from the political economy perspective there should be structural reforms in taxation system, preferential, input-output pricing that is one key area of structural reforms. Here the question is, is it politically feasible?

The other key area of structural reforms is the power sector in terms of merit order of plants. As the power sectors problems have reached a dimension that they are beginning to be a limiting source to growth in terms of financial liability (which is mentioned as contingent liabilities in budgetary documents and nobody wants to talk about it) and how can we build markets for the power sector. We should also focus on cost plus price mechanism rule of NEPRA. These are some fundamentals step we have to take to ease the process of long-term growth.

As inflation is one of the most important factors to accelerate growth and we have an inflationary economy. IMF set an inflation target of eight to five percent and the Phillip curve clearly demonstrates that there is a trade-off between growth and inflation. So, the questions are, do we need to chock off the growth with real interest, do we need a higher inflation target and where is the sacrifice ratio of low growth rate?

There are some other factors in which we are lacking and that have a strong and long-term impact on growth. One of them is, Pakistan's lack of concern for human development and history exposed that we didn't spend a fair amount of money on developing human capital. If we compare our level of human development with very small and young countries like Bangladesh and Nepal, we will be disappointed to see that we have a lower level of human development as compared to these nations. Unless we don't train our people in innovation and technology, we cannot achieve the higher level of productivity which ultimately creates maladjustments in the growth process. So, there is a need to spend a handsome amount of money on tanning and soft skills for the long-run stable growth rates and fortunately this program also supports this.

At last they give emphasis to strengthen the planning commission once again to negotiate the fund programs and to develop the growth led strategies. Further, the 18th amendment has extremely strong planning development departments or boards in the provinces which is quite required for the growth. The critical element in this within the federal government is the absence of the role of think-tank institutes like Pakistan Institute of Development Economics in the planning process. We need more

participation from the civil society and the key institutions of the government universities to develop more critical thinking for growth led strategies. The growth led strategies have to be more broad-based and transparent. On the other hand, if we compare governance indicators to countries like Vietnam, we will see a clear collapse of governance in Pakistan which is also a hindrance to move towards long-term growth with stabilization.

Therefore, the only solution is to do the reforms as the Prime Minister has already said this is the best time for doing reforms particularly the time period of COVID-19.

To sum up, Pakistan is facing a lot of challenges to achieve long-term growth with stabilization not limited to the taxation system, land management system and banking sector. One of the prominent challenges is the absence of growth led strategies along with lower levels of human development, lack of innovation and technology and absence of the academic institutions in the planning process. Therefore, there is a need for structural reforms in the taxation system and to spend a prestigious amount of money in resource development and research & development. Furthermore, to achieve the higher growth we have to promote and develop innovative SME sectors.

Haque Survey on Foreign Consultants and Donors

Foreign consultants and donors seek to achieve narrow short-term interests through their aid.
It causes a greater risk to detracting attention, resources and efforts from the primary objective of sustainable development

April 29, 2020

Nadeem Haque @nadeemhaque · Apr 29
Why are we so dependent on foreign consultants?

Good advice	12.3%
Bad domestic intellect	26%
Money trips local agents	16.8%
Colonial legacy	**45%**

358 votes · Final results

February 06, 2020

Nadeem Haque
@nadeemhaque

How is policy made in Pakistan

Based on good research	6.1%
Pushed by donors	37.5%
on whims of leaders	**56.4%**

459 votes · Final results

Nadeem Haque @nadeemhaque · May 17
For solving policy problems or developing research for policy, should government turn to

Local universities	**86.4%**
Donors	13.6%

279 votes · Final results

Report Prepared by
Abdul Khaliq

Banking Finance and Economic Growth

Guest Speakers

Atif Bajwa
(President and CEO, Bank Alfalah)

Zubyr Soomro
(Chairman, National Bank of Pakistan)

Syed Salim Raza
(Former Governor, State Bank of Pakistan)

Alman Aslam
(Ex, Citibank) and

Shahzad Dada
(CEO, Standard Charted Bank Pakistan)

Key Questions

- What role do our banks play in our economy?
- Are they merely bankers to the government?
- How do we get more consumed and investment focus?
- Are deposit coming from the poor areas and going to rich areas?
- Are they helping or slowing down technology adaptation and digitizing payments?

Banking system plays a pivotal role in human resource building and economic development. If the banking system is not well organized and efficient, it creates obstacles and instabilities in economic growth and development. In the past, foreign banks in Pakistan had an important role as they were allowed to operate at the time of nationalization. Foreign banks had three factors that gave an edge over Pakistani banking system: delegation of authority, they promoted training and skills and followed the merit. When we privatized our banking sector, a lot of foreign banks exited and our local banks selected a plethora of people from the pool of foreign banks which were appropriate in terms of delegation of authority, perception of merit, and in terms of training. At present, our banking system faces serious hurdles in attracting talent both domestically and overseas for the public sector banks as well as for the private sector.

In the context of public sector banks, the question is, why does this sector have to face difficulty in attracting the talented people? The answer may be the governance standards which impacted the ability to choose the right team, it means, there is more bureaucracy in it. The issues in the public sector are harassed by the NAB, FIA, the judicial activism all these things create maladjustments to attract and retain the talent in public sector banking.

On the other side, in the private sector there is delegation of authority and decisions made on purely professional terms. Although, it has been impacted by the Seth culture as the bigger banks were more professional and benefitted by attracting talent. However, now the opportunities to attract talent are vast because the banking sector overseas throughout the Middle East and beyond, there is a pressure on banking jobs as the economy is suffering. Another serious barrier in attracting the talent back to the country is unhealthy emphasis on dual nationality and trust issues, as it discourages required talent. Although, we still can attract the talent but with more difficulty.

In the past, our domestic banks attracted that talent and created some of the best bankers even though they did not always come from foreign banking community. The institutions that went through the process of producing best bankers globally blame nationalization or other forces that brought professionalism down. The situation in the current banking system is the lack of concerted efforts to train people. It is crucial for us to address the merit of talent in our current banking sector in particular training efforts. As there is no shortage of talent but the training of talented people is required. Moreover, training

was a dominant factor in foreign banks to stand out in terms of creating talent, since the foreign banks left, the national training grounds has reduced; unfortunately, the domestic banking sector has not taken up that challenge and did nothing in terms of training. If we look at our training budgets and the development of training centers, we will be disappointed as our banking system has the tendency to cut the training budgets. Local banks need to fill this gap, need to spend a fair amount of money on training; similarly, boards and the sponsors have to support this due to the fact that it is a business and an industry where the long-term real asset is people. We have also seen some great examples where the quality of management, longevity of management and management strategies have shown success, such as Meezan Bank.

The development is not something that comes naturally and Pakistan is far behind in it. Although, banks are privatized now. They are earning by investing in PIBs and lending to the government. Despite all these, there is no incentive for banks to train people. Our banking sector is not capable of producing leaders like Zubyr Soomro and Salim Raza. There is dire need for within organization mentorship and learning culture. Banks that do not do this will be the net losers regardless whether the public sector, private sector, state or non-state sector because this is the biggest asset of any economy.

By the same token, wage is the prominent and first factor which attracts the talent in any organization irrespective of the locale. The employees on a high grade are getting a lot of facilities and incentives as compared to the lower graded staff. In Pakistan's banking system the professionals who come from the foreign banking community paid highly relatively to the domestic staff. This discrimination is discouraging the talent heading towards banking sector.

In any economy, the banking sector invests a huge amount of money in project financing, they give incentives to the line of business, exclusively to SMEs, training, product development and the like. In the current banking system, banks collect deposits from the customers and invest them into government papers and in return they earn money. Now when the interest rates come down, they will be sitting on huge capital gains for the next four to five years. So, the question is why they should invest in human resources or in product development, when they can earn by doing nothing? It's convenient for banks to make money being bankers to the government because it's risk free. Government pays more for three months paper treasury than the banks pays in the market, therefore, it is the market failure. Furthermore, there are two alarming developments in the last four to five years in the banking system. One is, our banking system is very small and only accounts for 33 percent of GDP as compared to India's 64% and Bangladesh's 47% part of GDP. Hence, against our small banking system we have a massive ramp up in cash in circulation which is 43% whereas a decade ago it was 27%, 14%, and 16% in India and Bangladesh, respectively. Cash leakage or cash not coming to the banking sector mutes the capacity of banking multipliers to expand deposits. We are not expanding the banking sector, we are debunking as when cash grows faster than deposits, we potentially debunking. To address this problem, fiscal

policies have to take necessary measures and interest rates must not be in a soaring trend. The second unfavorable development in our banking system is our two-thirds deposits go to government securities and guarantees. Resultantly, there is no project financing and no product development.

Glaringly, competition is an essential factor for the growth and efficiency of any industry. In the banking system of Pakistan, the smaller banks do not have the capability of raising deposits at the same cost at which the larger banks can because larger banks have bigger branch networks. The cost of network expansion is too high so the smaller banks cannot afford this. Likewise, the larger banks have the low deposit cost, they can easily lend to the large corporates as it is agreeable by everyone at the finite rates because of the low the risk; vice versa is true for the smaller banks. The ability of small banks to attract talent in the risk management department is very difficult, at that time it becomes expensive and they are not financially capable of doing this. Thus, this scenario is in favor of large banks and not in the small banks. In the same way, the interest of the big banks in the market is putting money in government papers to earn money with zero risk, so, the competition for the rest of business is not a great competition. Additionally, the state bank of Pakistan has vetoed the issuance of further banking licenses from the past 15 to 20 years, which is also a hindrance in the way of the competitive banking market.

In addition, our current banking system still has commodity financing but the corporate financing has not changed yet. The issue on the equity side is that there is not a huge incentive for issuers to issue equity because the p-ratio in the market is around four and half. When the cost of raising funding by issuing equity is multiples by what can raise money in the banking sector, in other words, debt is cheap in terms of cost. As far as the equity market is concerned, there is great desire by the issuers at this time to issue equity. So, there is a dire need of the venture capital and corporate bond market because it can develop project finance and long-term loans will be offered. At present, our saving institutions, pension funds and insurance companies do not have a reliable long-term market to invest.

In Pakistan, there is a perception about the banking sector that the deposits come from the rural areas and go to the urban areas through large corporates. Admittedly, it's true, according to the State bank, 10 percent of the total deposits comes from the rural sector and only 4 percent of that lend to the rural areas; this is clearly a mismatch. It's easy to blame banks for that, but we cannot neglect the fact that finding credible borrowers in those areas is not easy because they are not structured and also the local environment, commercial banks do not support them. To make it clear, banks lend where the risk is lower and due to the lack of legal framework banks do not invest in SMEs as the risk is higher and there are still pockets of the economy dominated by the financial sector and by the state which just distorts things and those are things which cause amongst other distortions of the system. So, in the current time there is a problem with the lending system.

At last they highlighted the innovative and technological aspects that the advancement in these two considered as an imperative tool that

affected the banking sector. Ostensibly, the banks are not only the large user of technology but also the large investors; however, they are not great innovators of technological solutions. The lethargy that comes from the large institutions reflects itself in the ability to innovate quickly and therefore partnering with FinTech is absolutely an essential element of the future strategies. The Pakistani banking sector is not so innovative because we lack in talent development which is the essential element for innovation. As far as technological solution concerns, there are things coming from technological solutions: digital banking and structuring credit. The biggest issue in the current banking system is mispricing of risk and in its presence, creating a market and environment is difficult where the development of products can be intermediate between the suppliers of money and the demand for the money.

Report Prepared by
Wajid Islam

Why Businesses Don't Grow in Pakistan

Atif Bajwa (President, Bank Alfalah)

Waleed Saigol (CEO, Kohinoor Group)

Alman Aslam (Ex Corporate Consultant, Citi Bank)

Mohsin Iqbal (Ex Country/ Regional Manager, Intel Corporation & Hewlett Packard)

Business in Pakistan after 20 years of protection and subsidy still remain SMEs by international Standards
Local corporates are family owned with a small share on the stock market, hardly any is professionally managed or run
Few have innovated in product or process or broken into new markets
No country can grow without corporate growth. What are the reasons for this corporate malaise on Pakistan?

Pakistan is the 5th largest country by population in the world. According to the World Bank 64% of Pakistan's population is under the age of 30. The country is full of natural resources, with vibrant population and myriad opportunities. Unfortunately, after 73 years of independence we have not capitalized our resources and population to improve businesses in our country. On the other hand, our regional competitors and other countries have managed to grow very rapidly in a very short span as compared to Pakistan. Here our main concern is why Pakistan has not managed to improve its business environment in the presence of humongous opportunities for businesses growth.

As the famous saying goes that data and facts speak louder than words. We are lacking some measures due to which businesses do not thrive in Pakistan. Firstly, our credit to GDP ratio is extremely low, that is only 18%, while India and Bangladesh are far better than us. According to an approximation they are 3 times better than us in this regard. Secondly, collateral-land value is locked in Pakistan. We have only 10 to 20% of land for collateral. Thirdly, we completely lack better bankruptcy laws. Moreover, our government has high credit demand from the banking sector as compared to our competitors. Furthermore, our investment to GDP ratio is very low.

Regrettably, the business environment has not improved in our country with the passage of time. In 1986, our exports were 3.8 billion dollars and the exports of Vietnam were only 0.8 million dollars. But currently, Pakistan exports are only 24 billion dollars, while Vietnam

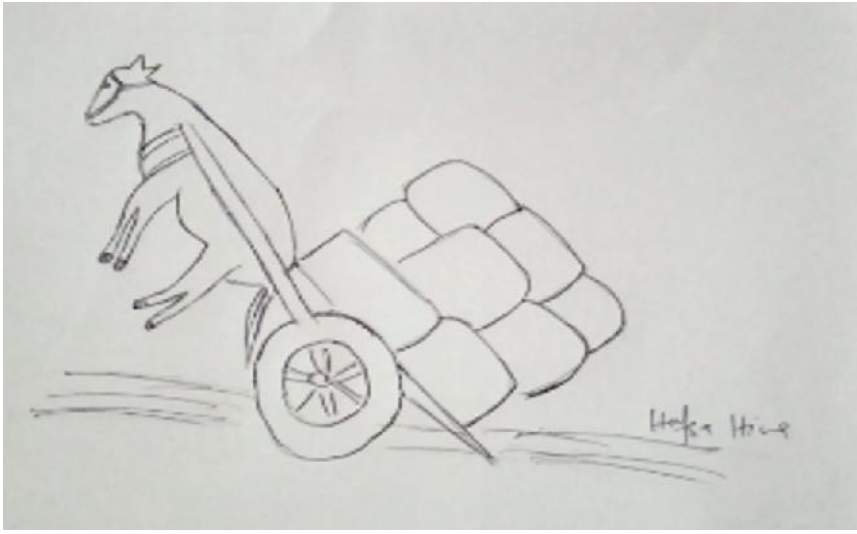
exports have sky-rocketed to 264 billion dollars. Pakistan has only managed to improve its exports 6 times, while Vietnam exports have grown exponentially by 330 times. Apart from the export sector, we have failed to improve the market Capitalization of our large sectors like; OGDCL, MCB, Power sector, PTC, ENGRO etc. The market cap of our large firms is about 2.8 billion dollars, however, in India it is 13 billion dollars. We have miserably failed to improve our financial, power and export sectors.

Why have we failed to spur businesses growth in our country? Is the culture not suitable for growth? Does the mindset of people a hurdle? Is the government failing to provide opportunities for businesses growth?

These are some of the reasons, which is adversely affecting businesses. The first barrier is the lack of professionalism in our business community. Our local businessmen do not invest in professionalism. On the other hand, international businesses Mughals invest heavy sums on improving professional ethics and environment.

Moreover, our local businesses are not adopting the modern ethos of businesses, by failing to establish good organizations and suitable environments. They are only busy in the blame game by blaming the government for not providing a feasible macro-environment. Furthermore, we lack innovation and entrepreneurships. There is no trend of risk taking. They all are in the search of a golden way to boost their profits by avoiding risk. Contrarily, the trend is different in the international arena. Large businesses are investing hefty amounts on innovation and new ways of improving businesses growth. Moreover, foreign firms hire their human resources on merit basis, which then prove their worth.

Apart from business community failures, the role of government is also not very supportive. The market is overregulated by the government. Rent seeking is widespread. FBR policies are making barriers for a growth environment. Moreover, the corrupt and inept elements in FBR are making the survival of businesses difficult. In addition to this, we lack a vibrant legal system for businesses protection. We still rely on old colonial laws. Government is only supportive to elite groups, who actually run the governments. Perks and privileges are only awarded to a few selected ones, which further deteriorate the competitiveness of the market. New players cannot afford to enter the market, as entering needs linkages in bureaucracy, government and heavy bribes for the authorities.



The list of impediments to businesses growth in Pakistan is very lengthy due to which we have failed for 73 years. But now it needs drastic reforms, if we want to create a viable and vibrant environment for businesses thriving. First, the government has to implement business friendly laws. Moreover, changes its monetary and fiscal policies according to the needs of circumstances for growth. In addition, stringent reforms in institutions will also help to develop good business practices. Providing facilities to the firms will enhance their productivity. Bringing good legislation and implementation will attract large businesses from abroad as well as from the local market. Without reforming the current faulty system, the revival of businesses growth is near to impossible. We can only hope for the best and can struggle to bring the growth on the right track.

Working Papers @ PIDE

Omer Siddique
PIDE Working Papers No. 2020:11

Total Factor Productivity and Economic Growth in Pakistan: A Five Decade Overview

- The evolution of total factor productivity (TFP) is a key determinant of the long-run output growth. There is substantial evidence available that shows that the countries that managed to boost their TFP grew at a much higher rate and for a sustained period.
- This study presents an account of Pakistan's output and TFP growth rates for the total economy as well for three main sectors, viz. agriculture, industry, and services sectors.

Box 1: What is TFP?

- In the growth accounting framework, total factor productivity (TFP), also known as multifactor productivity, tells us how productively the economy uses the factors of production to produce output.
- TFP is that part of the GDP growth that cannot be attributed to factor inputs.
- TFP may also increase economic growth by allocating inputs more appropriately and efficiently, resulting in production getting very close to the optimum combination of inputs and outputs.

The Findings

Table 1: Sources of Growth in Pakistan's Economy:1972-2019

	Annual Average Growth (%)				Investment (% of GDP)
Period	GDP	Capital	Labour	TFP	
1972-2019	4.81	4.11	2.21	1.62	18.32
1972-1980	5.06	1.80	5.04	1.71	15.00
1981-1990	6.00	6.25	-0.06	2.77	23.43
1991-2000	4.01	4.49	2.81	0.33	20.82
2001-2010	5.06	3.32	4.21	1.31	17.03
2011-2019	4.28	2.82	1.55	2.07	14.60

- As Table 1 indicates, GDP, TFP, and capital grew at the highest rates during the 1980s. The growth rate of employed labour was negative during that period. Hallmarks of this period were halting the nationalization regimes of the 1970s and the revival of private industrial investment.
- The impressive, important performance also came on the back of the large public sector investments made in the 1970s, such as Tarbela Dam, and fertilizer and cement factories
- Table 1 also shows that TFP was the highest in the period (the 1980s) when the investment-GDP ratio was also the highest at 23.43 percent.
- In the 1990s, also sometimes remembered as Pakistan's "lost decade", the economy took a turn for the worse.
- There are many explanations, such as soaring external and public debts, for the lackluster performance of Pakistan's economy during the 1990s.
- The TFP growth rate improved during the 2000s to 1.31 percent and so did the GDP growth rate, which was 5.06 percent. The improvement in the growth rate in the 2000s can be attributed to improvements in stabilization policies and most importantly to structural reforms. There were improvements in trade openness and financial depth.

- In the 2010s, the GDP growth declined to 4.28 percent from 5.06 percent in the 2000s. What is surprising, though, is the impressive growth rate, by Pakistan's standards, of TFP.
- It grew at 2.07 percent during this period, which is higher than TFP growth rates in all the decades except for the 1980s.
- In the 2010s, the TFP growth rate accounted for almost half of the GDP growth during the decade. It may reflect, the growing contribution of the services sector in Pakistan's economy, which requires less investment as compared to the industrial sector and an increase in capacity utilization, especially in the latter half of the decade, which was lying idle due to the energy crisis in the first part of the 2010s

INTERNATIONAL COMPARISON

Table 2:GDP and TFP Growth Rates (%): Cross-Country Comparison

	1971-2017		1971-1980		1981-1990		1991-2000		2001-2010		2011-2017	
Country	GDP	TFP	GDP	TFP	GDP	TFP	GDP	TFP	GDP	TFP	GDP	TFP
Pakistan*	4.81	1.62	5.06	1.71	6.00	2.77	4.01	0.33	5.06	1.31	4.28	2.07
India	5.40	1.37	2.96	-0.30	5.40	1.75	5.32	1.69	7.17	2.40	6.50	1.31
China	8.50	2.87	6.03	0.27	8.87	3.36	9.92	4.55	10.02	3.54	7.30	2.54
South Korea	6.59	1.94	8.46	2.66	9.32	2.97	6.72	2.10	4.45	1.03	2.89	0.54
Taiwan	6.41	2.36	9.94	3.19	7.89	3.23	6.49	2.21	4.08	1.65	2.46	1.14

- Pakistan's TFP growth rate, compared internationally, is not dismal, especially when compared with India's TFP growth.
- Pakistan's lackluster TFP growth performance, however, becomes clearer if compared with other high-performing countries, especially China and Taiwan.
- During the current decade, though, surprisingly, Pakistan's TFP growth is quite impressive at 2.07 percent compared to India's 1.31 percent. It is the period during which India's GDP has grown at 6.50 percent whereas Pakistan's GDP growth rate is 4.28 percent.

Takeaways

- On average it is the input accumulation that has driven growth in Pakistan. It was only in the 1980s and 2010s that the TFP growth contributed respectably to the output growth—in the total economy and the industrial sector. In the other sectors, the main contributors to the output growth have been capital and labour.
- The labour input has contributed the most in the agriculture output growth, except for in the 1980s.
- In the services sector, the main contributor has been the capital input except for in the 1980s.
- There has been some revival in the TFP growth in the current decade (the 2010s) because of, perhaps, the utilisation of idle capacity and some of the reforms undertaken in the previous decade.
- The Paper argues that there is substantial scope for the private sector to invest and lead the economic recovery of Pakistan

Nadeem Ul Haque
PIDE Working Papers No. 172

Macroeconomic Research and Policy Making Processes and Agenda

- The paper is focusing on the epistemology and the constraints faced by the process of policymaking in Pakistan. It suggests the correct macroeconomic approach for Pakistan.
- First of all, we need to end austerity, which is a primary condition of the IMF adjustment program. It remained in practice to cut expenditures and raise taxes on account of austerity regardless of its harmful impacts on growth. Austerity in Pakistan has created an economy of shortages and is choking growth and employment.
- Secondly, growth must be central to any policy going forward unless adjustment programs which do not frame the growth issue. Unfortunately, Pakistan is a slave of redundant and obsolete economics where megaprojects and aid if end up in a 5 percent growth rate our policymakers start congratulating each other. However, reality shows that Pakistan needs a growth rate of 8% for the next 30 years, according to its demography. Global experience has shown that for sustained growth, there is a need to bring systematic reforms in government and institutions.
- Thirdly an excellent macroeconomic approach should not overlook the significance of governance system. In Pakistan, reform and renewal have been postponed for decades. Resultantly, the governance system has suffered not only natural depreciation but also is weighed under with huge new responsibilities that it was not designed for. The thinking community of Pakis tan must take up the impact of poor governance in its every detail in an extensive research program to develop serious reform and policy choices and plans.
- Lastly, there is a dire need to clarify the difference between reform, policy, and project. Academia must help to develop a better understanding of reform and policy and guide the government to move beyond projects and aid. Reform must go beyond price adjustments, increased taxation, and privatization. It must seek to change institutional, organizational, human resource management, and decision-making processes where necessary. At the same time, a policy should follow thorough research and consultation to set up a coherent set of principles for guiding individual and group decision-making and interaction. Both policy and reform must be based on local context and cannot be mere aping the west as in the best practice thesis.
- Nadeem ul Haque suggests that we must learn from Mahbub ul Haq and challenge ourselves to be relevant and use our knowledge and research to inform policy. In order to get here, the economist/public policy community must take a few important steps. These include a focus on building knowledge, dare to question, funders must listen, and develop more forums.

Nasir Iqbal and Vince Daly
PIDE Working Papers 2013:

Rent-seeking Opportunities and Economic Growth in Transitional Economies

- This paper focuses on the issue of Rent-Seeking Activity (RSA). The authors discuss why the countries are not catching up despite launching a process of economic development but are still in a transitional phase.
- The study finds a considerable heterogeneity in opportunities for rent-seeking activity (RSA) in a group of 52 developing/transitional countries.
- The rule of law is not equally effective, property rights are not equally well-defined; democratic rights are not equally extensive. Individuals and organizations that have political or administrative authority will not find that authority is equally restricted by checks and balances.
- Unrestricted authority is an opportunity for rent-seeking behaviour that may redirect resources, violate regulations, and focus effort on wealth re-distribution ("bribery"). The consequences for growth can be harmful: resources may not be efficiently allocated, externalities may be ignored, and transaction costs may be increased.
- However, the study does not argue that RSA is absent in more developed economies but believes that there are grounds for expecting them to be "… far more severe in middle and low income countries".
- Arguments can also be made for some positive consequences of RSA: for example, bribes may facilitate production or trade that would not have happened otherwise, or may serve as signals for growth opportunities; corrupt practices may promote efficiency by allowing private sector agents to circumvent restrictive regulations.
- This particular study offers an empirical assessment of the overall macroeconomic consequences of institutional frameworks that offer opportunities for RSA.
- The study uses Generalized Method of Moment (GMM) to estimation, and the extent of cross-sectional variation leads us to prefer the "System GMM" estimator.
- The empirical analysis has shown that RSA retards economic growth, in that democratic institutions, which are inimical to RSA, are growth enhancing. It is also find that reduction in the perceived extent of corrupt practices can be growth-enhancing, but only if supported by well-developed democratic institutions.
- In the "weakly democratic" countries, the study finds an absence of path dependence; the growth experience thus appears fragile and uncertain in the sense that random disturbances have relatively high persistence, compared to the countries with an institutional framework that is more supportive of growth. In this RSA-prone group of countries, the study also finds an insignificant coefficient for physical capital investment.
- The main policy implication of this study is that governance institutions that are not overtly "economic" in their focus may nevertheless be integral to economic development. The study finds that democracy in and of itself is associated with more sustainable economic development for transition economies and additionally, within the more democratic countries, a reduced incidence of (perceived) corruption is associated with faster growth.

Nasir Iqbal, Musleh ud Din, and Ejaz Ghani
PIDE Working Papers 2013: 89

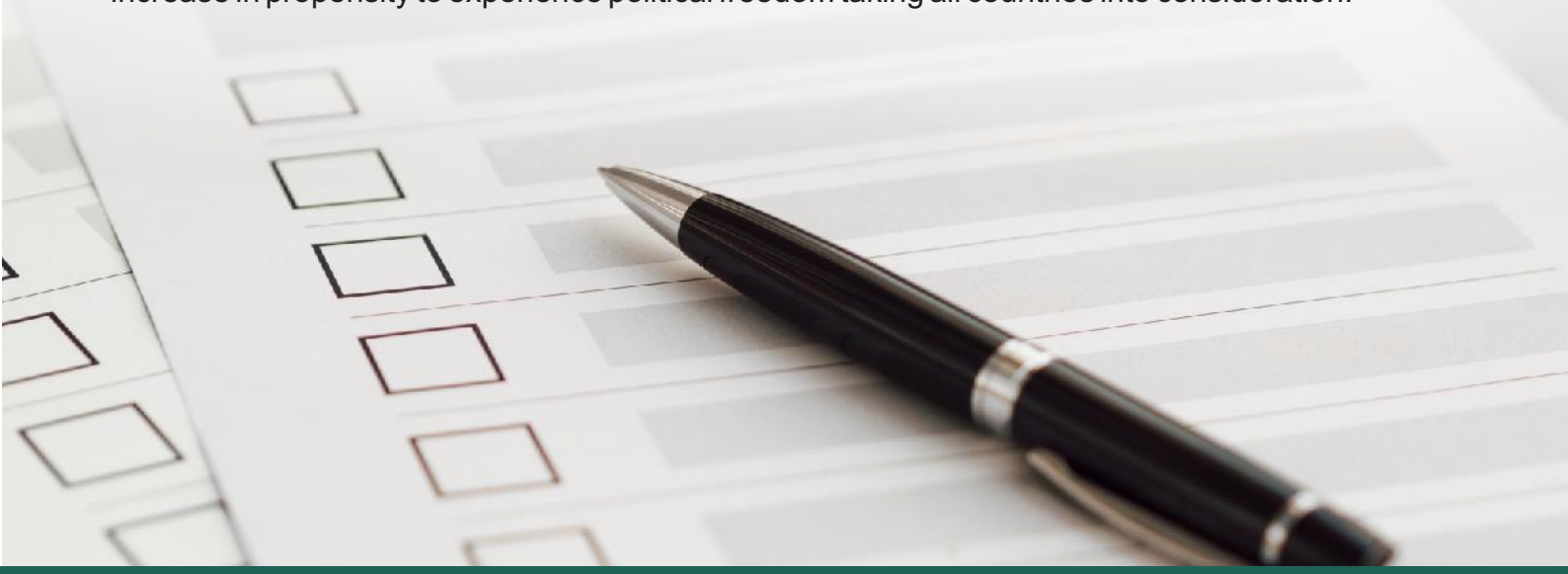
Fiscal Decentralization and Economic Growth Role of Democratic Institutions

- This paper attempts to analyze the impact of fiscal decentralization (FD) on economic growth. FD involves shifting some responsibilities for expenditures and/or revenues to lower levels of government. It is an effective strategy to promote economic growth by increasing the efficiency of the public sector.
  - This procedure reinforces the government's responsibility to the residents by including them in checking government execution and requesting remedial measures. This procedure moreover makes governments responsive and responsible, prompting lower defilement and improved conveyance of open administrations. The certain presumption behind the positive commitment of FD is the presence of an overall characterized institutional system. This expands the responsibility and straightforwardness in the political framework and henceforth bringing down corruption. That, at last, prompts a significant portion of open assets and, consequently, financial development.
  - Since autonomy, the Niemeyer Award 1947, the Raisman Award 1952, the One-Unit Formula 1961 and 1965, and seven NFC grants dependent on the 1973 Constitutions for income sharing have been reported. As of late, the administration of Pakistan has attempted two significant improvements by marking the National Finance Commission (NFC) grant and bypassing the eighteenth Constitutional Amendment. These improvements would cause a major move in the division of forces between the inside and the provinces. The need for FD in Pakistan arose due to the mismatch between expenditure requirements and the revenue generation capacity. This mismatch necessitates the inter-governmental transfer among the federation and provinces, which is a vital part of the decentralization process.
  - The empirical analysis shows that revenue decentralization is growth-enhancing in Pakistan. The decentralization of revenue generation responsibilities generates positive externalities that increase the per capita income of the country.
  - On the other hand, it is found that expenditure decentralization has a negative association with the growth rate of per capita income. This is mainly due to the low institutional quality, which may increase the corruption level and make public officials less accountable.
  - Few policy implications emerge from these empirical analyses to enhance economic growth. Firstly the tax to Gdp has a positive association with economic growth. In Pakistan, the tax to GDP ratio is very low as compared to other developed and developing countries. Due to a low tax base, Pakistan is consistently facing the problem of a high budget deficit. Increasing the tax to GDP ratio has two advantages: it directly contributes to economic growth and, it mitigates the negative impact of budget deficit on economic growth through reducing budget deficit. In Pakistan the main source of tax is the general sale tax on goods and services (GST) which is non-distortionary in nature. Thus, there is a need to further broaden the tax base and tax rates.
  - Secondly, The process of FD especially revenue decentralisation is beneficial for the economy of Pakistan. To achieve long term economic growth, revenue decentralisation should be better streamlined through making the provinces more reliant on their own resources.
  - Lastly, expenditure decentralisation can only be effective when the provinces have sufficient administrative capacity and are made accountable and transparent through good institutions.

Madeeha Gohar Qureshi
PIDE Working Papers 2012: 85

The Inter-Linkages between Democracy and Per Capita GDP Growth: A Cross Country Analysis

- This study is an attempt to answer the question that captivates the minds of all political economists, "Is it polity with more political rights and civil liberties that leads to economic growth or is it the reverse phenomenon of economic growth leading to democracy that holds empirically?"
- The empirical growth literature gives no clear indication as to how democracy impacts economic growth despite having the moral high ground and as a system of governance is much superior to an authoritarian regime. That is, there is evidence of both positive and negative effects and also of no direct link in democracy and growth nexus.
- Therefore, this study an attempt resolve this controversy by putting this question in a dynamic simultaneous equation framework that combines in a system the regression in differences with regression in levels applied on a cross county data set over the period 1987-2002 for 73 developed and developing countries.
- This type of modelling not only controls for the endogeneity of the explanatory variables and the unobserved country-specific effects but also allows to analyses the impact of democracy on per capita GDP growth and the reverse causation from per capita GDP growth on political and civil freedom simultaneously.
- The findings show evidence in support of a quadratic impact of the democracy on per capita GDP growth (an inverted U relationship) that is per capita GDP is found to be increasing in democracies at low levels but after a certain moderate level of democracy this relation turns negative.
- This means that per capita GDP is increasing in democracies at low levels but after a certain moderate level of democracy, this relation turns negative. Non linear relationship is also indicated in our sub groupings' estimates. Hence at a moderate level of political and civil freedom, the positive impact of democracy on per capita growth dominates but after a certain level the rent seeking activities of interest groups and the redistributive pressures in democratic regimes dominate, depressing growth levels.
- The support of reverse causation from per capita GDP growth to political and civil freedom is found only in countries grouped as partially free and free democracies.
- Also by modelling democracy and per capita GDP growth nexus in a simultaneous equation framework, we are able not only to analyse the impact of changes in democracy level on per capita GDP growth but also the reverse causation from per capita GDP growth as an indicator of prosperity on democracy, a phenomenon that has been termed as Lipset hypothesis in literature.
- However, the study does not find any evidence in support of Lipset Hypothesis that prosperity leads to increase in propensity to experience political freedom taking all countries into consideration.



Rashida Haq and Uzma Zia
PIDE Working Papers 2009: 52

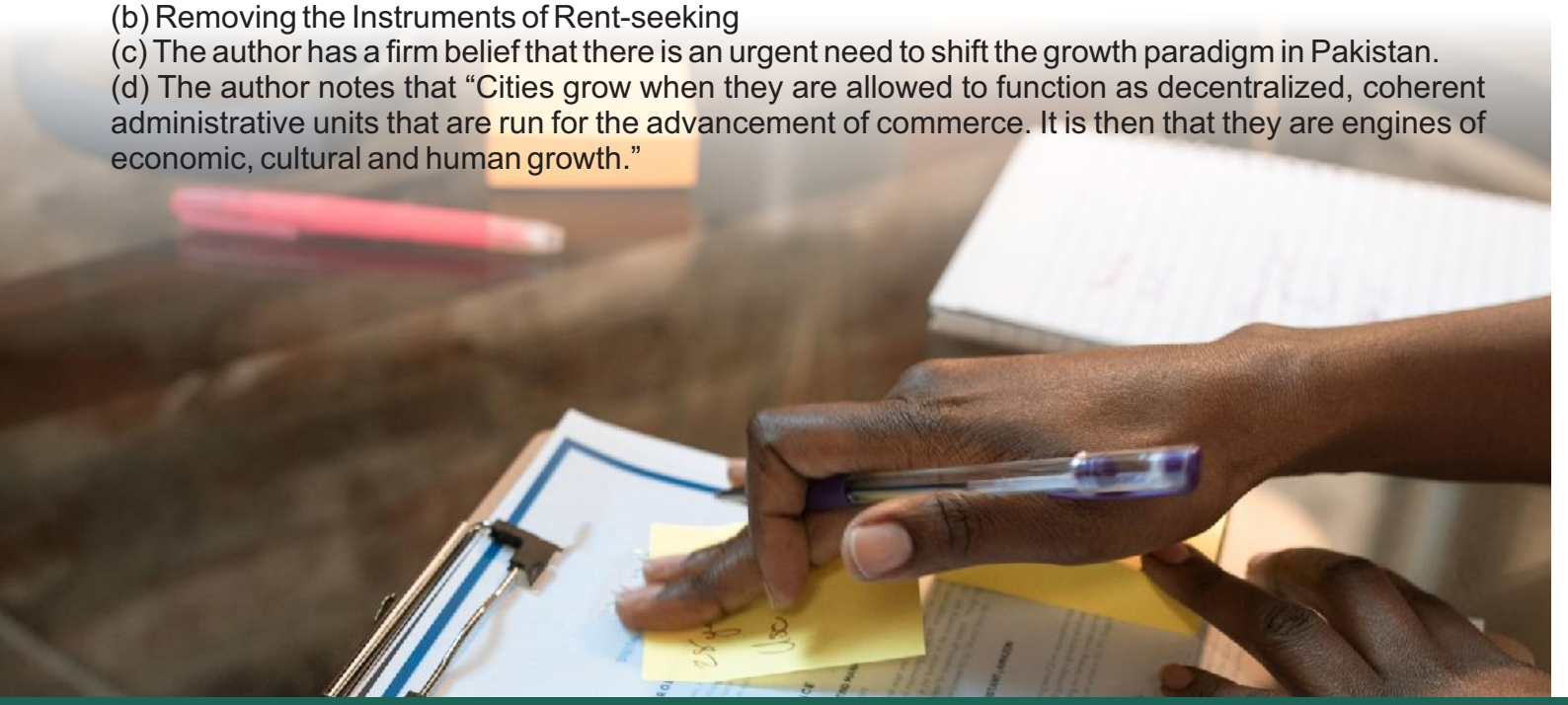
DOES GOVERNANCE CONTRIBUTE TO PRO-POOR GROWTH? EVIDENCE FROM PAKISTAN

- Economic growth is the spine of prosperity, and one of the essential agents which spur economic growth is 'good governance.' The study has introduced various types of governance indicators, namely; political governance, economic governance, and institutional governance, and then find out that how good governance of these areas is related to pro-poor growth.
- The empirical analysis of different countries in the study reveals that good governance is an agent of faster economic growth in the long run. On the other hand, lack of quality governance obstructs growth and investment and aggravates poverty and inequality. Poor governance hinders every effort for the improvement of infrastructure, investment, and educational standards. In the case of Pakistan, many problems of social and economic deprivation of people have directly related to the low economic growth.
- Furthermore, the study has also elaborated that good governance has a positive influence on economic performance. Good governance means that institutions work to fulfill the needs of society while ming the best use of resources.
- However, in developing countries like Pakistan, public institutions are overwhelmingly ruled by authoritarian and corrupt leaders, which make these institutions a root cause of countless economic, political, and social problems.
- The finding of the study shows that political governance which includes voice and accountability and political stability are negatively and significantly correlated with poverty. Apart from this, greater accountability and political stability are also associated with a reduction in poverty.
- Increase in poverty is not the sole ascription of slow growth in the '90s. Besides, the immeasurable deterioration of institutions has markedly eroded the State's capacity to deliver social and economic service. Political stability also has a direct effect on the continuity of policies which ultimately influence the poverty reduction strategies.
- Moreover, findings show that the quality of institutional supremacy has a progressive effect on economic growth, whereas, inequality has a negative effect on growth.
  Accountability in Pakistan has been low at all levels of state, judiciary, and civil society, which needs to be improved.
- To sum up, an effective governance strategy should encourage economic liberalization, deregulation, and tax restructuring, macroeconomic stability, administrative and civil service reform.
  Honest commitment by the leadership to the fight against corruption and encouraging accountability will be proved fruitful in the war against poverty. We have to adopt the four basic elements of good governance such as accountability, participation, predictability, and transparency, which we currently lack.

Nadeem Ul Haque
PIDE Working Papers 2007:29

Entrepreneurship in Pakistan

- This paper is focused on the subject of entrepreneurship in Pakistan and how policy and the environment can be adjusted to allow entrepreneurship to play a more significant role in the economy of Pakistan.
- Moreover, it aims to provide a general understanding of entrepreneurship. Furthermore, this paper also argues that economic growth and progress with poverty reduction have both been seriously impeded because of a policy environment that is unfriendly to entrepreneurship.
- This paper presents an analysis of the state of entrepreneurship/rent-seeking to prevail in Pakistan. This analysis allows us to obtain an understanding of the kinds of reforms (including legislative changes) that are required to develop entrepreneurship.The author defines that entrepreneurship is a combination of innovation and risk-taking. When such activity thrives, high growth rates are achieved as well as opportunities offered to all segments of society, including the poor.
- In Pakistan, innovation and risk-taking are severely inhibited by the intrusive role of government in the marketplace. From the early days of planning when protection and subsidy policies determined winners in the market place, entrepreneurship has been diverted to seeking government favours.
- Government economic policy also seeks to promote growth through a basically 'mercantilist' approach where domestic commerce through seriously neglect is heavily regulated. This sector either employs most of the poor or offers them entrepreneurial opportunities. Hence deregulating this sector could be a priority in and anti-poor strategy.
- The paper also argues that land distribution and city zoning and management have also evolved to further reinforce the prevalent rent-seeking path to success. The result is that cities are by design not allowed to become clusters of commerce that will be entrepreneur-friendly. These clusters of dense urban commerce are magnets of employment and opportunity for the poor.
  To develop an entrepreneurship culture in the country, the system of incentives (laws and policies) that promote rent-seeking will have to be dismantled.
- Recommendations of the paper If entrepreneurship is to develop and be at the root of development in the country, it is imperative that there must be deep government reform that limits rent-seeking, encourages innovation, and fosters enterprise. The following is recommended:
  (a) Reinventing the Role of Government and Ensuring Rule of Law
  (b) Removing the Instruments of Rent-seeking
  (c) The author has a firm belief that there is an urgent need to shift the growth paradigm in Pakistan.
  (d) The author notes that “Cities grow when they are allowed to function as decentralized, coherent administrative units that are run for the advancement of commerce. It is then that they are engines of economic, cultural and human growth.”



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