GROWTH STRATEGIES AND DEVELOPMENT PRIORITIES

Report by the Sub-group

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Section 1 Pakistan's Growth Experience

1.1. Introduction

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

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

3. These include:

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

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

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

d) A low level of commitment to institutional strengthening affected the quality of governance. Weak governance and lack of institutional capacity to prioritize, plan and design development strategies resulted in the poor selection of economic and social projects/ programmes[1], and leakages on account of corruption. The issues concerned with the poor formulation of projects were compounded by ineffective implementation and deficient oversight and evaluation;

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

f) Fortuitous events internationally at critical moments of the country's history that lead to large inflows of capital on concessional terms, facilitating fiscal indiscipline and the frequent postponement of fundamental reforms[2].

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

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

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

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

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

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

1.2. THE CONSEQUENCES OF A SECURITY STATE

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

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

TABLE 2: DEFENSE EXPENDITURE (AS % OF GDP)

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

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

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

8. These priorities resulted in Pakistan spending US$24 per capita on defence compared with $12 per capita on education and health combined in 2000, as against US$19 and US$35 per capita spending on these social sectors by India and Sri Lanka respectively (Tables 3a and 3b). By 2008/09 Pakistan's expenditure on the military (including pension payments) at around 2.8% of GDP was US$26 per capita as against US$24 on education and health combined, at 2.5% of GDP[4].

TABLE 3A: PER CAPITA EXPENDITURE ON EDUCATION AND HEALTH – US$

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

Source: World Bank, 2003

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

Table 3b: Expenditure on Education

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

[1]As % of GNP; [2]Figures for 2003-04,   Source: For Pakistan, Economic Survey, various issues.   For the rest,

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[4] At Rs.80=1US$

1.3. INEQUITABLE TAX STRUCTURE AND SKEWED ASSET DISTRIBUTION

10. The elite has failed to establish an equitable taxation structure in its own enlightened self-interest that would finance spending on infrastructure development and on the delivery of key social services. Pakistan's consolidated tax to GDP rate is just over 10% which is 5 to 7 percentage points lower than the ratio for counties similarly placed economically (see Section 2). With a large outflow to meet the requirements of defence and keep the rest of the oversized state machinery functional there is a lack of adequate resources to improve the access to, and quality of, education (by enhancing expenditure from under 2% of GDP to the UNESCO recommended 4%), basic health and safe drinking water facilities. Even after some reforms undertaken over the last 7-8 years the system is still highly iniquitous because of either exemptions or light taxation of certain sectors, activities or sources of income.

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

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

1.4. FISCAL DEFICITS AND DEBT BURDEN

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

Table 4: Fiscal deficit (as % of GDP)

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

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

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

14. With this background the deregulation of the interest rate in the early 1990s raised the cost of debt servicing. Since domestic debt had risen in the 1980s the deregulation of the interest rate increased the debt servicing burden. Thus, debt increased from 20.8% of the GDP in 1981 to 42.7% of GDP in 1988 and 43.9% of GDP in 1998 (Table 5) and interest on public domestic debt and defence spending consumed 70% of total revenues as debt servicing on domestic debt rose from 3.5% of GDP in 1990/91 to 6.3% in 1997/98 (Table 6). This development forced the government to borrow externally which sharply increased the share of external debt in the 1990s. As a result, the overall growth in debt exceeded the nominal growth of GDP and by 2000 the overall public sector debt had exceeded 100% of GDP as against 52% in 1981 and 77% in 1988 (mostly domestic) and 105% in 2000 which is mostly external.

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

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

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

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

Table 6: Debt Servicing (as % of GDP

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

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

1.5. HEAVY DEPENDENCE ON EXTERNAL FLOWS AND ASSISTANCE

16. Pakistan's average annual GDP growth which was 6.8% in the 1960s, 4.8% in the 1970s and 6.5% in the 1980s, and higher than that of the other South Asian countries, was achieved through heavy and continued dependence on external resources (remittances and foreign assistance) without structural weaknesses in industry and exports being addressed. Growth was driven by high aggregate domestic demand; remittances spurred private consumption while government expenditure provided impetus to public demand (financed through budget deficits and external flows). However, in the 1990s, remittances, which had provided the stimulus to the economy during the latter half of the 1970s and most of the 1980s (growing, dropped from around 7% of GDP in the 1980s to 3% in the first half of the 1990s and further to just over 2% of GDP in the latter half (giving an average annual rate of fall of 5.3% in the 1990s) (Table 7). Savings and investments also continued to be low (13.8% of GDP and 18.3% of GDP respectively), macro-economic imbalances persisted [6]. During this period inflation also began to rise (at 9.7% per annum as against the average of 7.2% in the 1980s) because of the fiscal deficit which was being monetized. There was also a sharp decline in the availability of external assistance that had played a key role in financing investment until the 1980s.During the latter half of the 1990s the scheme of Foreign Currency Deposits was introduced which were used by the government as a substitute for declining external assistance (see below). The rate of growth slowed down to an annual average of 4.6% between the 1985-95[7], although there were years of high growth followed by years of slow growth, with a high rate in the first 2 years or so of the government of Mr. Nawaz Sharif.

Table 7: Remittances (as % of GDP)

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[6] An overall deficit of just under 7% of GDP and a CAD of 4.5% of GDP compared with 3.9% of GDP in the 1980s.

[7] Per capita income grew at only 1.2% per annum between 1985 and 1995, partly also because the population growth rate was 3%.

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

Source: State Bank of Pakistan, Annual Reports.

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

18. It is important to note that the dependence on foreign savings remained high and even when remittances were more than 7% of the GDP, Pakistan's dependence on foreign savings was still high, having reached around 5% of the GDP in 2006/07, the dependence having declined in the late 1990s and the first 2 years of the new century because of lack of availability of foreign assistance (Table 8). They financed more than 25% of investment. However, the primary reason why Pakistan did not run into serious difficulties in financing its external debt servicing obligations until the second half of the 1990s was because much of our debt is multilateral and bilateral and on concessional terms, with low rates of interest and long debt maturities. There was no extensive borrowing from foreign commercial banks[8], although the composition was changing with more being borrowed at market rates from the mid 1990s with a first Eurobond issue in 1998/99. Despite this advantage, the ratio of external debt to GDP ratio rose from 31.2% of GDP in 1981 to 54.9% in 1998/99 and the ratio of debt to exports increased from 296% to 326.8% over the same period. As the profile of external liabilities worsened, the difficulties of finding the foreign exchange to service these became acute by the second half of the 1990s as the reserves became negligible.

Table 8: Foreign Savings (as % of GDP)

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

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

19. The Current Account Deficit has been a major problem throughout our history, averaging 5% of the GDP over 1974-93 (higher than that in any other comparable developing country), 3.9% of GDP in the 1980s and 4.5% in the 1990s while rising to 7.2% in 1996. Thereafter, it declined gradually to 4.1% in 1998/99 and 0.7% of GDP in 2000/01 because external funding was not

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

available to finance investment outlays which also fell, only to rise again to 5% of GDP in 2006/07 having becoming a surplus from 2001/02 to 2003/04 because of improved financial management, external debt rescheduling and liberal availability of grants from bilateral sources after 9/11 (see Table 5)- see more detailed post 2000 discussion in Section 1.8. Its financing has become an increasingly challenging task following the speedy increase in outflows to service requirements of foreign direct investments relating to royalties, dividends and profit repatriations at a time when the debt rescheduling period has also expired.

1.6. INDUSTRIAL STRATEGY BASED ON IMPORT SUBSTITUTION AND THE ANTI-EXPORT BIAS

20. The other weakness was the continued reliance for a long period on an industrial strategy based on import substitution. Under the policy of import substitution, that got additional fillip after the nationalization of the commanding heights of the economy in the early 1970s, the industrial sector was provided a high degree of protection. This period also marked the abandonment of the East Asian route to development that the country had espoused earlier and the adoption of the South Asian model of heavy protection to industry and public ownership of the leading sectors of the economy. The assumption of this approach contributed significantly to the slowing down of industrial growth throughout the 1980s. The GDP growth remained steady, if not in some ways robust, during this period and the early part of the 1990s and was largely owing to agricultural growth resulting from an increase in the cropped area[9], liberalization of the import of pesticides and the wider distribution of the benefits of the Green Revolution, largely through the provision of improved seeds, the cotton or white revolution in agriculture and the strong growth in services.

21. An anti-export bias underlay the industrial policy. This operated through the import tariff policy (high foreign trade taxes[10]) disincentivising diversification of exports, especially investment in the value added sub-sectors of industry (as it increased the cost of imported intermediate inputs for processing exports). The overvalued exchange rate also played a key part in discouraging the development of a vibrant export sector (see discussion in Section 2). Moreover, the heavy taxation of rice and raw cotton exports discouraged export-oriented agriculture and lead to substantial investments in the yarn spinning industry (licences issued by government as patronage) which had negative value-added, and contributed to lopsided development in the textile sector.

22. Pakistan was unable to increase its export earnings because it was unable to diversify its exports or move into high value added items owing to the lack of adequate quantity, value and mix of

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

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

skills and partly owing to the secular deterioration in the country's the terms of trade because of the low value added products being exported.

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

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

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

Table 9: Clothing Exports (as % of world exports)

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

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

1.7. INSTITUTIONAL CAPACITY TO DESIGN AND IMPLEMENT ECONOMIC POLICY

26. The country took a long time, as late as the early 1990s, to initiate the ethos of deregulation, liberalization and privatization. However, since this policy package was essentially driven by the Washington Consensus[11] the problems in implementing it were muted ownership[12] and lack of policy making and policy executing ability at the administrative and political levels. Weak institutional capacity to design economic strategies and polices resulted in greater reliance on development partners to provide related advice, while the lack of capability to implement policy and programmes effectively influenced the style of policy application, which proceeded in an unsophisticated and simplistic manner. In the past, economic supervision was carried out through administrative controls. But liberalization being difficult to manage requires more professional and deft handling. Given the lack of both commitment and competence, successive governments tried to superimpose the proposed modifications on the economic and industrial structures that had been inherited.

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

    a) The liberalization of the capital account before the liberalization of the current account without thinking through its implications. As remittances declined and the current account deficit increased the government incentivized the opening of foreign currency accounts through hidden subsidies[13] in search of sources to finance the CA deficits. The artificially sustained additions to the foreign currency deposits[14] of 7% to 8% of GDP enabled financing high levels of CA deficit in the 1990s, which following the May 1998 nuclear tests were forcibly converted into rupees or long-term foreign currency bonds at low interest rates to avert a huge outflow of capital.

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

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[11] Imposed by the World Bank, the IMF and the Asian Development Bank, who were the country's major donors and development partners.

[12] Essentially only that of the Nawaz Sharif government.

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

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

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

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

d) The process of tariff reform to lower the level of protection available to industry was an issue that was addressed only half-heartedly. A major part of the industrial sector was able to lobby successfully for the retention of the regime of SROs to provide repeated bailouts and postpone the introduction of an incentive system that encouraged efficient producers who could compete internationally on the basis of comparative advantage and the strengths of their business model and practices. Through the arbitrary application of SROs some entrepreneurs managed to secure special deals on rates of import duties affecting the level playing field for those without appropriate access to decision makers. The extent of the reduction in protection until 1998 was well short of the reforms undertaken by countries such as Indonesia, Mexico, and Philippines with which Pakistan competes in world markets for labor-intensive products (Table 10). The tariffs were reduced rapidly thereafter and by 2007 the average rate was 14%.

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

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

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

1.8. REFORMS SCUTTLED BY FORTUITOUS EVENTS

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

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

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

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

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

1.9. IMPACT OF GROWTH AND GOVERNMENT POLICIES ON POVERTY

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

34. During the 1970s, the average GDP growth fell to 4.8% from 6.8% in the 1960s while poverty head count declined fell from 47% to 31% of the population during 1969-1979. The reasons for such an outcome included remittances which had touched US$1.4 billion, almost 9.5% of the GDP, by 1978/79 (which stimulated demand for housing and goods like fans, air and water coolers, small electric motors, hand-pumps, water tanks, etc. produced by the small scale sector), larger volumes of public investment that created job opportunities for those with limited skills combined with laws that strengthened labour rights[15] especially following the state takeover of private enterprises and the shifting in the Terms of Trade in favour of agriculture with the large devaluation of the rupee. Therefore, despite a slowing down in the rate of economic growth, employment increased along with earnings of workers for the same level of effort. However, rural poverty continued to be higher than urban poverty largely owing to poor agricultural growth, 2.4%, as against the growth of 5.5% and 6.3% witnessed in manufacturing and services respectively.

35. GDP growth of 6.6% per annum in the 1980s was accompanied by a further decline in the proportion of the population below the poverty line, from 31% in 1979 to 17.32% in 1987-88. Rural poverty also declined as a result of remittances and the improvement in rate of growth of agriculture to 5.4% from an average of 2.4% in the 1970s, mainly as a result of good weather. The reduction in overall poverty is likely to have also been positively impacted upon by higher levels of private investment, to 16.8% of GDP compared with 15.5% in the 1970s, which would

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

have spurred employment opportunities. However, for a variety of reasons the growth rate and the trend in poverty reduction could not be maintained, which principally include the decline in external aid at the end of the Afghan war. This led to a cutback in public investment and a diminution in employment opportunities, also because of public sector recruitment bans for almost 5 years, even for hiring personnel for delivering social services. The deteriorating conditions of growth and poverty were also adversely affected by frequent changes in government policies, a weakening in the bargaining position of trade unions since the 1980s (owing to the presence of military dictatorships) reflected in fewer worker stoppages bans on strikes of labour, growing casualization of job markets and increasing pro-employer attitude of governments. The proportion of population living below the increased from 17.3% in 1987-88 to 32.6% in 1998-99, partly owing to lower rates of growth.

36. The end of the 1990s suffered from an acute drought in 2000 which had negative spill-over effects on agriculture and consequently on farmer incomes. Overall poverty rose further to 34.5% in 2000-01 from 32.6% in 1998-99 while rural poverty increased from 34.8% in 1998-99 to 39.3% in 2000-01. Another factor was the continued skewness in land distribution; only 37% of rural households own land (of which 61% households own less than 5 acres and 2% own 50 acres or more) giving a Gini coefficient of land ownership of 0.66 (and if rural landless households are included, the Gini coefficient is 0.86)[16]. Since there is clustering around the poverty line, especially in rural areas, small movements in the growth rate can influence poverty levels significantly, say because of a good harvest owing to favourable weather conditions.

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

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

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

skilled or by providing social protection which could in turn feed into growth through the consumption route.

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

SECTION 2 SUSTAINABLE GROWTH RATES AND RESOURCE AND EMPLOYMENT GAPS

2.1. PAKISTAN'S RESOURCE GAP AND EMPLOYMENT GAP: COMPARING SUSTAINABLE GROWTH RATES TO FULL-EMPLOYMENT GROWTH RATES

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

41. As a first step, we need to estimate the availability of resources in the economy, defined as the sum of sustainable levels of national savings and current account balance. Simple averages have been employed to determine sustainability as both these variables do not exhibit a statistically significant time trend[17]. Compared with the twenty year national saving average of 15.55%, the ten year national saving average equals 16.86%, while compared with the ten year current account balance average of -1.27%, the twenty year current account balance average equals -3.06%. Consequently, available resources are calculated by summing the 10 year average savings rate with the 20 year average current account deficit (both excluding 2007-2008), which equals 19.92% of GDP. This number at the minimum presents an optimistic scenario.

42. The next issue is the level of investment required to maintain a certain GDP growth rate as well as the growth in employment associated with this GDP growth rate. To estimate the investment required we need to have a number for the likely ICOR. The ICOR for the last 20 years in Pakistan was found to be approximately 3.65. Compared to international estimates, this number seems like an underestimate, so a more pessimistic but realistic analysis employing an ICOR value of 4 has also been undertaken. Further, an average employment elasticity of 0.465[18] was used to calculate changes in employment associated with different growth rates.

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

[18] Economic Survey (various issues)

43. The key analysis is shown in Tables 11 and 12, which present different GDP growth rate targets, the investment rates required to achieve these targeted growth rates and the increased investment generated by the growth targets (Please refer to Appendix II for a detail of these tables):

Table 11: Resource and Employment Gaps for Various Targeted Growth Rates*

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

Table 12: Resource and Employment Gaps for Various Targeted Growth Rates*

	% of GDP	% of GDP	% of GDP	annual %	annual %	annual %
GDP Growth Rate	Available Resources	Investment Requirement	Resource Gap	Change in Labor force	Change in Employment	Employment Gap
4.5	19.92	18	1.92	2.95	2.09	-0.86
4.98	19.92	19.92	0.00	2.95	2.32	-0.63

5.0	19.92	20	-0.08	2.95	2.33	-0.63
6.0	19.92	24.00	-4.08	2.95	2.79	-0.16
6.35	19.92	25.40	-5.48	2.95	2.95	0.00
7.0	19.92	28.00	-8.08	2.95	3.26	0.31
8.0	19.92	32.00	-12.08	2.95	3.72	0.77
9.0	19.92	36.00	-16.08	2.95	4.19	1.24

44. The first column of Tables 11 and 12 shows the targeted growth rate. The second column shows the long-term sustainable resources available in the economy while the third shows the degree of investment required. Table 11 reflects an optimistic view with an ICOR of 3.65 while table I-B illustrates a somewhat pessimistic view with an ICOR of 4. The fourth column (defined as the difference between available resources and required investment) shows the 'resource gap' or the gap between sustainable, available resources and the level of investment required to achieve the targeted growth rate. As the numbers show, with the present level of national savings and sustainable current account deficit, Pakistan can achieve a growth rate of approximately 5.45% (4.98%). But in order to achieve a 6% growth rate, Pakistan would face a 1.98% (4.08%) resource gap, which increases to 8% for a 7% growth rate and 12% for an 8% growth rate.

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

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

SECTION 3 SAVINGS AND INVESTMENT

3.1. GAP BETWEEN DOMESTIC SAVINGS AND INVESTMENTS

47. Maintaining high growth rates on a sustainable basis requires a combination of high levels of national savings and investments and noteworthy growth in productivity. Pakistan has had low rates of investment (although underestimated[19]), largely owing to low levels domestic savings needed to finance this investment. This rate of investment compares poorly with those of other Asian countries like China, India, Indonesia and Thailand who are all able to finance their investments from much more robust domestic savings. Pakistan's rate of investment has fluctuated between 16% and 17 % of GDP for most of its history which, given the Incremental Capital Output Ratios (ICORs) of 4 in the case of other countries in the region (with a Total Factor Productivity growth in excess of 1.5 compared with Pakistan's 1[20]), appears to be low for even maintaining a growth rate of around 6% let alone pushing the economy onto to a higher growth path[21].

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

	Pakistan	India	China	Indnesia	Malaysia	Philipines	Thiland
Invstment	23.0	38.2	44.4[1]	24.9	23.1	15.0	29.9
Domestic Savings	16.0	35.1	52.3[1]	28.9	37.1	10.4	33.4
National Savings	17.8	37.2	53.8[1]	26.1	36.2	29.5	32.0

*For China the figures are for 2006. **Source: Key Indicators for Asia and the Pacific 2008, Asian Development Bank. For Pakistan: Economic Survey of Pakistan (07-08);**

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[19] Domestic savings are derived by subtracting the contribution of foreign savings to investment and since we know that the estimated domestic savings are understated (for reasons explained later below) it means that investment levels and rates must be underestimated.

[20] Shantanayan Devarajan and Ijaz Nabi, Economic Growth in South Asia: Promising, Un-equalizing, Sustainable?, World Bank (2006).

[21] In view of the huge investments that will be required in infrastructure connected with energy, roads, rail transportation, ports, irrigation storages and networks, etc., (which invariably have longer gestation periods) to reduce the private sector's cost of doing business and remain competitive, the ICOR will need to be closer to 4. As it is even at historical rates of ICORs resources are inadequate to maintain a growth rate of 6%.

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

Table 14: Share in Investment (%)

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

Source: Economic Survey of Pakistan (07-08)

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

3.2. DOMESTIC SAVINGS

3.2.1. INTRODUCTION

50. According to Rodrik (2005) the causality between savings rates and economic growth is not clear. He argues that while growth in income impacts savings rates positively on a permanent basis higher savings rates only raise GDP provisionally and in the interim. However, savings drive investment and investments generate their own savings. To this end, domestic savings are critical for financing investment since foreign capital can only supplement or complement them- FDI follows a boom and does not create it. And Pakistan has a low rate of domestic savings[22].

3.2.2. LEVELS AND COMPOSITION OF DOMESTIC SAVINGS
51. Pakistan's domestic savings rate (estimated by subtracting foreign savings from investment), while understated (for reasons see below), is low in comparison with that of India and countries with roughly similar GDP per capita levels. (Table 13), although the level of national savings is more respectable, averaging 14.3% of GDP between 1990 and 2000 (also see Appendix I) [23],

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[22] Domestic savings refer to savings of government, the corporate sector and resident households, while national savings include net factor incomes current transfers/remittances from abroad by overseas migrants. The bulk of this report focuses on the importance of domestic savings, while recognizing the continuing and important role of remittances in providing resources for financing domestic investments.

[23] With the domestic savings rate falling from 16.6% of GDP between 2000 and 2007 to 11% in 2008.

largely because of net factor incomes and current transfers from abroad in the form of remittances which constitute a much larger fraction of national savings than in the corresponding countries. That this average rose to 17.8% between 2000 and 2007 was again primarily as a result of the sharp increase in capital inflows and remittances after 9/11[24]. The share of net incomes and current transfers from abroad increased from a negative 1.3% of GDP in 2000/01 to a positive 2.2% till 2008.

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

Table 15: Investment and Savings (as % of GDP)

	1990s	2000	2001	2002	2003	2004	2005	2006	2007	2008P
Gross Total Investment	18.8	17.4	17.2	16.6	16.8	16.6	19.1	22.1	22.9	21.6
Changes in Stocks	1.7	1.4	1.4	1.3	1.7	1.6	1.6	1.6	1.6	1.6
Gross Fixed Investment	17.1	16.0	15.8	15.3	15.1	15.0	17.5	20.5	21.3	20.0
(a)Public Sector	7.8	5.8	5.7	4.1	3.9	4.0	4.3	4.8	5.7	5.7
(b)Private Sector	9.3	10.4	10.2	11.1	11.2	10.9	13.1	15.7	15.6	14.2
Net External		1.6	0.7	-1.8	-3.8	-1.3	1.6	4.4	5.1	8.3

[24] Reasons include debt rescheduling and large inflows of remittances through official channels following the greater scrutiny of funds invested or held abroad by Muslim sounding names. Moreover, the Pakistani diasporas which had done well during the longest spell of economic growth and prosperity that the world had experienced was able to remit fairly large amounts to Pakistan in search of lucrative investment opportunities- which explains the US$5 billion per year of remittances being received in recent years (more than 40% of which were from the US and Europe as opposed to the 80% received from the Middle East and the Gulf in the 1980s).

Resource Inflow	4.6									
National Savings	14.1	15.8	16.5	18.4	20.6	17.9	17.5	17.7	17.8	13.3
(a)Public Savings	1.9	-0.1	1.6	1.7	1.6	4.8	3.4	2.3	0.8	-1.0
(i) General Government	-0.4	-0.9	-0.1	0.2	0.0	2.9	1.6	1.6	0.3	-1.4
(ii) Others	2.3	0.8	1.7	1.4	1.6	1.8	1.8	0.7	0.5	0.4
(b)Private Savings	12.3	15.9	14.9	16.8	19.0	13.2	14.1	15.4	17.0	14.3
Net Factor Income	0.2	-1.3	-1.3	0.5	3.1	2.2	2.1	2.0	1.8	2.2
Domestic Savings	14.1	17.1	17.8	17.9	17.4	15.7	15.4	15.7	16.0	11.0

Source: State Bank Annual Report, various issues.

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

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

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

3.3. REASONS FOR LOW SAVINGS RATE

3.3.1. GOVERNMENT SAVINGS

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

Table 16: Tax Revenue (as % of GDP) 2007

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

[1] For 2003.

Source: Key Indicators for Asia and the Pacific 2008, Asian Development Bank;

for Pakistan: Economic Survey of Pakistan (07-08); for India:
<http://knol.google.com/k/alexander-emilfaro/government-spending-and-tax-revenue-as/kpxsjkpzgwux/8#>

57. The main reasons for this low ratio are a) the inelasticity of the tax structure; b) the horizontal inequity of the tax system in that it either does not extend to certain sectors like wholesale and retail for GST and agriculture for income tax, gives preferential treatment to some sectors or activities like some sub-sectors under services for GST and real estate and trading in equities for capital gains and taxes partnerships[25] and the rich lightly; and c) that the administrative system is characterized, for a variety of reasons, by poor collection efficiency.

58. The income tax to GDP ratio is a mere 2.5% which when adjusted for corporate income tax, reveals a personal income tax to GDP collection of perhaps less than 1%. Moreover, tax and economic policies are also speculator friendly. By taxing investments and transactions in speculative activities like the stock/equity market and real estate lightly, the structure disincentivizes investment in productive activities like manufacturing, which cannot surely be the objective of any rational tax policy.

59. To improve public savings the country needs to generate a large revenue surplus (say by broadening the tax base through a phased elimination of exemptions, enlarging the application of GST, containing recurrent expenditures, etc.) and dramatically raise resources from other earnings, say through a more efficient system of user charges for public services and dividends from its holdings in state owned enterprises (the latter will decline with the privatization/dilution of the government holding in public sector enterprises like PTCL, PSO, OGDC, PPL, etc.). The

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

short-term constraints for achieving such an outcome are the present domestic and international environment characterized by economic stagnation, a contracting manufacturing sector (a major contributor of government tax revenues) and declining prices of imported commodities.

3.3.2. CORPORATE SAVINGS

60. The low estimate of the rate of corporate savings is because of the small size of the corporate sector[26], the inadequacy of the information gathering systems and the faulty computation methodology that tends to under-estimate corporate savings, since it only covers listed companies and not the private, non-listed corporate and SME sectors. And surveys suggest that 13.6% of new investments of SMEs are financed by informal sources, family or friends, roughly 2.8% of GDP. Only Indonesia and Cambodia use more of the informal sources for financing investments (Vincellete, 2006).

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

3.3.3. HOUSEHOLD SAVINGS

62. Although it is not quite clear if household savings are overall low, they are a function of income levels (real income per capita), growth in GDP, demographics (the high dependency ratio - almost 43% of the population is below 14 years of age- and share of working age population), cultural habits and behaviour[27], the existence of social protection/insurance schemes and the wealth effect of the investments in existing assets. Moreover, other than savings through the informal institution of "Committees" (see below) a major portion of household savings are in the form of gold and silver[28], rather than in the form of financial savings[29]. This is partially because of low real returns on bank deposits, especially in recent years, which has discouraged savings (see Table 15 and 17) and incentivised consumerism instead. The latter was further encouraged by better access to consumer finance in recent years. According to State Bank date household savings as a percentage of GDP increased from 14% in 2000 to 16.8% in 2003, a period which coincided with positive real interest rates (Table 17), only to decline again to and around 13% thereafter with real interest rates becoming negative.

Table 17: Inflation and One Year Deposit Rates

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[26] It is also not quite clear if the retained earnings of the corporate sector are a small percentage of their incomes/profits.

[27] It is generally accepted that the Pakistani middle and upper income groups tend to have more ostentatious lifestyles.

[28] According to the Gold World Council Pakistan is among the top 10 consumers of gold

[29] To illustrate, bank deposits in Pakistan are only 40% of GDP, whereas in China they are 190% and while there are 192 deposits per 1000 persons in Pakistan, in Malaysia the corresponding number is1,250 (Vincellete, 2006). And this

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

[1]Source: Economic Survey of Pakistan (07-08)

[2]Source: Key Indicators for Asia and the Pacific 2008, ADB

63. Household surveys suggest that while 56% of the total adult population saves and/or invests either formally or informally of which 39% save regularly only 12% do so with banks[30]. The top four modes of saving are informal in nature of which close to a quarter are through "Committees"[31]. Furthermore, net income and transfers from abroad-remittances of overseas migrant Pakistanis- account for a large proportion of Pakistan's national savings.

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

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

3.4. RECOMMENDATIONS FOR ENHANCING HOUSEHOLD SAVINGS

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[30] According to the Survey results (see footnote below) 41% reported that they did not have enough money and 41% said that they never felt the need to have one. Eighty one percent of those having a bank account maintained one to save or for reasons of safe keeping.

[31] Pakistan: Access to Finance Survey, 2008, sponsored by DFID and supervised by the World Bank

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

67. We, therefore, recommend that the government consider raising the interest rates on individual investments in instruments on offer under the National Savings Schemes[32], ensuring that they are in real terms positive and sufficiently attractive. In the absence of a robust and nationally broad-based social protection and welfare system higher after tax returns can be given to pensioners and small savers, as is already being done. In our opinion, such an arrangement will not necessarily result in the switching of bank deposits into savings in NSS instruments, suggesting that there will be no net addition in financial savings. Moreover, private financial institutions, especially commercial banks, will be forced to compete for funds by providing higher and positive real returns to depositors as against the negative real returns being received by them currently. However, the weakness in adopting this route is the poor outreach of NSS[33] and the weak management systems and procedures to tap savings. A fair amount of effort is required to strengthen the NSS system to widen its access and make it user-friendly.

68. Another possibility to generate savings that could be exploited is that offered by technology in the form of "mobile phone banking", as such a vehicle would improve access and outreach substantially, considering more than 60% of the adult population has access to a mobile phone[34].

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[32] Disallowing the corporate sector and provident and pension funds from investing in such instruments.

[33] According to the Access to Finance Survey, only 1% of the population saves in NSS instruments.

[34] Access to Finance Survey, op.cit.

SECTION 4 ADDRESSING THE BOP CONSTRAINT AND ENHANCING COMPETITIVENESS

4.1. INTRODUCTION

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

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

71. Unfortunately however, Pakistan's experience with improvements in total factor productivity has not been encouraging. Appendix IV shows that for the economy as a whole, total factor productivity has been increasing at an average rate of 1.1 percent a year[35], with almost three quarters of GDP growth being explained by increases in labour and capital stock. The results highlight that productivity growth in Pakistan, at both the sectoral as well as the aggregate level, while not being sustained, has been slow and that growth has been driven by inputs rather than by productivity.

4.2. SKILL DEVELOPMENT

4.2.1. INTRODUCTION

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

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

73. Keeping in view current demographics and the dynamics of migration to Pakistan and abroad, achieving sustained poverty reduction would require a coherent, robust and durable development strategy that is anchored in the enhancement of the productivity of existing assets. The most important of these assets is the relatively young labour force, which will continue to grow at more than 3% per annum in the foreseeable future. Such a focus will enable the country to also reap the considerable potential of the demographic dividend.

4.2.2. WEAKNESSES OF INSTITUTIONAL ARRANGEMENTS FOR SKILL DEVELOPMENT

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

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

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

4.2.3. RECOMMENDATIONS FOR SKILL DEVELOPMENT
4.2.3.1. Introduction

77. To improve the productivity of the young labour force, we recommend skill development initiatives through public private partnerships, instead of expanding the operations of the public

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

4.2.3.2. Modality

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

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

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

4.2.3.3. Type of skills

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

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

83. In this digital age IT services could be a valuable source of economic development and as a provider of employment opportunities, especially for the educated females, who are more socially and physically immobile labour force. We, therefore, also advise that the Government support the potential of IT given a variety of factors that advocate e the adoption of this sector as a dynamic and sustainable source of growth for the less skilled and less capital intensive sub-sectors of IT services; especially with the declining costs of telecommunications as a result of the rapid development in related technologies. There is a huge potential for providing BPO services[36] like customer support (e.g. help lines and reservations), technical support facilities, telemarketing, accounting services, medical prescription entries, processing of insurance claims, processing of mortgage applications, etc[37].

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

4.2.3.4. Certification of Quality of Skills Developed

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

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

85. To ensure that the training is of the level and quality demanded by the private sector (especially those engaged in the exports of services and manufactured goods) we strongly recommend the adoption of a system for international certification of these skills. In a globalized world only those skills will have market value, and are likely to be sought by the private sector, that have been certified by an internationally recognized organization. Only a credible certification system will have acceptance, ensuring quality and relevance of training, especially if it meets selected international certification standards. Such an approach will provide employability to graduates in line with emerging market needs, and strengthen their capability to earn a higher and steady stream of earnings in markets in Pakistan or abroad.

4.3. COST OF DOING BUSINESS

4.3.1 INTRODUCTION

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

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

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

89. Pakistan's existing policy formulation system, and the mechanisms, institutional arrangements and capacity for implementation are major causes for the gulf between the objective of the legislation and policy and its practice. Poor implementation, retention of a wide range of discretionary powers that facilitate rent extraction through either selective or delayed policy implementation all raise the cost of doing business. Moreover, implementation related issues

exacerbate the problems of uncertainty and unpredictability. For small enterprises, in view of their size and limited managerial and other resources, these impediments are particularly debilitating for conducting commercial operations competitively.

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

4.3.2. MULTIPLE/NUISANCE TAXATION

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

92. There is also an electricity duty[38] and a service charge levied by the provincial government on the use of generators installed by private businesses for ensuring uninterrupted supply of electricity because of the poor service provided by WAPDA!

4.3.3. LABOUR RELATED LEGISLATION

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

94. Whereas recent or proposed legislation makes a serious attempt to strike an appropriate balance, between the objectives of greater labour market flexibility and autonomy to enterprises on business matters (to reduce cost of doing business) and protecting workers' rights, some of the historical weaknesses remain unaddressed – as reflected in the wide gap between market practices and legislation – including those related to the costs of regular workers on account of labour

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

levies imposed through legislation. This is particularly true in the area of minimum wages, overtime wages, hours of work per day, mode of payment for contract employees, holidays and leaves, cost of living allowances, basis for employee retrenchment, termination notice period for employees irrespective of period of service with enterprise, etc., operational matters which are critical for the flexibility required to enhance enterprise competitiveness, which would best be left to labour management negotiations and free play of market forces, rather than being mandated by law.

4.3.4. LABOUR LEVIES

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

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

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

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

4.3.5. OTHER REGULATORY LEGISLATION AND STRUCTURES

99. At times the regulations actually block private efforts to improve productivity, efficiency and sustainability of operations. For instance, inefficient and smaller sized units should be allowed to restructure through relocation of assets for facilitating consolidations and mergers. The policies of

the provincial government discourage the restructuring of the sugar industrial units by blocking the relocation and consolidation of mills required to achieve scale and production capacities required to maintain international competitiveness.

4.3.6. TRUST

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

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

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

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

4.3.7. RECOMMENDATIONS ON REDUCING COST OF DOING BUSINESS
4.3.7.1. Rationalization of Administrative Regulations

104.   By reducing the degree of administrative regulation and control of the economy, reducing multiple taxation and by strengthening the accountability of public functionaries not only can cost

of doing business be reduced but also opportunities for rent seeking by political and bureaucratic functionaries and the potential for arbitrary exercise of discretionary powers can be curbed.

4.3.7.2. Improving Legal Systems

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

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

4.3.7.3. Rule-based Tax Refund Systems

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

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

4.3.7.4. Reduction and Rationalization in Labour Levies

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

4.3.7.5. Private Health Insurance for Workers

110.　　　We also propose the option for private/national health insurance scheme[39]. The coverage and quality of medical care facility for workers can be supplemented by their contribution of say 2.5% to 3% of the wage, thereby also creating better ownership among them for such a facility.

4.3.8. RECOMMENDATIONS WITH RESPECT TO INVESTMENTS IN INFRASTRUCTURE

111.　　　According to the World Economic Forum Survey, 2006/07, Pakistan was ranked 67 out of 125 countries in basic infrastructure. Lack of infrastructure has constrained Pakistan's growth and affected the competitiveness of the economy. Pakistan is seriously deficient in the availability of adequate and uninterrupted supply of energy. According to one estimate the cost of outages owing to the acute shortage of power was approximately 9% of value added in the industrial sector, representing a 7% loss in industrial output[40]. It is difficult for a country to develop at a rapid pace without the estimated power shortage of 6,000 megawats by 2010[41].

112.　　　The World Bank estimates that transport sector inefficiencies cost the economy 4% to 5% of GDP annually, while water and irrigation needs an investment of US$70 billion[42]. Moreover, lack of adequate human resources, high taxes and duties on inputs of construction materials[43], corruption (accounting for almost 15% of project value)[44], delays in project implementation because of poor planning, design and execution capacity, inadequate contracting procedures and cumbersome contractual processes affect sectoral performance and efficiency.

113.　　　Investments in economic infrastructure of roads[45], ports, additional power/energy[46] and water storage[47] and conservation (supplemented by public works programs to absorb the rapidly

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

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

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

[42]

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

[44] Ibid.

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

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

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

growing labour force) and better management and maintenance of existing assets are critical. They are desirable not only for releasing bottlenecks to growth but also for reasons of access and equity, since in the short-medium term, until the issues of governance and management of social service delivery are tackled effectively, they would be more effective in achieving the objective of inclusive growth than increasing expenditure on social services delivered by the public sector.

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

4.4. TRADE FACILITATION

4.4.1. INTRODUCTION

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

a) Significantly reduce transaction costs in terms of time and resource use, reliability, predictability and security and thereby increase competitiveness in global markets.
b) Enhance trade volumes by even more than the direct gains from policy reform;
c) Improve government revenues and collection efficiencies;
d) Contribute to overall welfare improvements and economic growth.[48]

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

4.4.2. PAKISTAN'S EFFORTS ON TRADE FACILITATION

117. The Global Enabling Trade Index, featured in the Global Enabling Trade Report (2008), measures the factors, policies and services facilitating the free flow of goods over borders and to destinations. The index breaks the enablers into four overall areas: (1) market access, (2) border

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[48] Milner, Chris, Morrissey, Oliver and Zgovu, Evious (2008). "Trade Facilitation in Developing Countries." Center for Research in Economic Development and International Trade, University of Nottingham.

administration, (3) transport and communications infrastructure and (4) the business environment.[49] Pakistan has been ranked at 84 among the 118 other economies studied for this report. Similarly, the Logistics Performance Index (LPI) ranks Pakistan 68 out of 150 countries.[50]

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

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

Country	Documents to export (number)	Documents to import (number)	Time to export (days)	Time to import (days)	Cost to export (US$ per container)	Cost to import (US$ per container)
Pakistan	**9**	**8**	**24**	**18**	**611**	**680**
Sri Lanka	8	6	21	20	865	895
India	8	9	17	20	945	960
China	7	6	21	24	460	545
Nepal	9	10	41	35	1764	1900
Egypt	6	6	14	15	737	823

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[49] <http://www.nation.com.pk/pakistan-news-newspaper-daily-english-online/Business/06-Jul-2008/Global-Enabling-Trade-Report-2008-Pakistan-at-84-among-118-countries>.

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

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

Malaysia	7	7	18	14	450	450
Singapore	4	4	5	3	456	439
Korea	4	6	8	8	767	747
Thailand	4	3	14	13	625	795

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

119.   International logistics encompass a broad range of activities in connection with trade, including transportation, consolidation of cargo, warehousing, and border clearance and in-country distribution and payment systems. In the case of Pakistan, port and terminal charges for an average sized container ship of 35,000 tons are significantly higher than those prevailing in the region, ranging from US$ 25,100 to US$ 27,200 compared with US$ 23,000 in India, US$ 2,900 in Dubai, US$ 7,200 in Sri Lanka and US$ 3,000 in Singapore.[51]

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

121.   Furthermore, a computerized system is being developed to make the customs clearance procedures completely paperless, web based to provide online access to all stakeholders with information in advance of cargo and facilitate risk management capability. Its objectives will be to reduce the cost of doing business through simplification of procedures, reduction in clearing-agency and port charges (the latter through fewer inspections) and greater predictability and reliability.

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

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

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

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

4.4.3. RECOMMENDATIONS ON TRADE FACILITATION

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

a) There is a need to further simplify customs procedures for establishing consolidation activities, bonded storage and transport in bond[52]. These initiatives would reduce the constraints to setting up bonded storage and inland container depots. It would also allow the designation of certified factories engaged in the production of exports as bonded facilities.

b) Challenges facing the local logistics industry include developing an efficient less-than-truck- load and less-than-container-load (LTL/LCL) supply chains to serve the Small and Medium Enterprises (SMEs) and to offer an integrated supply-chain management service with real-time cargo monitoring and internet based transactions. This will require changes in customs procedures regarding bonded warehouses and movement of goods in bond. It will also require better cargo consolidation, cross-docking, and inventory monitoring services and more efficient data interchange between shippers and logistics providers.[53] Warehousing and storage facilities are thus needed as a support measure to facilitate trade and industry to help Pakistan become part of the global supply chain.

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

d) Freight and forwarding agents (with no assets to offer as collateral) lack access to credit. Making credit more available to them by increasing flexibility in defining acceptable

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

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

collateral and by requiring full insurance coverage for truck operators can serve as a stimulus for modernizing fleets as well help in consolidating the industry.[18]

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

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

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

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

i) The major challenges currently facing the port container terminals are the traditional ones of expanding capacity to meet growth in demand, pricing services to encourage efficient use of facilities, decreasing operating costs and increasing the capacity of land and water access to the terminals.[54] Investment in improved port facilities would lower export costs while improved operating practices at the port will reduce turnaround times (of feeder vessels). Although the set up and operating costs of this proposal are large, the long term gains would outweigh the costs.

4.5. INCENTIVIZING EXPORTS

4.5.1. OVERVALUED EXCHANGE RATE
4.5.1.1. Introduction

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

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

127. Although the causation between currency valuation and growth rates may not be that clear, maintaining an undervalued currency requires higher rates of savings relative to investment or lower expenditures relative to incomes-say through large revenue surpluses, redistribution of incomes in favour of high savers, mandatory saving schemes and building up of foreign exchange reserves[55].

4.5.1.2. *Pakistan's Experience with Exchange Rates and Remittances*

128. Pakistan has experienced an overvalued exchange rate for most of its history. This was largely because of remittances of overseas migrants, ranging from an average of 7.1% of the GDP in the 1908s to 2.6% in the 1990s and just under 4% of GDP ever since and liberal inflows of foreign assistance during the period of the Cold War, then the Afghan war during most of the 1980s, then after 9/11 and the war against terror since 2001[56]..

129. The inflows on the capital account, rather than on the current account (especially those that were short-term, non-recurring and unsustainable in nature as a consequence of the fortuitous events referred to above), and more recently privatization proceeds have propped it up artificially[57]. Hamna (2009) argues that these capital flows had an appreciating effect on the exchange rate. She also argues that by filtering unsustainable and temporary flows the extent of overvaluation ranged from as low as 0.75% in 2001 to almost 23% in 2007.

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

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

4.5.2. OTHER RECOMMENDATIONS ON EXPORTS

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

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

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

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

133. We also recommend the provision of an environment in which export industries/exporters are not at a disadvantage. Such an environment would be represented by: a) an undervalued exchange rates; b) availability of imported raw materials, intermediate goods and plant and machinery to exporters at world prices; c) government pro-active initiatives with G20 countries on market access for our products-e.g. GSP and ROZ[58]; and d) incentives/ subsidies to the private sector to develop new markets.

4.6. REGIONAL TRADE: OPPORTUNITIES AND CHALLENGES

4.6.1. INTRODUCTION

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

4.6.2. TRADE WITH INDIA
4.6.2.1. Introduction

135. Although the bilateral trade between Pakistan and India in 2007/08 valued US$2.3 billion representing approximately 2% and 5% of Pakistan's total exports and imports respectively,[59] a more comprehensive analysis of trade data reveals that the two countries are important partners in trade. Pakistan's exports to India are almost half its exports to South Asia while its imports from India are in excess of 70% of its imports from South Asia, which in value terms are more

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

[59] State Bank of Pakistan.

than its imports from France, Canada, the Netherlands, Turkey, Iran and Thailand. Nevertheless, trade between the countries is lower than its potential.

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

Graph II

Note: Graph based on Table A.2, India Reporting Country
Source: Direction of Trade IMF (2006)
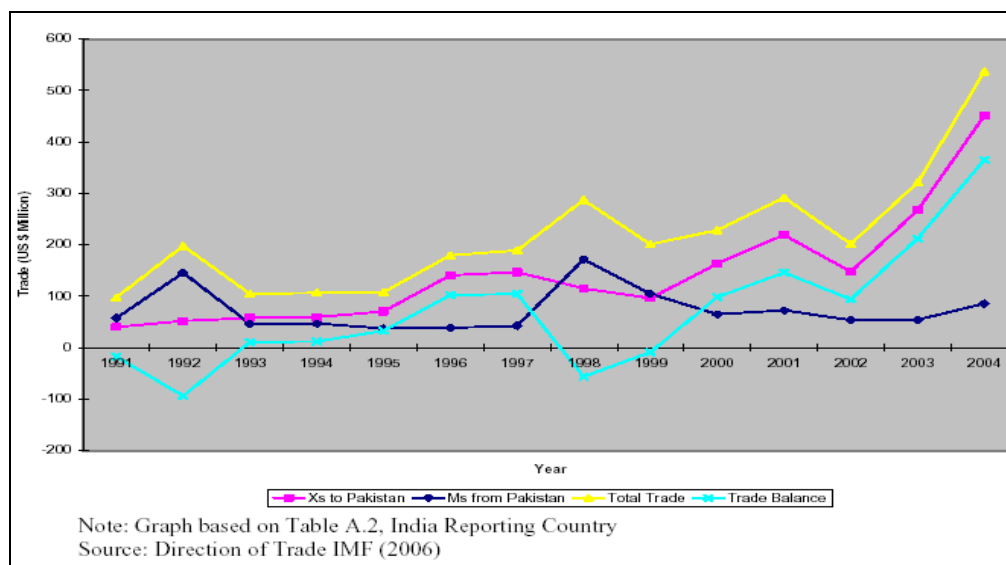
136. Although no proper estimates exist on the extent of informal, including illegal, trade between the two countries the World Bank estimated it at US$545 million in 2005, some "guesses" suggest that it is approximately US$ 2 billion[60], with around 50% of it through third countries (technically official trade) like Dubai, Singapore and Afghanistan. The balance represents cross-border informal/illegal trade. Unofficial imports is of items that are either not on the 'positive list' or are subjected to high duties and include betel leaves, tyres, tea, medicines, videotapes, chemical products, cosmetics and jewelry while items in demand include medicines, household products, iron ore, transport equipment including motorcycles and motorcars, plastics, textiles and agricultural products. Informal exports from Pakistan include food products and synthetic fibers.

137. Recent estimates on trade potential suggest that trade could be in a range of $ 3 to $ 10 billion compared with the annual official trade flows over the last six years of less than $400 million; in other words only 4% to 13% of the potential bilateral trade is being exploited. Since Pakistan and India account for almost 90 % of South Asia's GDP, low bilateral trade is an important constraint for growth of South Asian exports to the rest of the world, as well as for an expansion of intraregional trade.[61]

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

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

138. Viewed in the larger regional context, South Asia is the least integrated region compared to other regions such as East Asia, Latin America, Europe and Central Asia, Middle East and North Africa as well as sub-Saharan Africa. The reasons for the relatively low trade have been political tensions, the use of import-substitution policies to promote industrialization and the relatively little commitment to regional integration.[62].

4.6.2.2. The Benefits of Trade between Pakistan and India

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

140. Cooperation in the agriculture sector could turn out to be beneficial to Pakistani farmers. The success achieved by India in raising yields per acre[63] through improvements in extension services and research and seed, irrigation and mechanical technologies offers opportunities that Pakistani agriculturists can exploit gainfully. The Pakistan textile sector (cotton based fabrics and short-staple fiber yarn/fabric) should be expected to benefit (through increased production and higher productivity owing to a more modern technological base and equipment) from an improved access to the huge Indian market, with the latter having a distinct advantage in polyester fibers and related fabrics. Similarly, Pakistan's leather products (manufactured from the more durable cow skin) will be well-received in the Indian market where leather products are essentially made from goat skin.

141. Opening up trade with India will also have a salutary effect on prices. By depressing inflation rates it will also ease the inflationary burden in Pakistan[64]. The Indian machine tool and capital goods producing industries are regarded as highly developed and efficient. Therefore, access to cheaper capital goods, technology and skills should, by reducing the cost of investment, also improve the productivity and efficiency of Pakistani industry, thereby strengthening our global competitiveness.

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

[63] These differentials have, however, narrowed significantly over time.

[64] For instance, in view of the recent shortage of wheat in the country, Pakistan could decide to import wheat from India rather than from Australia/the US, since this would be a cheaper option.

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

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

144. It is estimated that full SAFTA will help double Pakistan's exports to South Asia[65], although India by preferring FTAs/RTAs with other SAARC countries has more or less signaled the demise of regional trade under SAFTA (Table 19), suggesting that if Pakistan is not to be marginalized in South Asia trade because of FTAs and RTAs it should fully support SAFTA and the first step in the direction would be for us to give MFN status to India.

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

Table 19: Export Gain for Pakistan in SAFTA Market (percent)[66]

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

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

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

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

4.6.2.3. The Costs and Constraints of Trade with India

146. In the context of South Asia, U.S. Trade and Development Agency in its 2005 report identified the major constraints to trade. Much of the source of trade costs results from lack of trade facilitation and lack of availability of physical infrastructure in South Asia.[67]

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

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

4.6.2.4. Overall Analysis: Benefits outweigh the Costs

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

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

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

of the services sector in South Asia, and the potential for rural development by cooperation in the agricultural sector, consideration could also be given to explore the opportunities for intraregional trade and cooperation in each of these two sectors. Processed food in agriculture and ICT and tourism in the services sector are potential alternative priority sectors.

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

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

4.6.2.5. Policy Suggestions to Enhance India-Pakistan Trade[68]:

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

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

153. The main policy suggestions are outlined below:

a) Normalization of Trade

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[68] Taneja, Nisha (2006) "India-Pakistan Trade." Working Paper No. 182. ICRIER

<http://www.icrier.org/pdf/WP182.pdf.>

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

b) Banking

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

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

c) Transport Routes

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

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

d) Transport Bottlenecks

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

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

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

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

e) Information Exchange

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

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

f) Non-Tariff Barriers

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

g) Visas

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

h) Communications

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

i) Investment

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

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

4.6.2.6. Conclusions

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

much more positive role, which in turn would hinge on the normalization of relations. The viability of the process will depend upon a continuing political commitment to trade expansion and to the need to manage disputes while keeping other interfaces for engagement intact.

4.6.3. TRADE WITH CHINA

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

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

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

Source: Ghani et. Al (2009)

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

157. Pakistan and China have signed a comprehensive Free Trade Agreement (FTA) covering trade in goods and services, bilateral investment, and institutional mechanisms for enhancing bilateral trade and investment. The FTA follows the 'Early Harvest Program' between the two countries under which tariff reductions have been implemented on Chinese and Pakistani products in over 3,000 tax items since January 1st 2006. A key feature of the agreement is the establishment of China-specific investment zones in Pakistan in which Chinese investors shall enjoy fiscal and other incentives. Moreover, both countries are negotiating an Agreement on Trade in Services.

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

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

Section 5 Promoting Inclusive Growth

5.1. Preamble

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

5.2. Identification of Sectors and Activities to Support Inclusive Growth

5.2.1. Introduction

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

5.2.2. Sectors and Activities to be targeted

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

163. Sectors like agriculture (particularly horticulture) and livestock, housing and construction[69], information technology (especially in the form of BPO services) and communications, wholesale and retail, our range of merchandise exports and SMEs are essentially labor intensive, with relatively higher employment elasticities[70] (Table 21). Therefore, these sectors offer a promising potential to generate fairly large and diversified job opportunities, both directly and indirectly, because of their strong forward and backward linkages with other sectors of the economy. Even sub-sectors of industries like consumer appliances, auto assemblers, engineering, and communications which are relatively capital intensive, generate large employment opportunities through their backward and forward linkages- especially through the development of the vendor industry and related service sector for the sale and after sale maintenance of these products.

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

Table 21: Employment Elasticities

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

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

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

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

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

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

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

5.3. AGRICULTURE AND LIVESTOCK

5.3.1. INTRODUCTION

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

5.3.2. AGRICULTURE

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

Table 22: Mt. Tons/ hectare, 2004-06

	Highest	China	USA	India	Pakistan
Rice (Egypt)	10.1	6.3	7.6	3.1	2.4
Wheat (UK)	8.0	4.4	2.9	2.7	2.4
Sugarcane					

(Egypt)	121.0	70.6	70.3	60.0	48.0
Cotton (Egypt)	2.8	3.5	2.4	1.2	1.85

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

170. The performance of agriculture is heavily dependent on the weather, water availability[71] and the continued focus on traditional crops like wheat, cotton, rice and sugar-cane, partly because of the large base of subsistence farmers. The sharp rise in international prices for food crops and the opportunities arising for Pakistani farmers to trade in other cash crops and enhance their earnings (especially with the gradual removal of subsidies in OECD countries and the resulting increases in prices of such crops) could contribute significantly to the rapid enlargement of the middle class even in the rural areas. Furthermore, to augment farmer prosperity there is a need to narrow the gap between the yields of the progressive farmers and the large population of the small farmers, and shift cropping patterns in favor of value-added horticulture[72] which presently suffers on account of marketing system.

5.3.2.1. Issues with Extension Services

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

5.3.2.2. Issues with Market Committees

172. For maximising the returns to farmers for their agricultural produce factors related to the infrastructure, framework and institutional arrangements for the marketing of these products are important. The agriculture marketing acts govern the regulation of the purchase and sale of agricultural produce (including livestock and poultry) through the institution of market committees. A licence is required from the provincial government to establish a market within a

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

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

notified area and once the notification of the market committee has been issued no other market can be established in that area without prior approval from government. The government nominates the members of the market's oversight committee and maintains significant control over the inflow of resources and assets owned by the market committee. This arrangement also results in the lack of accountability of the committee to market users and key stakeholders.

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

174. The Committees have monopolistic power and control over the bulk/wholesale purchase and sale of farmer produce in the area that is traded in these markets. This is detrimental to the interests of growers, most of whom tend to be middle farmers- with the small landowner largely resigned to selling his entire produce to the "beopari" (contractor/middlemen/trader) who picks it up from the farm gate (see below) or to the arthi in the market[73].

175. Over the years, however, a) commodities like wheat, rice, maize, cotton, sugar cane and oil seeds are no longer being traded in these markets and are being sold directly to processors like ginners, rice husking mills, flour mills and sugar mills[74]. Similarly, fruits and vegetables grown are being bought directly by middlemen/trader/contractor from the farms of the small farmers[75] and brought for sale in the markets under discussion or sold directly to large wholesalers who in turn either export the produce or sell directly to large retailers; and b) poultry is not being traded in these markets while local governments (largely since the devolution in 2001) and private entrepreneurs in complete contravention of the law (reflecting on its poor enforcement) have set up markets for livestock[76]. In other words, only fruits and vegetables (contributing 10%-13% of Sindh's crop produce, valuing around Rs.30 billion at 2006/07 prices), but making up 40%-45%[77] of the total production of these commodities, find their way into the government

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

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

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

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

[77] Sindh Government officials, however, challenge this claim. They argue that the volume traded through these markets is larger-in their opinion sales of 60% to 70% of fruits and vegetables are transacted in these markets. Smaller quantities are being

controlled markets. If livestock is included as agricultural produce that has to be traded through these markets, then in the case of Sindh the provincial government exercises control over the trade of almost Rs.70 billion of value added in agriculture[78].

176.   There are too many intermediaries in the marketing chain (as illustrated in Figure I below). As explained above the beopari/trader and the arthi provide the link between the farmer (and the commission agent in some instances) and the wholesaler. The wholesaler serves as the link between the mandi/market and the retailer. At each step the intermediary marks up the price to factor in his profit/ "cost of service" making the supply chain inefficient. It is estimated that in Sindh the wholesaler marks up the auction price at which he bought the produce by 10%-15% (depending upon the commodity and the supply and demand situation) when he sells to the small wholesaler or retailer[79], who in turn, when selling to the final consumer, mark up the produce by an overall 20%-40% depending upon the commodity and its quality to account for spoilage, especially of perishable items and the consumer markets in which they are sold, the more up-market the locality the higher the mark up for quality and the cost of operations. In other words, the intermediaries pocket two-thirds to three-fourths of the price paid by the final consumer. The process of price discovery is opaque and places the grower at a disadvantage. The number of intermediaries also contributes to overall wastage-the spoilage in this lengthy chain can be as high as 40% of the total supplies of the farmer. The farmer and the consumer pay for these inefficiencies.

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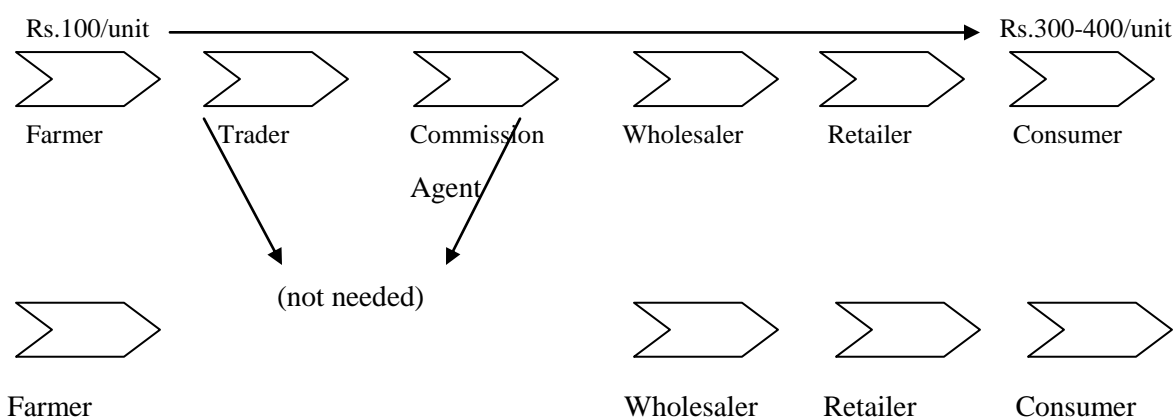
Source: Khan, Mahmood Hasan (2008). Agricultural Growth in Irrigated Punjab: Some Issues and Policies. Centre for Research in Economics and Business, Lahore School of Economics.

reported by market administrators simply to justify the total market fees of Rs.70 million being accounted for officially-leakage being a major issue. However, Arthis and traders claim that more than 80% of the fruits and vegetables cultivated in Sindh find their way into these markets.

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

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

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

5.3.2.3. Recommendations for Enhancing Agricultural Productivity and Growth

178. To enhance agricultural productivity and growth government intervention in agriculture must move away from aimless subsidization of outputs (like production of wheat this year) and inputs (fertilizer and under-recovery of the cost of provision of irrigation services)[80] to: a) introduction of BT cotton learning from the experience of India where production of cotton increased 2.6 times from 10 million bales in 2001/02 to almost 26 million bales in 2007/08 while yields rose from 186 kgs per hectare to 466 kgs per hectare over the same period compared with Pakistan where there has been no significant upward trend in yields since 1990[81] (Appendix V; b) integrated pest management and testing facilities and regulatory oversight for quality of pesticides cotton; c) improved availability of good quality certified seed[82] (through the approval of the draft Seed Act, improvements to enhance the efficiency and effectiveness of the process and institutional framework for seed certification and public private partnerships for sharing foundation seed and multiplication); d) more efficient utilization of water[83] (largely through better pricing and conservation of this scarce resource, including precision land leveling[84]); e) speedy implementation of projects relating to cold storages and additional support for development of such storages[85] say through period based tax exemptions; f) investment in, and dissemination of, research to increase yields; g) improved extension services (in part by incentivizing private sector provision of extension services); h) establishing a futures market for crops and a system of crop insurance so that pricing signals can work; i) constructing and maintaining farm-to-market roads; and j) rural electrification. Other interventions should include

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

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

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

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

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

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

a) addressing of the issue of asymmetric prices for inputs and outputs[86]; b) allowing farmers opportunities to export[87] say through provision of export re-finance (thereby improving the terms of trade in favour of agriculture); and c) strengthening agricultural marketing, partly through public-private partnerships in the development of agricultural markets, and through revisions in the regulatory framework for market committees.

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

5.3.2.4. Recommendations on Extension Services

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

181. The provincial governments need to strategize their interventions for greater effectiveness of its objectives associated with extension services. They should reprioritize and re-align budgetary allocations to support farmer efforts to augment yields by exploiting the opportunities provided by modern communication technologies (including web-based systems) to transmit powerful messages and production enhancement techniques to large, relatively less educated audiences in a cost efficient manner.

5.3.2.5. Recommendations on Market Committees

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

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

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

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

184. Although the legislation governs the orderly flow of farm produce to the consumer with price discovery through the auction process the farmer, especially the small landowner, is exploited by the arthi and the commission agent a) because of the monopoly they enjoy since the produce can only be sold in that particular market[88]; and b) through unfair grading and weighing of the produce. An amendment in the legislation or its repeal will open up opportunities for improving the farm produce supply chain- permitting retailers to buy directly from the farmer by-passing the markets and the intermediaries. Such an arrangement will enable organized retailing (e.g. Metro type organized retailers/wholesalers) directly sourcing from the farmer-eliminating at least two intermediaries from among the arthi, commission agent and the wholesaler, with the need for central storage and reliance on wholesalers also being eliminated in the process.

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

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

187. The reforms in the area of agriculture marketing should also aim to strengthen market related information systems. There is a need to tackle information asymmetry on prices to enable farmers to maximize their returns without being exploited by middle men on this account. To this

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

end, there is a need to improve the information providing network comprising websites and electronic boards in markets to make data real time.

5.3.3. LIVESTOCK
5.3.3.1. Issues with the Livestock Sector

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

189. The estimated livestock population is in excess of 151 million[89] with an average of 3.2 milch animals per livestock holding household, with one-half to two thirds having a herd size ranging from 4 to 6 milch animals. However, despite the size of the animal population, its outputs are well below the potential in terms of yields of milk and meat because of traditional and poor farm management practices with regard to the nutrition and management of animals, the inadequate cover and quality of animal health, the inferior genetics of the breeding stock, long calving intervals, the weak quality product controls with respect to milk and meat, the lack of availability of credit and lack of access to, and weak, marketing networks. The small herds that are largely dependent upon local fodder, open/communal grazing areas and farm and household waste are also factors underlying the poor yields.

190. Therefore, the primary focus of interventions in the livestock sector should be to enhance yields of milk and meat and improve access to markets through assistance in the adoption of modern farming practices, development of effective insemination centres to upgrade the genetic base of the animals, better quality animal feed, training in animal care and disease prevention and better access to animal health services through social mobilization of farmers. However, although milk sales provide a daily income, less than 8% is processed and marketed through formal channels and an estimated 20% is lost during transportation and storage[90]. It is generally accepted that the sector is failing to reach its potential due to poor nutrition and management of stock, lack of access to services, weak market linkages and lack of availability of credit

5.3.3.2. Recommendations on Livestock

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[89] Census of Livestock, 2006

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

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

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

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

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

195. Therefore, through a package of interventions along the lines proposed above, milk yields of beneficiary households could increase by 35%-40% over a 3 year period. This is likely to be the maximum improvement in yields due to limitations imposed by the genetics of the livestock breed. Currently, the average yield is about 1,100 litres/ year. An increase of 40% in milk yields, assuming each household has 3.5 animals on average, and taking a conservative price estimate of Rs. 20/litre[91], would raise the annual household income by Rs.31,000. The marketing of this milk should not pose any serious problems because of the healthy competition between milk processors. If the marketing of the milk is viewed as a major constraint facing livestock-rearing households, then through a PPP arrangement an organization could be established to either create or manage (for a nominal fees) a central milk collection facility, buying the product and storing it in chillers for onward sale to other milk processors, thereby ensuring better returns and timely payments to these households.

196. A related intervention to enhance farmer incomes could be an initiative to increase livestock yields of meat (both in terms of quantity and quality), which requires effective and efficiently

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

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

197. Furthermore, animals are sold in the unregulated, if not illegal, market fetching lower prices. Presently, markets for trading livestock can only be set up under the auspices of local governments. If the private sector were to be permitted to set up local bulk markets for the sale of livestock and also encouraged to set up abattoirs (some privately owned ones are unauthorized)[92] with direct links to such markets, greater competition and fewer intermediaries between the livestock holder and the end consumer will reduce margins, thereby benefiting both producers and final consumers. The establishment of slaughter houses locally would stimulate economic activity in backward areas like Southern Punjab, lower Sindh and Balochistan.

5.4. HOUSING AND DOMESTIC COMMERCE

5.4.1. INTRODUCTION

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

199. With the sharp escalation in prices of land in recent years, even improved availability of housing finance will not enable the vast majority of the less affluent segments of society and those among the low to middle income households, whose primary source of earnings is salaries from employment, to buy residential property. For such households, especially with the rise in nuclear families, the only option to escape from high land prices, low housing affordability, over-crowded dwellings and congested surroundings would be the move away from horizontal to vertical development in major cities and availability of housing on rent. For the latter, the structure of property taxation and the pro-tenant bias of the rent related legislation serve as principal disincentives.

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

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

5.4.2. KEY CONSTRAINTS TO DEVELOPMENT OF HOUSING AND DOMESTIC COMMERCE

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

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

b) High rates of stamp duty and other levies.

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

d) Contract enforcement.

e) High property tax rates on rented properties.

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

5.4.2.1. Unclear Land Titles

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

203. Pakistani law does not view registration or any other record of rights in land as a guarantee from the government or its agencies that the person mentioned in the records of any agency is the rightful owner, so that if the records turn out to be incorrect, the government cannot be held liable for the inaccuracy of the record and the loss if any incurred by the buyer of the property on the basis of the information contained in the records. In transactions involving property transfers, the documents of 'title' provided by the seller to the buyer do not certify title. These are private documents that confirm one of the transactions in the entire chain of transactions. By entering the transaction in respect of any property in the official records, the Registrar only confirms that the transaction has been recorded and does not provide any guarantee for either the validity or the accuracy of the document. Erroneous documentation and multiple registrations of the same lot in

the names of different transactors and poor recording of plot size and boundaries encourage overlapping claims on ownership.

5.4.2.2. High Rates of Stamp Duties

204. An important factor hindering the growth of housing is the high cost of registering property transfers. All related instruments are either wielded by or within the control of the provincial and local governments. In Punjab and Sindh the costs in urban areas include a 1% registration fees, a 3% provincial stamp duty and local government property transfer fees on the value of the property[93] (plus a 2% Capital Value Tax levied by the FBR), compared with a nominal transfer fee of Rs.150 per sq. yard (and no stamp duty) payable to the Capital Development Authority in Islamabad[94]. In the case of a loan, there is a 0.25% charge for registering mortgage documents.

5.4.2.3. Out-dated and Non-uniform Building Laws

205. The building by-laws are outdated and do not reflect realties or the needs of major urban centres and leave discretion in the hands of officials. For instance, residential zones only cover single family homes and not greater urban density through apartment blocks for constructing, which developers are liable for commercialization charges[95].

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

5.4.2.4. Land Regulation-Commercialization Charges

207. Some local government taxes and fees overly load the cost of investment for the construction sector. For instance, the Lahore Development Authority (LDA) levies a commercialization fees equivalent to 20% of the value of the plot in case of change of use of property, even in areas

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

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

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

declared as commercial zones[96]. In Karachi, the flat rate commercialization fee of Rs.8,000 per sq. yd. is approximately equivalent to 10% of the value of the plot in case of change of use of property in prime commercial areas of the city. Moreover, commercial space in residential sites and services schemes tends to be limited and also restrictive in nature in terms of plot sizes for warehousing and retail outlets. As a result, commercially zoned property is inadequate, explaining the lack of warehouses, hotels, large departmental stores and shopping malls in major urban centres.

208. We understand that the rationale underlying these rates is the wide gap between revenues from property tax[97] and receipts from the provision of other services (for example, water tariffs in the case of WASAs) and the requirements to finance capital expenditures and recurring obligations of these agencies. In our view, the deficits faced by these agencies to satisfy their mandates should not be bridged by taxing investment but addressed through a combination of measures involving the re-structuring of property tax, rationalization of user charges, appropriate strengthening of the collection machinery, enhancements in the efficiency of expenditures and better financial management.

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

5.4.2.5. Restrictions on the Height of Buildings

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

5.4.2.6. Other Building Regulations

211. The current building regulations require the provision of parking space on the basis of one car for every 1000 square feet of covered area. In our view, there is a need to re-examine this

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

[97] 50% of the property tax receipts are handed over to WASA, 25% are distributed to LDA and the remainder are passed on to the City District Government Lahore (CDGL)

requirement for mandatory provision of parking space in commercial plazas since it is the responsibility of the government to enforce traffic laws and ensure the free flow of traffic.

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

5.4.3. PRIVATE SECTOR DEVELOPMENT OF HOUSING

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

214. An overarching, and formidable, constraint to the bulk development of property by the private sector for eventual sale [98]is the 'legality or white' aspect of the source of money tied up in land. The antecedents of the bulk of the wealth invested in land are dubious, being 'black' in character.

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

216. Developers also complain: (a) of the high charges or rates of penalties for modifying building plans, even when the variations do not result in any increase in the covered area of the building; and (b) the demands of the Employees Old Age Benefit Institution (EOBI) and the Provincial Employees Social Security Institutions for contributions at 5% and 7% of wages respectively even for casual workers, which make up most of the labour force in the construction industry. The latter is a particularly contentious issue in NWFP where the bulk of the labour force in the sector comprises Afghan refugees.

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

5.4.4. RENT CONTROL LEGISLATION AND OTHER FACTORS INFLUENCING PROPERTY DEVELOPMENT FOR RENTAL PURPOSES

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

218. In Sindh and NWFP the legislation empowers a Rent Controller to determine a fair rent for the residential premises and disallow the increase of rent of residential buildings over a 3 year period, while the rent of non-residential buildings can be raised by 25% every three years. It appears that even when there is a suitably framed, and legally binding, lease/contract the tenant can still apply to the Controller for assessing a fair rent.[99]

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

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

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

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

b) in the event that the landlord has been given possession of the property for new construction or renovation and the old building has not been demolished within six months or the new building has not been constructed within two years after this six month period, in Sindh the Controller can fine the landlord up to a maximum of one year's rent. In the NWFP he can even be sentenced for a period of 6 months!; and

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

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

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

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

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

a) The high rate of stamp duty (e.g. in Sindh 3% of value of contract) and registration fee (1% of contract value) on the compulsory registration of lease documents covering a period of 1 year and above;[100] and

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

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

5.4.5. RECOMMENDATIONS ON HOUSING AND DOMESTIC COMMERCE

226. The housing and construction sector with its high employment elasticity, strong forward and backward linkages with a number of sectors and sub-sectors[101] and large direct and indirect employment and income generating impacts is most affected by the tax regime and regulatory structures within provincial control. For these reasons the following reforms are proposed to exploit the huge untapped potential of the sector.

a) Reducing the cost of investment by:

i) Rationalizing the stamp duty on property related transactions.

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

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

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

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

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

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

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

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

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

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

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

228. The measures proposed above should be combined with disposal of land owned by government in prime commercial locations and being used for less productive purposes. The divestment of

this land or that leased out to the private sector at a nominal rent[102], will help exploit the potential of this scarce asset, thereby stimulating private construction activity, improving utilization of land, mobilizing revenues for all levels of government and generating resources for utility agencies from sunk investments in completed sites and services schemes not fully colonized.

5.4.6. OTHER RECOMMENDATIONS

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

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

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

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

5.5. SME CLUSTERS

5.5.1. PREAMBLE

233.   SMEs bring numerous advantages to regions of their location. They provide employment opportunities, encourage entrepreneurial activities and innovation and can lead to basic technological capacity building and skill development. Furthermore, a dynamic SME sector, especially when such enterprises are located in clusters, serves as

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

an important complement to a more open economy. In most of the countries which appear to have reaped major benefits from export orientation the SME sector has been an important player in that process (Berry, 1998).

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

5.5.2. INTRODUCTION

235. Clusters can simply be defined as sectoral and spatial concentration of firms.[103] An industrial cluster is an agglomeration of companies, suppliers, service providers and related institutions producing a similar range of products. An example would be a country's auto industry, with its manufacturers and all their supporting services, like parts and equipment suppliers, transportation companies, retail distributors, educational institutions and R&D firms, public relations, advertising agencies, etc.[104]

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

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

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

237. In view of the increasing internationalization of production, distribution and marketing has created global community chains and business networks from supplying raw material to production, marketing and retail (retailer and brand merchandizing control chains) that are buyer driven (design and marketing intensive garments and leather sectors) or are producer driven, as is the case of capital and technology intensive products, automobiles and electronics, SMEs have to become part of a chain to access markets. And external actors such as global buyers and global lead firms not only link local producers to global markets but also provide a framework for understanding how clusters are inserted into global value chains to enable them to upgrade their technological and complementary capabilities[105].

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

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

5.5.3. ISSUES AND NEEDS OF CLUSTERS IN PAKISTAN

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

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

b) The existence of a large pool of labour with specialized skills should reduce search and hiring costs for firms located within the cluster as well as reduce the risk and cost of re-location for labour looking for a better job opportunity. However, in the case of Pakistan a major constraint faced by those located in the cluster concerns the easier and rapid mobility of labour from one

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

enterprise to another largely because of skill shortages, which pushes up the cost curve affecting the competitiveness of the cluster. Hence, the need to improve availability of relevant skills that can adapt quickly to changing technologies.

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

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

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

5.5.4. RECOMMENDATIONS ON POLICY INTERVENTIONS FOR STRENGTHENING CLUSTERS

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

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

a) Collective action could be promoted by identifying the common needs of a particular cluster. SMEs generally lack modern design and production facilities and nor do they have the financial muscle to acquire these. To support their ability to compete and becoming efficient producers the government could consider setting up common facility centers[106] that would provide access to technology, machining facilities and market related information and other common services. For example, well-designed export processing zones (EPZ) with decent quality physical infrastructure can be developed with proper bonded warehousing capability and the above referred support facilities. In such export processing zones, the location of SMEs can be encouraged on the basis of transparent criteria such as a minimum number of workers, volume of exports and share of total turnover, etc.

b) Proper training facilities could be set up under a public-private partnership agreement with certification by some internationally recognized body for workers in such

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

clusters. To facilitate development in relevant skills industries located in the cluster would identify the skills needing creation or upgrading.

c) Public information and knowledge of buyer needs, markets and production mechanisms are more effectively accumulated and disseminated within clusters Organizations can be established to develop linkages, for example, between buyers and sellers by acting as repositories of information of potential venture capitalists, potential buyers of products, potential trainers and to act as repository of information for market research reports which have already been conducted on various clusters.. The public sector say through SMEDA can play a key role in this area[107] .

d) The flow of sector-specific and technical information within the cluster generates important knowledge spillover gains for local firms. Widespread subcontracting allows for economies of scale and scope, leading to savings on costs, skills and space.[108] The flow of such technical information could be facilitated by the government, for example by arranging seminars and workshops within clusters thereby reducing transaction costs while generating high returns through wider and more effective participation of the key stakeholders.

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

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

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

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

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

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

h) To facilitate the growth of SMEs and SME clusters there is a need for a carefully designed programme to develop secondary/intermediate cities/towns[109] by adopting a cluster based approach (with the cities/towns to be connected, if necessary, through expressways) on the basis of economic potential (in terms of available markets and commercial centers), returns to the economy and payback period, instead of selecting individual cities in different parts of a province. Initially, for instance in Punjab, this may result in the selection of clusters in the central districts of the province with basic infrastructure (supplemented/upgraded by infrastructure to be provided under this project/programme), with markets having strong forward and backward linkages, because of readily available supply chains, skills, population concentrations with purchasing power and entrepreneurial talent.

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

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

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

Pakistan, the cases in point are the production of surgical instruments and sports in general and, until very recently, footballs in particular, in the city of Sialkot.

243. Therefore, over and above the above suggested interventions and initiatives that the government should consider to strengthen existing clusters, it may also support investment in technology and equipment in some new areas or sub-sectors of industry that it may wish to promote on grounds of their products being primarily exported or general value added and future potential for export. To this end it can provide incentives in terms of time based subsidized credit for all new entrants setting up new industry or opting for upgrading existing operations in the same industry through acquisition of specialized equipment and technology or/and accelerated depreciation allowances on investment in new plant and machinery. In addition, there is a need to continuously revisit the incentive structures for upgrading technology and products in response to changing market demands. The government can help develop foreign partnerships through tax incentives which can be period-specific incentives or linked to exports. Quasi public goods like specialized infrastructure, specialized educational programs, foreign direct investment (FDI) attraction, information and technology pools, quality centers and so on can be better handled by the government at the cluster level than either the macro or sector levels[110].

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

SECTION 6 PROVINCIAL STRATEGIES AND REDUCING REGIONAL INEQUALITIES

SECTION 7 CONCLUSIONS

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

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

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

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

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

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

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

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

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

253. To facilitate trade there is also a need to further simplify custom procedures, develop an integrated supply chain management service with real-time cargo monitoring and internet-based transactions, invest in infrastructure through better port facilities, create an efficient rail and air freight service and introduce new and less polluting trucks for freight service. There is also a need to exploit the huge potential offered by regional trade, and thereby build strong constituencies for peace, through first granting India MFN basis and abandoning the positive list approach, easing visa processing to facilitate freer movement of people, an institutional

arrangement for banks to participate freely in transactions relating to L/Cs and payments, opening up of new transportation routes, better information exchange, reduction in NTBs and creating an enabling environment for investment in joint ventures.

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

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

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

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I. GROWTH AND POVERTY

I.1. INTRODUCTION

Pakistan has experienced fairly large fluctuations in its growth rates in its history (Table I.1), which has also demonstrated that while growth may be a necessary condition for reducing poverty it may not be a sufficient condition. Periods of high growth like in the 1960s have coincided with high levels of poverty levels while periods of slow growth (1970s) have accompanied low incidence of poverty, the reasons ranging from skewed asset distribution to specific government policies. (Background Paper: 1 Poverty, Economic Growth, and Inequality: A Review of Pakistan's Poverty Literature (ADB)).

Table I.1

ECONOMIC AND SOCIAL INDICATORS

Indicators	1960's	1970's	1980's	1990's	1980-81	1984-85	1990-91	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 P
	Average (Annual)																				
GROWTH RATE (%) (Constant fc)																					
➜ GDP	6.8	4.8	6.5	4.6	6.4	8.7	5.6	5.1	6.6	1.7	3.5	4.2	3.9	2.0	3.1	4.7	7.5	9.0	5.8	6.8	5.8
- Agriculture	5.1	2.4	5.4	4.4	3.7	10.9	5.0	6.6	11.7	0.1	4.5	1.9	6.1	-2.2	0.1	4.1	2.4	6.5	6.3	3.7	1.5
- Manufacturing	9.9	5.5	8.2	4.8	10.6	8.1	6.3	2.5	3.7	-0.1	6.9	4.1	1.5	9.3	4.5	6.9	14.0	15.5	8.7	8.2	5.4
- Commodity Producing Sector	6.8	3.9	6.5	4.6	6.3	9.5	5.9	5.7	8.5	0.4	5.3	3.4	3.0	0.8	1.4	4.3	9.2	9.5	5.1	6.0	3.2
- Services Sector	6.7	6.3	6.7	4.6	6.6	8.2	5.2	4.8	5.0	3.6	1.6	5.0	4.8	3.1	4.8	5.2	5.9	8.5	6.5	7.6	8.2
GROWTH RATES (%)(Current MP)																					
➜ Total Investment	-	21.8	4.2	8.1	9.8	12.8	19.4	13.4	16.4	8.0	9.0	-3.6	10.2	8.6	3.2	10.7	14.4	32.6	36.1	18.3	13.1
- Fixed Investment	14.8	20.5	3.7	7.8	4.8	12.6	20.0	13.3	16.9	7.7	1.5	1.6	10.5	8.5	3.2	8.2	14.7	34.3	38.0	18.6	12.5
- Public Investment	14.0	25.3	2.6	7.3	-1.2	11.4	20.9	18.8	13.0	-5.3	-14.9	25.8	5.5	11.1	-22.2	4.0	19.3	23.7	30.3	36.1	20.2
- Private Investment	20.9	17.0	5.1	8.8	13.1	14.1	19.2	8.5	18.7	19.6	13.3	-11.4	14.3	7.2	17.3	9.8	13.1	38.3	40.5	13.3	9.7
As % of Total Investment																					
- National Savings	-	67.5	22.6	57.6	80.6	70.6	74.8	77.9	61.9	65.7	82.7	75.2	91.0	95.8	110.7	123.1	108.0	91.5	82.3	77.7	64.5
- Foreign Savings	-	32.5	7.4	20.1	19.4	29.4	25.2	22.1	38.1	34.3	17.3	24.8	9.0	4.2	-10.7	-23.1	-8.0	8.5	17.7	22.3	35.5
As % of GDP (Current MP)																					
Total Investment	-	17.1	18.7	18.3	18.8	18.3	19.0	18.4	18.8	17.7	17.3	15.6	17.4	17.2	16.8	16.9	16.6	19.1	22.1	22.9	21.6
- Fixed Investment	-	15.9	17.0	16.6	17.2	16.5	17.4	16.9	17.2	16.2	14.7	13.9	16.0	15.8	15.5	15.3	15.0	17.5	20.5	21.3	20.0
- Public Investmnet	-	10.3	9.2	7.5	9.4	8.9	8.5	8.2	8.2	6.8	5.2	6.1	5.6	5.7	4.2	4.0	4.0	4.3	4.8	5.7	5.7
- Private Investment	-	5.6	7.8	9.1	7.8	7.6	8.5	8.7	9.0	9.4	9.6	7.9	10.4	10.2	11.3	11.3	10.9	13.1	15.7	15.6	14.2
National Savings	-	11.2	14.8	13.8	15.1	12.9	14.2	14.3	11.6	11.6	14.3	11.7	15.8	16.5	18.6	20.8	17.9	17.5	18.2	17.8	13.2
Foreign Savings	-	5.8	3.9	4.5	3.6	5.4	4.8	4.1	7.2	6.1	3.0	3.9	1.6	0.7	-1.9	-3.8	-1.3	1.6	4.5	5.1	8.4
Domestic Savings	-	7.4	7.7	14.0	7.0	4.8	9.9	13.6	12.0	12.8	15.7	12.9	17.1	17.8	18.1	17.6	15.7	15.4	16.3	16.0	11.7
GDP DEFLATOR (GROWTH %)	-	-	2.3	8.3	10.4	4.5	13.1	13.8	8.3	14.6	6.6	5.9	2.8	8.0	2.5	4.4	7.7	7.0	10.5	7.9	13.4
CONSUMER PRICE INDEX (CPI)																					
(Growth %)	3.2	12.5	7.2	9.7	13.9	5.7	12.7	13.0	10.8	11.8	7.8	5.7	3.6	4.4	3.5	3.1	4.6	9.3	7.9	7.8	12.0
FISCAL POLICY																					
As % of GDP (MP)																					
➜ Total Revenue	13.1	16.8	17.3	17.1	16.9	16.4	16.9	17.3	17.9	15.8	16.0	15.9	13.5	13.3	14.2	14.9	14.3	13.8	14.2	14.9	14.3
- Tax Revenue	-	-	13.8	13.4	14.0	11.9	12.7	13.8	14.4	13.4	13.2	13.2	10.7	10.6	10.9	11.5	11.0	10.1	10.6	10.2	10.0
- Non-Tax Revenue	-	-	3.5	3.7	2.9	4.5	4.2	3.5	3.5	2.4	2.8	2.6	2.8	2.7	3.3	3.4	3.3	3.7	3.6	4.7	4.3
➜ Total Expenditure	11.6	21.5	24.9	24.1	22.9	24.7	25.7	22.9	24.4	22.3	23.7	22.0	18.8	17.4	18.3	18.5	16.7	17.2	18.5	19.1	21.7
- Current Expenditure	-	-	17.6	19.4	13.6	17.7	19.3	18.5	20.0	18.8	19.8	18.6	16.5	15.5	15.9	16.3	13.5	13.3	13.6	14.9	17.7
Defence	-	-	6.5	5.6	5.5	6.7	6.4	5.6	5.6	5.2	5.1	4.9	4.0	3.2	3.4	3.3	3.3	3.3	3.2	2.8	2.7
Interest Payment	-	-	3.8	6.8	2.1	3.5	4.9	5.2	6.3	6.6	7.6	7.5	6.9	6.0	6.2	4.8	4.0	3.4	3.4	4.4	4.7
- Development Expenditure (#)	-	-	7.3	4.7	9.3	7.0	6.4	4.4	4.4	3.5	3.9	3.3	2.5	2.1	2.8	2.2	3.1	3.9	4.8	4.9	4.0
➜ Overall Deficit	2.1	5.3	7.1	6.9	5.3	7.8	8.8	5.6	6.5	6.4	7.7	6.1	5.4	4.3	4.3	3.7	2.4	3.3	4.3	4.3	7.4
MONEY & CREDIT (GROWTH %)																					
- Monetary Assets (M2)	16.3	21.0	13.2	16.8	13.2	12.6	17.4	17.2	13.8	12.2	14.5	6.2	9.4	9.0	15.4	18.0	19.6	19.3	15.2	19.3	15.3
- Domestic Assets	15.0	20.5	15.4	12.2	16.5	25.0	16.8	13.1	18.8	15.3	15.0	3.5	9.0	3.7	2.2	0.5	23.7	22.4	15.8	14.2	23.1
STOCK EXCHANGE MARKET (GROWTH %)																					
- General Index for Share Prices	-	-	0.1	4.1	-1.0	-3.3	42.6	-35.6	-8.9	-15.9	-30.5	5.8	22.4	5.3	-30.9	91.2	53.2	15.1	18.6	28.2	-16.8
- Aggregate Market Capitalization	-	-	2.5	13.4	-1.9	11.7	40.7	-27.5	24.5	28.5	-44.7	10.4	36.9	-13.4	20.2	88.1	81.9	48.3	37.4	43.9	-5.9

- Not available
\# From 1998-99 onward also include net lending to PSEs.

Contd.]

Source: Economic Survey of Pakistan (2006-07)

In excess of 44% of Pakistan's population is poor or vulnerable, reflected in the bunching around the poverty line. A slight shock at the macro level or at the level of the household (e.g. the death or illness of the main bread-earner) can throw large numbers of people into poverty (Table I.2).

Table I.2: Population Quartiles over Population Bands.

	2000-01	Poverty Band (2003-04)	2003-04 (%)	2004-05 (%)
Non Poor	13.0%	Rs. 1,497	15.3%	20.5%
Quasi Non-Poor	30.1%	Rs. 936	32.2%	35.0%
Vulnerable	22.5%	Rs. 749	20.4%	20.5%
Poor	22.5%	Rs. 561	20.1%	16.4%
Ultra Poor	10.8%	Rs. 374	10.4%	6.5%
Extremely Poor	1.1%		1.6%	1.0%
Total Below Poverty Line	34.4%		32.1%	23.9%

Source: CPRID/Planning Commission, Pakistan Economic Survey 2003-04 and 2005-06

I.2. TRENDS IN GROWTH AND POVERTY

During the 1970s, the average GDP growth fell to 4.8% from 6.8% in the 1960s while poverty head count declined from 47% to 31% of the population during 1969-1979. The reasons for these outcomes include larger volumes of public investment that created job opportunities for those with limited skills combined with laws that strengthened labour rights[111] especially following the state takeover of private enterprises (Arif, 2006). Therefore, despite a slowing down in the rate of economic growth, employment increased along with earnings of workers for the same level of effort. However, rural poverty continued to be higher than urban poverty largely owing to poor agricultural growth, 2.4%, as against the growth of 5.5% and 6.3% witnessed in manufacturing and services respectively.

The 1980s experienced a higher GDP growth rate of 6.6% driven mostly by external assistance as a result of the Afghan War and an upsurge of remittances from Pakistanis working in the Middle East. They averaged $2,355m annually (11.0 % of GDP) in the 1980s compared with their average of $713m (4.2 %

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

of GDP) in the 1970s (Tables I.8-11 Appendix I). This increased GDP growth was also accompanied by a further reduction in the proportion of population below the poverty line, from 31% in 1979 to 17.32% in 1987-88. Rural poverty also fell as a result of remittances and the improvement in rate of growth of agriculture to 5.4% from an average of 2.4% in the 1970s, mainly as a result of good weather. The reduction in overall poverty is likely to also have been positively impacted upon by higher levels of private investment, to 16.8% of GDP compared with 15.5% in the 1970s (Table I.3), which would have spurred employment opportunities. However, for a variety of reasons the growth rate and the trend in poverty reduction could not be maintained (Arif, 2006), which principally include a decline in external aid at the end of the Afghan war. This led to a cutback in public expenditure and a diminution in employment opportunities (Table I.4). The deteriorating conditions of growth and poverty were also adversely affected by frequent changes in government policies; a weakening in the bargaining position of trade unions (owing to the presence of a military dictatorship) reflected in fewer worker stoppages; bans on strikes of labour, growing casualization of job markets and increasing pro-employer attitude of governments. See Table I.3 for period averages of Gross Investment as percentage of GDP.

Table I.3- GFCF

Average During	GFCF (Total) as % of GDP (Current Prices)	GFCF (Private) as % of GDP (Current Prices)	GFCF (Public) as % of GDP (Current Prices)
1960-1973	15.28	8.21	7.26
1973-1978	15.50	4.79	10.71
1978-1988	16.77	7.10	9.66
1988-1993	17.95	9.22	8.73
1993-1998	16.31	9.32	7.36
1998-2000	13.26	8.10	5.31

Source: Economic Survey, GOP, Economic Advisor's Wing, Finance Division, various Issues.

Table I.4 – Development Expenditure as percentage of GDP

Average During	ADP as a % of GDP
1972/73 to 1976/77	7.4
1977/78 to 1986/87	6.24
1987/88 to 1996/97	4.26
1997/98 to 1999/2000	3.5

Source: Economic Survey, GOP, Economic Advisor's Wing, Finance Division, Various Issues.

All these factors combined with a decline in agricultural growth from 5.4% in 1980s to 4.4% in 1990s as well as slackening of external assistance led to a fall in employment opportunities and incomes, contributing to a rise in headcount poverty. By the 1990s the proportion of population living below the poverty line increased from 17.3% in 1987-88 to 32.6% in 1998-99 and once again rural poverty exceeded urban poverty. Among other factors, the poor generation of employment opportunities during the 1990s was on account of weak rates of GDP growth and low PSDP allocations for development of physical and social infrastructure and public sector recruitment bans for almost 5 years, even for hiring personnel for social service delivery.

I.3. AGRICULTURE AND NON-FARM SOURCES INCOME

The end of the 1990s suffered from an acute drought in 2000 which had negative spill-over effects on agriculture and consequently on farmer incomes <http://www.un.org.pk/drought/rcreport11.htm>. Overall poverty rose further to 34.5% in 2000-01 from 32.6% in 1998-99 while rural poverty increased from 34.8% in 1998-99 to 39.3% in 2000-01. Since 44% of Pakistan's labour is employed in agriculture, there were bad tidings for the rural population.

Another factor was the continued skewness inland distribution. A report by the World Bank shows that with only 37% of rural households owning land (of which 61% households own less than 5 acres and 2% own 50 acres or more) the Gini coefficient of land ownership is 0.66 (and if rural landless households are included, the Gini coefficient is 0.86). The link between landlessness and poverty has further been discussed by Anwar et al who carry out a province-wise analysis to reveal that the poorest landless households are in Balochistan where the poverty incidence of 69.6% followed by NWFP with poverty at 65.9% and Sindh at 58.6%. Anwar et al. emphasizing the role of unequal land distribution in worsening poverty show that only 0.1% of the households in Sindh and NWFP own 55 acres and above of land compared with Punjab and 0.3% in Balochistan. A high Gini coefficient of 0.6339 in Punjab shows how unequal the land ownership is here while it is 0.5893 in NWFP and 0.5072 in Sindh (Anwar et al). Studies also provide evidence that **'land productivity of large farms in Pakistan is lower than that of small farms" suggesting that** 'increases in the share of land cultivated by small-holders would help increase overall farm productivity in Pakistan' (World Bank, 2007).

However, data post-2000 shows that both rural and urban poverty have declined (Table I.7a and Table 1.7b, Appendix I). The primary reason for this development has been improvement in agricultural growth that had dropped to 0.1% in 2001-02 but started climbing, reaching 6.5% in 2004-05 (Table I.1 Appendix I). During this period that remittances also rose as did development expenditure rising from 3.8% of GDP in 2001-02 to 5.7% in 2006-07 (Table I.15 Appendix 1).

Although 44% of the total labour force is engaged in agriculture non-farm sources of income for rural households also play an important role in poverty reduction. Non-farm incomes as well as remittances

together comprise 49% of overall rural income (World Bank, 2007). Also, agriculture credit lending which started growing after 2000 (Table I.16) should have also contributed to poverty reduction. The 'Khushhal Pakistan Programme' which aims at creating employment opportunities specifically for those in rural areas via micro-credit, skill enhancement and agriculture development was also initiated in this period benefiting almost 3.2 million households in 2,000 rural union councils in Pakistan (Economic Survey 07-08). This period also coincided with rapid growth in manufacturing, trade and services (Table I.17 Appendix I).

I.4. SECTORAL GROWTH (AGRICULTURE AND CONSTRUCTION) AND EMPLOYMENT ELASTICITIES

The root cause for the prevalence of rural poverty, despite decreasing levels of overall poverty, can be traced to the conditions in the agriculture sector. Agricultural growth in Pakistan has been erratic (Figure I.2 Appendix I) and (Table I.18 Appendix 1) shows how the share of agriculture in GDP has declined over time. A good year followed by another bad one may keep a household trapped in poverty (Malik, 2005).

Another important factor in affecting headcount poverty has been the employment elasticities of different sectors Anwar (2004) (Table I.5 Appendix I) provides the employment elasticity of each sector, the highest, 0.87, being that of construction. Secondly, although agriculture has low employment elasticity, since a large proportion of the labour force is employed in this sector, focus on agriculture would address the issue of underemployment and increase earnings of the work force of this sector. There is much higher under-employment in the agriculture sector (including livestock), followed by services (which absorbs 35% of the labour force) with close to 24% and just over 13% of their respective work force is employed for less than 35 hours a week. Such a strategy would not only help achieve inclusive growth but would have a multiplier effect by putting money in the hands of those segments of the population that are more likely to consume goods and services produced domestically, thereby encouraging domestic production and helping achieve a more sustainable growth rate while also bringing stability into it the latter because the consumption patterns of such households also tend to be stable.

Table I.5-Employment Elasticities

Sector of activity	Elasticities
Overall Elasticity	0.41
Agriculture	0.37
Large Scale Manufacturing	0.02
Small Scale Manufacturing	0.85
Construction	0.87
Transport & Communication	0.45
Trade	0.57
Electricity & Gas	0.54
Others	0.68

Source: Anwar, Talat (2004) Recent Macroeconomic Developments and Implications for Poverty and Employment in Pakistan: The Cost of Foreign Exchange Reserve Holdings in South Asia.

I.5. POVERTY AND INEQUALITY

Studies show that while poverty decreased during the 1970s and 1980s, inequality rose depicting how even if incomes rise as a result of more and better employment opportunities and large inflows of remittances, the distribution of the benefits of growth were not uniform; Table I.6 and Anwar (2004) shows how inequality has risen between 1998 and 2001-02 (Figure I.1 Appendix 1).

Table I.6

Trends in Inequality in Pakistan 1963-64 to 1998-99			
Years	Rural	Urban	Overall
1963-64 to 1966-67	↓	↑	↓
1966-67 to 1968-69	↓	↓	↓
1968-69 to 1970-71	↓	↓	↓
1970-71 to 1971-72	↑	↑	↑
1971-72 to 1978-79	↑	↑	↑
1978-79 to 1984-85	↑	↓	↑
1984-85 to 1987-88	↑	↑	↑
1987-88 to 1992-93	↑	Stagnant	↑
1992-93 to 1998-99	↑	↑	↑

↑ : An increase in inequality between two years.
↓ : A decrease in inequality between two years.
Source: Various studies cited above.

The share of the poorest 40% households declined while that of of the richest 20% increased worsening income inequalities. Income disparity rose more because the poorest 20% as well as middle 40% lost their share.

Provincial disparities have also widened with NWFP experiencing the highest incidence of poverty (Figure I.3 Appendix I). There is also intra-provincial disparity for example between: "Northern Punjab (including Islamabad, Rawalpindi division, and the district of Mianwali), Central Punjab (including Sargodha, Faisalabad, Gujaranwala, and Lahore divisions), and Southern Punjab (including Multan, Dera Ghazi Khan, and Bahawalpur divisions)". Northern Punjab has lower levels of poverty than Southern Punjab so that for example in 1999 "urban poverty was the highest in the country in Southern Punjab (35 percent), and almost three times more than was the case in Northern Punjab". Also, while poverty was lowest in Pakistan in urban Northern Punjab, rural

Northern Punjab had the lowest levels of poverty, 29%, in the rural areas of the country (ADB, 2002).

According to an ADB (2006) report, Jamal et al (2003) create indices of deprivation for education, health, housing and employment and their results show that Sindh faces the highest urban/rural inequality and stands out as the only province with the least deprived urban areas; whereas Punjab stands out as the only province with almost half of its rural population living in districts which are least deprived. Tables I.21 and I.22 identify the ten least and most deprived districts of Pakistan reflecting disparities in income and social indicators.

These inter and intra provincial disparities, which have sharpened more over these past 5-6 years and which show better human development indicators in Punjab for instance, may possibly be because of better quality governance, a more competent bureaucracy, historical advantage in education and skill development, managerial and technical skill development in well-run private institutions for higher education, better public sector institutions of higher learning, agriculture sector gaining more in Punjab due to better irrigation system, more equitable land distribution especially in the central and northern parts of the province and better availability of credit to small farmers, etc.

I.6. CONCLUSION

The disparities between the rich and the poor have widened sharply. This, combined with growing poverty from 3 years of high inflation, is damaging social harmony. The benefits of economic development during the previous 5 to 6 years have largely accrued to the richer and more educated because the bulk of this growth was witnessed in the relatively skill-intensive sectors of finance, telecommunications, IT and oil and gas, and in the capital intensive industries of cement, motor vehicles and motorcycles, in which those with limited skills, the majority of the labour force, could not participate meaningfully. It is neither desirable nor feasible to separate economic growth from distributional outcomes since they are inextricably linked through employment growth.

The important lesson from this discussion is the need for the conscious adoption of a strategy for inclusive and sustainable growth, suggesting focus on agriculture, housing and domestic commerce, the latter being sectors with high employment elasticities and strong forward and backward linkages with several sub-sectors of industries. Such a strategy by creating a demand for unskilled and skilled labour will incentivize demand for education and skill acquisition, helping push the economy onto a higher and more stable growth path.

Table I.7a

Trends in Poverty: Consistent estimates of Head Count

Year	Total	Rural	Urban
1963-64	40.24	38.94	44.53
1966-67	44.50	45.62	40.96
1969-70	46.53	49.11	38.76
1979	30.68	32.51	25.94
1984-85	24.47	25.87	21.17
1987-88	17.32	18.32	14.99
1990-91	22.11	23.59	18.64
1992-93	22.40	23.35	15.50
1996-97	31.00	32.00	27.00
1998-99	32.60	34.80	25.90

Source: Kemal, A.R. "State of Poverty in Pakistan: Overview and Trends."Presentation

<http://siteresources.worldbank.org/PAKISTANEXTN/Resources/pdf-Files-in-Events/Briefing-on-PRSP/OverviewAndTrends.pdf>

Table I.7 b

	2000-01	2004-05	2005-06
	Headcount		
Pakistan	34.46	23.9	22.3
Urban	22.69	14.9	13.1
Rural	39.26	28.1	27

Source: State Bank of Pakistan Annual Report (2007-08).

Table I.8-11

WORKERS REMITTANCES

(US $ million)

COUNTRY	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82
Total Middle East	34.74	43.90	83.63	214.05	437.20	938.39	1100.91	1361.47	1666.44	1848.58
Abu-Dhabi	0.00	0.00	10.54	26.24	46.68	81.79	92.68	105.00	131.90	113.07
Bahrain	2.46	3.39	4.56	13.84	24.27	43.43	37.21	33.04	42.43	43.39
Dubai	0.00	0.00	9.92	28.87	55.19	96.55	88.13	86.87	102.04	83.29
Iran	0.66	1.33	2.39	7.26	14.40	26.40	26.85	16.49	11.18	5.05
Iraq	0.12	0.13	0.49	0.78	2.96	5.46	5.00	0.00	0.00	12.82
Kuwait	7.04	6.93	10.28	17.23	27.37	53.97	75.11	111.64	133.23	151.69
Libya	2.22	3.03	4.95	7.83	12.15	21.90	42.59	51.27	75.09	97.11
Qatar	2.17	2.63	5.46	10.85	24.41	50.93	52.24	63.20	62.55	65.67
Saudi Arabia	7.87	10.52	17.26	46.36	158.82	464.10	594.38	795.46	984.27	1129.45
Sharjah	0.00	0.00	1.88	7.31	15.90	29.93	24.94	24.93	31.49	28.52
Sultanat-e-Oman	12.20	15.94	15.90	47.48	55.05	63.93	61.78	73.57	92.26	118.52
Germany	1.32	2.73	3.49	5.27	9.04	16.95	37.36	57.38	59.14	51.90
Norway	0.67	1.65	2.58	4.68	6.49	9.26	10.37	14.46	16.54	14.86
United Kingdom	72.13	55.38	74.11	54.38	49.29	76.69	119.12	149.72	184.92	121.31
Canada	2.12	3.16	3.62	5.53	7.87	6.69	6.95	7.33	7.85	7.43
USA	9.98	14.41	19.18	25.77	29.32	51.53	53.64	61.47	70.97	72.11
Others	15.04	17.91	24.49	29.34	38.51	56.82	69.58	92.31	110.02	108.70
Total	136.00	139.14	211.10	339.02	577.72	1156.33	1397.93	1744.14	2115.88	2224.89

(Contd.)

WORKERS REMITTANCES

(US $ million)

COUNTRY	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
Total Middle East	2408.44	2344.28	2069.29	2021.51	1673.61	1418.51	1356.51	1322.56
Abu-Dhabi	163.68	169.92	144.70	145.07	101.41	75.83	66.06	67.20
Bahrain	46.80	52.48	51.07	61.92	51.58	41.10	42.40	46.00
Dubai	143.49	110.28	112.06	114.78	126.80	112.25	97.12	83.74
Iran	3.40	2.37	2.50	0.00	0.00	0.00	1.34	0.83
Iraq	22.22	13.67	6.06	0.00	0.00	0.00	1.10	1.08
Kuwait	210.88	239.35	205.39	225.18	208.21	193.90	172.00	167.25
Libya	99.27	50.11	31.65	10.57	3.16	2.71	2.46	3.47
Qatar	92.18	67.38	59.05	63.65	52.92	34.00	34.80	30.65
Saudi Arabia	1441.96	1441.08	1245.23	1162.87	945.52	827.75	819.95	792.19
Sharjah	37.51	28.78	45.17	51.62	49.95	28.25	28.19	30.18
Sultanat-e-Oman	147.05	168.86	166.41	185.85	134.06	102.72	91.09	99.97
Germany	49.87	36.18	36.43	35.27	34.77	35.75	27.92	31.54
Norway	14.30	13.85	13.47	21.51	24.77	29.16	22.27	19.75
United Kingdom	161.72	141.79	135.98	223.27	204.93	215.06	171.06	178.16
Canada	6.99	7.76	6.49	7.71	8.63	9.88	11.19	13.98
USA	133.52	105.82	105.35	194.46	191.94	178.33	174.78	209.24
Others	110.83	87.76	78.91	91.58	139.91	125.91	133.26	167.12
Total	2885.67	2737.44	2445.92	2595.31	2278.56	2012.60	1896.99	1942.35

(Contd.)

WORKERS REMITTANCES

<div align="right">(US$ Million)</div>

COUNTRY	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
I. Cash Flow	1,626.92	1,252.45	1,238.51	1,093.36	1,317.73	1,227.28	1,078.05	1,237.68	875.55
Bahrain	37.20	27.75	25.42	25.92	35.90	33.23	29.16	34.31	33.31
Canada	11.26	9.86	7.54	5.65	4.91	5.67	3.59	4.14	3.46
Germany	32.62	33.12	40.64	28.88	27.71	26.06	18.98	16.62	11.93
Japan	26.84	12.96	11.62	7.13	6.90	3.65	3.05	2.65	3.09
Kuwait	15.12	44.24	60.22	47.85	57.86	45.43	38.38	52.40	106.36
Norway	21.28	16.25	15.18	11.85	13.40	11.72	7.97	7.16	5.26
Qatar	24.27	12.87	10.91	7.57	11.52	14.08	9.68	12.17	12.94
Saudi Arabia	681.97	516.16	525.94	493.65	554.08	503.22	418.44	474.86	318.49
Sultanat-e-Oman	74.98	60.35	51.67	46.07	61.49	64.44	46.11	61.97	44.67
U.A.E.	172.03	105.07	97.76	99.36	178.26	161.93	164.39	207.70	125.09
Abu Dhabi	75.71	38.74	32.47	29.32	51.99	48.98	44.91	75.13	38.07
Dubai	68.72	49.07	47.79	51.12	90.09	81.19	93.07	101.01	70.57
Sharjah	27.60	17.26	17.50	16.73	28.96	28.95	22.90	28.54	14.69
Others	-	-	-	2.19	7.22	2.81	3.51	3.02	1.76
U.K.	180.05	137.02	114.02	101.19	109.96	109.74	97.94	98.83	73.59
U.S.A	190.23	150.34	157.80	122.49	141.09	141.92	146.25	166.29	81.95
Other Countries	159.07	126.46	119.79	95.75	114.65	106.19	94.11	98.58	55.41
II. Encashment*	221.37	215.03	323.73	352.20	548.37	233.89	331.42	251.87	184.64
Total (I+II)	1,848.29	1,467.48	1,562.24	1,445.56	1,866.10	1,461.17	1,409.47	1,489.55	1,060.19

* Encashment and Profit in Pak Rs. of Foreign Exchange Bearer   (Contd.)
Certificates (FEBCs) & Foreign Currency Bearer Certificates (FCBCs)

WORKERS REMITTANCES

<div align="right">(US $ Million)</div>

COUNTRY	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
I. Cash Flow	913.49	1,021.59	2,340.79	4,190.73	3,826.16	4,152.29	4,588.03	5,490.97	6,448.84
Bahrain	29.36	23.87	39.58	71.46	80.55	91.22	100.57	136.28	140.51
Canada	3.86	4.90	20.52	15.19	22.90	48.49	81.71	87.20	100.62
Germany	10.47	9.20	13.44	26.87	46.52	53.84	59.03	76.87	73.33
Japan	1.58	3.93	5.97	8.14	5.28	6.51	6.63	4.26	4.75
Kuwait	135.25	123.39	89.66	221.23	177.01	214.78	246.75	288.71	384.58
Norway	5.60	5.74	6.55	8.89	10.19	18.30	16.82	22.04	28.78
Qatar	13.29	13.38	31.87	87.68	88.69	86.86	118.69	170.65	233.36
Saudi Arabia	309.85	304.43	376.34	580.76	565.29	627.19	750.44	1,023.56	1,251.32
Sultanat-e-Oman	46.42	38.11	63.18	93.65	105.29	119.28	130.45	161.69	224.94
U.A.E.	147.79	190.04	469.49	837.87	597.48	712.61	716.30	866.49	1,090.30
Abu Dhabi	47.30	48.11	103.72	212.37	114.92	152.51	147.89	200.40	298.80
Dubai	87.04	129.69	331.47	581.09	447.49	532.93	540.24	635.60	761.24
Sharjah	12.80	12.21	34.05	42.60	34.61	26.17	26.87	28.86	28.58
Others	0.65	0.03	0.25	1.81	0.46	1.00	1.30	1.63	1.68
U.K.	73.27	81.39	151.93	273.83	333.94	371.86	438.65	430.04	458.87
U.S.A	79.96	134.81	778.98	1,237.52	1,225.09	1,294.08	1,242.49	1,459.64	1,762.03
Other Countries	56.79	88.40	293.28	727.64	567.93	507.27	679.50	763.54	695.45
II. Encashment*	70.24	64.98	48.26	46.12	45.42	16.50	12.09	2.68	2.40
Total (I+II)	983.73	1,086.57	2,389.05	4,236.85	3,871.58	4,168.79	4,600.12	5,493.65	6,451.24

* Encashment and Profit in Pak Rs. of Foreign Exchange Bearer   Source: State Bank of Pakistan
Certificates (FEBCs) & Foreign Currency Bearer Certificates (FCBCs)

Source: State Bank of Pakistan (2007-08).

Table I.12

Percentage Share of Expenditure between 1998-99 and 2001-02 in Pakistan

Population Income Groups	Percentage Share of Expenditure		% Change in Expenditure Share
	1998-99	2001-02	
Lowest 20%	9.45	9.12	−3.4921
Lower Middle 20% to 40%	13.17	13.16	−0.0759
Middle 40% to 60%	16.34	16.46	0.7344
Upper Middle 60% to 80%	20.88	20.98	0.4789
Highest 20%	40.16	40.28	0.2988

Table I.13

Percentage Share of Expenditure between 1998-99 and 2001-02 in Rural and Urban Areas

Population Income Groups	Percentage Share of Expenditure Rural		% Change in Expenditure Share between 1998-99 and 2001-02	Percentage Share of Expenditure Urban		% Change in Expenditure Share between 1998-99 and 2001-02
	1998-99	2001		1998-99	2001	
Lowest 20%	10.38	10.26	−1.1560	8.17	7.7	−5.7527
Lower Middle 20% to 40%	14.33	14.35	0.1395	11.63	12.02	3.3533
Middle 40% to 60%	17.54	17.53	−0.0570	14.92	15.37	3.0160
Upper Middle 60% to 80%	21.95	21.99	0.1822	20.24	20.6	1.7786
Highest 20%	35.80	35.87	0.1955	45.04	44.31	−.6207

Source: Anwar, Talat (2003).

Table I.14

Gini Coefficient for 1998–99 and 2001–02

Region	1998-99	2001-02
Pakistan		
Overall	0.3019	0.3067
Rural	0.2521	0.2534
Urban	0.3596	0.3581
Rural		
Punjab	0.2575	0.2699
Sindh	0.2477	0.2228
NWFP	0.2390	0.2359
Balochistan	0.2274	0.2040
Urban		
Punjab	0.3777	0.3475
Sindh	0.3352	0.3763
NWFP	0.3535	0.3207
Balochistan	0.2583	0.2519
Overall		
Punjab	0.3099	0.3059
Sindh	0.3082	0.3434
NWFP	0.2684	0.2555
Balochistan	0.2314	0.2179

Source: Author's computation from PIHS, 1998-99 and 2001.

Table I.15- Social Sector and Poverty Related Expenditure   (Rs. Billion)

	2001-02 Actual	2002-03 Actual	2003-04 Actual	2004-05 Actual	2005-06 Actual	2006-07 Actual	2007-08 Projected
Community Services	11.0	16.6	28.5	41.7	63.6	76.6	82.5
i. Roads, Highways & Buildings	6.3	13.2	22.8	35.2	53.3	60.0	69.1
ii. Water Supply and Sanitation	4.6	3.4	5.8	6.5	10.3	16.6	13.4
Human Development	90.7	105.8	134.1	155.8	217.9	231.8	316.3
i. Education	66.3	78.6	97.7	116.9	141.7	162.1	224.7
ii. Health	19.2	22.4	27.0	31.4	39.2	53.2	62.3
iii. Population Planning	1.3	3.1	4.7	4.6	10.2	7.0	13.3
iv. Social Security & welfare	3.7	1.3	4.1	2.0	7.6	4.5	9.8
v. Natural Calamities	0.2	0.4	0.5	0.9	19.2	5.0	6.2
Rural Development	24.3	34.2	44.5	59.7	78.5	101.8	101.9
i. Irrigation	10.1	15.5	22.5	37.9	59.8	74.8	77.6
ii. Land Reclamation	1.8	1.8	2.0	2.1	2.7	2.3	3.5
iii. Rural Development	12.3	16.9	18.6	15.4	15.0	22.2	19.5
iv. Rural Electrification			1.4	4.4	1.0	2.5	1.3
Safety Nets	8.3	13.8	12.3	8.4	9.4	9.2	12.2
i. Food Subsidies	5.5	10.9	8.5	5.4	6.0	5.5	7.8
ii. Food Support Program	2.0	2.2	2.8	2.7	3.1	3.5	4.0
iii. Tawwana Pakistan	0.8	0.6	0.6	0.1	0.0	0.0	0.0
iv. Low Cost Housing		0.1	0.4	0.3	0.3	0.3	0.4
Governance	33.0	38.5	41.8	50.5	65.2	78.1	84.6
i. Administration of Justice	2.0	2.3	2.4	3.1	5.6	5.1	7.3
ii. Law and order	31.0	36.3	39.4	47.4	59.6	73.0	77.3
Total	167.3	208.8	261.3	316.2	434.6	497.5	597.5
As % of GDP	3.8	4.32	4.6	4.8	5.6	5.7	6.0

Source: Economic Survey of Pakistan (2007-08)

Table I.16

CREDIT DISBURSED BY AGENCIES

(Rs million)

Fiscal Year	ZTBL a	Taccavi	Domestic Private Banks	PPCBL b	Commercial Banks	Total
1990-91	8,323.95	56.30		3,017.45	3,517.59	14,915.29
1991-92	6,996.44	56.80		3,247.01	4,179.56	14,479.31
1992-93	8,643.40	50.80		2,978.00	4,525.91	16,198.11
1993-94	8,989.26	..		2,621.49	4,063.30	15,674.05
1994-95	14,575.74	..		3,756.74	4,040.79	22,373.27
1995-96	10,339.27	..		3,803.38	5,044.66	19,187.31
1996-97	11,687.11	..		3,431.13	4,429.43	19,547.67
1997-98	22,353.60	..		4,928.93	6,109.70	33,392.30
1998-99	30,175.96	..		5,439.97	7,236.00	42,852.00
1999-00	24,423.89	..		5,951.23	9,312.50	39,687.60
2000-01	27,610.20	..		5,124.20	12,056.00	44,790.40
2001-02	29,108.01	..	592.82	5,127.54	17,486.12	52,314.49
2002-03	29,270.17	..	1,421.11	5,485.39	22,738.60	58,915.27
2003-04	29,933.07	..	2,701.80	7,563.54	33,247.45	73,445.86
2004-05	37,408.84	..	12,406.82	7,607.47	51,309.78	108,732.91
2005-06	47,594.14	..	16,023.38	5,889.40	67,967.40	137,474.31
2006-07	56,473.05	..	23,976.16	7,988.06	80,393.19	168,830.46
2007-08 P	39,561.17	..	29,975.57	3,935.16	65,124.83	138,596.72

.. not Available

P: Provisional(Jul-Mar)

b: Punjab Provincial Corperative Bank Ltd.

a: Zarai Taraqiate Bank Limited, formerly Agriculture Development Bank of Pakistan

Source : i) State Bank of Pakistan

ii) Ministry of Food, Agriculture & Livestock

Table I.17- Employed Labour Force by Sectors (%)

Sector	2003-04			2005-06		
	Total	Rural	Urban	Total	Rural	Urban
Agriculture	43.05	60.03	5.94	43.37	59.87	6.32
Manufacturing	13.73	9.05	23.97	13.84	9.00	24.71
Construction	5.82	6.02	5.39	6.13	6.23	5.91
Trade	14.80	9.39	26.62	14.67	9.30	26.71
Transport	5.73	4.33	8.80	5.74	4.64	8.22
Services	15.01	10.36	25.17	14.35	10.06	24.00
Others	1.85	0.82	4.12	1.89	0.89	4.13
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Labor Force Surveys, 2003-04 & 2005-06

Table I.18-

SECTORAL SHARE IN GROSS DOMESTIC PRODUCT (AT CONSTANT FACTOR COST OF 1999-2000)

	Sectors	99-00	00-01	01-02	02-03	03-04	04-05	05-06	06-07	07-08
A.	**Agriculture Sector (1 to 5)**	**25.9**	**24.9**	**24.1**	**24.0**	**22.9**	**22.4**	**22.5**	**21.8**	**20.9**
	Crops	13.1	11.8	11.2	11.2	10.7	11.1	10.1	10.0	-
	1. Major Crops	9.6	8.5	8.0	8.2	7.8	8.4	7.6	7.7	7.1
	2. Minor Crops	3.5	3.3	3.1	3.0	2.9	2.7	2.6	2.4	2.4
	3. Livestock	11.7	11.9	12.0	11.7	11.2	10.6	11.6	11.1	10.9
	4. Fishing	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
	5. Forestry	0.7	0.7	0.7	0.7	0.6	0.4	0.4	0.2	0.2
B.	**Industrial Sector (1 to 4)**	**23.3**	**23.8**	**23.7**	**23.6**	**25.5**	**26.3**	**25.9**	**26.1**	**25.9**
	1. Mining & Quarrying	2.3	2.4	2.4	2.5	2.6	2.7	2.6	2.5	2.5
	2. Manufacturing (i+ii+iii)	14.7	15.7	15.9	16.3	17.3	18.3	18.8	19.0	18.9
	i) Large Scale	9.5	10.3	10.4	10.6	11.7	12.9	13.2	13.4	13.3
	ii) Small & Household	3.7	3.9	4.1	5.6	4.2	4.1	4.3	4.3	4.4
	iii) Slaughtering	1.5	1.5	1.5	0.0	1.4	1.3	1.4	1.3	1.3
	3. Construction	2.5	2.4	2.4	2.4	2.0	2.1	2.2	2.5	2.7
	4. Electricity and Gas & Water Supply	3.9	3.3	3.0	2.5	3.7	3.2	2.2	2.1	1.7
	Commodity Producing Sector (A+B)	49.3	48.7	47.9	47.6	48.4	48.7	48.3	47.9	46.8
C.	**Services Sector (1 to 6)**	**50.7**	**51.3**	**52.1**	**52.4**	**51.6**	**51.3**	**51.7**	**52.1**	**53.2**
	1. Transport, Storage &	11.3	11.6	11.4	11.4	10.9	10.4	10.4	10.2	10.0

	Communications								
	2. Wholesale & Retail Trade	17.5	17.9	17.8	18.0	18.2	18.7	17.2	17.0	17.1
	3. Finance & Insurance	3.7	3.1	3.5	3.3	3.4	4.0	5.5	5.9	6.5
	4. Ownership of Dwellings	3.1	3.2	3.2	3.1	3.0	2.9	2.8	2.7	2.6
	5. Public Administration & Defence	6.2	6.2	6.4	6.6	6.3	5.9	6.1	6.2	6.5
	6. Social, Community & P. Services	9.0	9.3	9.8	9.9	9.7	9.5	9.9	10.1	10.4
D.	Gross Domestic Product FC (A+B+C)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Economic Survey of Pakistan (2006-07).

Table I.19-Growth Performance of Components of Gross National Product (% Growth at Constant Factor Cost)

	1980's	1990's	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Commodity Producing Sector	**6.5**	**4.6**	**4.2**	**9.3**	**9.5**	**5.1**	**6.0**	**3.2**
1. Agriculture	5.4	4.4	4.1	2.4	6.5	6.3	3.7	1.5
- Major Crops	3.4	3.5	6.8	1.7	17.7	-3.9	8.3	-3.0
- Minor Crops	4.1	4.6	1.9	3.9	1.5	0.4	-1.3	4.9
- Livestock	5.3	6.4	2.6	2.9	2.3	15.8	2.8	3.8
- Fishing	7.3	3.6	3.4	2.0	0.6	20.8	0.4	11.0
- Forestry	6.4	-5.2	11.1	-3.2	-32.4	-1.1	-29.5	-8.5
2. Mining & Quarrying	9.5	2.7	6.6	15.6	10.0	4.6	3.1	4.9
3. Manufacturing	8.2	4.8	6.9	14.0	15.5	8.7	8.2	5.4
- Large Scale	8.2	3.6	7.2	18.1	19.9	8.3	8.6	4.8
- Small Scale *	8.4	7.8	6.3	-20.0	7.5	8.7	8.1	7.5
4. Construction	4.7	2.6	4.0	-10.7	18.6	10.2	17.9	15.2
5. Electricity & Gas Distribution	10.1	7.4	-11.7	56.8	-5.7	-26.6	2.5	-14.7
Services Sector	**6.6**	**4.6**	**5.2**	**5.8**	**8.5**	**6.5**	**7.6**	**8.2**
6. Transport, Storage and Comm.	6.2	5.1	4.3	3.5	3.4	4.0	6.5	4.4
7. Wholesale & Retail Trade	7.2	3.7	6.0	8.3	12.0	-2.4	5.4	6.4
8. Finance & Insurance	6.0	5.8	-1.3	9.0	30.8	42.9	15.0	17.0
9. Ownership of Dwellings	7.9	5.3	3.3	3.5	3.5	3.5	3.5	3.5
10.Public Administration & Defence	5.4	2.8	7.7	3.2	0.6	10.1	9.1	10.9
11.Services	6.5	6.5	6.2	5.4	6.6	9.9	8.8	9.4
12.GDP (Constant Factor Cost)	**6.1**	**4.6**	**4.7**	**7.5**	**9.0**	**5.8**	**6.8**	**5.8**
13.GNP (Constant Factor Cost)	**5.5**	**4.0**	**7.5**	**6.4**	**8.7**	**5.6**	**6.7**	**6.1**

* Slaughtering is included in small scale   Source: FBS

Table I.20 - Trends in Gini Coefficents

Years	Pakistan	Rural	Urban
1963-64	0.3666	0.3543	0.3698
1966-67	0.3672	0.3416	0.4068
1968-69	0.3456	0.3005	0.3975
1969-70	0.3394	0.3122	0.3694
1970-71	0.3379	0.3061	0.3687
1971-72	0.3607	0.3546	0.3886
1979	0.3946	0.3450	0.4118
1984-85	0.3802	0.3526	0.3884
1985-86	0.3629	0.3410	0.3589
1986-87	0.3580	0.3289	0.3643
1987-88	0.3608	0.3227	0.3782
1990-91	0.4099	0.4218	0.3788
1992-93	0.3937	0.3668	0.3970
1993-94	0.3864	0.3647	0.3685
1996-97	0.3598	0.3517	0.3691
1998-99	0.4187	0.3796	0.4510
2001-02	0.4129	0.3762	0.4615

Source: Kemal, A.R. "Income Inequalities in Pakistan and a Strategy to Reduce Income Inequality.

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Table I.21

Ten Least Deprived Districts of Pakistan			
	MID 2005	**MID 1998**	**Annual Rate of change (%)**
Karachi	20.9	24.6	-2.3
Lahore	29.2	34.3	-2.3
Gujranwala	38.5	45.1	-2.2
Sialkot	40.9	40.3	.2
Rawalpindi	41.4	41.0	.1
Gujrat	42.7	46.5	-1.2
Faisalabad	44.2	45.6	-.4
Peshawar	44.2	50.8	-2.0
Sukkur	44.5	58.0	-3.7
Quetta	46.0	46.0	.0

Source: Jamal, Haroon and Khan, J. Amir (2003). "The Changing Profile of Regional Inequality," The Pakistan Development Review, Pakistan Institute of Development Economics, vol. 42(2), pages 113-123.

Table I.22

| Ten Highest Deprived Districts of Pakistan			
	IMD 2005	**IMD 1998**	**Annual Rate of change (%)**
Kohistan	71.7	83	-2.1
Khuzdar	72.8	79	-1.1
Qilla Abdullah	73.9	76.1	-.4
Jhal Magsi	74.7	79.2	-.8
Panjgur	75.6	79.2	-.7
Qilla Saifullah	76.8	76.2	.1
Zhob	77.1	79.3	-.4
Kharan	77.6	82.9	-.9
Awaran	79.8	80.4	-.1
Musakhel	82.8	89.1	-1.0

Source: Jamal, Haroon and Khan, J. Amir (2003). "The Changing Profile of Regional Inequality," The Pakistan Development Review, Pakistan Institute of Development Economics, vol. 42(2), pages 113-123.

Figure I.1 – Lorenz Curve for Pakistan (1998-99 to 2001-02)
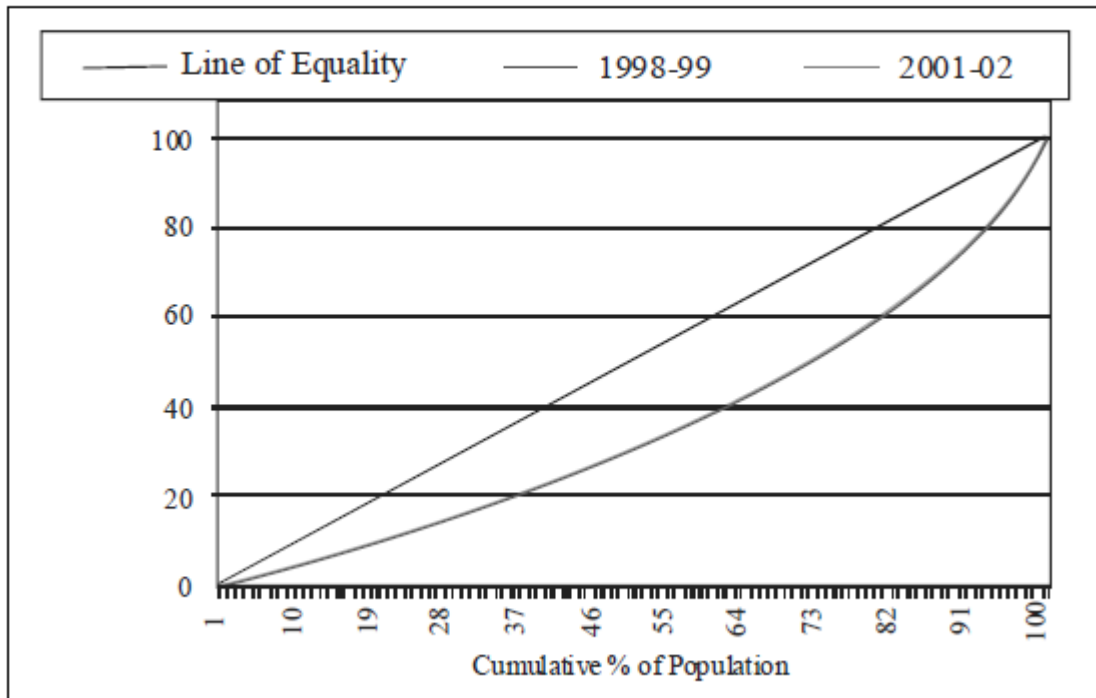
Source: Anwar, Talat (2003). "Trends in Inequality in Pakistan between 1998-99 and 2001-02." Pakistan Development Review 42:4, pp.809-821.

Figure I.2 – Percentage agricultural growth
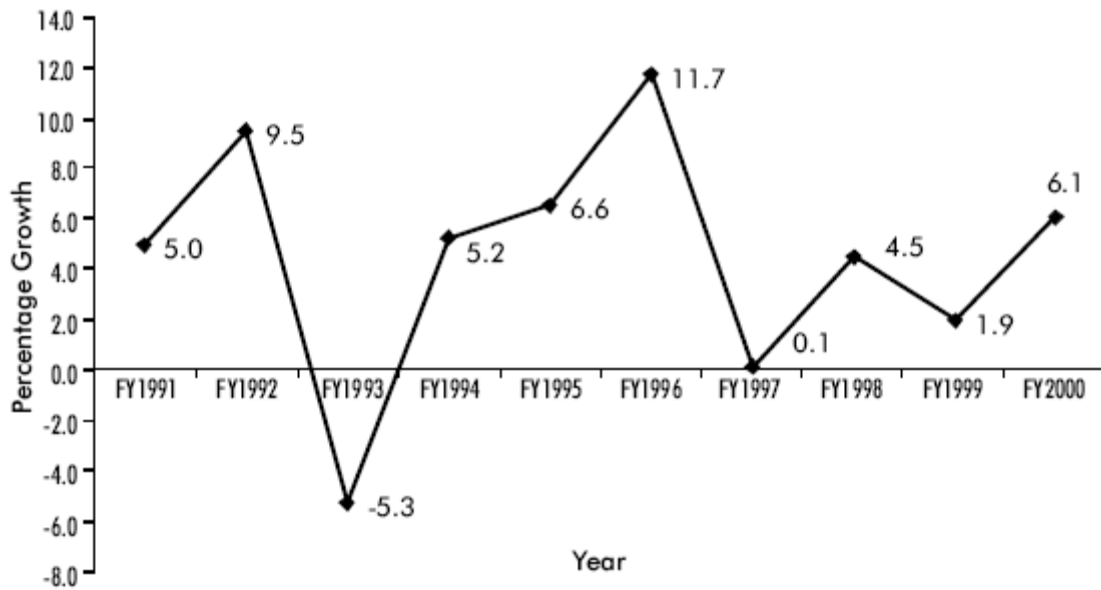
Source: Government of Pakistan. 2003. *Pakistan Economic Survey 2002–03.*
          Islamabad: Economic Advisor's Wing/Finance Division.

Figure I.3- Incidence of Poverty by Province.
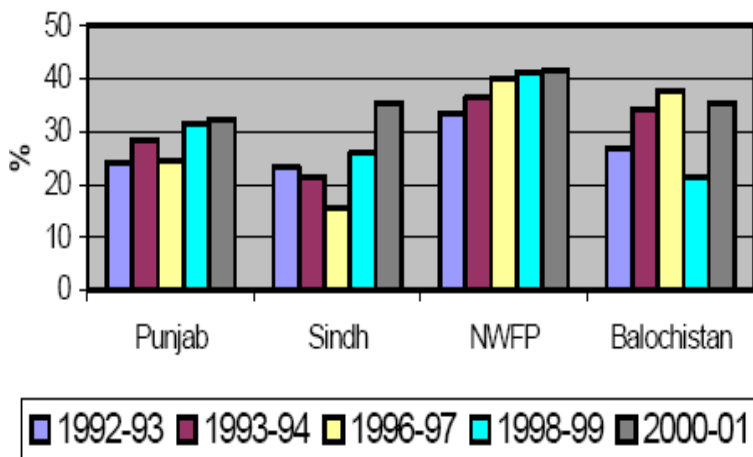
Source: Kardar, Shahid (2008) "Regional Inequalities."

II. SUPPORTING TABLES FOR THE SECTION ON SUSTAINABLE GROWTH, RESOURCE GAP AND EMPLOYMENT GAP

Table II.1 shows data on national savings and current account deficit (as a percentage of GDP) between 1988-89 and 2007-08. Tables II.2A and 2B reveal sustainable levels of these two variables (as given by ten and twenty year averages). For the purposes of analysis entailed in this section of the report, the most optimistic scenario as given by a ten year national savings average and a twenty year current account balance average (both excluding 2007-08) have been employed. In tables II.3A and 3B growth in labor force and employment elasticity are shown. Finally, tables II.4A and 4B illustrate the investment capital output ratios for Pakistan between 1990-91 and 2007-08.

Table II.1: National Savings and Current Account Deficit over time*

Year	National Saving (% of GDP)	Current Account Deficit (% of GDP)
1988-89	14.1	-5.4
1989-90	14.2	-5.3
1990-91	14.2	-2.3
1991-92	17.1	-2.8
1992-93	13.6	-7.1
1993-94	15.7	-3.8
1994-95	14.7	-4.1
1995-96	13.7	-7.2
1996-97	11.8	-6.1
1997-98	14.7	-3.1

1998-99	11.7	-3.8
1999-00	15.8	-1.9
2000-01	16.5	-0.7
2001-02	18.4	1.8
2002-03	20.6	3.8
2003-04	17.9	1.3
2004-05	17.5	-1.4
2005-06	17.7	-4.0
2006-07	17.8	-4.8
2007-08	13.3	-8.4

*Table II.2A: Sustainable Levels of Resources – Current Account Deficit**

Current Account Deficit	including 2007-08	excluding 2007-08
10 year average	-1.80	-1.27
20 year average	-3.26	-3.06

*Table II.2B: Sustainable Levels of Resources – National Savings**

National Saving	(% of GDP)
10 year average (excluding 2007-08)	16.86
10 year average	16.72

(including 2007-08)	
20 year average (including 2007-08)	15.55

Table II.3A: Labor Force*

Year	Labor Force (million)	Labor force (Growth rate)
1990	31.63	-
1991	31.50	-0.41
1992	32.48	3.11
1993	33.01	1.63
1994	33.87	2.61
1995	34.18	0.92
1996	35.01	2.43
1997	37.45	6.97
1998	39.26	4.83
1999	40.15	2.27
2000	40.49	0.85
2001	41.38	2.20
2002	43.21	4.42

2003	44.12	2.11
2004	45.95	4.15
2005	46.82	1.89
2006	50.50	7.86
2007	50.78	0.55

Source: Economic Surveys (various Issues)

The following regression is run to account for the possibility of a trend in labor force growth over time. The estimation results reveal that labor force has a statistically significant linear time trend[112]. The average annual growth rate of labor force is estimated to be 2.95%

Labor force(logs) = α + β*t + μ

*Labor force (logs) =3.384 + 0.02954*t*

Table II.3B: Employment Elasticity over Time*

	1961 to 1971-72	1971-72 to 1977-78	1977-78 to 1986-87	1990s to 2000s
employment elasticity	0.45	0.64	0.36	0.41

Average employment elasticity: 0.465

Source: Economic Surveys (various Issues)

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[112] T statistic → 32.22 with a p-value of 0.000

Table II.4A: Investment Capital Output Ratio (ICOR) over Time*

Year	ICOR
1990-91	3.38
1991-92	2.62
1992-93	9.12
1993-94	4.30
1994-95	3.56
1995-96	2.90
1996-97	9.27
1997-98	4.12
1998-99	4.95
1999-00	3.90
2000-01	8.60
2001-02	5.35
2002-03	3.57

2003-04	2.21
2004-05	2.12
2005-06	3.35
2006-07	3.27
2007-08	3.72

Source: State Bank Annual reports (various Issues) and own calculations

The following formula has been employed to estimate ICOR for each period:

ICOR = Average annual share of investment in GDP/Average annual growth rate of GDP

Table II.4B: Investment Capital Output Ratio (ICOR) over different time periods

Between 1987-88 and 2006-07	
average investment	18.57
average GDP growth	5.08
ICOR	3.65
Between 1989-90 and 1999-00	
average investment	18.61
average GDP growth	4.60
ICOR	4.05
Between 2000-01 and 2007-08	
average investment	19.11
average GDP growth	5.71
ICOR	3.35

Source: State Bank Annual reports (various Issues) and own calculations

Table II.1 Investment and Savings Rates (as % of GDP)

	090	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07	08
Gross Total Investment	18.9	18.9	20.2	20.7	19.4	18.7	19.6	17.9	17.70	15.6	17.4	17.2	16.6	16.8	16.6	19.1	22.1	22.9	21.6
Changes in Stocks	10.6	1.6	1.5	1.6	1.6	1.5	1.6	1.6	2.70	1.6	1.4	1.4	1.3	1.7	1.6	1.6	1.6	1.6	1.6
Gross Fixed Investment	17.3	17.4	18.6	19.1	17.9	17.2	17.9	16.3	15.00	13.9	16	15.8	15.3	15.1	15	17.5	20.5	21.3	20
(a)Public Sector	80.4	8.5	8.8	9.1	8.3	8.3	8.1	6.8	5.30	6.1	5.8	5.7	4.1	3.9	4.0	4.3	4.8	5.7	5.7
(b)Private Sector	80.9	8.9	9.8	10.1	9.6	8.9	9.9	9.5	9.80	7.9	10.4	10.2	11.1	11.2	10.9	13.1	15.7	15.6	14.2
Net External Resource Inflow	40.7	4.8	3.1	7.1	3.8	3.9	5.8	6.1	3.10	3.9	1.6	0.7	-1.8	-3.8	-1.3	1.6	4.4	5.1	8.3
National Savings	14.2	14.2	17.1	13.6	15.7	14.7	13.7	11.8	14.70	11.7	15.8	16.5	18.4	20.6	17.9	17.5	17.7	17.8	13.3
(a)Public Savings	20.8	0.7	4.3	1.5	2.6	2.1	2.5	0.99	0.10	0.9	-0.08	1.6	1.7	1.6	4.8	3.4	2.3	0.8	-1
i) General Government	1	-1.3	0.8	-1.1	-0.3	0.2	-0.3	-0.95	-1.50	-0.1	-0.9	-0.1	0.2	-0.02	2.9	1.6	1.6	0.3	-1.4
(ii) Others	10.8	2.0	3.5	2.6	2.8	1.8	2.8	1.9	1.70	0.9	0.8	1.7	1.4	1.6	1.8	1.8	0.7	0.5	0.4
(b)Private Savings	11.4	13.5	12.8	12.1	13.1	12.7	11.2	10.8	14.50	10.8	15.9	14.9	16.8	19	13.2	14.1	15.4	17	14.3
(i) House-hold	10.2	12	11.4	10.7	11.6	11.2	9.9	9.5	12.80	9.5	14	13.1	14.8	16.8	13	13	13.7	15.1	12.6
(ii) Corporate	10.2	1.5	1.4	1.4	1.6	1.5	1.3	1.3	1.70	1.3	1.9	1.8	2.0	2.2	0.1	1.1	1.8	2.0	1.6
Net Factor Income	20.5	1.6	0.4	0.1	-0.3	0.2	-0.7	1.2	-1.40	-1.2	-1.3	-1.3	0.5	3.1	2.2	2.1	2.0	1.8	2.2
Domestic Savings	11.8	12.7	16.7	13.4	15.9	14.5	14.5	12.9	16.00	12.9	17.1	17.8	17.9	17.4	15.7	15.4	15.7	16	11
GDP (at mkt prices)	856	1021	1211	1342	1573	1866	2175	2428	2678	2938	3793	4163	4453	4876	5641	6499	7623	8723	1047
GNP (at mkt prices)	893	1045	1224	1352	1577	1881	2188	2409	2653	2913	3746	4108	4476	5028	5765	6634	7773	8882	1071

Source: State Bank of Pakistan, Annual Reports, various

IV. PRODUCTIVITY GROWTH IN PAKISTAN: SIGNIFICANT BUT NOT SUSTAINED

IV.1. INTRODUCTION

One of the fundamental questions that arises across all economies is how much of economic growth is caused by growth in physical and human capital and how much is caused by factors such as technology and institutional change. Though there is little doubt about the positive impact of increased physical and human capital on growth, most economists feel that sustained high growth is dependent on sustained technological and institutional growth. Based on the assumptions of constant returns to scale and competitive factor markets, one can calculate the growth rate implied by the rates of change in physical and human capital and find the deviations of the actual growth rate from this implied growth rate. These deviations are the result of technological and institutional change and are called growth in total factor productivity (TFP).

This Appendix looks at the productivity growth rates for the Pakistani manufacturing sector, the Pakistani agricultural sector and the Pakistani economy as a whole. The reason why a disaggregated analysis is meaningful in the context of a developing country like Pakistan is because of the prevailing view that agricultural productivity growth is significantly lower than manufacturing productivity growth. This has extremely important policy implications: First, if agricultural productivity is perceived to be perpetually lower than manufacturing productivity, then policy makers will tend to bias policies and incentive structures towards manufacturing (which has generally been the case in Pakistan). Second, if agricultural productivity is perceived to be lower than manufacturing productivity, then research resources and technology adoption will be more heavily directed towards the manufacturing side.

IV.2. MANUFACTURING SECTOR PRODUCTIVITY

TFP growth over the period 1985 to 2005 average 2.48% per year in the manufacturing sector A detailed breakdown of the growth in the manufacturing sector is provided in Tables III.1 and III.2. As Table III.1 shows, the average growth rate of large scale manufacturing output is 7.8 percent between 1985 and 2005. During this same period, the capital stock grew at an average of 6.6 percent a year, the labour force grew at 3.5 percent per year and TFP grew at 2.4 percent per year. Table III.2 presents an interesting breakdown of the components of manufacturing sector growth[113]: 56 percent of total large scale manufacturing sector growth was due to growth in capital stock, 15 percent was due to growth in labour and 29 percent was due to growth in TFP. Thus, it can be clearly seen that manufacturing sector growth has been driven primarily by increases in capital and not increases in productivity.

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[113] The shares of capital and labour were taken from the estimated Cobb-Douglas functional forms and are consistent with the shares used by other authors, including Martin and Mitra.

Table III.1: Average Growth Rates in the Pakistani Large Scale Manufacturing Sector, 1985-2005 (%)

Large Scale Manufacturing Output	Large Scale Manufacturing Capital Stock	Large Scale Manufacturing Labour	Total Factor Productivity (TFP)
7.8 %	6.6 %	3.53 %	2.4 %

Table III.2: Components of Pakistani Large Scale Manufacturing Sector Growth, 1985-2005 (%)

Growth in Capital Stock	Growth in Labour	Growth in Total Factor Productivity
56 %	15 %	29 %

Figure I.1: Pakistani Manufacturing Sector Output and Productivity Growth
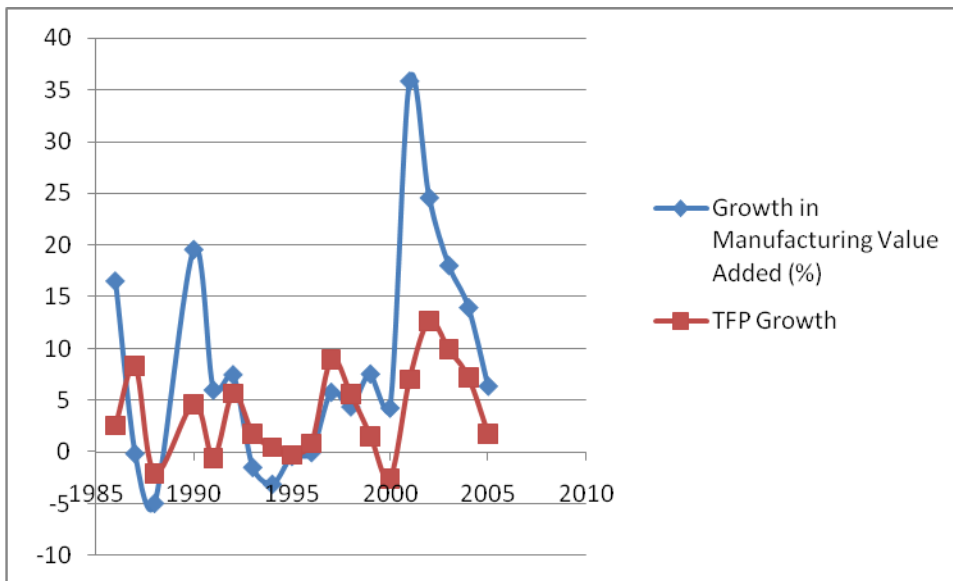
Figure I.1 shows the high correlation of manufacturing sector growth with changes in productivity. As can be seen, periods of high productivity are accompanied by high growth and periods of low productivity are accompanied by low growth. Table III.3 shows an international comparison manufacturing productivity growth. As the numbers illustrate, the Pakistani manufacturing sector has experienced higher productivity growth than comparable sectors in other South Asian economies, but has grown significantly slower than the manufacturing sectors in the East Asian economies.

Table III.3: Comparison of Manufacturing Sector TFP Growth[114] (%)

Country *(Time Period)*	*Growth in Manufacturing Total Factor Productivity (%)*
Pakistan (1985-2005	2.48
China (1967-1999)	3.86
India (1967-1999)	-0.33
South Asian Average (1967-1999)	0.31
East Asian Average (1967-1999)	3.81
Low Income Developing Countries Average (1967-1999)	0.22
All Developing Countries Average (1967-1999)	1.91

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[114] Estimates for countries other than Pakistan are taken from Martin, Will and Mitra, Devashish (1999). "Productivity Growth and Convergence in Agriculture and Manufacturing." World Bank Working Paper Number 2171, World Bank, Washington DC.

IV.3. AGRICULTURAL SECTOR PRODUCTIVITY

For the agricultural sector the estimated TFP growth rate over the period 1990 to 2005 was equal to 1.75 % per annum. A detailed breakdown of the growth in the agricultural sector is provided in Tables III.4 and III.5. As Table III.4 shows, the average growth rate of agricultural output is 3.57 percent between 1990 and 2005. During this same period, agricultural labour increased by 2.09 percent per year, agricultural land increased by 0.2 percent per year, the number of tubewells increased by 7.03 percent per year, the number of tractors increased by 9.1 percent per year, the amount of fertilizer used increased by 4.37 percent per year, water decreased by an average of 0.79 percent per year and TFP grew at 1.75 percent per year. Table III.5 presents an interesting breakdown of the components of agricultural sector growth[115]: 40 percent of total agricultural sector growth was due to growth in labour, 49 percent was due to growth in TFP and 11 percent was due to growth in other factors of production. These results show that agricultural sector growth has been low and has been primarily driven by growth in labour and productivity. But these results have to be viewed more critically than the results obtained from the manufacturing sector, because the unreliability of agricultural input data may have led to an underestimation of the contribution of the other factors in agricultural sector growth and an overestimation of the TFP growth rate.

Table III.4: Average Growth Rates in the Agricultural Sector, 1990-2005 (%)

Agricultural Output	Agricultural Labour	Agricultural Land	Surface Water	Tubewells	Tractors	Fertilizer	Total Factor Productivity
3.57 %	2.09 %	0.2 %	-0.79 %	7.03 %	9.1 %	4.37 %	1.75 %

Table III.5: Components of Agricultural Sector Growth, 1990-2005 (%)

Growth in Labour	Growth in Total Factor Productivity	Growth in Other Factors of Production
40 %	49 %	11 %

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[115] The shares of capital and labour were taken from the estimated Cobb-Douglas functional forms and are consistent with the shares used by other authors, including Martin and Mitra.

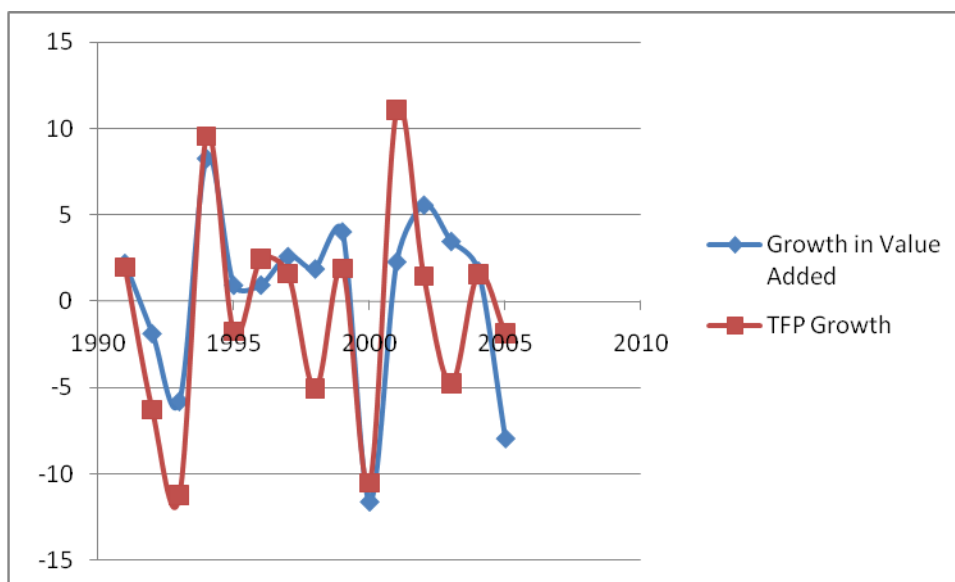*Figure III. 2: Pakistani Agricultural Sector Output and Productivity Growth*

Table 6: Comparison of Agricultural Sector TFP Growth[116] (%)

Country *(Time Period)*	*Growth in Agricultural Total Factor Productivity (%)*
Pakistan (1985-2005	1.75
China (1967-1999)	2.49
India (1967-1999)	1.52
South Asian Average (1967-1999)	1.72
East Asian Average (1967-1999)	2.64

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[116] Estimates for countries other than Pakistan are taken from Martin, Will and Mitra, Devashish (1999). "Productivity Growth and Convergence in Agriculture and Manufacturing." World Bank Working Paper Number 2171, World Bank, Washington DC.

Low Income Developing Countries Average (1967-1995)	1.44
All Developing Countries Average (1967-1995)	3.35

Similar to the manufacturing sector discussed above, Figure III.2 shows the high correlation of agricultural sector growth with changes in productivity. As can be seen, periods of high productivity are accompanied by high growth and periods of low productivity are accompanied by low growth and interestingly the volatility of agricultural sector productivity growth is comparable to the volatility of manufacturing sector productivity growth. Table III.6 shows an international comparison agricultural productivity growth. Again, the Pakistani agricultural sector has experienced higher productivity growth than comparable sectors in other South Asian economies, but has grown significantly slower than the agrilcural sectors in the East Asian economies and has also grown more slowly than the average developing economy.

IV.4. OVERALL PRODUCTIVITY

The final analysis is done for the entire economy in order to compare TFP growth in agriculture and manufacturing with overall TFP growth. The results for the GDP growth are shown in Tables III.7 and III.8. As Table III.7 shows, the average growth rate of GDP is 4.1 percent between 1985 and 2005. During this same period, the capital stock grew at an average of 4.2 percent a year, the labour force grew at 2.4 percent per year and TFP grew at 1.1 percent per year. Table III.8 presents a breakdown of the components of GDP: 33 percent of GDP growth was due to growth in capital stock, 40 percent was due to growth in labour and 27 percent was due to growth in TFP. Thus, it can be clearly seen that overall growth in Pakistan has been driven primarily by increases in capital and labour and not increases in productivity.

TableIII. 7: Average Growth Rates in Pakistan, 1985-2005 (%)

GDP	Capital Stock	Labour	Total Factor Productivity (TFP)
4.1 %	4.2 %	2.4 %	1.1 %

Table III.8: Components of GDP Growth, 1985-2005 (%)

Growth in Capital Stock	Growth in Labour	Growth in Total Factor Productivity
33 %	40 %	27 %

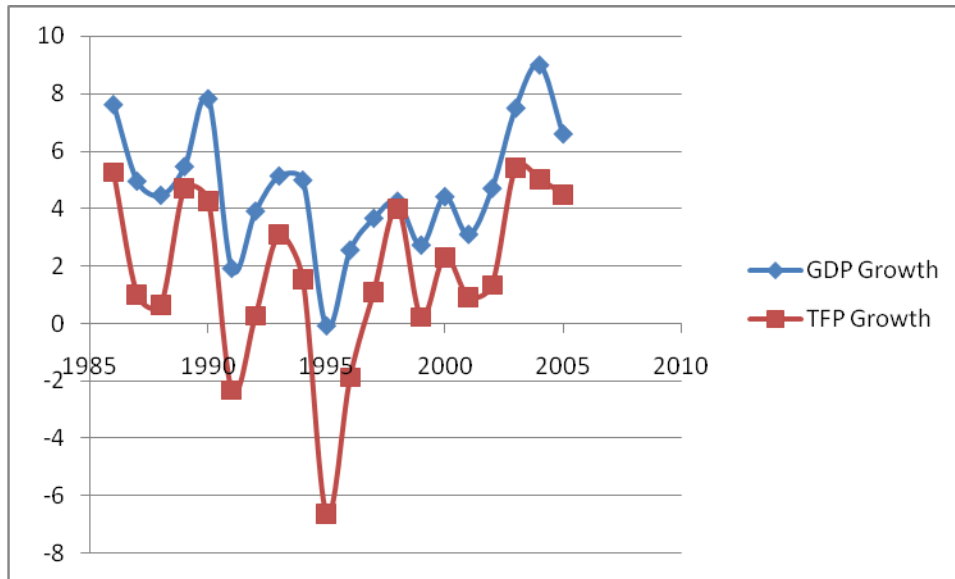*Figure III.3: Pakistani Output and Productivity Growth*

Figure III.3 shows the high correlation of overall output growth with growth in productivity. For the economy as a whole, productivity and output growth in far more volatile than for the manufacturing and agricultural sectors.   Table III.9 shows an international comparison productivity growth. Here the numbers are extremely revealing: For the economy as a whole, productivity growth in Pakistan has fallen slightly behind the average South Asian economy and significantly behind the average East Asian economy.

Table III.9: Comparison of TFP Growth [117] (%)

Country (Time Period)	Growth in Total Factor Productivity (%)
Pakistan (1985-2005	1.1
China (1960-2000)	3.3
India (1960-2000)	1.53
South Asian Average (1960-2000)	1.84
East Asian Average (1960-2000)	2.8

IV.5. CONCLUSION

The results of the analysis in this paper imply that total factor productivity in the manufacturing sector has grown at a higher rate than total factor productivity in the agricultural sector over the last two decades in Pakistan. On the manufacturing side, though productivity is increasing at an average of 2.4 percent per year, output growth is being driven by increases in capital. On the agricultural side, productivity is growing at an average rate of 1.75 percent per year (though this is probably overestimated due to data limitations). With the available data, the major drivers of agricultural sector growth are labour and TFP growth. For the economy as a whole, total factor productivity is increasing at an average rate of 1.1 percent a year, but almost three-quarters of GDP growth is caused by increases in labour and capital stock.

Cross-Country analyses find that high growth economies are driven both by growth in their inputs as well as sustained growth in their productivity. The interesting aspect of this conclusion is not that productivity growth has to be extremely high, but simply sustained over a long period of time. The results in this analysis show that productivity growth in Pakistan, at the sectoral level and at the aggregate level, has been slow and that growth has been input driven rather than

[117] Estimates for countries other than Pakistan are taken from Baier, Scott, Dwyer, Gerald and Tamura, Robert (2006). "How Important are Capital and Total Factor Productivity for Economic Growth?" *Economic Inquiry* 44 (1):23-49.

productivity driven. Also, productivity growth has not been sustained in Pakistan. When looking at the TFP growth experiences of other countries, one finds that factors such as human capital development, physical capital development (including infrastructure), financial development, technology absorption and openness (especially in terms of openness to imports) have a significant impact of TFP growth and until Pakistan focuses on these issues, growth will remain unsustainable.

V. THE IMPACT ON COTTON PRODUCTION AND YIELDS IN INDIA AFTER INTRODUCTION OF BT COTTON

India ranks third in global cotton production after the United States and China, and with 8-9 million hectares grown each year, India accounts for approximately 25% of the world's total cotton area and 16% of global cotton production producing almost three million tonnes.

Although quantity-wise, Indian cotton production is ranked third in the world, its productivity is substantially lower; and the primary cause for this low productivity is the damage caused by 'insect pests, notably *Helicoverpa armigera*, commonly referred to as American Bollworm'. Nearly Rs.12 billion worth of pesticides are used in India to control just the bollworm complex of cotton, which can be damaging to both the environment and human health. To overcome this issue, 'Mahyco (Maharashtra Hybrid Seed Company), in collaboration with Monsanto, introduced 'Bt cotton' technology in India. (Barwale et. Al 2004—Prospects for BT cotton tech in India) which has resistance to bollworm in six states.

The yields of Bt cotton have been observed to be higher than those of Non-Bt cotton (Gandhi and Namboodiri 2006, since Bt cotton requires a lesser amount of spraying as compared with Non-Bt cotton while the quality of BT cotton is also cleaner (Table IV.1). Table IV.2 also shows how overall cotton production and yield in India experienced a sharp growth post-2002. Total production rose from 10 million bales to almost 26 million bales in 2007/08 with yields growing from 186 kg per hectare to 466 kg per hectare over the same period, compared with irregular trends in earlier years but with lower production and yield outcomes (also refer to Figures IV.1 and IV.2).

Gandhi and Namboodiri (2006) conducted a study in 2004 in order to compare the effects of Bt versus non-Bt technology on the yield and value of cotton as well as the on use of pesticides across four Indian states, namely, Maharashtra, Andhra Pradesh, Gujarat and Tamil Nadu. Their results show how in all these four states pesticide spraying was reduced considerably along with the cost of spraying per hectare via Bt cotton (Table IV.3) and how under both irrigated and non-irrigated conditions, Bt cotton yielded higher output with a greater value than non-Bt cotton (Table IV.4).

While Pakistan's production of cotton is lower its yield per acre is higher than that of India (Tables IV.2 and IV.5). While India's production and yield of cotton were both rising post-commercialization of BT cotton, the trend beyond 2005 in Pakistan shows a decline in cotton production and yield even though absolute yields are still than those of India (Figures IV.3 and IV.4). Therefore, with India's visible success

with BT cotton, adoption of this technology should ate least check the falling trend in Pakistan's cotton production and yield.

Table IV.1 -BT cotton results from kharifa 2002 season, June-December (yield in   quintals).

State	Non-Bt yield	Bt yield	Yield increase with Bt	Non-Bt sprays	Bt sprays	Spray reduction with Bt	Economic benefit per hectare[c]
Andhra Pradesh	14.42 (5–25)	20.52 (12.5–32.5)	6.10	4.81 (1–8)	2.08 (0–4)	2.73	Rs.16,747
Gujarat	19.80 (3.7–37.5)	28.35 (10–44)	8.55	3.42 (1–7)	2.09 (0–5)	1.33	Rs.18,430
Karnataka	10.50 (1.3–30)	17.82 (7.5–40)	7.32	2.53 (0–6)	1.00 (0–3)	1.53	Rs.16,170
Madhya Pradesh	15.00 (10–50)	25.82 (35–62.5)	10.82	3.29 (1–9)	0.93 (0–3)	2.36	Rs.24,000
Maharashtra	14.47 (2.5–45)	20.82 (2.5–62.5)	6.35	2.78 (0–7)	0.99 (0–4)	1.79	Rs.14,490
Tamil Nadu[d]	—	—	—	—	—	—	—
Total	13.25	21.35	8.10	3.10	1.17	1.93	Rs.18,130

Note. All figures given in the table are based on a survey conducted by Mahnyco in the six states where Bt cottonseed cotton was sold in the kharif 2002 season.[a] The total sample size was 1,069 farmers. Averages are on weighted average basis. Figures in parentheses represent the range for yield (quintals per hectare) and number of sprays.
[a] Kharif refers to a crop that is harvested at the beginning of winter.
[b] 1 quintal = 100 kg.
[c] Economic benefit per hectare was calculated on the basis of an average cotton rate of Rs.2,000/q and an average cost of each bollworm complex spray of Rs.1,000/ha.
[d] Cotton picking still in progress in Tamil Nadu at date of writing.

Source: Zehr, Usha et al. (2004) "Prospects for BT Cotton Technology in India."   Agriculture Bio Forum 23-26.

Table IV.2 : All-India Area, Production and Yield of Cotton

Year	Area (million hectares)	Production (million bales)	Yield (kg/hectare)	%age change in prod	%age change in yield
1980-81	7.82	7.01	152	-	-
1981-82	8.06	7.88	166	12.4	9.21%
1982-83	7.87	7.53	163	-4.4	-1.81%
1983-84	7.72	6.39	141	-15	-13.50%
1984-85	7.38	8.51	196	33	39.01%
1985-86	7.53	8.73	197	2.6	0.51%
1986-87	6.95	6.91	169	-21	-14.21%
1987-88	6.46	6.38	168	-7.7	-0.59%
1988-89	7.34	8.74	202	37	20.24%
1989-90	7.69	11.42	252	31	24.75%
1990-91	7.44	9.84	225	-13.835	-10.71%
1991-92	7.66	9.71	216	-1.3211	-4.00%
1992-93	7.54	11.40	257	17.4047	18.98%
1993-94	7.32	10.74	249	-5.7895	-3.11%
1994-95	7.87	11.89	257	10.7076	3.21%
1995-96	9.04	12.86	242	8.15812	-5.84%

1996-97	9.12	14.23	265	10.6532	9.50%
1997-98	8.87	10.85	208	-23.753	-21.51%
1998-99	9.34	12.29	224	13.2719	7.69%
1999-00	8.71	11.53	225	-6.1839	0.45%
2000-01	8.53	9.52	190	-17.433	-15.56%
2001-02	9.13	10.00	186	5.04202	-2.11%
2002-03	7.67	8.62	191	-13.8	2.69%
2003-04	7.60	13.73	307	59.2807	60.73%
2004-05	8.79	16.43	318	19.665	3.58%
2005-06	8.68	18.50	362	12.5989	13.84%
2006-07	9.14	22.63	421	22.3243	16.30%
2007-08	9.43	25.81	466	14.0521	10.69%

Source: DACNET(2009). AN EGOV4D INFRASTRUCTURE (AN APPROPRIATE ECONOMIC STRUCTURE) FOR GLOBALIZING INDIAN AGRICULTURE. <HTTP://WWW.DACNET.NIC.IN/>

Table IV.3 – Application of pesticides in BT and Non-BT cotton

State		Bt Cotton	Non-Bt Cotton
Maharashtra	Average Number of Sprays	3.37	5.28
	Cost per ha (Rs.)	3242	4120
Andhra Pradesh	Average Number of Sprays	4.27	8.11
	Cost per ha (Rs.)	7926	10675
Tamil Nadu	Average Number of Sprays	4	6
	Cost per ha (Rs.)	1910	4195

Source: Namboodiri, N.V. and Gandhi, P. Vasant (2006). "The Adoption and Economics of BT Cotton in India: Preliminary Results from a Study. Indian Institute of Management, Ahmedabad, India.

Table IV.4 – Yield and Value of output from BT and Non-BT cotton

State		Bt Cotton			Non-Bt Cotton		
		Irrigated	Unirrigated	Total	Irrigated	Unirrigated	Total
Gujarat	Yield (Kg/Ha.)	3176		3176	2345		2345
	Value of output (Rs.)	61848		61848	44720		44720
Maharashtra	Yield (Kg/Ha)	2755	2410	2605	1856	1747	1780
	Value of output (Rs.)	57262	50487	54313	39948	38973	39270
Andhra Pradesh	Yield (Kg/Ha.)	2933	2961	2962	2793	1607	2049
	Value of output (Rs.)	49437	52847	50970	48810	28372	35870
Tamil Nadu	Yield (Kg/Ha.)	2375	1335	1893	1697	1210	1473
	Value of output (Rs.)	45599	29797	38282	29307	23632	26032

Source: Namboodiri, N.V. and Gandhi, P. Vasant (2006). "The Adoption and Economics of BT Cotton in India: Preliminary Results from a Study. Indian Institute of Management, Ahmedabad, India.

Table IV.5: Cotton in Pakistan

Year	Production(million bales)	Yield(kg/hectare)
1980-81	4.2	339.18
1981-82	4.4	337.85
1982-83	4.8	364.12
1983-84	2.9	222.87
1984-85	5.9	449.60
1985-86	7.2	511.00
1986-87	7.8	522.55
1987-88	8.6	571.65
1988-89	8.4	544.48
1989-90	8.6	560.22
1990-91	9.6	615
1991-92	12.8	769
1992-93	9	543
1993-94	8	488
1994-95	8.7	557
1995-96	10.6	601
1996-97	9.4	506
1997-98	9.2	528
1998-99	8.8	511
1999-00	11.2	641
2000-01	10.7	624
2001-02	10.6	579

2002-03	10.2	622
2003-04	10.1	572
2004-05	14.3	760
2005-06	13	714
2006-07	12.9	711
2007-08	11.7	649

Source: Agricultural Statistics of Pakistan (2006-07).
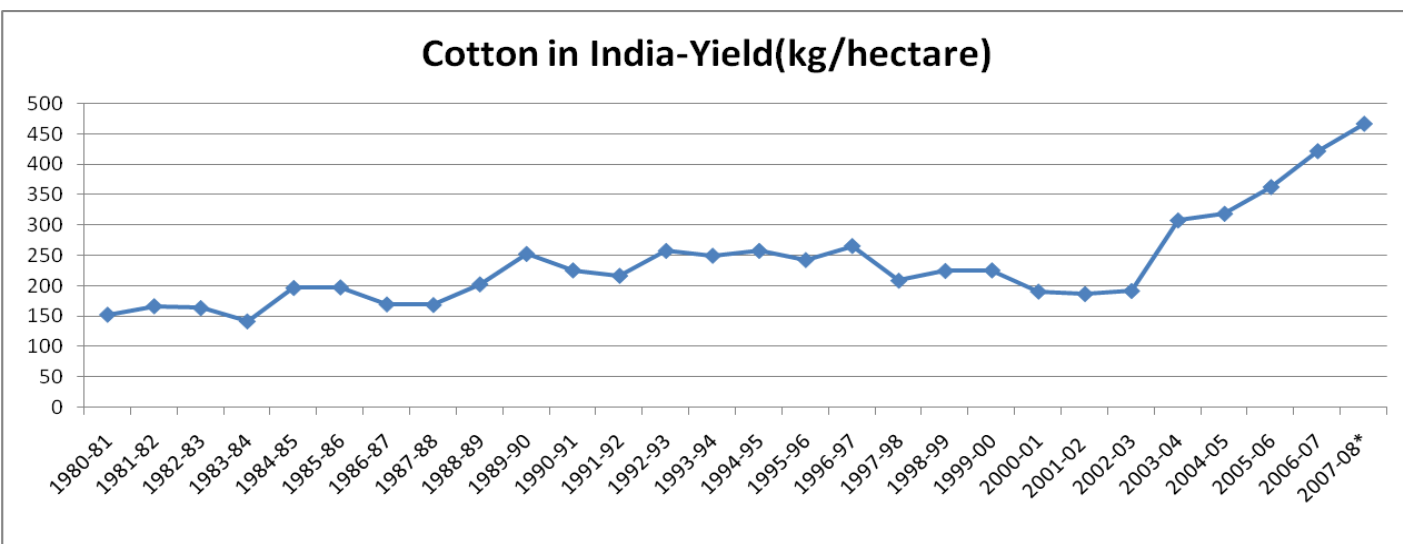
Figure IV.1-Cotton in India

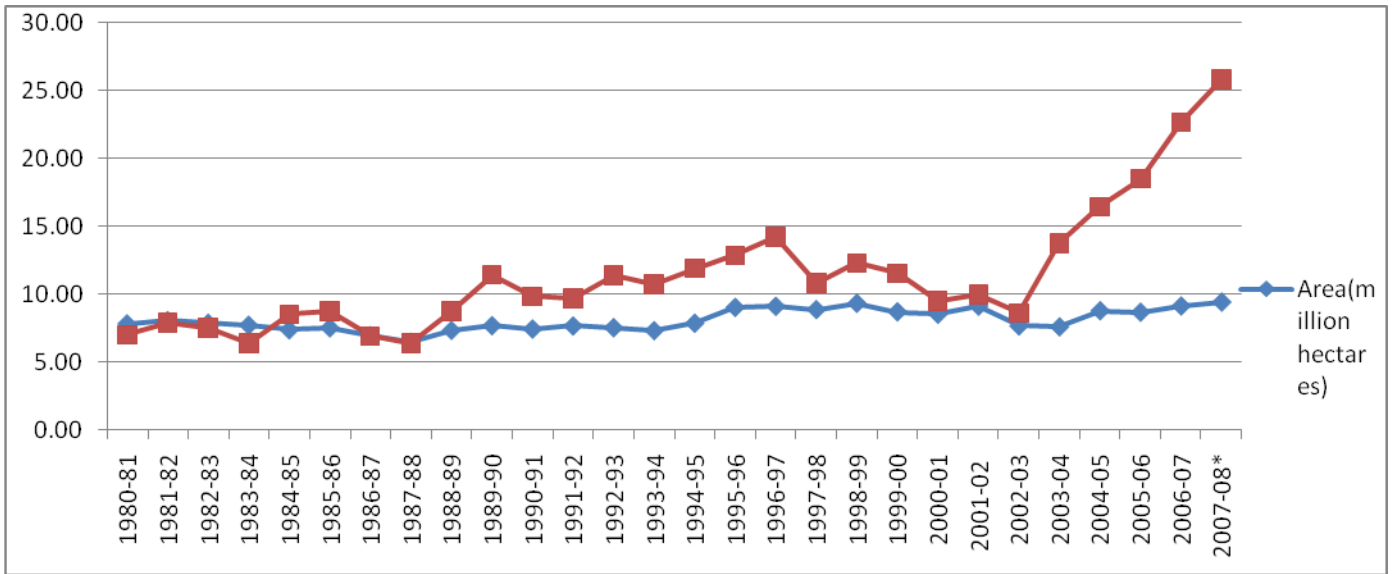**Figure IV.2 – Area and Production of Cotton in India**

Figure IV.3-Production of Cotton in Pakistan
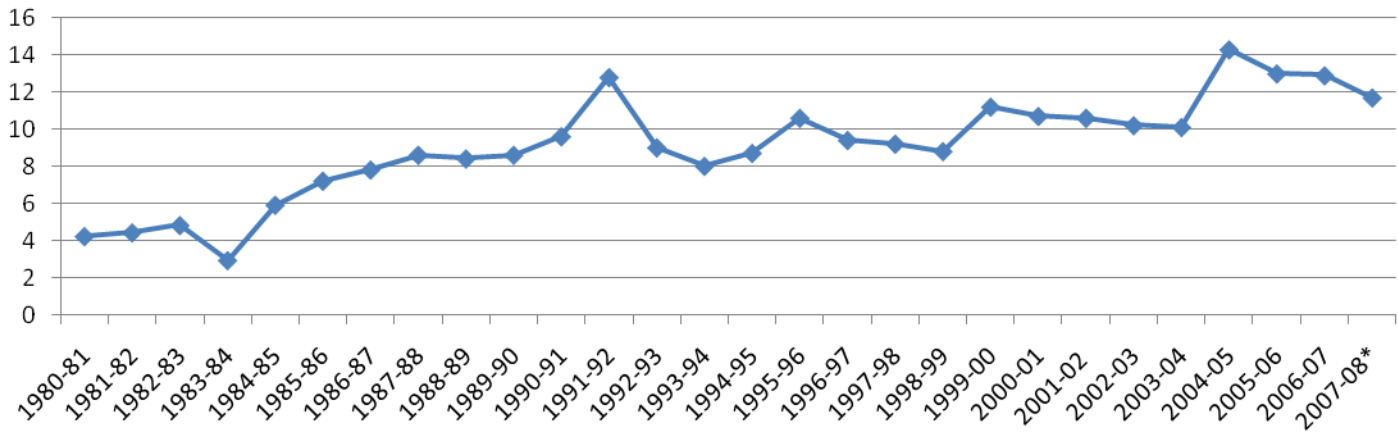
Cotton in Pakistan-Production(million bales)

Figure IV.4- Yield of Cotton in Pakistan

Cotton in Pakistan-Yield(kg/hectare)