

CREB Working Paper No. 01-09

Economic Development - A View from the Provinces

Khalid Ikram



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Preface

Centre for Research in Economics and Business (CREB) was established in 2007 to conduct policy-oriented research with a rigorous academic perspective on key development issues facing Pakistan. In addition the Centre (i) facilitates and coordinates research by the faculty at the Lahore School of Economics, (ii) hosts visiting international scholars undertaking research on Pakistan and (iii) administers the postgraduate programme leading to the M Phil and PhD Degree at the Lahore School.

An important goal of the Centre is to promote public debate on policy issues through conferences, seminars and publications. In this connection, the Centre organizes the Lahore School's Annual Conference on the Management of the Pakistan Economy. The proceedings of which are published in a special issue of the Lahore Journal of Economics.

The CREB Working Paper Series has been started to bring to a wider audience, the research being done at the Centre. It is hoped that these Papers will promote discussion on the subject and contribute to a better understanding of economic and business processes and development issues in Pakistan. Any comments and feedback on these Papers will be appreciated.

Abstract

Analysis of economic development in Pakistan has traditionally followed a "top-down" approach. This approach—that it is the federation as a whole rather than the federating units that matter— is so ingrained that even after 60 years of Pakistan's existence the authorities do not produce official statistics of provincial GDPs, investment, and savings. The importance of examining the differential growth of provinces can hardly be exaggerated—a main reason for the breakup of Pakistan in 1971 was the issue of income disparity between West and East Pakistan. A dearth of existing literature on regional issues on the one hand, coupled with stark differences across provinces on the other, motivates this study. The development of provinces has to be studied, and measures to accelerate the growth of lagging regions identified. This paper has tried to provide a framework for thinking about the development of Pakistan's provinces. More specifically the objective of this study is to employ a 'bottom-up' approach to analyzing development in Pakistan, to formulate a development strategy and to suggest sectoral and other relevant policies for the provinces. This paper is intended to highlight some of the main issues and to bring together some key data and discussion that might otherwise be difficult to access.

Economic Development – A View from the Provinces

1. Introduction

Analyses of economic development in Pakistan have traditionally followed a "top-down" approach. The studies look at the behavior of macroeconomic indicators for the country as a whole, and refer only in a general manner to the trajectories of each province and even more cursorily to the policy issues, constraints, and opportunities that confront the different provinces. This approach—that it is the federation as a whole rather than the federating units that matter—is so ingrained that even after 60 years of Pakistan's existence the authorities do not produce official statistics of provincial GDPs, investment, and saving.

These gaps have only partially been filled by the efforts of private researchers and international institutions. The early attempts were primarily designed to address the question of income disparities between East and West Pakistan; see, for example, Haq (1963), Khan and Bergan (1966). Therefore, these estimates looked at West Pakistan as a whole and did not investigate regional subdivisions.

A pioneering effort at constructing individual GDPs for the four provinces of (West) Pakistan was made by Bengali (1997) and extended in Bengali and Sadaqat (2006). Analysis of provincial development issues—as opposed to calculations of provincial GDPs—has in recent years attracted the attention of a growing number of private scholars; see, for example, Hamid and Hussain (1992), Ghaus-Pasha *et al* (1996), Jamal and Khan (2003), Jamal and Aamir (2003), and Pakistani think tanks, for example, Social Policy and Development Center (2001, 2004). More comprehensive studies have been conducted by international institutions such as the World Bank which, in partnership with the provincial governments, the Asian Development Bank, and the United Kingdom's Department for International Development, prepared reports on the economic development of each province; for example, World Bank (2005a, 2005b, 2007a, 2007b), Asian Development Bank (2005), and UNDP (2003). These reports are underpinned by a very substantial array of background papers. The joint studies by the international organizations

and the provincial governments represent a valuable first step in analyzing critical issues and recommending policies, and also in generating time series of provincial GDPs using procedures consistent with those of the Federal Bureau of Statistics for the construction of the national accounts. However, at times the nonavailability of survey data compels the unofficial estimates to rely on some assumed relationships between different variables. The nonavailability of data also meant that some key indicators, such as investment (public and private) and provincial savings could not be calculated.

The numbers generated by the foregoing studies cannot, of course, substitute for an official set of figures prepared by the Federal Bureau of Statistics. The existing estimates can serve only as an interim measure. It is hoped that the Federal Bureau of Statistics will soon begin to issue officially-sanctioned figures for the GDP and other macroeconomic variables at the provincial level. Such data have long been published in India by both official and nonofficial sources.¹

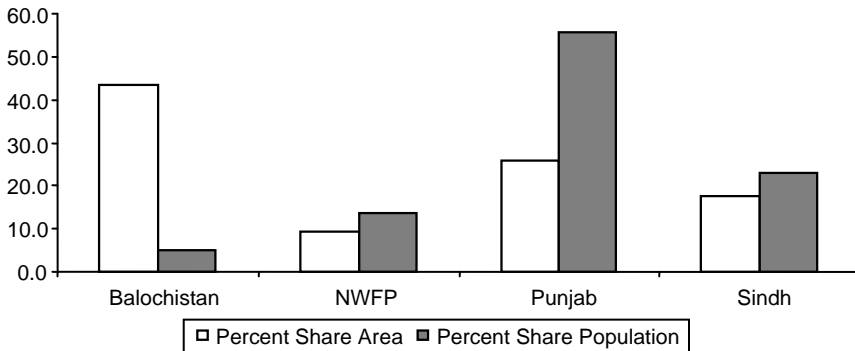
It is necessary to strengthen studies at the provincial level, because policies to address questions of employment, poverty, feelings of deprivation, and to improve the delivery of key services are more effective if the perspective is as close to the ground as possible. The validity of this approach is recognized by the burgeoning number of regional or state studies in India and in other parts of the world (such as Malaysia, Vietnam, Thailand, Indonesia, Brazil, and Argentina) where the individual provinces or states can exercise a significant degree of autonomy over many economic decisions. Moreover, disparities in the endowment of physical and human resources and divergences in the strength of institutions mandate different policies to realize the development potential of each jurisdiction—one size of policy will not fit all. Economic policy will thus be most effective if the usual country-wide macroeconomic analysis is supplemented by a detailed “bottom up” approach, based on a comprehensive examination of the challenges and opportunities specific to each province.

The importance of such a differentiated approach becomes quite evident when one examines the distribution of land and population between the provinces. The disjunction between the endowments of

¹ See, for example, Government of India, Ministry of Commerce (1949); National Council of Applied Economic Research (1967).

these two factors of production, especially comparing the Punjab and Balochistan, is brought out in Figure 1 below. In 2006, Balochistan's population density at 19 persons per square kilometer was only 5, 8, and 9 percent respectively of that of the Punjab, Sindh, and the NWFP.

Figure 1: Share of provinces in area and population of Pakistan, 2006 (Percent)



Source: Pakistan Economic Survey, 2004/05

2. Provincial Economic Development

The division of authority between the federal and the provincial governments is laid down in the Constitution of Pakistan. Some areas—such as defense, foreign affairs, customs duties, income tax—fall within the ambit of the central government, while others—for example, agriculture, irrigation, primary education—are covered by the remit of the provincial authorities. In formulating a strategy of provincial development and recommending sectoral and other policies, one must bear in mind what the provinces are and are not empowered to do. The effects of central government policies impact on provinces in broadly similar ways;² however, substantial differences can arise in the application of provincial policies.

2.1. GDP Growth and Structural Change

It was argued above that a definitive analysis of provincial economic performance is not yet possible because of the absence of reliable

² But not necessarily to exactly the same degree; thus when the central government decided to support the mujahedin in Afghanistan, the effect on the Punjab was negligible compared with that on the NWFP.

provincial GDP accounts. A number of attempts have been made to calculate the GDPs of the different provinces, but some serious methodological and data considerations remain. The main ambiguities arise from the treatment of what would be foreign trade and investment had the accounts referred to countries.

This weakness is particularly apparent in the case of Balochistan, where it arises from the treatment of the production and distribution of natural gas. For many years, Balochistan remained the biggest producer of natural gas in Pakistan. However, the overwhelming amount of Balochistan's gas is used in other provinces. In a system of national accounts, this would appear as exports to other countries for which Balochistan would be recompensed by acquiring financial claims on these countries. Under present circumstances, Balochistan does not receive compensation for the full value of its natural gas exports, but is only paid a small fraction of that by way of a royalty. The practical effect is that only a limited amount of the income generated in the natural gas sector benefits Balochistan, and that therefore most estimates—since they are based on value added within the province—substantially overstate the GDP and per capita income actually available to the residents of Balochistan.³

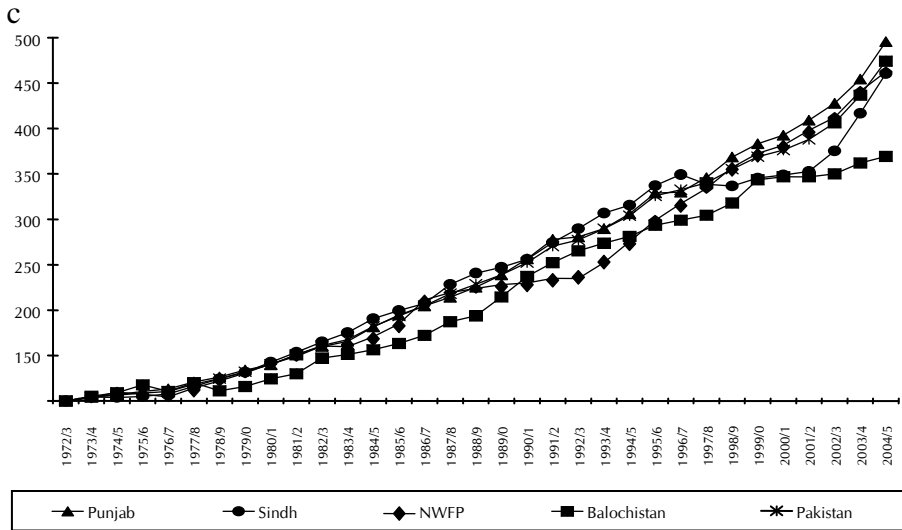
An important question of interpretation also affects the figures for Sindh. The size and performance of Sindh's economy is heavily influenced by the presence of Karachi. Many of the numbers for Sindh—not only for the GDP and per capita income, but also the outcomes for education, health, availability of drinking water, access to roads, and so on—change quite dramatically depending upon whether Karachi is included or excluded. Thus, the overall figures for Sindh are not necessarily a reliable guide for assessing the standard of living or the quality of life for all Sindhis; rural Sindh is noticeably less developed than the province's urban areas.

Other difficulties in constructing real GDP series that cover a long period are well-known: questions arise about the choice of deflator, and

³ Another way of considering this matter is the following. The total value-added within the borders of a national entity comprises its gross *domestic* product, or GDP. Payments that accrue to factors of production that are not nationals of the reporting entity, known as “factor payments abroad,” are subtracted from the GDP, while those that accrue to nationals are added, in order to obtain the gross *national* product, or GNP. Where Balochistan is concerned, the returns to capital, i.e., profits on natural gas production, accrue to organizations located outside Balochistan and far outweigh the inward flow of remittances from Balochis working outside the province. In other words, the provincial national product (measured from the flow of incomes) is less than the provincial domestic product (measured from value added in production).

most price indices that span a 30-year period are affected by issues concerning choice of commodities, weightage, and changes in quality. However, subject to these caveats, some broad indications can be given about the growth of real GDP for Pakistan and the provinces from 1972/73 to 2004/05. During this period, the GDP of Pakistan in constant prices increased at an annual average rate of about 5.0 percent. The growth rate of the provinces naturally varied—the Punjab is estimated to have grown at an annual rate of 5.2 percent, Sindh and the NWFP at 4.9 per cent, and Balochistan at about 4.2 percent. These trends are shown in Figure 2.

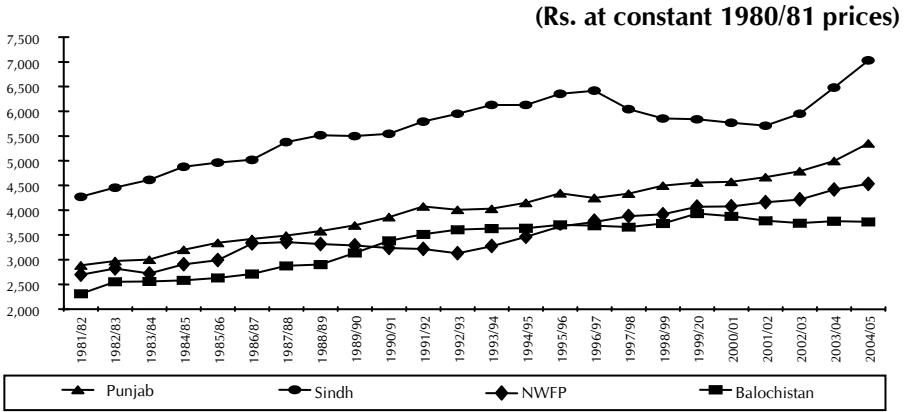
Figure 2: Growth of provincial GDP at constant 1972/73 prices, 1972/73–2004/05
(Index numbers, 1972/73 = 100)



Source: World Bank et al. (2007a)

With the same caveats in mind, one can estimate increases in per capita incomes. Between 1980/81 and 2004/05, the per capita income of Pakistan is estimated to have grown at an annual average rate of 2.6 percent. The growth rates (percent per annum) for the provinces are: the Punjab 2.8, Sindh and the NWFP 2.3, and Balochistan 2.1. These results are displayed in Figure 3.

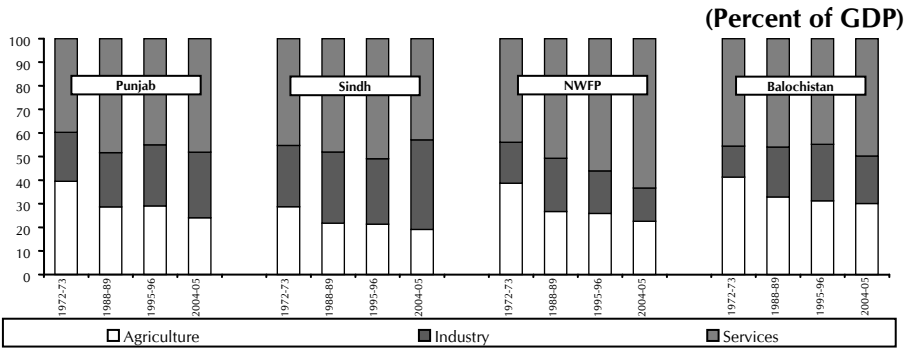
**Figure 3: Growth of provincial GDP per capita
1980/81–2004/05**



Source: World Bank et al. (2007a)

Over the three decades from 1972/73, the structure of the provincial GDPs changed. The broad movement was towards a relative reduction in the share of agriculture and an increase in the share of value-added contributed by manufacturing and services. The change was most pronounced in Sindh (largely reflecting the performance of Karachi), and the least in Balochistan. Structural changes in the GDP are displayed in Figure 4.

**Figure 4: Change in structure of provincial GDP
1972/73–2004/05**

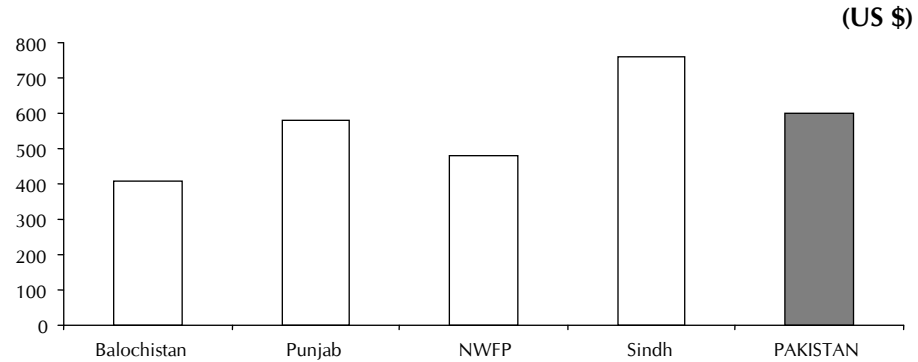


Source: World Bank et al. (2007a)

The cumulative effect of GDP growth, population growth, and structural changes in the economy created significant differences in the per capita incomes of the provinces. According to the World Bank’s Atlas methodology, GDP per capita in 2004 amounted to \$600 for Pakistan overall, \$410 for Balochistan, \$480 for the NWFP, \$580 for the Punjab,

and \$760 for Sindh (but much of this was contributed by Karachi). These results are displayed in Figure 5.

**Figure 5: Provincial per capita incomes 2003/04
(World Bank Atlas Methodology)**

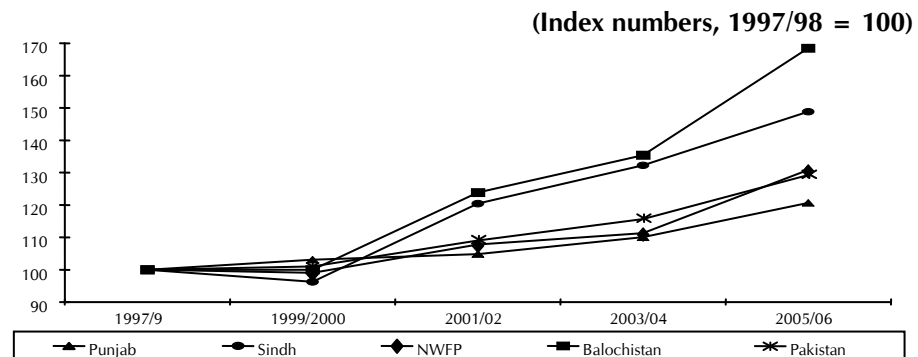


Source: World Bank

2.2. Employment and Wages

In a modern economy, the chief source of income is employment. The growth of employment is shown in Figure 6. The steep increase in the rate of growth of employment in Balochistan after 2004 should not mislead one into thinking that the performance of that province’s economy was stellar; it reflects a recovery after a prolonged period of drought. The growth rate of employment in the Punjab is expectedly below those of the other provinces, because it is calculated on a much larger base.

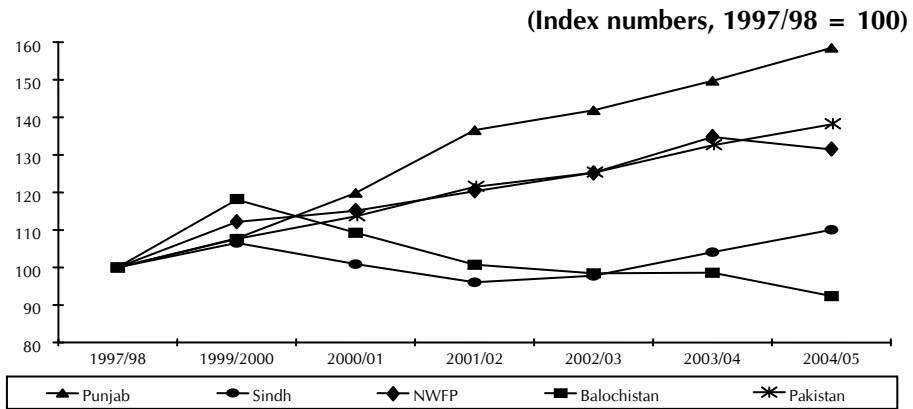
**Figure 6: Growth of provincial employment
1997/98–2005/06**



Source: World Bank et al. (2007a)

The growth of output per worker is shown in Figure 7. This is a rough measure of labor productivity, because it does not take into account the number of hours worked. However, it is useful as a first approximation. Developments in labor productivity are important, because the "potential rate of growth" of a region or a country is defined by the growth of the labor force and of labor productivity. The most rapid growth occurs in the Punjab; this is not surprising in view of the relatively higher rates of education and of investment (the latter is important because technological developments come embodied in physical capital).

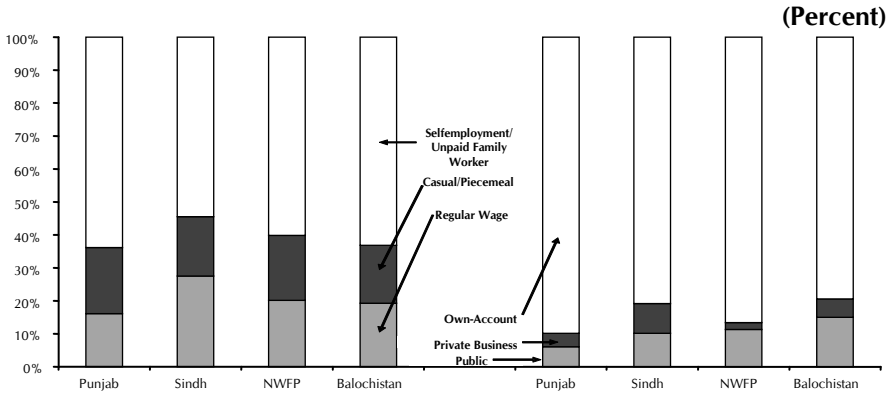
**Figure 7: Growth of labor productivity
1997–2004/05**



Source: World Bank et al. (2007a)

Figure 8 points to an important duality in the labor markets of the provinces. It shows the scarcity of regularly salaried jobs, especially in the private sector; and the large informal sector. Fewer than 20 percent of workers in the Punjab, the NWFP, and Balochistan received regular fixed wages in 2003/04. Over 60 percent of workers in these provinces were either self-employed and did not receive fixed wages, or acted as unpaid family workers. The figure also shows the overwhelming role of the informal economy—in each province, 80–90 percent of employment was accounted for by informal workers. This is a matter of concern, because the informal sector does not provide job security, labor protection, regulated hours of work, pensions or other benefits, and it largely evades the tax net.

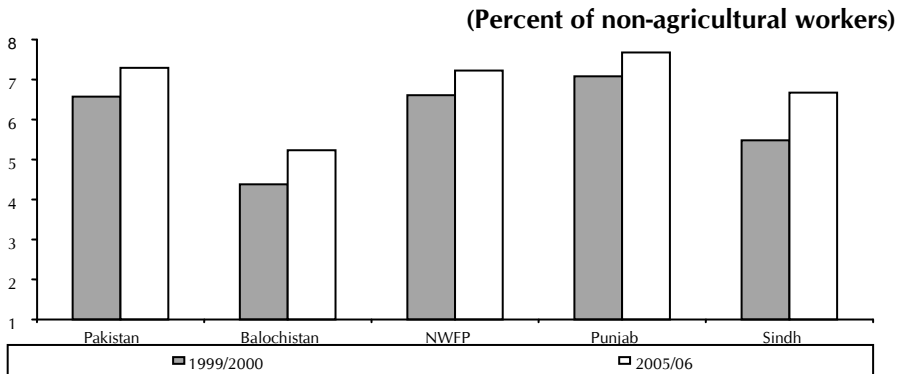
Figure 8: Provincial employment by wage payment type and ownership 2003/04



Source: World Bank et al. (2007a)

What makes matters worse is that informality appears to be increasing; Figure 9 shows that in each of the provinces, the percentage of non-agricultural workers in informal employment in 2005/06 was higher than in 1999/2000.

Figure 9: Provincial employment in informal sector outside agriculture 1999/2000–2005/06

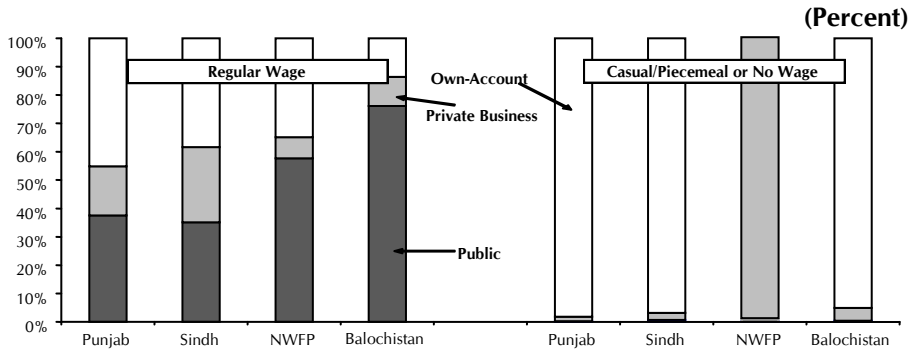


Source: World Bank et al. (2007a)

Figure 10 shows the composition of wage payment by ownership. It is striking that in Balochistan more than three-quarters of regular wage payments were accounted for by the public sector, compared with about one-half in the rest of the country. This arises because in 2003/04, nearly 15 percent of all workers in the province were government

employees; this compares with fewer than 8 percent in the rest of Pakistan. This is significant for incomes in Balochistan, because jobs in the public sector pay considerably more on average than in the private (as is the case country-wide).

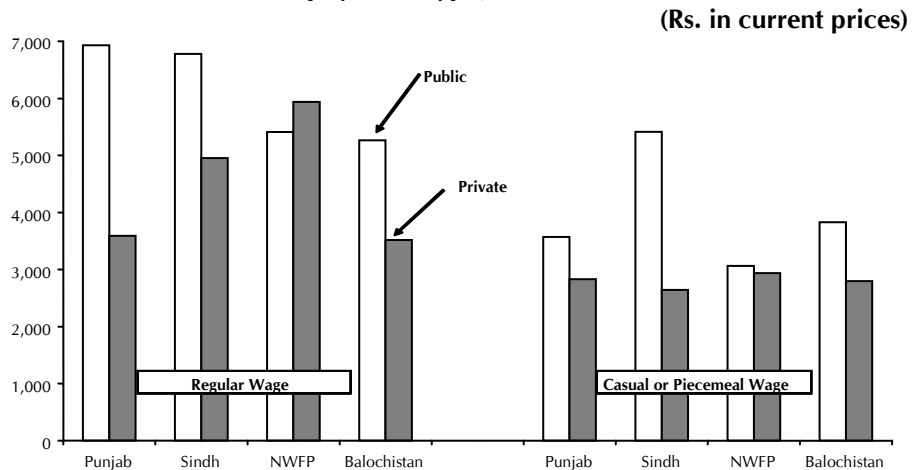
Figure 10: Composition of provincial wage payment by ownership, 2003/04



Source: World Bank et al. (2007a)

Since 1999/2000, real wage rates have begun to rise, reversing the trend of much of the 1990s. Jobs offering regular pay have benefited most from this development, but wages for casual wage earners have also risen (Figure 11).

Figure 11: Provincial monthly real wage rate by ownership and payment type, 2003/04

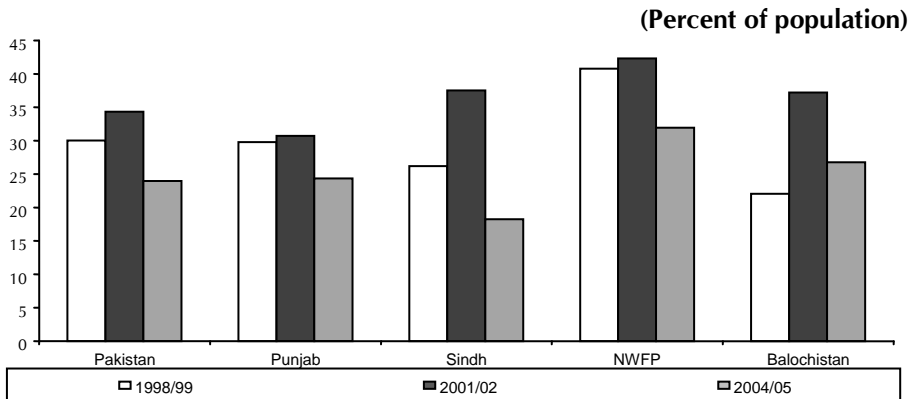


Source: World Bank et al. (2007a)

2.3. Poverty and Inequality

Figure 12 shows the poverty headcount ratios (the percent of the population below the poverty line) for three years between 1999/2000 and 2004/05. It shows a worsening of poverty in 2001/02 and an improvement in 2004/05. The figures for Balochistan merit a comment.

**Figure 12: Provincial poverty headcount ratios
1999/2000–2004/05**



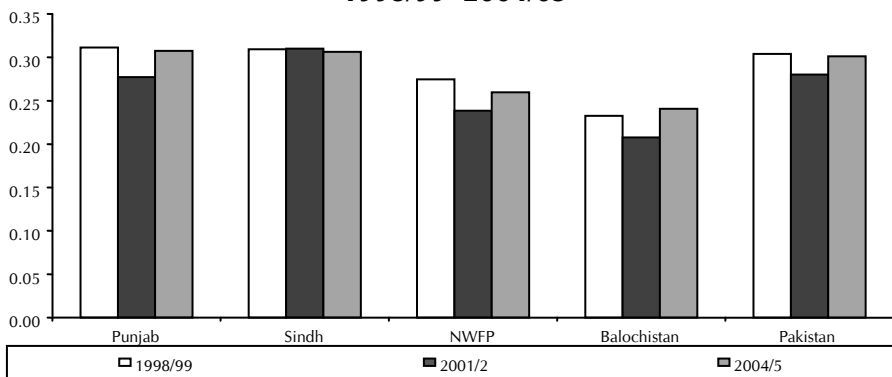
Source: World Bank et al. (2007a)

The 2003 *Balochistan Poverty Reduction Strategy Paper* calls the reduction in poverty recorded in 1998/99 by the Pakistan Integrated Household Survey (PIHS) “a statistical aberration,” and declares that the results of the 2001/02 PIHS “continue to be a source of considerable controversy,” largely because of biases in the sampling procedures. A discussion of the issues in World Bank (2002), World Bank et al (2007a), and the data from the 2004/05 Pakistan Social and Living Standards Measurement Survey (PSLM) using larger samples suggests that poverty in Balochistan increased between 1998/99 and 2004/05, and became statistically indistinguishable from poverty in the NWFP, which has systemically had the highest measured rate of poverty. The use of the “poverty severity measure,” which gives higher weight to the poorest than does the headcount measure, confirms that poverty continued to rise between 2001/02 and 2004/05. The World Bank (2007a) estimates that the number of poor people increased from 1.5 million in 1998/99 to 2.1 million in 2004/05.

Measures of inequality (the Gini index) are displayed in Figure 13. This index varies from zero (denoting complete equality) to 1 (complete

inequality—one household consumes everything). Thus, the available data indicate that for the country as a whole, consumption inequality increased between 2001/02 and 2004/05. Over the same period, this inequality increased in the Punjab, the NWFP, and Balochistan, but stayed more or less constant in Sindh. The data also suggests that the distribution of consumption was more egalitarian in Balochistan and the NWFP, but the figures for Balochistan might still be affected by an element of sampling bias.

**Figure 13: Provincial Gini index of real per capita consumption
1998/99–2004/05**

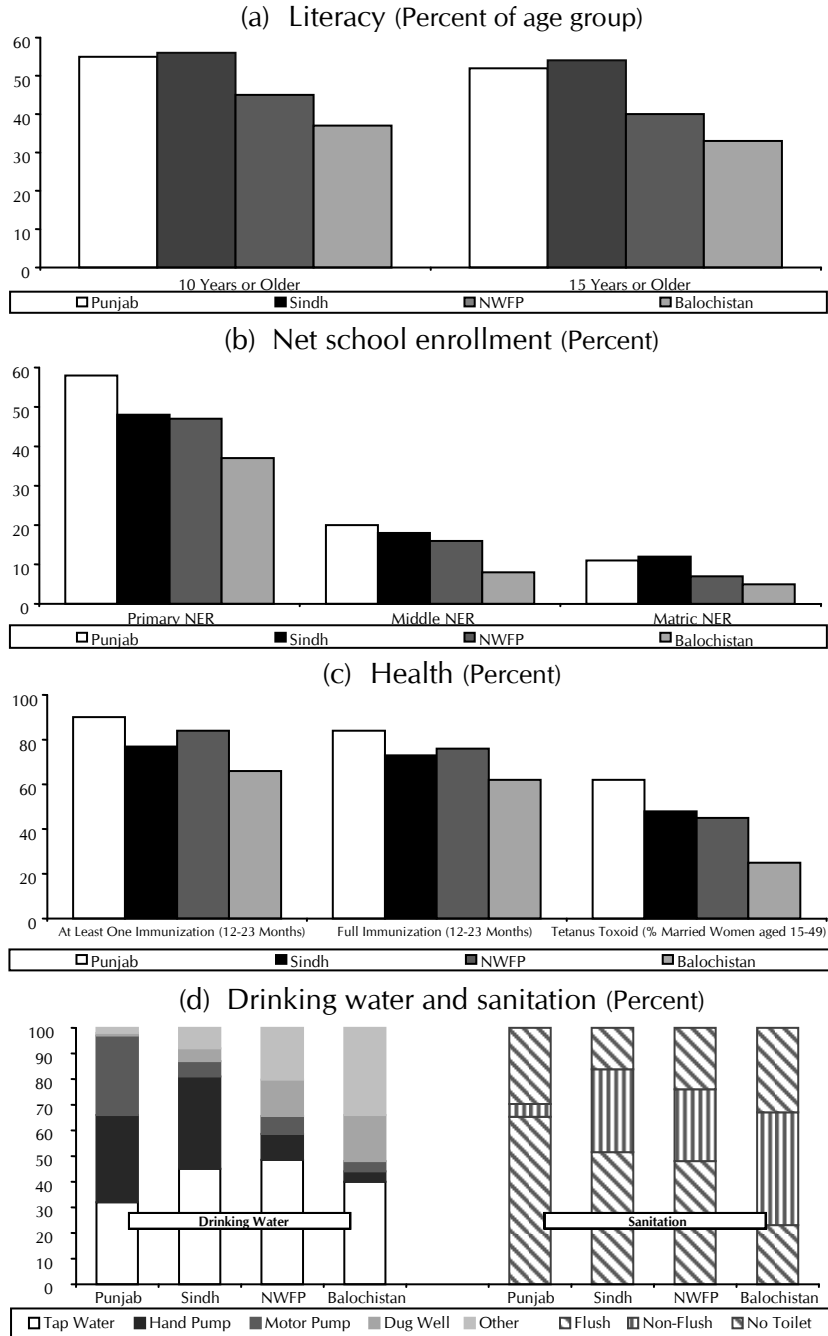


Source: World Bank et al. (2007a)

2.4. Social Indicators

Number of indicators, relating principally to education and health, are displayed in Figure 14. There is no need to labor their findings; they indicate clearly that uniformly Balochistan and the NWFP have the worst social outcomes. The results for education give rise to particular concern, especially for Balochistan where only one in three adults is literate. The low enrollment rates (e.g., in Balochistan, less than two in five of children aged five to nine are enrolled in primary school) suggest that the educational weaknesses of these two provinces are likely to continue for some time into the future. This will create difficulties in improving the quality and productivity of the labor force, and also dilute the quality of life enjoyed by the citizens of Balochistan and the NWFP.

Figure 14: Provincial Human Development Indicators – 2004/05

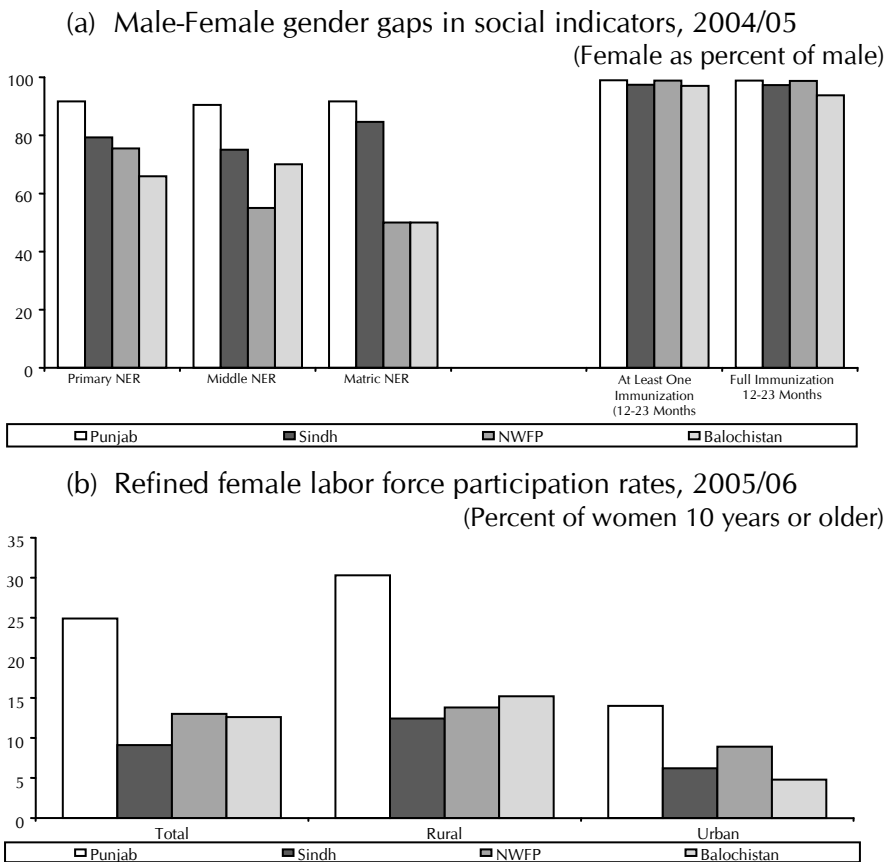


Source: World Bank et al. (2007a)

2.5. Gender Gaps

Social outcomes for women are generally worse than those for men. According to the 1998 population census, the sex ratio (male to female population), a widely-used measure of sex-based discrimination, was over 100 in each of the provinces. The worst outcome was in Balochistan, where the ratio was 115, compared with 112 in Sindh, 107 in the Punjab, and 104 in the NWFP. The gender gap is also vividly present in indicators of education (such as the net enrollment rate), of health (such as rates of immunization), and in the labor market, where participation rates of women aged 10 years or older can be up to 60 per cent lower than those of men in the same age group. These outcomes are illustrated in Figure 15.

Figure 15: Provincial Gender Indicators



Source: World Bank et al. (2007a)

3. The Economic Environment

The foregoing section summarized some of the key indicators showing the economic and social development of the provinces. The next section sketches out the main issues that confront each province, and outlines a medium-term strategy that would enable the provinces to attain its goals. But before outlining an agenda for each province, it may be useful to explore the main contours of the environment within which the development of all the provinces takes place, and to examine the chief pressures, external and internal, that all the provinces are likely to be subjected to during the next, say, 20 years.

3.1. International Factors

The spread of globalization, meaning the continuing integration of the countries of the world, is likely to be a major factor shaping the world in which Pakistan's and the provinces' development will take place. The increasing integration of trade and factor movements between countries is already leading to much stronger competition for capital and offering greater inducements for skills to move across borders. This will impinge strongly on the economy of Pakistan as a whole. Capital resources, both external and domestic, can move relatively easily to most parts of the world and, within Pakistan, can be located in any province that offers the appropriate mix of security and financial return.

All the provinces, therefore, will be competing with each other to attract domestic and international capital. Moreover, in view of the relative paucity of labor and managerial skills, some provinces (such as Balochistan and the NWFP) cannot afford a brain drain. Talented people are more mobile; they will move to places that offer not only good job opportunities, but also a high quality of life. The competition for human talent is nationwide, indeed, world-wide. If a province is not deemed more "livable" compared with other provinces in Pakistan, or indeed with other countries, it will increasingly run the risk of losing its best and brightest citizens. Thus, economic decisions taken in any province will progressively have to take account of decisions and actions taken in other provinces and other countries.

3.2. Internal Factors

Globalization will not be the only force impinging upon the provinces' development in the next 20 years. The development strategy for each province must also incorporate alterations to the domestic political and social profile of the country. The first of these changes is likely to be a continuation of the movement towards increased decentralization, democratization, and people's participation in society. Thus the development agenda must clearly recognize a different and a more nuanced role for government.

3.2.1. *Decentralization*

In the modern world, successful countries have found that they can respond more quickly and flexibly to the needs of the citizens by decentralizing many government functions and relying more on local bodies. Constitutional changes in Pakistan are also hastening moves in this direction; the results are likely to impact especially on the delivery of key services. Other things being equal, a decentralized system can increase the speed and responsiveness of governments, because locally elected leaders are more familiar with their constituents' needs than authorities at the national level, and physical proximity can make it easier for citizens to hold local officials accountable.

The increased decentralization and more vigorous civil participation will require changes in a manner in which economic and other policies are conducted. First, it means that there will have to be more transparency and accountability for government actions and less of an ability on the part of the government to impose its will unilaterally. This may initially cause some discomfort in certain areas of the government, but overall should make government actions more effective because they will be more responsive to people's felt needs.

Second, the increased political pressure will almost certainly require making the provision of full employment a central tenet of economic policy-making. This will call for a delicate balance. The budgetary resources of the provincial governments do not permit the creation of large numbers of "make-work" jobs in the public sector; nor would this be an efficient use of scarce resources. Hence, most of the jobs will have to be created in the private sector. However, in dealing with the private sector, an important asymmetry exists. The authorities can

prevent the private sector from doing certain things (by, for example, passing a law or denying the sector access to some key input), but they cannot *make* the private sector do something. They can only provide incentives that they hope the private sector will consider sufficient. A key challenge for the provincial governments in realizing their vision will be to create a business environment in which the private sector feels comfortable and secure, and in which it is willing to invest on the scale required to create the appropriate number of productive jobs.

Third, the experience of other regions and countries shows that wider political participation will increase the demand for improved social services, particularly health and education. The provinces of Pakistan will not be exempt from such pressures. One cannot, for example, envisage a viable Balochistan 20 years hence in which the majority of the labor force is illiterate. Thus, the development agenda must incorporate very substantial improvements in the coverage and quality of healthcare, in access to higher quality education, and in the improvement of technical training to make it more relevant for the needs of the provinces' economy.

Fourth, participatory politics are likely to put more stress on equity in the distribution of incomes, both between persons and between different regions of the provinces. There will also be pressure to develop more comprehensive social safety nets so that the disadvantaged are, to a significant extent, protected from disaster. The development strategies must therefore explicitly incorporate policies to redress large-scale differences in the distribution of incomes between individuals, and explicit regional policies to stimulate the development of the more backward areas of the jurisdiction.

3.2.2. *Urbanization*

An important element that the development strategy must address is the issue of increasing urbanization. A strategy of rapid development that depends largely on industrialization, the exploitation of minerals, the creation of a massive amount of infrastructure, and development of the backward areas of the provinces will almost inevitably accelerate the urbanization of each province. This will pose a number of challenges.

The first important challenge is the cost of providing the infrastructure, such as water, sewerage, transportation, housing, health care, and educational services to the rapidly expanding urban population. Moreover, it must be remembered that the existing urban areas of the provinces evolved over a much longer interval, involved fewer numbers during much of their maturing, and developed in circumstances in which they did not have to apply strict standards relating to labor, human rights, and the environment. The present situation is very different. Urbanization must take place in a situation in which standards in these areas are specified and, over the next two decades, increasingly likely to be enforced. This substantially raises the costs of urban development. Mobilizing resources to provide these facilities, at an acceptable level of quality, to the increasing urban population thus will be relatively more difficult than was the case in earlier periods.

The second important challenge thrown up by urbanization is political. Large concentrations of population make it easier to organize and for groups to voice their demands more assertively. The development agenda of each province must therefore include a strong base of local government organizations that can respond more quickly and flexibly to rising expectations.

The third important consideration for provinces that stems from urbanization is a more rational use of land. Most of the provinces lack an effective urbanization strategy, with the result that urban sprawl is making it difficult to provide services and is steadily eating away valuable agricultural land. Moreover, insufficient coordination between industry location and the creation of housing communities has resulted in the expansion of informal settlements closer to where employment opportunities are present. The inhabitants of the settlements bear all the costs of informality: they cannot use the properties as collateral for loans (they represent “dead capital”), they are ill-served by public services, and they live on the fringes of the law and order network.

4. Strategies for Provincial Development

As was discussed earlier, some issues are common to all provinces—such as the general security situation in the country, problems of governance (such as access to justice and the working of the bureaucracy), the framework of macroeconomic policies, shortcomings of infrastructure, pressure on financial resources—while others are specific to each

province. In general, this section will not dilate on the set of common problems; its main focus is on the issues that are particular to a province.

It should also be clear that space will not permit a comprehensive discussion of the development of each province—this must be left to the provincial development plans; a more complete analysis has also been attempted in the World Bank/Asian Development Bank/DFID reports cited earlier. The purpose of this paper is to provide a framework for thinking about the critical issues and to suggest some ways in which they might be addressed.

4.1. Balochistan

Balochistan possesses the largest land area of any province of Pakistan; it is a major producer of natural gas; it possesses extensive deposits of copper, lead, gold and other minerals; it accounts for 70 percent of the coastline of Pakistan; it is well-situated for trade with Iran, Afghanistan, and the Persian Gulf countries; but in spite of these natural resource and locational assets it remains the poorest province in the country. The province's inadequate development during the past 50 years is a matter of serious concern. The development strategy must ensure that Balochistan's past does not become its future.

The basic development predicament for Balochistan is that while it accounts for nearly 45 percent of the land area of Pakistan, it is home to only 5 percent of the population. This combination results in many of the province's inhabitants being thinly dispersed over wide areas—in 2005, Balochistan's population density at 19 persons per square kilometer was only 5, 8, and 9 percent respectively of that of the Punjab, Sindh, and the NWFP. Such dispersion creates special difficulties. In particular, it means that the critical mass of skills required for specialization is present in only a few localities; it results in smaller markets, thus losing most economies of scale; and it raises the cost of providing a unit of service, including governance,⁴ above that in the rest of Pakistan.

A further challenge imposed by geography is a relatively small and highly variable water supply. Balochistan is an arid region because of its location and its physiography. The province lies outside the monsoon

⁴ In 2000, Balochistan had 1.85 civil service posts per 100 of the population, compared with 1.06 in the Punjab, 1.21 in the NWFP, and 1.29 in Sindh.

belt of the Indo-Pakistan subcontinent—therefore it does not have a copious or a regular source of rainfall. Its topography ranges from a few feet to over 9000 feet above mean sea level—therefore the sparse and irregular rainfall that it does get, varies markedly between different parts of the province.

Since Balochistan is largely an arid region, its development potential depends to a considerable extent on the amount of water available per unit area. By this measure, Balochistan is much less endowed than the other provinces. About 556 m³/ha/year of water are available to Balochistan, compared with a national average of 2453 m³/ha/year, and an average of 3921 m³/ha/year for the other provinces. Thus, spatial water availability in Balochistan is less than one-fourth the national average, and only about 14 percent of the average of the other three provinces. A further difficulty for water management is that the available water is very thinly distributed over the vast area of the province. The effects of physical geography have been made worse by human policies—uneconomic subsidies have provided incentives for the indiscriminate exploitation of groundwater, thus intensifying water scarcity and making water management even more difficult.

The combination of inefficient water use, waste of surface and ground water, and inadequate investment in water infrastructure has resulted in less than 40 percent of available water being utilized. It is not surprising that only about 2.1 million hectares (approximately 6 percent of Balochistan's geographical area) are cultivated,⁵ and that at recurrent intervals water shortages have been severe enough to tip the province into a prolonged drought. More recent experience indicates that the frequency of drought in the province has actually been higher than that projected using historical data. The most recent drought lasted for seven years between 1997 and 2004, and was the longest and most severe spell recorded in the history of Balochistan.

To sum up: A combination of geography and human policies has created a difficult development challenge for Balochistan. The key issues for the province are that its human resources, in numbers and quality, are insufficient to reap the full benefit of the territory's physical

⁵ About 47 percent of the cultivated area is irrigated, while the remaining 53 percent is under Sailaba and Khushkaba farming. The latter farming systems contribute to the livelihood of a sizeable majority of the population.

potential. The development problem is made more difficult by the security situation, the stabilizing of which is crucial if the province is to achieve prosperity.

The task confronting Balochistan is to pursue a strategy that builds on its assets and overcomes its liabilities⁶. Providing a better quality of life for Balochistan's citizens will require sustained action in a number of areas. A starting point is an increase in incomes.

4.1.1. A Strategy For Increasing Incomes

In a modern economy, most incomes result from employment. The first priority for the Government of Balochistan, therefore, is to adopt policies that will accelerate the growth of the GDP and create sufficient jobs to absorb the additions to the labor force and progressively decrease the backlog of unemployment and underemployment.

World Bank (2007a) estimates that if the labor force participation rate of the population aged 10 years or older continues in line with the trend of the last six years, an additional 158,000 jobs will have to be created annually over the next 20 years to prevent the unemployment rate from exceeding 3 percent. If GDP growth is maintained at 6.5 percent, as was the case from 2002/03 to 2004/05, the employment elasticity of GDP growth would not have to exceed 0.45.⁷ Attaining the employment target will not be easy, but it should be feasible, as Pakistan's average elasticity of employment with respect to GDP growth over the last two decades was around 0.55.

How can this growth be attained? A viable strategy must comprise several elements.

1. It must rely on a much stronger partnership between the public sector and the private. The past development strategy for Balochistan implicitly assumed that a geographically large and sparsely populated jurisdiction must necessarily rely on public sector and government leadership for its development. This assumption has turned out to be only partially true, and the strategy has carried a cost by allowing public

⁶ The following discussion draws in part on Ikram (2006).

⁷ Meaning that one percent increase in GDP need create less than half a percent increase in employment.

sector solutions to eclipse the potential of private investment and entrepreneurship as sustainable options for growth.

The authorities must therefore follow an approach that recognizes realistic limits on the government's capacity to determine economic growth through direct means, such as controls and spending. If Balochistan's long run economic growth is to be sustained and efficient, it must increasingly be driven by a combination of government, business, and other stakeholders, such as non-government organizations (NGOs), and it must also harness the talents of the province's intellectual centers.

While in the long run it is to the private sector that one must look to provide sustained and efficient growth for Balochistan, a somewhat different strategy might be more appropriate in the short to medium-term. This is caused by the following dilemma: while Balochistan needs rapid economic growth and while experience—internationally and from Pakistan's other provinces—indicates that this is most efficiently provided by the private sector, until the security situation improves the private sector is unlikely to invest on the scale required. An alternative method of triggering growth must therefore be considered.

One approach could be that adopted by Pakistan and several other countries, not least Japan, in their earlier phases of industrialization. This approach would support a greater role for the public sector in Balochistan than in the other provinces. The idea would be to set up a number of key industries in the public sector that would make use of Balochistan's locational and other advantages. These would be developed to the point at which they became sufficiently attractive for the private sector to purchase them.⁸ The longer term development would thus still be private sector led, but there would be an interim period during which the public sector would take the lead in a number of economic activities.

Such a transitional strategy offers a number of advantages. The pace of industrialization in the province would be accelerated beyond what would occur if matters were left entirely to the market, jobs would be created and incomes generated, the experience could help identify the infrastructure and institutional improvements required for large-scale

⁸ Such a policy was the *raison d'être* of the Pakistan Industrial Development Corporation (PIDC).

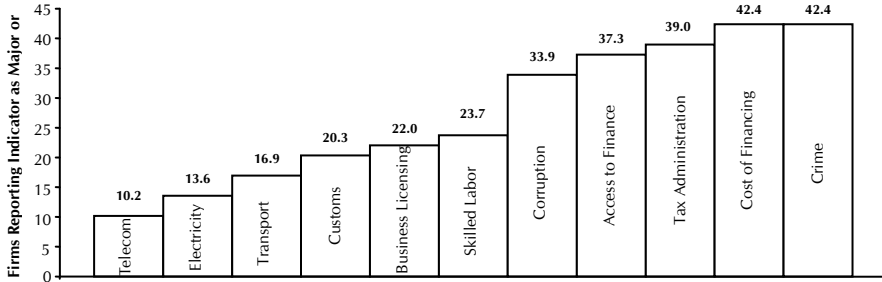
industrialization, and the whole process could help to mould workers' attitudes (regarding factory discipline, punctuality, consistency, acquiring and enhancing expertise, maintaining quality of production, etc.) in the direction required by a modern labor force. It is, of course, important that the industries selected for public support be congruent with the province's factor endowments; this strategy should not offer a blank cheque. However, a wide range of industries would still be eligible. Candidates include leather tanning and leather products, wool-based industries, fisheries and associated activities (such as freezing, the export of seafood, and the production of fishmeal fertilizer), gas-based industries, activities that use copper or coal in substantial quantities, and industries that rely to a significant extent on imports.

2. Ultimately, the growth of the GDP will depend largely on increasing the rate of investment in the province. Investments are driven primarily by financial factors, but supplemented by considerations of security and the quality of life offered to workers in the enterprises. In order to attract more investment than in the past, Balochistan must emphasize better location (in terms of access to markets and to factors of production), physical security, lower transport costs, and lower labor costs than an investor can expect in the other provinces. At the same time, Balochistan must pay attention to cultural and environmental considerations to improve the quality of life.

If in the long run the private sector is to generate the majority of jobs, then the bulk of investment will have to be located in the private area. This will require strengthening the investment climate in the province.

An examination of the investment climate and of the concerns of potential investors was undertaken by the World Bank in Hub (the major industrial and trading estate of Balochistan); the results are shown in Figure 16. The areas of particular concern to businesses were: the law and order situation; the cost of financing; and governance issues, such as tax administration and corruption. These are the areas to which the authorities must improve in order to make Balochistan an attractive destination for investment.

**Figure 16: Factors constraining the investment climate, 2001
(Industrial & Trading Estate, Hub)**



Source: World Bank Data Base

3. The next major element of the strategy should be to strengthen the growth generators—those parts of the economy that are the primary creators of the region's economic wealth—and to develop them efficiently. A major sector of the province's economy—contributing about 30 percent of the GDP and employing nearly two-thirds of the labor force—is agriculture, including livestock and fruit farming. The strategy in this area needs rethinking.

The most critical constraint on Balochistan's agricultural development is water. In order to make the best use of its scarcest resource, Balochistan will have to be very selective about the sources from which to elicit growth in the agricultural sector.

The most efficient path will be to concentrate on the expansion of *sustainable* high-value activities. In the context of a long-term strategy, this is likely to mean providing more support to ventures in livestock rearing and downplaying that in grain cultivation. It is also likely to require readjustments in the horticulture subsector, the present expansion of which derives largely from a generous subsidy to electricity for tubewells.⁹ This has resulted in excessive use of water, because the private cost of using the resource has become much less than the social cost. Indeed, more water is being extracted from the aquifer than is being added to it, with the result that the water table is falling. The dwindling supply of groundwater is demonstrated by the increasing depth to which tubewells have to be sunk—depths beyond 250 meters are now commonly reported. Moreover, the water table is dropping quite quickly;

⁹ A flat rate of Rs 4,000 per month is charged for electricity, and even that is often not paid by the farmer.

in some important districts (for example, Quetta, Mastung, and Mangochar) in the last eight years the level of groundwater has fallen by as much as 3 meters per year. The major part of groundwater has already been exploited. It is estimated that groundwater will contribute only about 2 percent of the total water available for future development.

4. The province must diversify the sources of its GDP. Agriculture by itself cannot accelerate the growth of the provincial GDP to the targeted 6.5 percent a year and Balochistan will increasingly have to turn to other sources, such as manufacturing and mineral development, while continuing to make agriculture as productive and efficient as possible. Reducing poverty will also require moving labor from the slow-growing sectors to faster growing ones, such as industry. At present, Balochistan has the highest proportion of its workforce in the agriculture sector—67 percent compared with the national average of 42 percent, and the lowest proportion in the industrial sector. Moreover, land ownership is highly skewed, with 10 percent of farmers owning 53 percent of the farm area. The majority of tenants work on small (5-12.5 ha) and not very productive holdings, with the result that their incomes remain below the poverty line. Agriculture contributes 52 percent to provincial GDP, compared with 23 percent at the national level; the industrial sector contributes only 13 percent (of which minerals constitute 3 percent). The changes to the structure of the GDP mean that the share of the industrial sector will have to increase.

The expansion of manufacturing in the province can rest on two foundations. One, it can be based on the natural resources—minerals such as natural gas, coal, marble, chromites, and copper, or the products of the agricultural sector (including those from the livestock and fisheries subsectors)—that are indigenous to the province. These would provide industries located in Balochistan with the advantages of lower transport costs and a steady and assured supply of inputs. When dealing with a strategy of manufacturing based on indigenous natural resources, Balochistan's longer-term aim should be to attract not just individual cost-sensitive firms (that often pay relatively low wages), but rather clusters of firms. Clusters are groups of firms and industries that are linked together by formal and informal relationships and which draw on the labor force of a common locality. A strategy to develop clusters will enable Balochistan to expand the wealth of the province by moving up the value chain.

Two, Balochistan should take advantage of its long coastline—the province accounts for over 70 percent of Pakistan’s coastline—and encourage the location of industries that use a significant amount of imported materials. Much of Pakistan's non-textile industry is based on imports, and to the extent that these facilities are situated away from Karachi, they are disadvantaged by having to pay additional transport costs. Moreover, Karachi itself is becoming a high-cost site. It will be in the interests of the country's industry and of the province to locate the expansion of import-intensive industries along the southern seaboard of Balochistan.

5. The province must develop its coastline in a comprehensive manner. Yusupha Crookes has pointed out that even though Balochistan possesses 790 km of Pakistan’s 1100 km coastline, the underdeveloped nature of this resource means that the province’s economic activities are as disadvantaged as if the area were landlocked.¹⁰ A start towards rectifying this situation has been made by constructing a port at Gwadar. In the longer run, Balochistan's coastline has the potential to be used for different activities—to situate manufacturing industries, to develop the fishing industry, and to build additional ports.

Developing the potential of Balochistan's coast, and even of the port of Gwadar, will take time and a significant amount of investment, and will require the fulfillment of a number of conditions. These include, *inter alia*, providing fresh water to the population that will locate there; offering incentives (e.g., low prices for industrial land, no restriction on foreign or local investment, fast one-window operations to set up industries) to attract industries and skilled labor to a region that has not traditionally hosted such activities; enlarging the transport infrastructure; and strengthening links with the other provinces in order to handle the domestic trade and traffic of the Punjab, the NWFP, and Balochistan. A major demand for transit and entrepôt trade from Afghanistan, the Central Asian republics, and China—if it arises—would be a bonus. See World Bank (2004, 2006).

6. Balochistan’s fishing industry performs well below its potential because of low productivity along the entire value chain. Fishing boats are small and unable to reach many fishing grounds; harbors and auction halls do not meet international health and safety standards; and processing units lack proper preservation equipment and are largely innocent of the required packaging techniques. Modernizing the fishing

¹⁰ In comments on World Bank *et al* (2007a).

industry will require investment in harbor facilities; the provision of echo-sounders to fishermen to locate fish; helping them finance on-board refrigerated fish-holds; and encouraging private investment to diversify activities in this sector, such as by moving into shrimp farming. The province will also have to strengthen institutions to ensure compliance with international standards of hygiene.

7. In Balochistan, as in the other provinces of Pakistan, most jobs are provided by small and medium enterprises (SMEs). Such enterprises work under four major disadvantages. They lack access to finance; their technology is often outdated and inefficient; they cannot easily find skilled labor; and they are not aware of market opportunities outside their immediate locality. It will not be easy to solve these problems. Some of them, such as access to finance, are structural and result from "asymmetric information." SMEs know their financial position and weaknesses much better than do banks, and the cost for the latter to obtain accurate information can often outweigh the profit from the loan. Moreover, the slow working of Pakistan's legal system means that the recovery of collateral in the event of a default by the SME is a drawn-out and expensive process. Thus banks and other financial institutions prefer not to lend to very small borrowers. These difficulties only underscore the need for provincial authorities to make every effort to develop innovative solutions to these problems, drawing as required on the experience of other provinces and other countries.

8. If private sector industry is to become the motor for the Balochistan economy in the longer term, then a number of important supporting measures will also have to be taken. One of the most important of these is to bring the supply of skills into line with the demand. Nearly two-thirds of Balochistan's labor force is illiterate. It is virtually impossible to provide significant skills to workers laboring under this handicap.

Moreover, the skills imparted by the system of technical education and training often do not correspond to those required by private industry. The authorities must ensure that the education system at all levels delivers the qualifications that meet the needs of employers and that support a changing economy. It seems essential that, as in other countries, elements of the private sector be encouraged to work with the authorities in charge of Balochistan's technical education system. This is an ideal area for public-private partnership.

9. The provincial and the federal authorities must make a concerted effort to develop more of the mineral resources of Balochistan and to ensure that this development is integrated with the rest of the economy. So far almost 90 percent of mineral production is attributable to natural gas alone; production of this resource is now declining. Moreover, the natural gas sector in Balochistan developed as an enclave. It has virtually no links with other sectors of Balochistan's economy, and thus does not create spillover effects that benefit other parts of the province's economy.

The province must also begin the vigorous exploitation of other important minerals, such as copper, coal, and marble. This will require the government to concentrate on settling the security issues and expanding the road network, while letting the private sector bring in more modern mining methods and technologies in order to speed up the development. Again, the aim must be to move up the value chain. See World Bank (2003).

10. It must not be forgotten that while stimulating economic growth is a necessary condition for alleviating poverty, it is by no means sufficient. The government must ensure that growth is broad-based, and to that end may have to provide support in certain areas.

In order to alleviate poverty for those in the labor force, the government can envisage two modes of intervention. The first is to create employment through a large-scale program to assist the small enterprise sector. This can take the form of expanding the system of credit, offering more vocational training, furnishing technical assistance in marketing and management, and providing serviced land for the establishment of new enterprises. Second, the government can design a program to help NGOs that work in the field of community development to expand their activities, especially as they relate to the creation of income-generating projects and to the development of human resources.

4.1.2. A Specialized Water Strategy

Balochistan is largely an arid region and drought is a frequent occurrence; the latest lasted from 1997 to 2002, and severe water shortages continued up to 2004. About one-quarter of the population was affected, and between 1996 and 2000 livestock holding fell by almost one-third.

Balochistan has three main sources of water: (a) the Indus basin irrigation system, which provides about 39 percent of the total water; (b)

floodwater (*sailaba*), which accounts for 57 percent; and (c) groundwater, which supplies the remaining 4 percent. However, much of the groundwater has already been utilized, and the province will have to exploit the other sources in order to meet the increasing demand. An assessment of future water potential indicates that the sources are likely to be: (a) Indus water, 26 percent; (b) floods and runoff, 72 percent; and (c) groundwater, only 2 percent. But harnessing the future potential will require a specialized strategy. As Ahmad (2006) points out, the chief strategic weakness in the province's water sector policy has been to treat water availability almost exclusively as a supply-side issue, to the neglect of demand-management considerations.

Such a long-term strategy must incorporate three pillars:

- (a) *Conservation*: The province must conserve groundwater by recharging the aquifer through the construction of a number of storage/delay action dams. It must also aim at reducing losses in irrigation and water use in agriculture by a combination of civil works and policy improvements (such as controlling the subsidy on tubewells), and by taking steps to improve the performance of the system. "More crop per drop" must be the guiding principle for water use in agriculture.
- (b) *Management*: In managing the province's water resources, maximum effectiveness will come from following an integrated approach. This means that a hydrological basin must be taken as the basic unit for planning, and planning and policies have to be tailored to the requirements of each basin (there are 14 such basins in the province).
- (c) *Augmentation*: In the medium- to long-term, Balochistan should aim at building new canals to make use of perennial and non-perennial flows of Indus Basin water. The province must make greater use of floodwater, and store and divert water for *Salaiba* (floodwater) agriculture. It must also develop new water resources by recycling and reusing waste water (such as sewage and agricultural effluents), and develop measures for the desalinization of brackish groundwater and of sea water.

It has been argued that the frequency of water scarcity and drought conditions in Balochistan means that they ought to be regarded not as

isolated or transient occurrences but as recurrent or structural phenomena. This implies that a long-term, pro-poor strategy should be developed to mitigate the impact of these events on the most vulnerable sections of society. A proposal along these lines put forward by Gazdar (2005) was that future investment should target the poor in highly drought-affected areas by prioritizing projects that would maximize labor demand.

4.1.3. Delivery of Key Services

This paper started with an outline of various measures to increase per capita incomes. However, clearly, income or wealth is not demanded for its own sake; rather, it is important because it enables one to acquire the goods and nonmaterial services that help an individual to lead a life that he or she has reason to value. Economic development must be used as an enabler of improved quality of life. Therefore, in addition to the measures that have been outlined above, the province must pay attention to the delivery of key services.

The areas of service delivery on which the government must primarily concentrate during the next two decades are health; education (especially of females); clean water and sanitation; transportation; distribution of gas and electricity and greater reliability in their supply. The provision of some of these services will obviously also have an economic impact, in that they could help produce a more efficient worker. However, while this is important, services such as health and educational facilities, clean drinking water, etc, must be provided because they are essential to producing individuals who can function in a modern society.

4.1.4. Monitoring and Feedback

The strategy outlined above must be reassessed in the light of experience and from the feedback received from other stakeholders. The government must continually evaluate progress in improving the business climate, promoting the rural economy, assisting industrial development, supporting knowledge and skills development, and upgrading the delivery of key services. To this end, it would be helpful to regularly benchmark the status of Balochistan against other provinces.

4.2. The Northwest Frontier Province

Four factors shape the development challenge for the NWFP.

- **Distance from seaports:** The NWFP is situated far from Pakistan's seaports. This raises the cost of imported inputs and also makes exports more expensive.
- **A front-line state:** As a result of international politics, the recent history of the NWFP has been turbulent. An eleven-year war against the Russian occupation of Afghanistan and the succeeding civil hostilities both used the NWFP as the base. This created a large amount of uncertainty in the province regarding economic conditions, and also flooded the area with a large amount of unregulated weaponry.
- **A limited modern private sector:** Modern private enterprise in the NWFP is relatively weaker than in the other provinces of Pakistan. A World Bank study of the perceptions of businessmen indicated that Peshawar ranked lowest among the major cities of Pakistan for conducting business. The reasons cited included a greater uncertainty of policy in the NWFP, weaknesses in infrastructure, and institutional impediments that increased the cost of doing business in the province.
- **Weaknesses in human resources:** The NWFP's social outcomes are significantly worse than those for Pakistan as a whole. The overall literacy rate for population 10 years and older in 2001/02 was 38 percent in the NWFP compared with 45 percent in Pakistan as a whole (the female rate was 20 percent compared with 32 percent); pre-natal consultations were 32 percent compared with 41 percent; post-natal consultations 4 percent versus 9 percent; births assisted by trained birth attendants 13 percent compared with 18 percent; and 58 percent of households in the NWFP had access to clean drinking water compared with 85 percent for Pakistan overall.

An effective development strategy must address these weaknesses to the extent possible, either by eliminating the deficiency or by mitigating its impact. Thus, while not much can be done to move the NWFP closer to the sea, it should be possible to improve the efficiency of the transport and communications network so that the higher costs for the province are minimized. It should also be possible to develop the NWFP's potential for trade with countries such as Afghanistan and the Central Asian republics that are geographically closer.

4.2.1. The Challenge of Poverty

Along with Balochistan, the NWFP has remained the poorest province of Pakistan. The difficulties imposed by geography and international politics have been compounded by natural disasters, such as the earthquake of October 8, 2005. The first step towards improving the quality of life for the NWFP's citizens is to tackle the problem of poverty.

As with the other provinces, estimates of poverty for the NWFP have raised questions. The analysis in this paper uses the World Bank's calculations based on three rounds of the Household Income and Expenditure Survey during the 1990s and the Pakistan Integrated Household Survey for 1998/99 and 2001/02. The poverty estimates used in this paper are thus not official, but they are founded on a standard methodology and provide a consistent measure based on a poverty line held constant in real terms from the early 1990s to 2001/02.¹¹

Poverty trends in the larger provinces of Pakistan are shown in Table 1.

**Table 1: Provincial poverty trends
(using World Bank poverty line)**

Provinces	(Percent of population)											
	Urban				Rural				Overall			
	1990/ 91	1993/ 94	1998/ 99	2001/ 02	1990/ 91	1993/ 94	1998/ 99	2001/ 02	1990/ 91	1993/ 94	1998/ 99	2001/ 02
Punjab	29	18	27	27	39	32	35	37	36	28	32	34
Sindh	24	14	19	24	31	32	37	51	28	23	29	40
NWFP	37	27	31	35	41	40	47	48	40	38	44	46

Source: World Bank 2002, Annex.

On the basis of the Basic Needs poverty line, the poverty headcount for the NWFP increased between 1990/91 and 2001/02. Between these two years, the proportion of the population belonging to households below the poverty line increased from 40 percent to 46 percent.

¹¹ The unofficial Basic Needs poverty line developed by the World Bank amounts to Rs 680 and Rs 767 for rural and urban areas respectively per equivalent adult per month (at constant 1998/99 rupees).

Moreover, because of the increase in the population during this decade, the actual numbers of the poor increased very substantially.

What are the reasons for the NWFP's poverty? The main reason is the slow growth of the province's GDP compared with the growth of population. Thus, for example, between 1990/91 and 2004/05, the NWFP's real GDP is estimated to have increased at an annual rate about 4.5 percent; the population growth during this period averaged 2.8 percent a year, so per capita incomes increased by only about 1.5 percent annually.

However, three other factors contribute in substantial measure to the NWFP's poverty incidence. These factors were: conditions in the labor market; the ownership of assets; and the educational attainment of the head of household.

Conditions in the Labor Market: While it is important that the province's GDP grow rapidly, it is equally important that this growth generate employment, lead to increased productivity (so as to permit higher wages), and impact on sectors in which the poor are more likely to be employed. This has not occurred consistently in the NWFP.

First, in 2001/02, the unemployment rate of 13 percent of the labor force in the NWFP was the highest of any province of Pakistan. This means that the growth of the GDP was not commensurate with that required to absorb the additions to the labor force. The labor force also contained a substantial number of underemployed workers, which are defined in the Labor Force Survey as "employed, but available for more work and actively looking for more jobs." In 2001/02, the unemployed and underemployed together amounted to about 15 percent of the labor force.

Second, the bulk of employment in the NWFP is in sectors and enterprises that do not provide rapid increases in employment or high real wages. In 2001/02, employment was mainly concentrated in rural areas, or self-employed in family businesses. Paid employment and regular salaried employment was very scarce.

Third, average earnings in the NWFP for male workers (who accounted for about 93 percent of the employed) were lower than in the other provinces of Pakistan. The average earnings for male workers in the

NWFP were about Rs 40,000, compared with a Pakistan average of Rs 45,000. The Labor Force Survey also showed that in 2001/02, a worker in almost any job in the NWFP earned lower amounts than someone in the same job in the rest of Pakistan. Since earnings generally reflect productivity, an implication of this finding is that productivity in the NWFP in a given job is less than the national average.

Fourth, average real earnings in the NWFP declined by about 4 percent between 1993/94 and 2001/02. Thus the already low nominal earnings were further eroded by inflation. The decline in real earnings was more severe in the rural sector (where most jobs were concentrated) than in the urban.

Ownership of assets: Poverty in rural areas is closely associated with the lack of ownership of agricultural land. The incidence of poverty declined sharply for households owning between 1 and 4 ha of land, falling to almost zero for households with more than 4 ha. The close correlation between ownership of land and poverty is shown by the finding that individuals with no land constituted about 58 percent of the rural population, but they accounted for about 70 percent of the population in the poorest quintile.

Education of household head: Poverty in the NWFP is characterized by poor outcomes for education and health. There is a strong association between the educational level of household head and poverty incidence. Data from the PIHS for 2001/02 show that households whose head has never attended school constitute 62 percent of the population, but account for 71 percent of the lowest quintile; on the other hand, households whose head has been educated to the level of matriculation or above constitute 16 percent of the population, but only 11 percent of the poorest quintile.

4.2.2. *The Strategy*

A strategy to tackle poverty in the NWFP can take heart from the findings—for example, Heltberg and Narayan (2005)—that a large proportion of the province's population is clustered close to the poverty line, and that extreme poverty accounts for a relatively small share among the poor. Helberg and Narayan conclude that since most of the poor are close to the poverty line, it suggests that a large part of the measured poverty in the province is likely to be transitory. It also means

that even small exogenous shocks to the system can lead to large changes in the measured poverty rate. Thus, in the NWFP a substantial part of the population is vulnerable to falling into poverty as the result of such shocks, but also can be lifted above the poverty line if there is a sustained growth in the GDP.

The strategy should therefore begin by estimating the growth rate required to create the desired number of jobs.

Following the analytical framework developed earlier, one can use the long-term elasticity of employment with respect to real GDP growth to estimate how fast the provincial GDP will have to grow in order to generate the required number of jobs. World Bank (2005) estimates that this long-term elasticity is approximately 0.55. It estimates that the provincial labor force is currently growing at about 3.2 percent a year; this implies that the GDP should grow at about 6 percent annually in order to provide employment to all the additions to the labor force. However, the growth of GDP will obviously have to be higher in order to cut into the backlog of unemployment and to reduce the numbers of underemployed. A rough estimate of the required GDP growth would then be in the neighborhood of 6.5 percent a year.

World Bank (2005) also estimates the potential growth rate for the NWFP's GDP. It concludes that, *given the NWFP's existing institutional and technological base*, the potential rate of growth is around 4.5 percent a year; it is therefore insufficient to attain the government's objectives. The priority for the authorities thus is to strengthen institutions and to upgrade the technological base of the province.

What would be the drivers of this growth rate? Broadly speaking, the growth will have to be underpinned by more efficient use of resources in the existing drivers, such as agriculture, and a structural change in the GDP toward sectors that have the potential for more rapid growth.

Agriculture will continue to play a central part in the strategy to accelerate growth and reduce poverty, because of the sector's potential and because most of the poor live in rural areas. However, within agriculture structural change will be necessary so that the province can deploy its scarcest resource, irrigated land, in uses that provide the highest returns. Basically, this means that thinking about agriculture must move away from emphasizing self-sufficiency in cereals towards a broader understanding

of food security. Concretely, this means that the province's agriculture should encourage farmers to move towards high-value activities, such as livestock and horticulture. The additional returns generated thereby can then be used to purchase cereals and other commodities in the production of which the NWFP does not possess a comparative advantage. This does not, of course, mean that the NWFP must give up the production of cereals; indeed, it cannot—these crops presently account for about three-quarters of land use. It simply means that the authorities must increasingly recognize that the most efficient use of the province's limited fiscal resources for assisting the development of the agricultural sector and prosecuting the war on poverty would be in support of the movement towards high-value products.

Such structural change could have a very considerable impact on rural poverty in the NWFP. Between 1998/99 and 2001/02, average daily wages in the agricultural sector fell from Rs 126 to Rs 80 (in 2001/02 prices). According to the World Bank (2005), farmers indicated that converting from cereals to horticulture provided *five* times the income per hectare. Horticulture also required up to five times the labor input of cereals; the move would therefore provide many more opportunities for landless laborers and under-employed farm households.

In addition to horticulture, a revised agricultural strategy will seek to expand the livestock sector (principally cattle, goats, and poultry). According to official statistics, the contribution of the sector to provincial GDP is greater than that of crops. This contribution is likely to grow quite rapidly, as increasing urbanization in the province has expanded the demand for meat and dairy products.

The NWFP is home to about 40 percent of Pakistan's forests (of which three-quarters are in the Northern Mountains) and about 2.1 million ha of range lands. Both these sources of high-value products. However, poor land-use rights and weak institutional arrangements have held back the optimal utilization of these assets, particularly in mountain areas.

In order to assist the move towards high-value products, the authorities will have to take a number of steps. The most important of these will be:

- Strengthening the infrastructure, particularly transport and cold storage facilities, in order to reduce the post-harvest losses of high-value products;

- Creating a research system for best-practice research into commodities and activities (such as rearing sheep for high-quality wool in the high mountain areas and goats suitable for the southern districts of the province; improving fodder production; and enhancing natural resource management, especially of forests and range lands);
- Improving linkages between agricultural research, extension and farmers;
- Increasing the capacity of small farmers by the development of farmer organizations.

As was discussed earlier, the manufacturing sector in the NWFP labors under the handicap of distance from the seaports. The result, of course, is higher costs of imported inputs and for exports. A strategy to develop this sector must emphasize three factors.

First, it must develop manufactures based on materials that are indigenous to the province. These would include gemstones, marble, granite, and construction materials, the latter especially for Afghanistan's reconstruction. While activities based on these materials offer considerable possibilities, they will not occur without intervention by the government. For example, an analysis by the World Bank of the value chain for marble showed that the government would have to clarify ownership rights (not least in order to improve access to finance), facilitate the private sector's adopting better technology for extracting marble (at present much of the marble is extracted simply by blasting, which both destroys a considerable part of the mineral and also results in non-standard blocks, which reduces their price), and provide training for workers in finishing and polishing the stone.

Second, the NWFP's comparative advantage in producing hydel electricity suggests that industries based on an intensive use of this input could prove competitive. This is discussed in a little more detail below.

Third, the NWFP should energetically explore the possibilities of export to the Central Asian republics and to Afghanistan (as the situation in the latter country stabilizes). Focusing on markets that are physically closer will reduce some of the province's disadvantage of distance from seaports. This means that the NWFP must engage more actively in obtaining market information from these destinations.

An activity related in some measure to manufacturing is the construction industry. The authorities should pay particular attention to this both because it generates a considerable amount of employment, and because of its vertical and horizontal links with other industries, such as cement, glass, brick-making, wood- and metal-working, furniture, plumbing, electricity, and so on. Studies of this activity show that the government must concentrate on policies to regulate quality, safety, and protection of casual labor. Moreover, since an important part of the demand for the NWFP's construction industry is provincial government contracts, the authorities must take measures—such as transparency in bidding, proper registration of firms, and standard sets of contracts—to ensure a level playing field.

An area that offers major possibilities is the generation of hydel power. The NWFP's potential is a large multiple of the 4000 MW that it currently generates.¹² Moreover, the electricity generated in the province is sold to WAPDA which then sells it to consumers, including those in the NWFP, at a higher price. It has been proposed that the province should set up electricity stations that, while covering their costs, could sell power to users within the NWFP at a lower price than that provided by WAPDA for the national grid. A number of private sector representatives in the NWFP have argued that this reduction in the cost of a major input could go a long way towards making the province's industries more competitive by offsetting the higher transport prices paid by NWFP industry for the shipment of inputs from the seaports. Of course, given the size of the province's potential in hydel generation, it would appear possible to pursue both options—selling large amounts of electricity to the national grid at WAPDA's price and smaller amounts at a lower price within the province—simultaneously. This would help the provincial budget as well as stimulate the province's industrial sector.

In the longer run, another important source of growth could be tourism. The NWFP is richly endowed with artifacts for cultural and historical tourism; these include ancient Buddhist monasteries, Gandhara sculptures, and a range of museums. The province also is replete with scenic sites, such as high mountain ranges, Alpine valleys, and rivers and streams. The development of the tourism sector requires investment

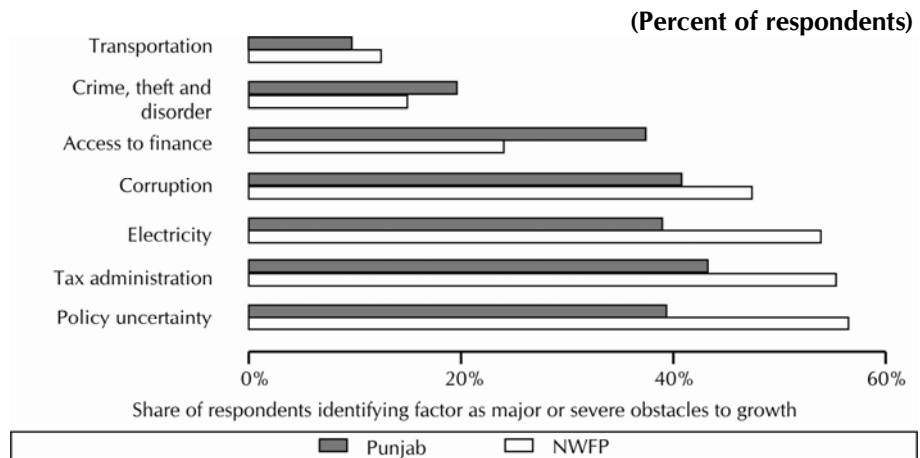
¹² The Sarhad Hydel Development Organization (SHYDO) has identified hydel potential of more than 6,500 MW and has completed feasibility studies of several hydel projects ranging from 8 MW to 125 MW.

in roads and other infrastructure to make the region more accessible, and a stabilization of the security situation so that the private sector has an incentive to invest in hotels and tourists, particularly international tourists, are encouraged to visit the region.

The bulk of jobs will have to be provided in the private sector. Therefore, improving the environment for this sector is an overarching issue in the strategy for the development of the NWFP. One way of identifying areas in which the NWFP authorities should act is by comparing the NWFP with the other provinces of Pakistan, particularly those that are performing better.

A study of the investment climate in Pakistan by the World Bank highlighted a number of areas in which the NWFP lagged behind the Punjab. These included the security situation, higher administrative barriers (particularly relating to tax administration), transport, and corruption. The findings are displayed in Figure 17, and underline the perception among investors that the NWFP has some distance to go in order to become a major magnet for private investment.

Figure 17: Obstacles to growth in NWFP compared with the Punjab 2004

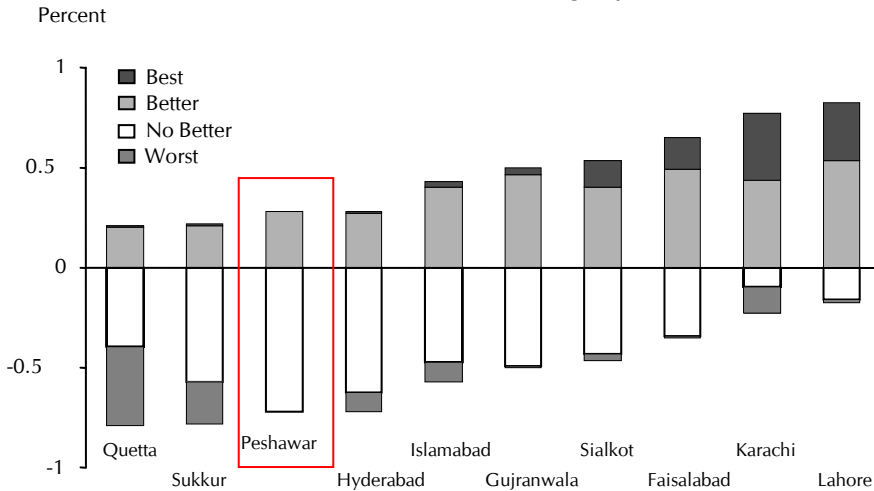


Source: World Bank et al. (2005b)

These findings are reinforced by the perception among investors that Peshawar is one of the least attractive cities to invest in, as ranked by firms outside Peshawar (See Figure 18). Additional investigations

showed that businessmen viewed questions of governance in the NWFP as being particularly inimical to private enterprise. This view was reinforced by a number of indicators; for example, the cost of enforcing a contract and the cost of creating a collateral agreement were both higher in Peshawar than in Karachi or in the main commercial cities of the Punjab (Lahore, Faisalabad, and Sialkot).

**Figure 18: Perceptions of the Investment Climate
2004
(Rankings by Firms Outside the City)**



Source: World Bank et al. (2005b)

4.3. The Punjab

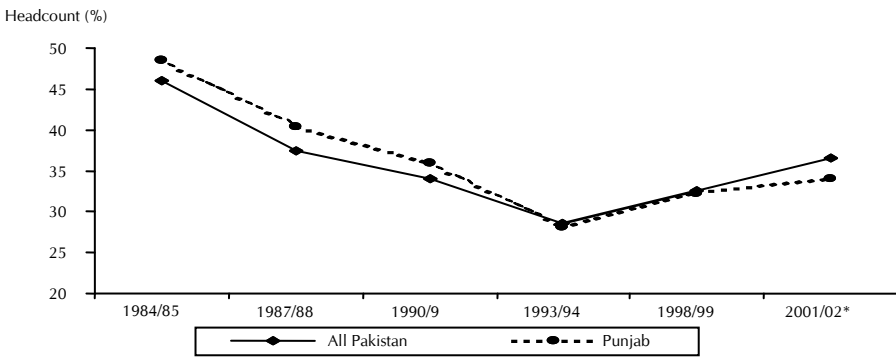
The Punjab accounts for more than half the population of Pakistan; therefore, the success of policies to increase incomes and well-being in this province is of enormous importance to the country.

The Government of the Punjab has been quite explicit about the main elements of its economic strategy. The strategy rests on five pillars: (i) enhancing governance; (ii) strengthening the fiscal position; (iii) improving the business environment in order to encourage private sector-led growth; (iv) upgrading the delivery of key public services; and (v) insulating the provincial economy from undue vulnerability to external shocks. The combination of these elements is intended to produce a package that would lead to a better life for the province's citizens.

There can be little dispute about the importance of the foregoing elements which, as a whole, are intended to increase incomes and improve service delivery. The issue is to put the components within a coherent structure and to identify measures to operationalize the strategy. The present section suggests a framework for reflecting on these matters.

In order to address the first of these issues, namely, the required increases in income, it may be useful to begin with a brief review of the evolution and structure of poverty in the Punjab. During the 1980s and early 1990s, poverty declined but after about 1993/94, it increased until 2001/02. The latter period was marked by deteriorating macroeconomic conditions in Pakistan and a slowdown in economic growth. These trends are presented in Figure 19, which shows the poverty headcount ratio. In recent years, GDP growth has picked up and poverty in the Punjab is likely to have been reduced.

**Figure 19: Poverty trends, Pakistan and the Punjab
1984/85–2001/02**



Source: World Bank et al. (2005a)

Table 2 shows poverty trends in more detail. In general, trends in the Punjab are similar to those in the country as a whole; however, at the beginning of the new millennium, poverty in the Punjab increased at a smaller rate than that of all-Pakistan. It will also be seen from table that poverty is much higher in rural Punjab than in urban. Moreover, data from the 2001/02 PIHS showed that the very poorest tended to reside in rural areas—8 out of 10 persons in the poorest 10 percent of the income distribution lived in rural areas.

**Table 2: Poverty trends, Pakistan and the Punjab
1983/84–2001/02.**

	(Percent of population)					
	1983/84	1987/88	1990/91	1993/94	1998/99	2001/02
All-Pakistan	46.0	37.4	34.0	28.6	32.6	37.3
Punjab	48.5	40.4	35.9	28.2	32.4	34.1
Rural: All-Pakistan	49.3	40.2	36.9	33.4	35.9	41.6
Punjab	50.5	42.1	38.5	31.9	34.7	37.0
Urban: All-Pakistan	38.2	30.7	28.0	17.2	24.2	26.4
Punjab	43.6	35.6	29.4	18.4	26.5	27.0

Source: World Bank et al. (2005a)

A considerable number of persons are vulnerable to falling into poverty—nearly three-fourths of the Punjab’s population lives on incomes that are less than 150 percent of the poverty line and 63 percent live on less than 125 percent of the poverty line. Relatively small shocks to the Punjab’s economy could thus substantially increase the numbers of the poor.

The labor force of the Punjab in 2005 is estimated at about 30 million, of which about 70 percent is located in rural areas. The labor force has increased steadily over the years, and there are some indications that the growth may be accelerating. This is not surprising, as it reflects increasing levels of education and urbanization; these factors usually lead to higher participation rates, especially by women. It is estimated that between 1984/85 and 1993/94 the labor force grew at a rate of about 2.4 percent annually, and between 1993/94 and 2001/02 it grew at a faster rate of 2.7 percent a year. For the next decade, World Bank et al (2005a) assume a rate of 3 percent a year. Moreover, open unemployment as measured by the Labor Force Survey was estimated at about 8.5 percent in 2001/02; this was equivalent to about 2.3 million persons. If the Punjab aims to provide full employment (defined as incorporating 5 percent unemployment for frictional and structural reasons, as is common in many countries), then it is estimated that 10 million additional employment opportunities (about one million per year) will have to be created during the next decade. On the present employment base, this means that the economy must generate 3.4 percent additional jobs (including self-employment) a year. This poses a considerable challenge; but, if these jobs can be provided, the faster growth of the labor force will help push up the potential growth rate of the province’s GDP.

Since incomes in a modern economy for the most part are provided by employment, it is necessary for the Punjab to increase the demand for labor by increasing the growth of the GDP. What growth rate of the GDP should the Punjab aim for? During the decade 1993–2002, the elasticity of employment with respect to GDP growth was 0.55—a growth of 10 percent in the GDP produced an increase of 5.5 percent in employment. Thus in order to produce the required employment growth of 3.4 percent, the Punjab's GDP needs to grow by about 6.2 percent a year.

On what can the Punjab base this growth? One must begin with the prospects for the largest single sector in the economy. Agriculture contributes about 27 percent of the provincial GDP and employs around 40 percent of the total labor force. However, the existing structure of the agricultural sector was not conducive to increasing employment in the last decade—according to the Labor Force Surveys, employment in the Punjab's agriculture in 1993/94 was 10.5 million workers, while in 2001/02 it was 10.6 million workers. On the other hand, through appropriate structural changes, it is possible to increase both value-added in agriculture as well as employment. A recent study—Ali and Abedullah (2002)—reports that the experience of several South and East Asian countries has demonstrated that converting 1 ha of rice to vegetable cultivation for one season generates one year-round job. This suggests that diversifying the structure of agriculture in the direction of higher value and more labor-intensive activities (rice is not the only possibility, fruits and vegetables, for example, offer much the same opportunities) can both lift the growth rate of agriculture in Punjab and create more jobs.

Raising the growth rate in agriculture requires a combination of physical investment and institutional improvements. Since the availability of water is an important constraint, the Punjab growth in agriculture will require increased public investment on irrigation and water management.¹³ Since the province's budget is limited, the authorities must create fiscal space by more carefully targeting areas for public investment, and allowing the private sector to finance some activities that the government presently undertakes. Under this rubric, it is desirable that commercial activities, for example, livestock breeding farms and veterinary services, be privatized. Similarly, cost recovery must be improved, especially where costs for canal maintenance are concerned.

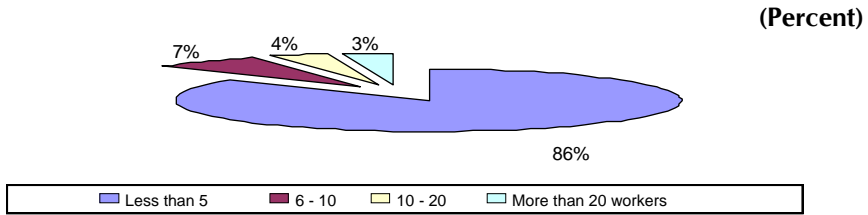
¹³ It is a source of concern that the productivity of water used in agriculture has declined during the past three decades; see Ali and Byerlee (2000).

The production of high-value crops will be encouraged if the government facilitates the marketing of such products. In this context, significant reforms to wholesale markets will be necessary. World Bank (2005a) comments that: "Market infrastructure tends to be biased towards major crops rather than livestock, fruits, vegetables, and other such high-value crops, the market information system is poorly developed, and the administrative structure to regulate output markets is highly bureaucratic and lacks effective private sector participation." The report goes on to recommend a number of concrete actions that the provincial authorities should take in order to modernize wholesale markets. These include improving the market information system by revamping the district-level market information system; developing in collaboration with the private sector critical infrastructure such as refrigerator bogies, cold storage facilities at major airports, and laboratories for food safety testing; and establishing minimum grades and standards for all agricultural raw and processed products for domestic and export markets.

Other institutional improvements that will be vital are improvements in the functioning of land and water markets, and encouragement of research and innovation in agriculture. Perhaps the most important institutional strengthening that is required is the creation of an effective land recording system. Such measures would clarify property rights and promote the smooth transfer of titles. Land taxes could be based on the size of holdings and calibrated to reflect the productivity potential of the land. The combination of clearly defined property rights and this type of taxation would discourage large landowners from holding on to underutilized land.

The next area to which the Punjab authorities must devote attention is the non-farm sector. This includes manufacturing, construction, wholesale and retail trade, transport, and other services. In 2004/05, the combined contribution of these sub-sectors accounted for well over two-thirds of the total provincial GDP. These areas are largely in the private sector and are also very important for providing employment—almost 90 percent of the Punjab's labor force is employed in the private sector. Within the private sector, the overwhelming amount (86 percent) of jobs is in units that employ less than 10 employees; such firms are normally defined as "informal." Figure 20 shows the distribution of private sector employment by size of firm.

**Figure 20: Share of private sector employment by size of firm
2003/04**



Source: World Bank et al. (2005a)

It is important that the authorities provide supporting policies for the small and medium enterprises (SMEs), because it is on the performance of these enterprises that the well-being of the majority of the population depends. Moreover, these enterprises are important generators of employment—the elasticity of employment with respect to output in this sector is estimated at 0.85 (a 10 percent increase in output will produce an 8.5 percent increase in employment).

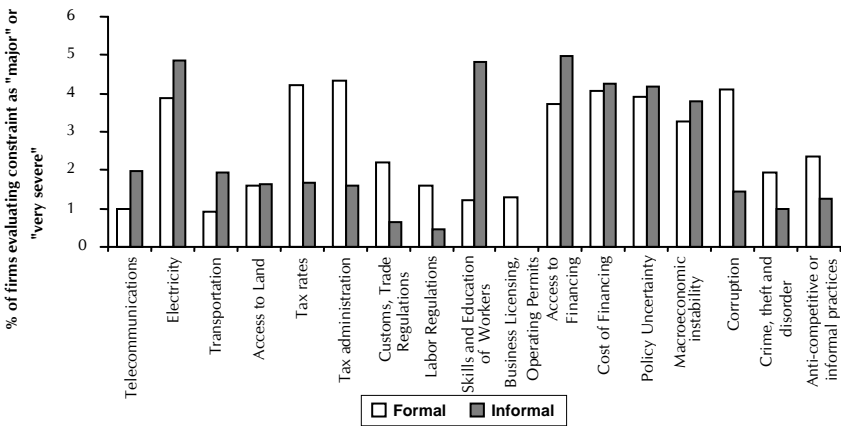
The performance of these enterprises is constrained by access to finance; access to electricity, and the availability of skilled workers. Surveys by the Asian Development Bank—reported in Bari and Cheema (2003)—show that only about 6 percent of fixed investment by SMEs is financed by development finance institutions and commercial banks. The SMEs tend to rely on self-financing to begin operations and continue them through retained earnings. Large enterprises, on the other hand, draw on commercial banks for both working capital and fixed investment.

The problems of access to commercial bank financing arise from the banks' cumbersome procedures and their requirements for collateral. The latter, according to the Small and Medium Enterprises Development Authority (SMEDA), is that often the banks and other financial institutions stipulated levels of collateral that even exceeded those mandated by the State Bank. SMEDA reported that the financial institutions frequently required collaterals from SMEs that reached 120–130 percent of the requested loan.

The reasons for banks' reluctance to lend to SMEs was discussed earlier. However, given the importance of such enterprises in providing jobs and generating incomes, it is essential that the provincial authorities examine ways of dealing with this problem, and can draw upon the experience of other developing countries that have coped with these difficulties more successfully.

A comparison of investment obstacles faced by formal and informal firms is displayed in Figure 21. The figure summarizes some of the findings from a survey conducted by the World Bank and SMEDA. The broad finding is that physical constraints (such as access to telecommunications, transportation, and electricity) appear to be systematically greater obstacles for the informal sector, but areas (such as customs and trade regulations, tax administration, labor regulations) in which the sector can function “under the radar” pose smaller problems for it than they do for firms in the formal sector.

Figure 21: Investment obstacles in the Punjab: formal vs. informal firms



Source: World Bank et al. (2005a)

Electricity-related problems were a major obstacle to investment facing both formal and informal firms. However, they affected nearly 50 percent of informal firms, compared with 39 percent of formal enterprises.

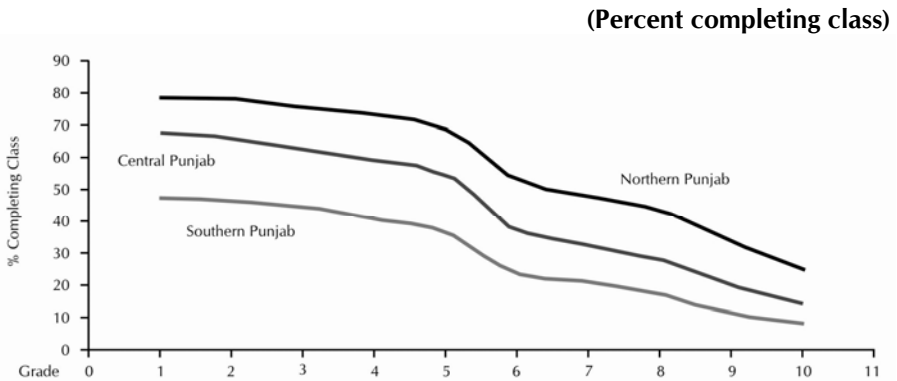
Informal firms reported difficulties in increasing their productivity because of the inability to attract skilled and educated workers. This is not surprising—skilled workers are in short supply in the Punjab, and would therefore be able to choose to work largely in the formal sector, where wages are higher and employment tends to be more stable.

Looking at the problems of the private sector as a whole, apart from the constraints already mentioned, the most important of the other restrictions serving to hold back investment and growth fall under the rubric of “governance.” The principal of these derive from poorly enforceable property rights and a judicial system that is perceived to work slowly, often unfairly, and to be costly. This raises the cost of

doing business, and makes markets inefficient, because difficulties in contract enforcement encourage businessmen (especially in small enterprises) to confine their dealings to a very narrow circle of actors whom they trust. Another area of governance that causes particular difficulties is taxation. Businesses have complained about the level and unpredictability of implementation of the different taxes. They have also complained about provincial and local government tax structures that effectively tax the same base multiple times and raise the cost of production.¹⁴ A rationalization of these tax structures should be a priority for the provincial authorities.

An effective development strategy for the Punjab must recognize that the province is not a monolith, but contains important regional differences. Living standards differ quite significantly between regions. Incomes, poverty, and social indicators are better in the North, less so in Central Punjab, and worst in South Punjab. This follows the pattern of urbanization and industrialization, which decreases from north to south. Data from the 2001/02 PIHS for education indicators and the poverty headcount rate in the different regions of the Punjab are shown in Figure 22 and in Table 3.

Figure 22: Punjab: Highest class completed by region, 15-19 year olds 2001/02



Source: World Bank et al. (2005a)

¹⁴ World Bank (2005a) gives a number of examples.

**Table 3: Punjab: Poverty headcount rate by region
1998/99–2001/02**

Punjab Regions	(Percent of population)					
	1998/99			2001/02		
	Urban	Rural	Overall	Urban	Rural	Overall
Northern Punjab	18.3	29.6	26.2	20.1	33.8	29.8
Central Punjab	25.2	32.1	29.9	24.6	33.8	31.8
Southern Punjab	36.1	40.6	39.7	38.7	35.3	40.4
All-Punjab	26.9	34.7	32.4	27.4	40.8	34.1

Source: World Bank et al. (2005a)

As far as improved service delivery is concerned, the process of devolution has placed local government *nazimeen* as the focal point regarding many key economic and social services. Devolution by itself will not improve the delivery of public services; it merely provides a mechanism which, if properly used, can improve matters by holding local government officials accountable for outcomes.

A satisfactory outcome will require that the locally elected officials and the public both have better information. The officials need to know what are their powers, their capacities (especially financial), and their responsibilities, while the public needs to know its entitlements and whom it should hold accountable for delivering these rights. Better service delivery will also require information to monitor the initiatives introduced by elected officials, and a careful evaluation of their results.

This raises questions of the capacity of the policymakers and the public to perform these functions. Moreover, as World Bank (2005a) points out, it is especially important that policymakers have the power to make service providers perform their duties properly. This will require fresh ideas—continuing high rates of absenteeism of teachers and doctors in public institutions, for example, testify that it will not happen without effort.

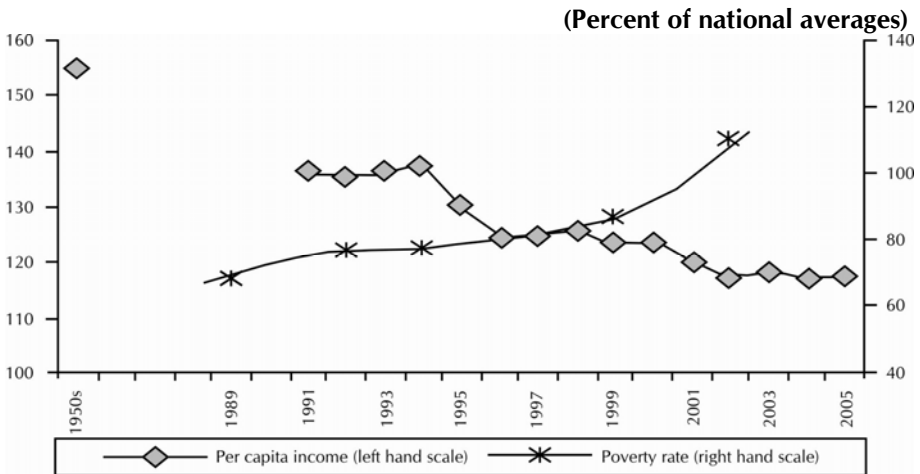
One method of tackling this problem that has been tried in the Punjab is for a number of district governments to enter into tripartite contract arrangements with NGOs to directly manage government primary schools in partnership with School Councils. This setup separates the role of policy maker from that of provider of service, and encourages the former to look for poor performance by the latter in order to correct it. It also provides the policymaker with the ability to withhold payment under the contract if performance is not satisfactory. The authorities

should examine the effectiveness of such arrangements, as well as initiatives that neighboring countries have adopted to address similar problems, in order to ascertain the most effective way to proceed.

4.4. Sindh

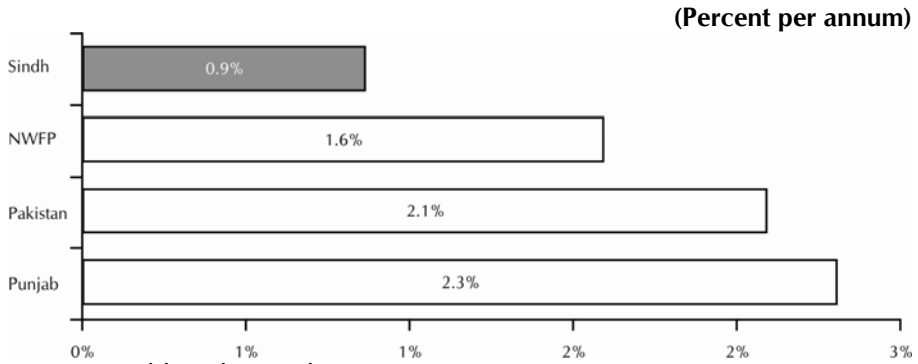
At the time of Pakistan's gaining its independence, Sindh was estimated to have had a per capita income that was perhaps 40 percent higher than the Punjab and 55 percent higher than the rest of the country. After the partition, with Karachi as the only seaport in the country, Sindh acted as a magnet for import-based and export industries. The economy of Sindh consequently grew rapidly. However, starting from the early 1970s, the economic performance of Sindh began to falter and this trend has continued well into the 2000s. In 1991/92, Sindh is estimated to have a per capita income that was one-third higher than the rest of the country; the difference fell to 16 percent by 2004/05. Concomitantly, poverty increased faster in Sindh than in the rest of the country. From 1994/95 to 2004/05, while per capita incomes in the Punjab and the NWFP grew at 1.6 and 2.3 percent respectively, that of Sindh grew only by 0.9 percent. See Figures 23 and 24.

Figure 23: Sindh: Per capita income and poverty ratio 1950–2005



Source: World Bank (2007b)

**Figure 24: Growth rates of provincial per capita incomes
1994/95–2004/05**



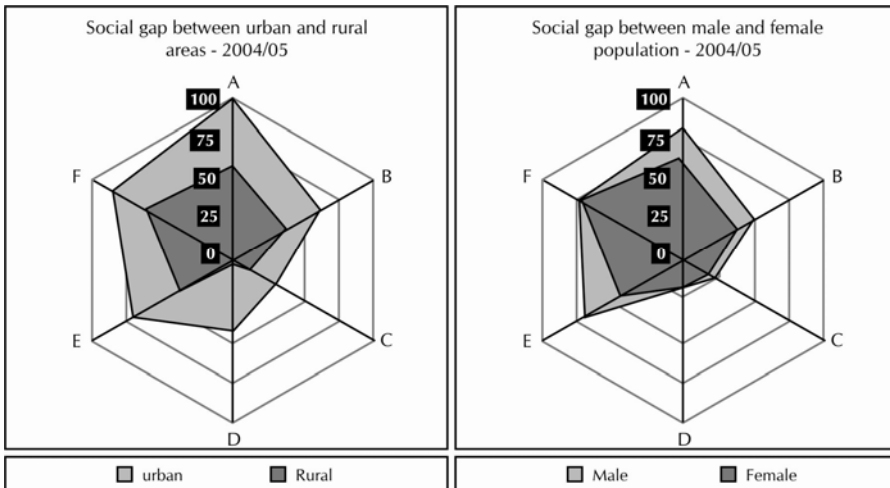
The earlier performance clearly demonstrates the enormous potential that Sindh possesses. The central issue facing the province on the economic side is how to perform once again to this potential and to deal with the question of poverty. The answer, not surprisingly, turns out to depend upon accelerating the rate of growth of the province's GDP and improving the delivery of key services, such as education and health. However, the particular constraints and the drivers of growth will to some extent differ from those affecting other provinces.

It has been argued in an earlier section of this paper that provinces should not be regarded as monoliths and that attention should be paid to the regional diversity within each province. Sindh, in particular, exhibits a strong duality. About half the population lives in rural areas where more than 70 percent of them depend upon agriculture, livestock, forestry, and fishing for their livelihood. There is practically no organized manufacturing or services sectors in these areas. The other half of the population, or about 18.3 million people, lives in the urban areas; of this number, about 12 million live in Karachi. This part of the population is heavily employed in the manufacturing and services sectors. According to the Labor Force Survey for 2003/04, nearly 32 and 66 percent of the urban labor force was employed in the industry and services sectors, compared with only nine and 21 percent of the rural labor force, respectively. The result of these structural differences is that mean per capita consumption in rural Sindh is only about half that in urban Sindh.

Indeed, World Bank (2007b) has argued that the urban-rural gap in Sindh is worse than the gender gap, even though the latter occupies much more

of the attention of policymakers. The report goes on to say: "With 99 percent gross primary enrollment, a 72 percent literacy rate, and 87 percent of babies fully immunized, urban Sindh's social indicators equal or surpass the level of development in other developing countries with comparable per capita income. On the other hand, with 58 percent gross enrollment at the primary level, a 38 percent literacy rate, and 62 percent of babies fully immunized, the level of human development in rural Sindh is worse than that in some of the Sub-Saharan African countries." The social gap between rural and urban residents is compared with that between males and females in Figure 25. For each of the variables, the rural-urban gap is larger than the gender gap.

Figure 25: Social gap between rural and urban Sindh, and between males and females, 2004/05.



Note: A-Gross Primary Level Enrollment Rate; B-Net Primary Level Enrollment Rate; C-Matric Level Enrollment Rate (Percent); D-Gross Primary Level Enrollment Rate (Private Schools); E-Literacy-Population 10 Years and Older; F-Fully Immunized.

Source: World Bank (2007b)

Moreover, the weight of Karachi is so overwhelming that it can seriously distort any analysis of the economic performance of Sindh as a whole. Therefore, while space and the availability of data do not permit a separate discussion of Karachi in this paper, to the extent possible the problems of Karachi will be highlighted in the context of the development of urban Sindh.

A further comment is necessary. As a result of the rapid growth of Karachi in the past, it attracted waves of immigration from other parts of Sindh and from the poorer provinces of Pakistan. This has put tremendous pressure on the physical and social infrastructure of the city. The concern is that renewed growth would again lead to a massive influx of population from outside Karachi. This, of course, does not mean that the growth of Karachi should not be accelerated. Rather, it means (a) that one must pay attention to a balanced development of all the provinces of Pakistan; and (b) that Sindh, in particular, should develop a comprehensive plan for the urban areas in the province, so that the other urban centers—Hyderabad, Sukkur, Larkana, Nawabshah, Rohri, Kotri, etc—are also developed as alternative growth poles. Such a policy should help to reduce the "push" factor from at least the other parts of Sindh and lessen the pressure on Karachi.

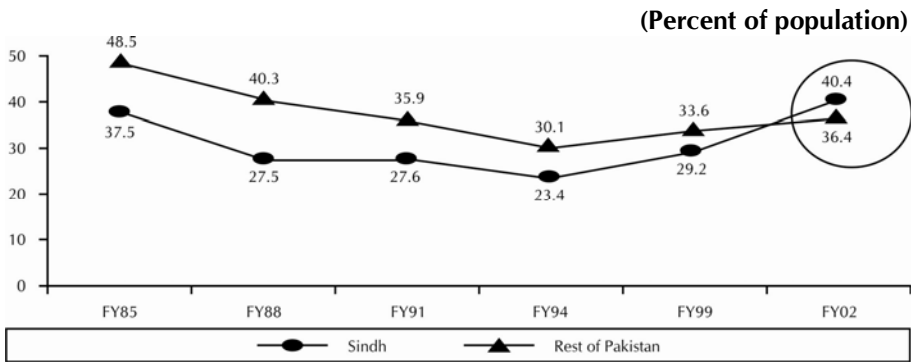
The first point to consider is the likely expansion in Sindh's labor force in the coming years. Four factors will shape the outcome. First, the size and age structure of the province's population suggest that about 380,000 persons will enter the labor force annually during the next decade. Second, the rise in the literacy rate and the increasing enrollment in primary and secondary schools is expected to add another 160,000 potential workers. Third, migration from other provinces could add as much as 50,000 persons a year to Sindh's labor force. Fourth, social changes are likely to increase the participation rate, especially of women, thereby adding more job seekers. In short, while over the long-term the province has on average created about 350,000 jobs annually (although job creation has touched about 500,000 in years in which the province's economy expanded rapidly), during the coming decade it will be expected to generate 600,000-plus jobs a year. World Bank (2007b) estimates that if current economic trends continue, then there could be an annual addition of nearly 100,000–250,000 to the pool of the unemployed every year. Such a situation could have very damaging social consequences.

On the basis of the past relationship between output growth and employment creation, it is likely that the GDP growth rate required to create 600,000 jobs a year will be closer to 7 percent a year in real terms than to six.

Such a rate of growth will also be required to deal with the problem of poverty. In 2001/02, nearly 40 percent of Sindh's population was

estimated to be below the poverty line.¹⁵ Movements in the poverty headcount ratio between 1984/85 and 2001/02 for Sindh and Pakistan are shown in Figure 26. The broad movement in Sindh's poverty track that of Pakistan's; however, after 1994/95 poverty in Sindh increased more sharply than that in Pakistan as a whole, and in 2001/02 to was estimated to be significantly higher. It is expected that the poverty rate, both in Pakistan and in Sindh, has declined in recent years because of the more rapid growth of both economies.

Figure 26: Sindh and Pakistan: Poverty headcount ratio 1984/85–2001/02.



Source: World Bank (2007b)

4.4.1. Developing urban Sindh

"Sindh needs to grow not in parts, but as a whole," commented the World Bank (2007b). It is not too much to say that Sindh has relied excessively on Karachi to act as its engine of growth. As a result, the potential of other urban centers has been stifled, and no dynamic second-tier city has developed. However, it appears that a strategy of relying almost exclusively on Karachi has gone as far as it can. In the future, Sindh will have to follow policies that maintain the dynamism of Karachi, but also develop additional growth poles that take some of the pressure off Karachi's infrastructure, and take advantage of Sindh's other assets that are located near these new urban centers. This will require the authorities to adopt a more comprehensive urban strategy that addresses issues

¹⁵ There is some dispute about this figure, because of questions pertaining to small sample size and high standard deviations in measurement of income and consumption. The SPDC (2004), using techniques more applicable to small area estimations, put the poverty incidence at 31 percent in 2001/02.

specific to each other major cities. While all cities in Sindh (including Karachi) face a number of common problems, such as an often unreliable and expensive electricity supply, there are a number of city-specific problems that discourage investment. Thus, a survey by the World Bank showed that in Karachi entrepreneurs felt most discouraged by the high price of land and problems with electricity; however, businessmen in Hyderabad and Sukkur did not regard access to land as a problem, but were most concerned with the unavailability of skilled labor. Again, entrepreneurs in the interior of Sindh regarded the law and order problem as the biggest impediment to their doing business.

The need to encourage private investment in the province means that the authorities must move vigorously to improve Sindh's investment climate. The World Bank (2007b) reports that between 2001 and 2004, there has been a significant change in the nature of the problems that businessmen described as being most hostile to the business environment. In the earlier year, the most serious constraints related primarily to those for which the central government had responsibility; these included tax administration, tax rates, cost of and access to finance, and electricity. In 2004, the major problems came under the remit of the provincial government; these included corruption, utility hookups, law and order, and uncertainty regarding the application of regulatory policies. Thus the ball is now squarely in the provincial government's court.

The major challenges to Sindh's investment climate can be grouped under four headings: (i) access to and workings of factor markets, especially land; (ii) governance issues, especially corruption, law and order, contract enforcement and the performance of the judicial system; (iii) infrastructure, particularly electricity and water supply; and (iv) policy uncertainty.

The distortions characterizing land markets are well known. They include unclear property rights; inflexible and apparently arbitrary zoning laws; fragmentation of land ownership among public sector bodies—nine such bodies own more than 90 percent of Karachi's land, and there is very poor coordination between them; high taxes on property-related transactions; and legislation that is heavily tilted in favor of tenants and against owners.

An efficient and inexpensive determination of a clear set of rights governing property is fundamental to any market economy. Enforcing contracts in Sindh, including Karachi, is both expensive and time-

consuming. These are important weaknesses, because the concept of a free, private-sector-led, market economy is based on the premise of enforceable rights and contracts that are rapidly and efficiently executed.¹⁶ Sindh is also the most litigious province in Pakistan. At the end of 2003, there were more than 2647 pending cases per million population in the Sindh high court, compared with 738, 429, and 377 in the Punjab, the NWFP, and Balochistan respectively. The nearly 88,000 cases pending before 15 judges in the Sindh High Court accounted for 48 percent of all pending high court cases in the country. The situation is getting worse—Sindh is the only province in which the number of new high court cases exceeds the number of cases disposed of.

4.4.2. Accelerating growth in rural Sindh

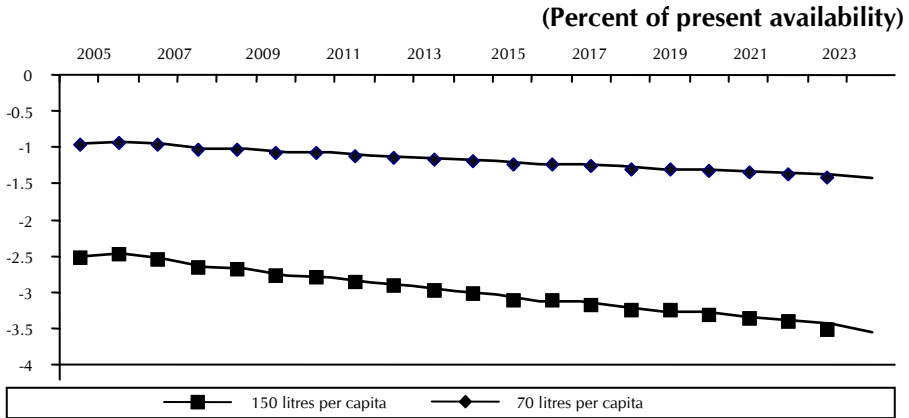
The wide gap in living standards and social outcomes between urban and rural Sindh was pointed out earlier in this paper. The biggest threat in rural Sindh to even the existing standard of living and the biggest challenge to raising it is the deteriorating water situation.

Sindh is an arid region that receives sparse and irregular rainfall. To make matters worse, its groundwater is largely saline and the province is therefore exceptionally dependent upon supply of water from the Indus and its tributaries via the canal irrigation system. From 1996/97 to 2001/02, annual rainfall in Sindh was between 35 and 80 percent lower than the long-term average. Since the drought had affected much of the rest of Pakistan as well, the supply of canal water also decreased; in most years from 1992, canal withdrawals in Sindh were below their long-term average—withdrawals in 2000 were 28 percent below the average.

The situation is likely to deteriorate even further. Population growth is projected to turn the province's water balance from a small surplus to a sustained deficit. (See Figure 27). Rapid industrialization will intensify the problem. The World Bank (2007b) estimates that if Sindh were to achieve the level of Indonesia's industrialization, the water deficit would be twice the 2004 level. It is clear, therefore, that future growth in Sindh's agricultural sector will have to emphasize water-efficient activities.

¹⁶ As Thomas Hobbes put it in *Leviathan* (1651): He that performeth first has no assurance that the other will perform after, because the bonds of words are too weak to bridle men's ambitions, avarice, anger, and other passions without the fear of some coercive power."

Figure 27: Projected shortfall from present availability at different levels of requirements



Source: World Bank (2007b)

A strategy for developing Sindh's rural areas will have to incorporate five elements. First, it must improve the productivity of water. This will involve adopting more effective water management practices, relating water fees to actual consumption levels (this should help shift the cropping pattern in the direction of more water-efficient products), and setting *abiana* rates at levels that cover operation and maintenance costs. Second, the strategy must encourage a movement *within* the crop sector in the direction of high-value added crops. Such a move will be facilitated by eliminating some of the existing distortions relating to prices, subsidies, and regulations (the economics of sugarcane versus cotton must be revisited). The idea is that the cropping pattern should, as far as possible, be determined by the market rather than the government. Third, developing the rural areas will also require a move away from the crop sector towards high-value non-farm activities, such as livestock and fisheries. While the investment in such productive facilities is expected largely to come from the private sector, the government can help by improving the infrastructure and facilitating the transfer of techniques and technology. Fourth, the authorities will also have to pay attention to problems that the agricultural sector faces that are not related to water. An important obstacle to the growth of the rural areas is that Sindh's agriculture is not properly integrated with the transport and storage sectors (in 2004, nearly 20 percent of communities in rural Sindh lacked basic motorable access and 63 percent of communities lacked paved access), nor does it provide a broad base for the development of agro-industry. Fifth, the marketing system must be strengthened, and the

sector linked more closely with retail trade activities in Karachi and the rest of the province.

5. Conclusion

This paper has tried to provide a framework for thinking about the development of Pakistan's provinces. The importance of examining the differential growth of provinces can hardly be exaggerated—a main reason for the breakup of Pakistan in 1971 was the issue of income disparity between West and East Pakistan. The official estimate of per capita incomes in East Pakistan as being only 25 percent lower than in West Pakistan carried little credibility.¹⁷ No more believable were many of the reasons on which the central government's resource allocation between East and West Pakistan was based. Military expenditure was excluded from the calculation because, it was said, the defense of the country was “indivisible”—an attack on East Pakistan would prompt a response from West. The events of 1971 show just how hollow was this premise. Investment in the Indus Basin works was kept out of the reckoning, because these works were said to be replacement rather than net additions. The expenditures on constructing the brand-new capital city of Islamabad were eliminated from the computation, because the capital was supposed to represent both wings of the country. And so on. The authorities chose to ignore the fact that all these expenditures occurred in the geographical entity of West Pakistan, added to incomes in this region, and generated multiplier effects within this jurisdiction. No serious analytical work—in research institutions, in academia, in the Planning Commission¹⁸—was undertaken on the extent or the causes of the disparity in incomes, or of measures to reduce it. The result of this ostrich-like attitude was the breakup of the country.

The country cannot afford an encore. The development of the provinces has to be studied, and measures to accelerate the growth of lagging regions identified. This paper is intended to highlight some of the main issues and to bring together some key data and discussion that might otherwise be difficult to access. The subject is vast and complex, and it

¹⁷ Especially when the foreign balance of each wing was converted into domestic prices using estimates of the scarcity price of foreign exchange; see Islam (1970) and Lewis (1968).

¹⁸ Although some (inconclusive) discussion did occur in the Planning Commission at the time of formulating the five-year plans (especially the Fourth Plan); see Government of Pakistan, Planning Commission (1970).

is clear that within the space available the choice of issues addressed in this paper had to be highly selective. I am also conscious that in order to highlight some issues, I have occluded others.

Let me list some key areas that should be explored in more detail, and consequently deserve much more comprehensive research.

1. It is quite unacceptable that even 60 years after the creation of Pakistan, we still do not have official GDP accounts for the provinces. The first requirement for any serious enquiry into the economic development of the provinces is for the Federal Bureau of Statistics to produce a reliable time series of the provincial GDPs in both current and constant prices. The absence of credible official figures will not make the heartburning over differential provincial development go away; it will only substitute a combination of wild guesses and dubious estimates as the basis of the argument. If required, private research institutions and international organizations that have worked in this field should assist the Federal Bureau.
2. It is very important to obtain measures of investment (both public and private) and savings for each province. Little macroeconomic analysis can be conducted or realistic plans or policies for growth formulated in the absence of this information.
3. We must obtain a much better understanding of the informal or "gray" economy. The absence of reliable information on the informal economy leaves policymakers without the wherewithal to answer questions about the actual level of employment in the province, the size of incomes, and the extent of poverty. It also leaves open two other important questions.

First, does the informal part of the economy move pro- or counter-cyclically with the formal economy? A tentative answer by the SPDC (2001) is that the gray economy largely moves in the same direction as the formal economy. This means that if the latter faces difficulties, the authorities cannot assume that the informal part will pick up the slack and that the impact on incomes and employment will be cushioned. This is an important implication, and deserves more detailed research in order to validate or refute this finding.

Second, does the presence of the gray economy imply that the distribution of income is more or less equal than it would have been in its absence? Based on a very detailed study for India, Acharya (1985, 1988) concluded that the distribution of actual household income from all sources was likely to be even more skewed in favor of the top decile than indicated by standard surveys. This would result (a) from the incentives for households with a higher proportion of gray income to understate their true incomes and to do so to a greater degree than households with little or no income from gray sources; and (b) from the greater opportunities for the "haves" (such as industrialists, traders, real estate operators, politicians, bureaucrats, etc) to earn gray incomes than the "have nots" (e.g., small farmers, peasants, rural and casual labor). These reasons would appear to apply to Pakistan just as strongly as to India. However, an analysis of the specifics for each of the provinces of Pakistan should be undertaken.

4. A study of regional variations within provinces is essential. This paper has highlighted some of the more important intra-regional differences, such as those between different parts of the Punjab, and between rural and urban Sindh. Even these few examples illustrate the stark differences in incomes, in social outcomes, and in the hope of a decent future that can exist within a province. Thus, preparing effective plans for improving the condition of all citizens within a province will require gathering and analyzing much more specific information than has hitherto been the case.
5. Within each province, a more comprehensive approach needs to be adopted towards using cities as engines of growth. Too many of the provinces rely on a single urban center to act as a growth pole. The examples are clear—Sindh on Karachi, the NWFP on Peshawar, Balochistan on Quetta. Only in the Punjab have second-tier cities grown up that investors find attractive. It is important that all the provinces, including the Punjab, devise a strategy whereby growth is not concentrated in just one or two centers. If growth is not spread over the province, not only will it raise questions of equity, but the influx of population into the prosperous center will fairly soon put unmanageable demands on its physical and social infrastructure and thereby severely restrict or even stifle its growth impulses.

6. Questions of fiscal federalism need to be examined in depth. The Constitution allocates responsibility to the provinces for primary education, health, agriculture, etc, but retains most of the revenue-raising capabilities for the center. This can result in a mismatch between what is expected from a province and its ability to deliver it.

The discussion of what the provinces must do in order to improve the life of their citizens has emphasized that the growth of provincial GDPs must be accelerated above what has been the historical norm. While the strategy recommended has identified the private sector as the principal motor for the economy, it is also evident that the required rate of growth will not come about without the public sector's playing the key role of refereeing the rules of the game and in drastically building up the physical and social infrastructure. Both these essentials—comprising "software" and "hardware"—will require substantial financial resources. The provincial governments, therefore, need to create sufficient fiscal space to finance these activities. Creating "fiscal space" does not mean simply freeing up resources to allocate to physical investment—neither growth nor welfare will be enhanced by constructing public hospitals or schools if the government cannot pay for the numbers of doctors, nurses, teachers, etc necessary to adequately staff these facilities. The provinces will continually face trade-offs between putting more public resources into recurrent spending (such as on wages, pensions, subsidies, etc) and on apportioning them to building physical facilities. There is nothing inherently "vile" in recurrent expenditure nor something unfailingly "virtuous" in putting up buildings. The purpose of each item of expenditure must be scrutinized. Fiscal space will have to be created by acting both on the expenditure and revenue sides of the budget. Aggregate expenditure must be rationalized by shifting resources from less to more efficient uses, by making existing spending programs more efficient (by, for example, improving procurement practices and providing training to increase labor productivity), and by reducing or eliminating uneconomic programs. There is a role here for civil society, especially universities, research institutions, and think-tanks to assist provincial authorities in improving the efficiency (i.e., attaining the province's goals at minimum cost) of public expenditures.

The mobilization of provincial resources must also be examined. The constitutional allocation of resource heads leaves only a rather limited range of options for the provinces. Nevertheless, even within these limitations, the provincial authorities can mobilize significant amounts

of additional resources by widening compliance, enhancing the performance of revenue collection, improving cost recovery, and by developing a more flexible system of taxing agricultural incomes.

The largest part of a province's resources will remain allocations from the Central Government. The allocation of resources under the present NFC award may have been the simplest and the best possible in the circumstances. Nevertheless, a mechanistic approach of allocations based solely on population cannot contribute to solving the problem of differential provincial development. Such an approach ignores the special problems of provinces such as Balochistan, in which a sparse population scattered over a vast land area necessitates a higher unit cost of delivering services. Mechanistic allocations also cannot address deep-seated grievances, such as a perception that a province has for long received less than the due value of its resources, and the surplus economic rent has been siphoned off to other provinces.¹⁹ There are no easy answers to these questions, but research bodies and international organizations can examine such issues and draw lessons from the experience of other countries that faced similar problems.

¹⁹ The Constitution provides that all natural resources that lie more than 7 feet underground do not belong to the province but to the center. This can be particularly problematical for provinces such as Balochistan and Sindh that possess substantial deposits of natural gas, coal, and other minerals.

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