

DRAFT

**GOVERNMENT OF PAKISTAN
PLANNING COMMISSION**



Pakistan: New Growth Framework

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I. Background

A. Growth, Investment & Savings: An Overview

Pakistan has historically witnessed a volatile growth history and falling potential GDP growth. While the regional economies saw rising investment and savings rates, Pakistan performed poorly in terms of resource mobilization, return on private and public investment and utilization of assets including physical and social infrastructure. During a period spanning over the past four decades (1971 – 2009) Pakistan could only achieve an average GDP growth of 4.9 percent with fixed investment to GDP ratio at around 17 percent and domestic savings to GDP ratio at 12 percent (Table 1). However during the same period many regional economies that had taken off from a low level of physical and human capital formation rose to join the ranks of industrialized economies.

Table 1 Growth, Investment & Savings 1971 – 2009 (Annual Average)

Country	GDP Growth %	Fixed Investment to GDP	Domestic Savings to GDP	ICOR
China	9.1	32.2	37.9	3.5
India	5.3	23.9	22.0	4.5
Malaysia	6.4	27.4	35.0	4.3
Indonesia	6.0	25.9	29.2	4.3
Thailand	5.9	29.5	28.8	5.0
Pakistan	4.9	16.6	11.9	3.4

*Source: World Development Indicators

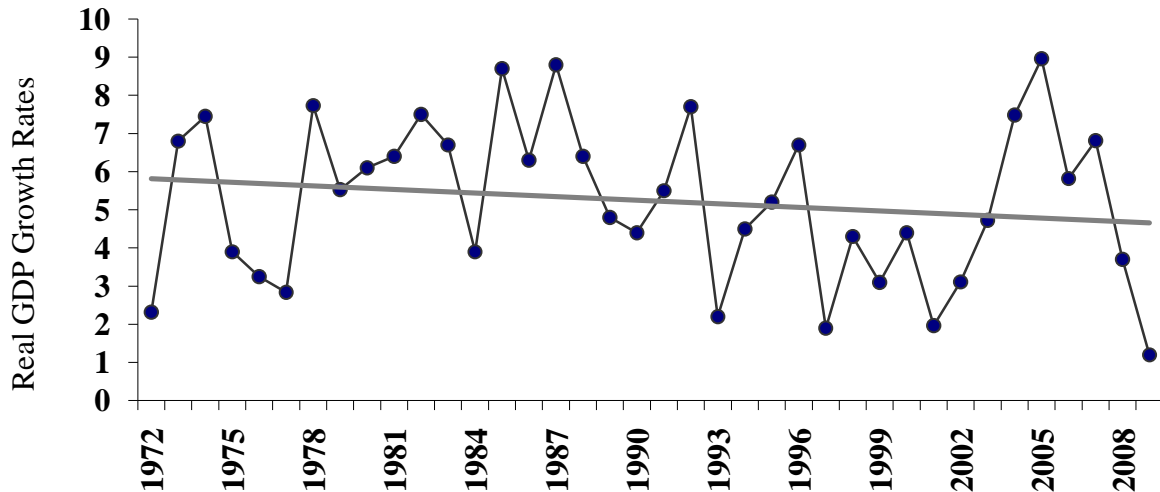
Figure 1 indicates Pakistan’s economic growth as a story of boom-bust cycles, where foreign injections led to sharp upward spikes; however, because the resources were not channelled into high-impact investments, the GDP would plummet to a low equilibrium, where it stayed until the next round of conducive external facilitation¹. There is evidence from literature that foreign aid in Pakistan was negatively associated with long run GDP growth in the absence of macroeconomic fundamentals². It is also argued that there was no strong relationship between

¹ Ahmed, V. and C. O’ Donoghue (2010) External Shocks in a Small Open Economy: A CGE-Microsimulation Analysis. The Lahore Journal of Economics, 15 : 1 (Summer 2010): pp. 45-90.

² Ishfaq M. (2004) “Aid effectiveness debt capacity and debt management in Pakistan” Department of Economics, Quaid-e-Azam University, PHD dissertation; Ahmed, V. and A. W. Farooq (2010) Nexus between Aid and Security: The Case of Pakistan. Country paper for Policy reforms for Aid Effectiveness. Institute of Policy Studies, Colombo, Sri Lanka.

public investment and economic growth³. However public investment did have some positive impact in luring private investment⁴.

Figure 1 Economic Growth 1972 - 2010



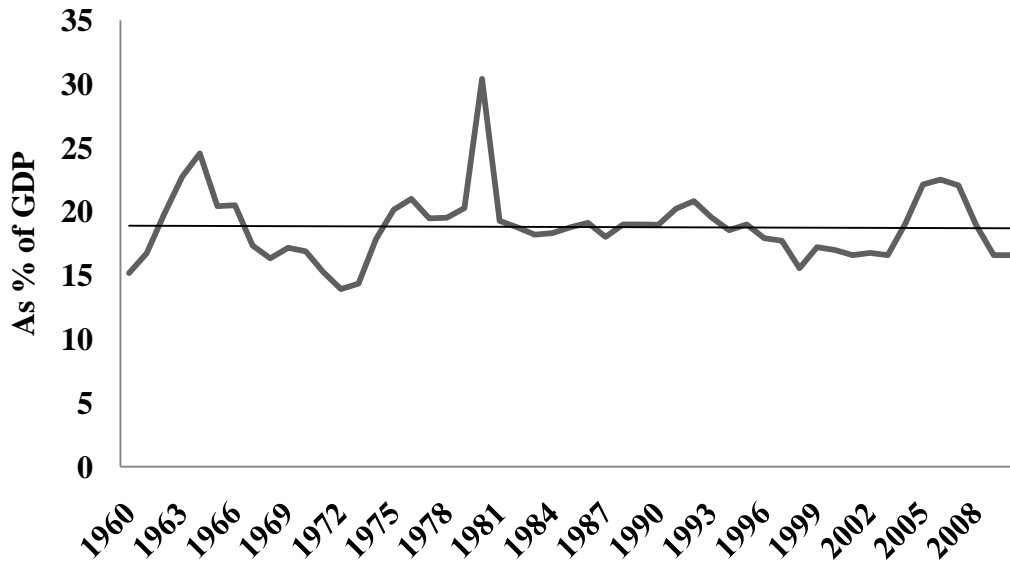
One of the key determinants of growth in conventional planning was physical capital formation. Given that markets were not well-developed to direct savings into productive investments with sustained payoffs, the investment to GDP ratio in Pakistan remained at abysmally low levels (Figure 2). The episodes of slowdown in investment rate have also been associated with frequent regime changes⁵ and balance of payments volatility in Pakistan.

³ Ghani, E. and Musleh-ud-Din (2006) The Impact of Public Investment on Economic Growth in Pakistan. The Pakistan Development Review, 45 : 1 (Spring 2006) pp. 87–98.

⁴ Naqvi, N. H. (2002) Crowding-in or Crowding-out? Modelling the Relationship between Public and Private Fixed Capital Formation Using Co-integration Analysis: The Case of Pakistan 1964 – 2000. The Pakistan Development Review 41:3 (Autumn 2002) pp. 255–276.

⁵ Naseem, S. M. (2008) Political Economy of Structural Reforms in Pakistan. No 2008.7, EABER Working Papers. East Asian Bureau of Economic Research.

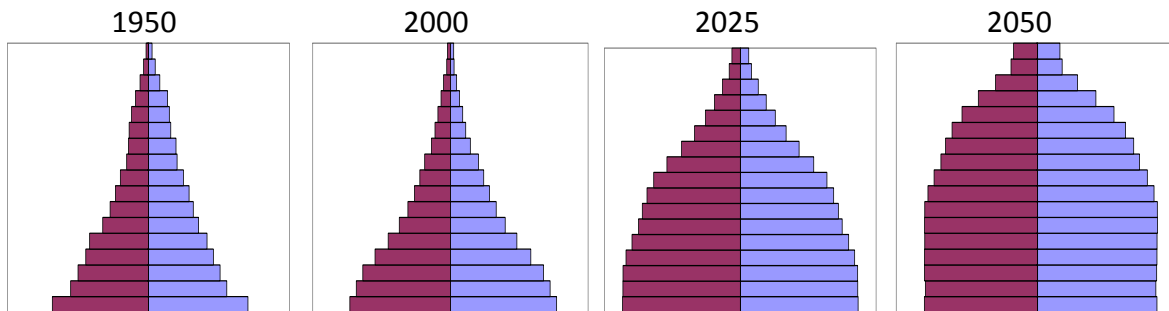
Figure 2 Investment to GDP Ratio 1960-2010



B. Demographic Dividend?

The population of Pakistan is projected to reach over 351 million by 2050⁶. It is not just the size but its age structure that is important. Number of those aged 0-14 years would start to stagnate after 2035 (due to fertility decline), but the numbers of working age group (15-64 years) and the elderly (65 and above) would continue to increase (population echo /momentum). It is the increasing numbers in the working age group that provides an economic opportunity to the country. By 2050, more than 236 million people would be in the working ages.

Table 2 Population Pyramids of Pakistan: Changes over Time 1950-2050



Source: Based on medium variant, UN 2005.

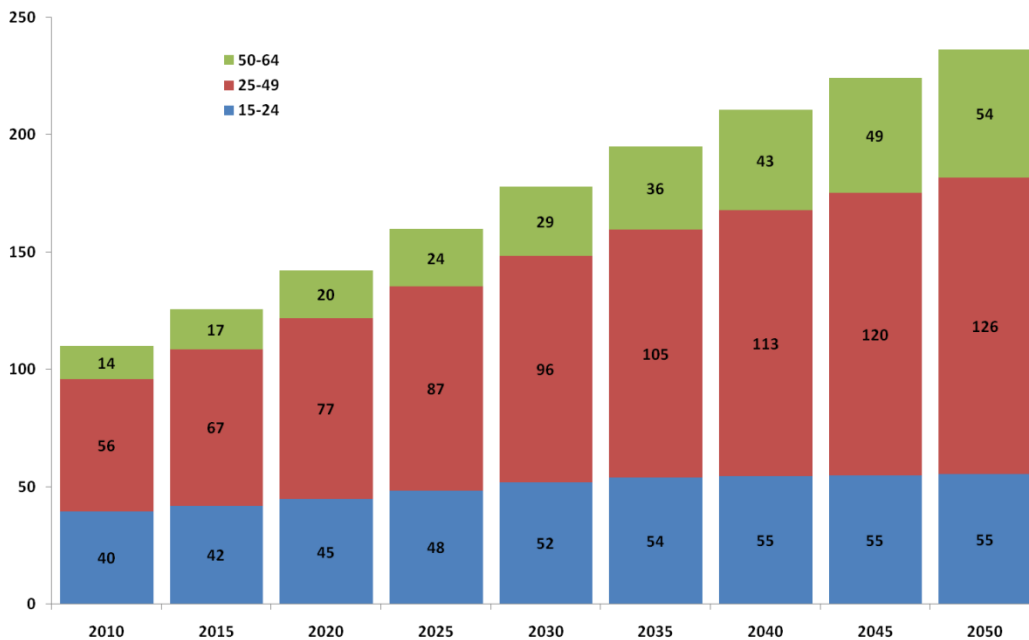
⁶ Draws from Durr-e-Nayab (2006) Demographic Dividend or Demographic Threat in Pakistan. PIDE Working Papers, 2006:10.

This changing age-structure lead to shifts in dependency ratios in the country. After peaking in late 1970s and early 1980s, the total dependency ratio begins to decline in late 1980s, mainly due to lowering of fertility rates. Due to increasing proportion of population in the working age group the dependency ratio continues to decrease, projected to reach its lowest point in 2030s. The dependency ratio will again show an increasing trend by 2050, but this time due to increase in the old dependency ratio. Lowered dependency ratio has implications for economic growth, as there are more working people taking care of fewer people (young and/or old), thus improving the probability of more savings and increased productivity.

‘Demographic dividend’ is basically an opportunity provided by the changing age structure when the growth rate of labour force is higher than the growth rate of the total population. Demography started providing this opportunity to Pakistan in the early 1990s and would continue to do so till 2050, when the two rates will merge. This, however, is just an “opportunity”, and the “dividend” has to be earned!

Before 1990s the growth rate of population was higher than the growth rate of the labour force, but once the latter started growing faster (due to the demographic transition--- mainly fertility decline) the “window of opportunity” was provided by the changing age structure. After 2050 this “window” is projected to shut. Since ‘demographic dividend’ is about the increasing ‘working age group’, here is a snapshot of the 15-64 age group in Pakistan.

Figure 3 Projected Labour Force Size and its Composition



By 2050 over 236 millions are projected to be in the working age group, a huge increase from the 110 million in 2010. How would all these numbers be provided employment? With the current level of human capital it is a looming disaster! Ageing of the labour force is another

factor. The number of new entrants/younger workers (15-24 years) would start to stagnate by 2040, while the number of older workers (50-64 years) would continue to increase.

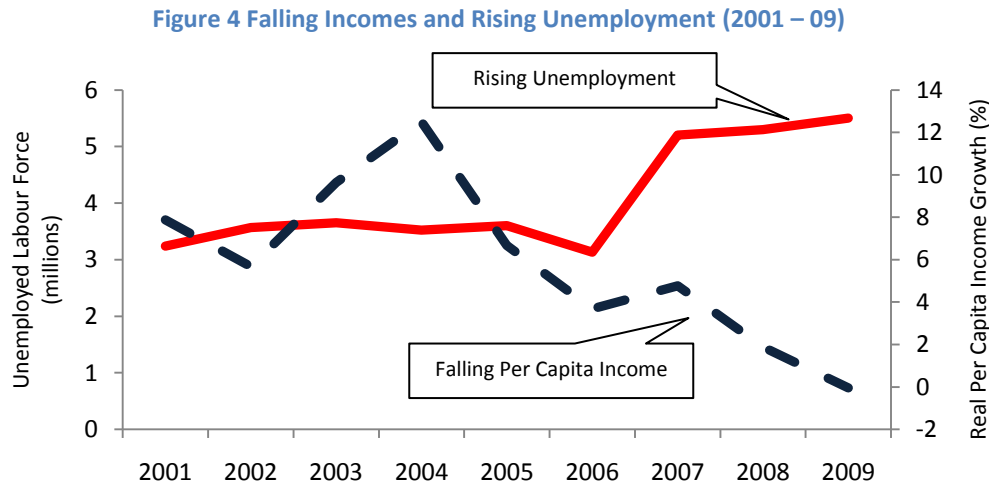


Figure 4 shows the falling growth in per capita income and rising unemployment levels. In order to counter this trend strong reforms are required not only to put the existing unemployed back to work but also to absorb the new comers in the labour market. The long run labour force growth is being estimated at 3.6 percent annually. With an employment elasticity of 0.45 percent, it will take a GDP growth in excess of 8 percent annually to absorb the incremental changes in labour⁷.

A bulge in the working age groups in coming 40 years will increase the economy-wide potential productive capacity. However if economic growth is not leveraged on a higher trajectory then the coming demographic changes will imply rising unemployment, shortage of assets and difficulties in competing with neighbouring South Asian countries – which are also benefiting from younger populations during the same period⁸.

⁷ Sectoral and overall employment elasticities in Planning Commission (2005) Medium Term Development Framework 2005-10, Government of Pakistan.

⁸ Ul-Haque, N. (2010) Towards Growth Strategy and Economic Reforms. Presentation at Pakistan Development Forum, Islamabad, 2010.

II. Why has growth been low?

In the standard neoclassical growth model, growth is determined by capital formation, labour force growth and changes in productivity. It is fair to say that the standard model is still relevant. The criticism is on how the model is applied. To make the standard model operational some simplifying assumptions are made. The growth of labour force is assumed constant and productivity growth is set to zero. An economic growth target is set and the investment requirement is then computed using a fixed incremental capital-output ratio. The question about where this investment will come from still remains unanswered. Traditionally it has been a combination of both public and private investments primarily driven by foreign aid and loans respectively and in Pakistan public investment has consistently been given greater emphasis than private investment⁹.

Search for a new economic growth framework stems from dissatisfaction with the old growth model that relied on investment, and particularly public investment, as the main driver of the growth. This (currently prevalent) strategy has led to PSDP being skewed towards brick and mortar projects, where the government is involved in building assets that could have been furnished by the private sector, more efficiently. Examples such as: government building houses, office buildings, roads and related infrastructure in commercially viable areas lead to encroachment in private sector initiatives and activities. The government ended up occupying land and dedicating it to a single use for many years, which could have been used for multi-purpose domestic commerce by the private sector. The high share of civil works in PSDP (almost 50 percent) leaves little space for training and retaining human capital in productive and social sectors. Our current throw-forward (accumulated backlog of approved projects where investment is lagging) is approximately Rs. 3 trillion, comprising about 2000 projects and schemes, which suffer from cost and time overruns, there exists substantial incentives for project initiation and delayed completion.

There is a tremendous need to review Pakistan's development planning process. Even within the structure of public investment, there is an urgent need to review underlying incentives for planners and project directors to assess the quality aspects of PSDP, timeliness, cost efficiency, and compute the net present values of the projects and return to the total portfolio of existing and potential investments. The current narrative of growth that focuses on 'my project' and 'my allocation' combined with distortive incentives (subsidies and protectionism) for industrialization needs to be shifted to a new narrative that drives us beyond excessive focus on building infrastructure and overly diversified public investment, and towards the pillars of 'new growth theory' – i.e., towards productivity (improving returns / yields) of assets and all factors of production and efficiency (producing goods and services cost-effectively).

⁹ Khan, Mohsin (2010) Revisiting Pakistan's Approach to Economic Growth. Consultative Workshop on National Growth Strategy. Higher Education Commission, Islamabad, 2010.

The Planning Commission has been involved in the formulation of Perspective, Medium-term and Annual Plans based on savings-driven approach, where growth rates are arbitrarily set and incremental capital (investment) to output ratios are used to generate investment requirements in key sectors of the economy. Public investment across sectors is allocated according to the planner's priority and it is assumed that public sector development programme (PSDP) will crowd-in private investment. However we now know that the Rostovian linear model and Harrod-Domar framework, where growth is a function of savings did not succeed for Pakistan because:

- Markets were not well-developed which implied that savings were not channelled into most productive uses
- Take-off does not materialize into sustained growth due to poor quality of investments
- Due to poor resource mobilization, there is continuous reliance on foreign resources
- Existing framework does not endogenize elements such as innovation, creativity and learning.

While several development plans during Pakistan's history were shelved due to regime changes, we briefly discuss here a few which saw their implementation at some level. The first five year plan (1955-60) laid emphasis mainly on achieving high national income. The development expenditures were regarded as the foundation for rapid progress in the future and plans explicitly affirmed that some sectors of the economy must be expanded much more rapidly than others in order to secure maximum gains.

The Second five year plan (1960-65) was largely a continuation of the first plan with more focus on the less developed areas. Specific agriculture and industrial sub-sectors were given priorities. Investment in technical and vocational education, and provision of housing also featured in this plan.

The third five year plan (1965-70) came around at a time when Pakistan faced reduced foreign assistance and domestic savings needed to be increased. Export promotion and import substitution were proposed. Relatively more emphasis was placed on heavy industry and on creating infrastructure. A substantial increase was projected in the inputs for the agricultural sector, especially the availability of water, fertilizer and credit.

The sixth five year plan (1983-88) focused on the pro-poor growth concept. The Plan, therefore, provided for small farms and facilitation to small scale industry. The Plan envisaged significant deregulation of economic controls. The efficient uses of fertilizer, water and farm technology were envisioned. Rapid development of steel-based engineering goods and modernization of textile industry was encouraged. The seventh five year plan (1988-93) also focused on the

renewed role of the government to provide public services and manpower training. The promotion of private sector activity through further deregulation was planned.

The eighth five year plan (1993-98) recognized the role of government as a catalyst and manager rather than the main vehicle of economic growth. The overall focus had been on strengthening individual initiative and private enterprise. The plan also focused on a social action program and augmenting energy and physical infrastructure.

The Medium Term Development Framework (2005-10) relied on upgrading physical infrastructure for accelerating output growth. Specific spheres were identified where support to private sector could be extended and finally social sector policies were envisaged for timely achievement of millennium development goals.

Never has there been a more pressing need in Pakistan's history to search for a new model, however at the outset it should be said that if there has to be a common vision on growth, it should by all means take account of the damages caused by security and governance issues currently facing the country. In the new framework, private sector should be the growth-driver in open market environment that rewards efficiency, innovation and entrepreneurship, while the government is facilitator that protects public interests and rights, provides public goods, enforces laws, punishes exploitative practices, and operates with transparency and accountability.

There is also a need to look at the economic strategies of regional economies, many of which also face issues such as security and governance difficulties. Indonesia's National Medium Term Development Plan 2010-14 which takes guidance from National Long Term Development Plan 2005-25 clubs national priorities into soft, social and physical infrastructure combined with creatively development. Thailand's Tenth Plan 2007-11 pursues a green and happiness society where foremost objective is to provide opportunities for learning, increase potential of communities by linking them in networks and ensure fair competition in trade and investment. Malaysia's New Economic Model launched in 2010 aims towards a coherent 'big push' to boost transformation and growth through developing quality workforce, competitive domestic economy and transparent markets. China's Eleventh Five Year Plan 2006-10 focuses on promotion of independent innovation, improve institutional mechanism, and enhance social harmony. India's Eleventh Five Year Plan (2007-12) reinforces focus on basic services such as education and urban development. The draft Perspective Plan for Bangladesh 2010-11 provides for effective governance, promoting innovative people for a digital Bangladesh, creating a caring society and enhancing regional cooperation. Finally Philippine's Medium Term Development Plan (2004-10) advocates the adoption of policies focused on making a national innovation system work through product and financial market reforms, reduction in barriers to technology entrepreneurship and support to research and development.

III. What Constrains Pakistan's Growth?

It is now time to argue that Pakistan stands reasonably sound as regards the hardware of growth (physical infrastructure). We now need to reorient our narrative towards software of growth (innovation, entrepreneurship and markets). Pakistan ranks 101 in global competitiveness out of 125 countries of the world¹⁰. This poor ranking is primarily due to the low rank of Pakistan in the index for business cost of violence, where Pakistan ranks 119. However, as argued above and exhibited in Table 3, Pakistan ranks close to India, Indonesia and China in terms of overall infrastructure (hardware of economic growth).

Table 3. Overall Infrastructure Quality

Country	Rank
Indonesia	96
India	89
China	66
Pakistan	87
Thailand	41
Korea	20
Taiwan	19
Malaysia	27
Hong Kong	3

Source: Global Competitiveness Report 2010

A break up of infrastructure quality in comparative economies (Table 4) reveals Pakistan standing close with countries like Indonesia, Thailand, India and China. A ranking out of 125 countries reveals Pakistan at 51 for rail, 65 for road, and 76 for air transport, reinforcing the argument that hardware of economic growth may not be the binding constraint for higher growth.

Table 4. Transport Infrastructure Quality (Rank out of 125 countries)

	Railways	Road	Air
Pakistan	51	65	76
India	20	89	65
Indonesia	60	94	68
Thailand	52	35	26

¹⁰ Global Competitiveness Report 2009-10.

Malaysia	19	24	27
China	27	50	80

Source: Global Competitiveness Report 2010

The lagging aspect is one of software of economic growth, which is defined as the human capital that is in sync with globally successful experiences, and capable of generating sustained productivity and efficiency. The software provides better management of what we have. It provides innovation in developing better uses of new and existing resources and assets, which generate greater productivity. The management of resources should be in line with the global standards and best practices and allow for innovation and entrepreneurship at all tiers, in all sectors, and in all regions. Endogenous growth models incorporate talent, technology and learning aspects into the overall development strategy of a country. It is from this perspective that Pakistan has been performing poorly.

Table 5. Technology and Competition

	Firm level technology absorption	FDI and technology transfer	Intensity of local competition	Effectiveness of antimonopoly policy
Pakistan	99	96	87	78
India	30	19	12	25
Indonesia	65	49	47	30
Thailand	61	50	41	53
Malaysia	37	8	42	47
China	47	77	13	50

Source: Global Competitiveness Report 2010

The learning aspect has been missing in firm-practices in Pakistan. This can be observed in poor technology absorption and transfer rankings of Pakistan (**Table 5**). Similarly our internal markets need major reforms. In the case of intensity of local competition, Pakistan ranks 87 out of 125 countries compared to India and China, which rank 12 and 13, respectively. The anti-monopolistic policies in Pakistan have not been very effective and Pakistan again ranks low at 78 out of 125 countries. One of the most fundamental components of growth software is governance structure. Focused attention to defining and strengthening the roles of judiciary, legislature and administration is urgent. Pakistan stands on the lower side in global rankings in judiciary, enforcement of contracts, and corruption (Table 6).

Table 6 Pakistan: State of Governance

Indicators	World Ranking out of 102 Countries
Judicial Independence	77/102

Property Rights	71/102
Favouritism in decisions of government officials	52/102
Irregular payments in tax collection	77/102
Corruption	77/102

Source: Global Competitiveness Report 2010

If Pakistan's demographic dividend has to be capitalized, scarce resources must be diverted towards harnessing the much desired human capital. Knowledge, creativity and independent innovation must counter the currently dismal performance of Pakistan in the education sector (Table 7).

Table 7 Education and Innovative Capacity

Country	Innovation Index (Out of 132 Countries)	Brain Drain	Quality of Education System
Pakistan	79	68	99
India	30	34	37
Indonesia	39	27	44
Thailand	57	38	67
Malaysia	24	28	23
China	26	37	52

Lack of innovative and entrepreneurial practices can be traced back to the underlying system of education in Pakistan. The reform of education needs to address both the public and private educational institutions. All tiers of schooling require a futuristic outlook which equips Pakistan's youth with tolerance, discourse and capacity for lifelong learning. Sadly the current education system ranks among the world's least effective and the current physical state of public sector schools endorses these low ranks¹¹ (Table 8).

Table 8 State of Public Sector Schools

Indicators	% of total
Schools without Electricity	59.6
Schools without building	10.9
Schools without boundary wall	37.7
Schools without drinking water	33.9

¹¹ Kronstadt, A. K. (2004) Education Reform in Pakistan. Congressional Research Service Report, RS22009.

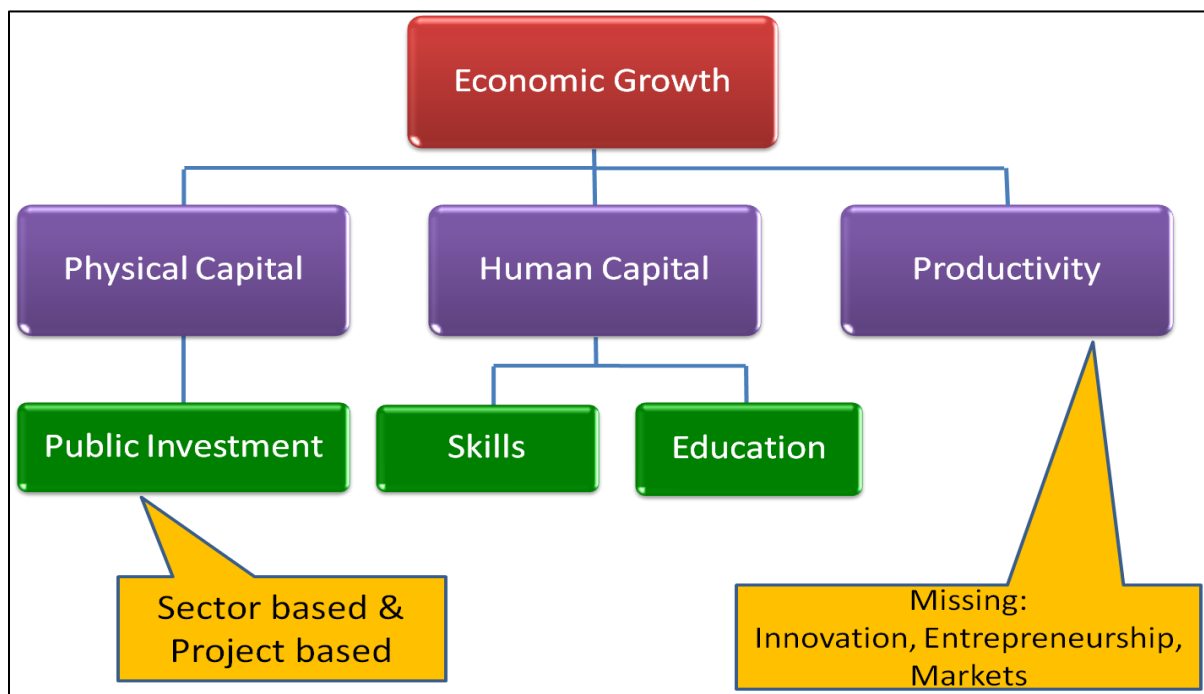
Source: Economic Survey of Pakistan 2009-10

To summarize one may advocate that amongst other factors the two most important constraints to growth are: a) market failure and b) governance failure. In case of the former, we are concerned about asymmetric information, lack of innovation and entrepreneurship; and in case of later, immediate attention is required to making the judicial process efficient along with clear enforcement of contracts and property rights.

IV. New Growth Framework

The two key factors that have determined economic growth in the past are external resource inflow and public sector projects. The later used to be mainly financed by the former. Figure 5 indicates that Pakistan, in the old model, has excessively focused on public sector investment and producing labour with low-end technical skills. The new framework should now be based on elements of endogenous growth model¹², where the quantity of investment should be complimented by efforts to improve the quality of investments – i.e., their productivity and efficiency. Private sector must drive economic growth with public sector ensuring timely implementation of market reforms, to promote competitiveness. Pakistani cities presently are configured as suburban clusters instead of as creative cities which can become locomotives of economic growth.

Figure 5 Endogenizing Productivity



It is essential for Pakistan to step up its efforts to produce high-end human capital. Promoting innovation and entrepreneurship should be the cornerstone of government’s facilitation to private sector.

The new approach represents a shift of emphasis in several dimensions. The new regime should develop the software of economic growth, increase competitiveness, everywhere, redefine government’s role in markets, promote investments on the basis of innovation and

¹² Romer, P. (1986) Increasing Returns and Long-Run Growth. *Journal of Political Economy*, 94, pp. 1002-1037.
Lucas, R.E. (1988) On the Mechanics of Economic Development. *Journal of Monetary Economics*, 22, pp. 3-43.

entrepreneurship, exploit the huge potential of a large domestic market, make cities and regional clusters the locomotives of growth, improve governance and better public service delivery and enhance connectivity. We may distinguish the old planning regime from the new thinking on six dimensions:

- a. *Hardware versus Software of Economic Growth*: Although the gap between us and our competitors has narrowed considerably, current approach focuses on building physical infrastructure. We continue to fare poorly against our competitors on the software aspects/inputs critical to growth. We need to learn from global experience and generate sustained productivity and efficiency by emphasizing the quality of investments in physical and human capital. Productivity and performance has to be measured in both the public and private sectors.
- b. *Dominant role of Public Investment versus Markets*: Public Investment has for a long time been incorrectly viewed as the main source of economic growth. Policy-makers have emphasized policies that crowd-out private investments. Government should not be involved in markets, except to regulate misbehaviour, reduce transaction costs and promote competition.
- c. *Exogenous versus Endogenous Competitiveness*: Our past and present growth strategies view global indicators that measure competitiveness and cost of doing business as “beyond our control”. By minimizing government intervention and making productivity endogenous we will be able to look beyond labour and capital accumulation to accelerate growth and improve risk-adjusted returns. To this end, we need to identify reforms needed to develop competitive, innovative and efficient markets.
- d. *Government Incentives versus Entrepreneurship*: Government policy favours specific sectors or sub-sectors through protection and subsidies. It also emphasizes the importance of commodity producing sectors and continues to support non-competitive industries. The enabling environment for investment should maximize gains from new ideas and open up opportunities for entrepreneurs. A new approach should incentivize innovation and entrepreneurship, which in turn will make growth more inclusive.
- e. *New Role for Cities*: Current development strategy views cities mainly as suburban clusters with an appended industrial park. Rezoning cities so that they become dense centres of diverse and creative activity to facilitate commerce and economic activity in several areas but especially in retail, distribution, transport, leisure and entertainment. Construction will increase quickly in cities with new zoning laws that enable repressed but productive activities. More construction will create jobs for the poor and become an essential mode of inclusive growth.
- f. *Quantity versus Quality of Service Delivery*: Increasingly, public service delivery has become costly and lacks in quality partly because governance has been found wanting in several areas. Efficient public service delivery with coordination between various government

institutions and service-providers is much needed. Asking for consumer feedback will provide an on-going mechanism for assessing the impact of reforms.

V. The Need for Productivity

Productivity in an economy can take place by either adding value to one's produce or by producing the existing output in a technically efficient manner. Pakistan being a resource constraint economy needs to address the currently prevalent productivity gaps in the public and private sector. The contribution of factor productivity in the growth process of Pakistan has been trivial. During the period 1960 to 2005, about 80% of the GDP growth rate in Pakistan was explained by capital accumulation and labor expansion whereas Total Factor Productivity (TFP) contributed the remaining 20% of the overall growth (Table 9). However, the contribution of TFP in GDP growth has fluctuated considerably during this period. TFP explained almost 38% of GDP growth rate in the 1980s but this fell to merely 18% in the 1990s. TFP growth then recovered to some extent during 2001 to 2005 and contributed 22% of the GDP growth rate¹³.

Table 9 Growth Accounting in Pakistan by Decades, 1961- 2005 (percent)

	GDP Growth	Capital	Labor	Total Factor Productivity
1961-1970	6.97	4.48	1.63	0.86
1971-1980	4.58	1.80	2.30	0.48
1981-1990	6.09	1.90	1.90	2.30
1991-2000	3.86	1.45	1.71	0.71
2001-2005	4.55	1.58	1.92	1.04

Source: World Bank 2006¹⁴

Productivity Gaps

The most crucial problem for the Pakistan economy is the abysmally low labor productivity. Cross country comparison of labor productivity indicates that among the regional competitors, Pakistani labor is the least productive (Figure 6) and over the last two decades the performance is on a downward slide. Different research studies have provided diverse reasons for this low productivity in Pakistan. Macroeconomic stability, foreign direct investment, and financial sector development play an important role in increasing TFP¹⁵. For Pakistan there is also a clear evidence of a relationship between the growth in TFP and the ailing science and technology apparatus¹⁶.

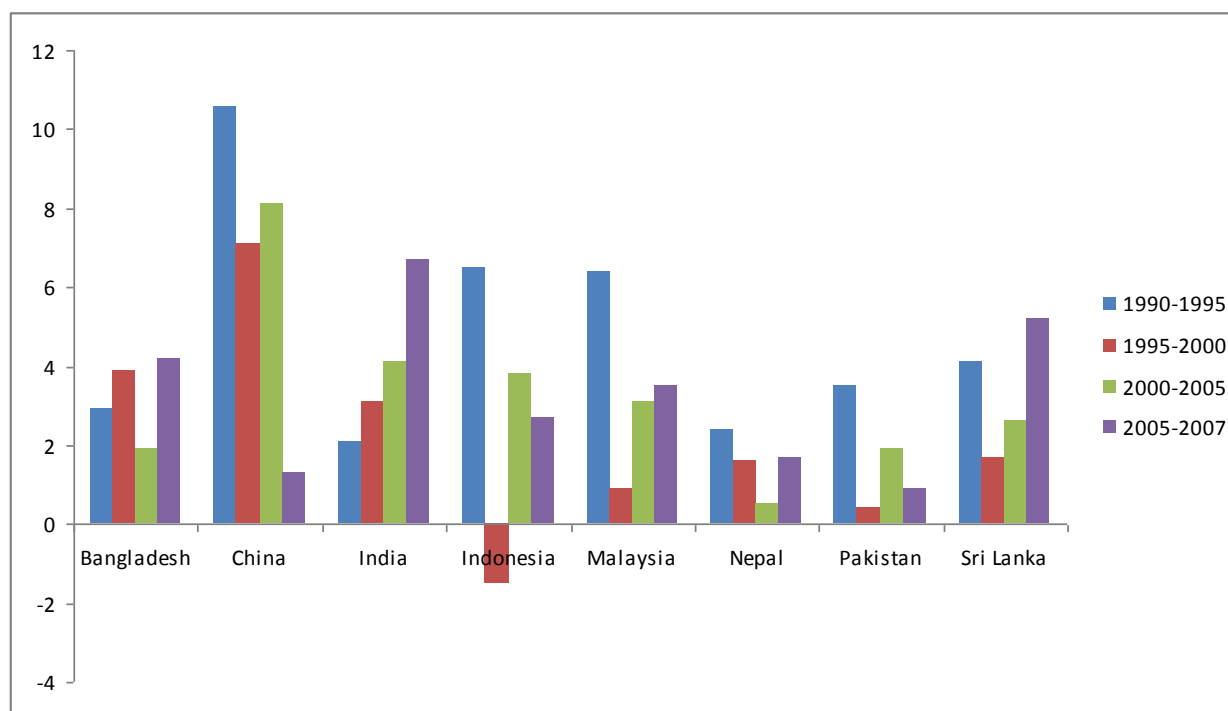
¹³ GoP (2007) Poverty Reduction Strategy Paper. Ministry of Finance, Government of Pakistan, Islamabad, 2010.

¹⁴ Growth and Export Competitiveness. Washington, DC: World Bank.

¹⁵ Khan (2006) "Macro Determinants of Total Factor Productivity in Pakistan" SBP Working Paper Series No.10

¹⁶ Mahmood & Siddiqui (2000) "State of Technology and Productivity in Pakistan's Manufacturing Industries: Some Strategic Directions to Build Technological Competence" Pakistan Development Review 39: 1

Figure 6 Cross Country Comparison of Labor Productivity Growth



Source: Asian Productivity Organization’s Productivity Data Book 2010

The detailed sectoral comparison also depicts that the performance of Pakistani labor is not exemplary in any of the major sectors of the economy (Table 10). The low productivity levels in electricity, gas, water and services sectors in general, is a matter of grave concern. Dismal performance in transport, storage and communication also point out towards room for improvement in connectivity and domestic commerce. This low labor productivity, coupled with capital constraints results in lower TFP.

Table 10 Cross-Country Labour Productivity by Sector

Sectors	Pakistan	India	China	Bangladesh
Agriculture	0.2	2.2	6.8	1.4
Mining	6.6	2.3	–	20.1
Manufacturing	2.8	0.5	6.4	1.9
Electricity, gas and Water Supply	-7.8	2.3	–	16.6
Construction	1.7	8.0	5.2	3.8

Wholesale and retail trade, hotels and restaurants	1.4	6.4	6.2	2.5
Transport, Storage and communications	0.7	10.8	6.7	-1.3
Finance, real estates and business activities	2.3	7.0	7.4	-8.4
Community, social and personal services	3.5	3.0	7.8	4.2

Source: Asian Productivity Organization's Productivity Data Book 2010

Low yields hinder agriculture sector's growth in Pakistan (Table 11). The unachieved potential is 67 to 84 percent out of which *extension*¹⁷ gap is 31 to 75 percent and *research gap*¹⁸ is 25 to 75 percent¹⁹. The reasons for such a huge productivity gap include: traditional farming practices, inefficient irrigation methods, high input costs, lack of *bio safety* regulations and insufficient institutional credit for poor farmers.

Table 11 Yield Gaps of Major Crops

Crop	Progressive Farmers' Yield (Tonnes / ha.)	National Average Yield (Avg. of last 3 years) (Tonnes / ha.)	Yield Gap (%)
Wheat	4.6	2.6	43.5
Cotton	2.6	1.8	30.8
Sugarcane			
Sindh	200	54.5	72.8
Punjab	130	49.9	61.6
Maize	6.9	2.9	58.5
Rice	3.8	2.1	45.6

Source: Planning Commission, 2009²⁰

Water use efficiency is the primal factor for reviving agriculture sector. In Pakistan irrigation efficiency is very low and 60 percent of irrigation water is lost during transmission of water from source to the field. Almost 50 percent of the losses are at watercourse level and 33

¹⁷ the difference between best practice and average yields

¹⁸ the difference between research potential yields and the best practice yields.

¹⁹ Iqbal and Ahmed (2003) "Science & Technology Based Agriculture Vision of Pakistan and Prospects Of Growth" Pakistan Development Review

²⁰ Task Force on Food Security- Final Report 2009

percent are at canal level due to lack of proper operation and maintenance of deteriorating canal system²¹.

Livestock contributes around 52 percent²² of the agriculture value added and has a promising potential for the growth of this sub-sector. Although, livestock is showing improvement over past few years, yet there is a great room for improvement of productivity. In dairy sector there is 78 percent yield gap if compared with minimum standards required to compete globally and the main determinants of this poor performance include an extension gap of 61 percent and research gap of 52 percent. Moreover, 30 to 40 percent of livestock is underfed and only 10 percent of the livestock is vaccinated, which makes it vulnerable to infectious diseases. According to estimates of Taskforce on Private Sector Development (in Planning Commission), South Asian region has a \$25 million worth of market for dry milk, but Pakistan is unable to secure a respectable share of this export market due to lack of economies of scale.

During the 1990s, TFP growth in the manufacturing sector was only 1.6% and over the period 1998 to 2007, TFP in overall manufacturing sector, increased only by 0.9%. This implies that the growth of the manufacturing sector has been mainly driven by growth in inputs²³. The estimates of Ministry of Industries and Production for 2009-10 show that the excess capacity of the manufacturing sector is almost 51 percent due to stifled energy supply, high cost of production and depressed external demand. Total manufacturing sector losses due to energy shortfall are equal to 2.5 percent of GDP²⁴. Power Sector subsidies are also eating up a huge chunk of GDP and for fiscal year 2010 Rs. 147 billion have been spent for this purpose.

Public Sector Enterprises (PSEs) are also a source of ill-efficiency and low productivity. These PSEs are running operational losses amounting to 1.5 percent of GDP annually and require regular budgetary support and sometimes distortive subsidies. Moreover, these PSEs are also a major reason for huge government borrowings from State Bank of Pakistan. These borrowings have nearly crossed 65 percent of total revenues of the government (SBP estimates 2010). The rising domestic debt is adding fuel to the inflationary trends and also crowding out the private sector²⁵.

On the side of resource mobilization, Pakistan's abysmally low tax-to-GDP ratio amongst other reasons is also attributed to the administrative gaps²⁶. Under-invoicing, smuggling, narrow tax base, low compliance, a large undocumented economy and weak audit and enforcement are major impediments in this regard. Currently only 2.75 million people are National Tax Number (NTN) holders in Pakistan which is around 1.5 percent of total population. The agricultural

²¹ Ahmed et al (2007) *Pakistan Journal of Water Resources*, Vol.11(2) July-December 2007 / 35

²² Task Force on Food Security- Final Report 2009

²³ Chaudhry, (2009) "Total Factor Productivity Growth in Pakistan: An Analysis of the Agriculture and Manufacturing Sectors" *The Lahore Journal of Economics*: Vol 14

²⁴ GoP (2010) Economic Survey 2009-10. Ministry of Finance, Government of Pakistan.

²⁵ SBP First Quarterly Report 2010

²⁶ Ahmed, V. and C. O' Donoghue (2009) Redistributive Effect Of Personal Income Taxation In Pakistan. *Pakistan Economic and Social Review*. Vol. 47, No. 1 (Summer 2009), pp. 1 – 17.

income earners and many services sector practitioners are not in the direct tax net. This anomaly needs to be immediately addressed²⁷. According to 2005 estimates overall tax gap for Pakistan had crossed Rs 400 billion²⁸. There is a very large informal sector in Pakistan, which is shy of becoming formal due to huge entry costs. By rationalizing entry costs and official procedures including labour market regulations, these businesses can be formalized and thus tax base can be broadened.

Reforms for Productivity

Cross-country comparison of TFP in 4 indicates that both the historical performance of Pakistan in terms of TFP and the future picture portrayed by the forecast for next decade is not encouraging. Pakistan has lowest TFP among the sample countries and the position does not seem to be improved in the future. This bleak picture calls for immediate and sincere efforts to uplift productivity and efficiency in all spheres of the economy.

Table 4 Cross – Country Comparison of TFP

Countries	TFP Growth			Capital Per Labour			GDP per Labour		
	1981-2007	2011-20	2021-30	1981-2007	2011-20	2021-30	1981-2007	2011-20	2021-30
	Annual Average Growth Rate								
China	4.07	2.36	2.17	7.80	7.50	7.02	7.73	5.75	5.06
India	1.34	1.16	1.26	3.78	3.56	3.68	3.35	2.94	2.90
Indonesia	0.59	1.37	1.37	3.25	3.79	3.84	2.21	3.16	3.08
Korea	1.35	2.14	1.91	6.43	4.08	3.93	4.51	3.97	3.66
Malaysia	0.71	1.67	1.58	4.19	4.02	4.16	3.15	3.59	3.41
Pakistan	0.78	1.04	1.19	1.29	2.85	3.38	1.84	2.70	2.83
Phillipines	0.19	2.21	2.03	0.33	3.50	3.74	0.70	3.84	3.71
Thailand	1.50	1.74	1.72	4.02	4.16	4.01	3.59	3.87	3.64
Viet Nam	1.52	2.27	2.07	6.08	2.91	3.08	4.08	3.73	3.37

*Source: Lee, Jong-Wha and Kiseok Hong (2010)²⁹

²⁷ Ahmed, S., V. Ahmed, A. Abbas (2010) Taxation Reforms: A CGE-Microsimulation Analysis for Pakistan. Development Economics eJournal. Vol. 2, No. 182: October, 2010.

²⁸ Ahmed, R. A. and M. Rider (2008) Pakistan's Tax Gap: Estimates by Tax Calculation and Methodology. Andrew Young School of Policy Studies, International Studies Program, Working Paper 08-11, December 2008.

²⁹ Economic Growth in Asia: Determinants and Prospects. ADB Economics Working Paper Series No. 220.

There is also a need to mimic best practices with in the country wherever they exist. Small indigenous innovations should be benchmarked and scaled up in order to achieve widespread benefits with lower sunk costs. Table 5 shows how Pakistan can improve its global position in doing business by adopting its own best practice benchmarks.

Table 5 Improvement by Adopting Best Practices in Doing Business

Indicators	Existing Ranks	Improved Ranks with Pakistan’s Best Practice
Starting a business	63	59
Dealing with construction permits	105	46
Registering property	119	87
Enforcing contracts	158	138
Paying taxes	143	107
Trading across Borders	78	73

Source: Doing Business, 2010 Reforming Through Difficult Times

Competitive markets are the starting point towards sustained economic growth. Free and flexible markets should allow businesses, which have run the course, to exit and be replaced by more efficient firms. Instead of providing fiscal incentives based on sector-specific biases, markets should be allowed to determine optimal allocation of resources. Incentives should however, be formulated to cultivate innovation and entrepreneurship.

Innovative practices can come about in public and private sector as well as in rural and urban areas. Private sector can only operate freely once government exists from the market and reorients its role as a regulator and facilitator. Currently one observes government’s distorting presence even in relatively smaller sectors of the economy like transport (for example National Logistics Corporation) and storage (Pakistan Agricultural Storage and Services Corporation – PASSCO). There is an immediate need to address missing and incomplete markets. To summarize major initiatives in this regard may be:

- Limiting the role of government in goods and factor markets

- Strengthening the role of private sector enterprises through:
 - Rewarding ideas-led innovation
 - Resolving the energy crisis by accelerating power sector reforms
 - Abolishing the bottlenecks in doing business
 - Computerising the land and revenue records
 - Speedy enforcement of contracts
- Preserve Autonomy of State Bank of Pakistan in order to limit government borrowing
- Restructuring of PSEs and ultimately divesting the control to private sector
- Removing imperfections from farm to market channels including storage
- Promoting the culture of commercial research and development
- Respecting intellectual property rights to attract mature investments

These and other initiatives will pave the way towards more productive and efficient Pakistan. There are no shortcuts to sustained growth, however in order to get started, short term growth spurts are possible by plugging the existing gaps and losses in the economy through sincere reform efforts.

Towards an Innovative Society

A perfect policy without an enabler is worthless. Government needs to de-couple the implementation of knowledge-driven innovation-policy from the rest of its bureaucratic skeletal. It needs to form a flexible, innovation-centric, entrepreneur-lead quasi-public autonomous body 'answerable to the Chief Executive of country only to orchestrate, implement and gauge the innovation strategy. Such a body should be guided by thinkers, innovators and corporate leaders, who are able to form alliances with private sectors, be able to bring in foreign expertise and capital, create center-backed innovation funds locally and internationally, be able to give sovereign guarantees to foreign investors who wants to invest, project the "Opportunity Pakistan" global campaign to cast "Enterprise Image" of the country's otherwise beleaguered depiction.

Government should take conspicuous steps to show its seriousness in innovation strategy, by financing (incentivizing) initially may be a few firms selected on competitive basis and gauging their performance, it should then publicize outcome to create a national *innovation-buzz*. Such an exercise for some time would build confidence in government and credibility in policy, would lure private sector, while giving hope to people who have innovative ideas. Successful

execution of such program would allow Government to gradually scale back its foot prints to just being a mentor.

Along with such top-down centre-push approach, there needs to be a parallel bottom-up pull strategy that empowers grass root constituencies in adopting a new mindset towards innovative practices. Regional chapters should identify and educate communities towards specific niches through entrepreneurial ideas. Such moves would be facilitated by regional universities and research institutions, local business interests, chambers, unions and other collective stakeholders. Prime example being Sialkot that built on its sports and surgical goods strength, and despite all the internal economic shocks (that left even the highly-pampered textiles sector struggling) Sialkot's produce remained competitive because of its self-generated competition, community sharing and catch-up spirit. Likewise University of Agriculture, Faisalabad is actively collaborating with local farmers and big corporations like Nestle in indigenizing and fine-tuning international best practices to local conditions³⁰.

The rest of this report will focus on four specific cross-cutting themes in growth strategy namely: market reforms, making cities creative and entrepreneurial, improving connectivity, and youth development.

³⁰ See National Institute of Food Science and Technology:
http://www.uaf.edu.pk/faculties/agri_eng/insts/food_science/food_mous.html

VI. Market Reforms

Traditionally, Pakistan's growth strategy has followed a mercantilist approach with a skewed focus on *import substitution* and at times *export promotion*. Past policies have supported this approach through high tariff walls for consumer goods imports and by giving subsidies to chosen sectors for export promotion. The approach that Pakistan has followed has not worked primarily because of the inherent lacunas in the incentive structure which in turn gave rise to rent-seeking and the neglect of governance³¹.

Agricultural markets are heavily regulated and domestic commerce has been ignored. Domestic Commerce, despite having a share of over 30% in Pakistan's GDP and employing about 20% of the total work force³², has never seen systematic and focused reform effort.

The Global Competitiveness Report 2010 places Pakistan poorly in terms of competitiveness and domestic commerce measures: business sophistication, goods market efficiency as well as property rights protection.³³ Pakistan ranks lowest when compared to other Asian countries including India, Indonesia, Thailand, Malaysia and China.

A. Key Issues in Markets

Outmoded Urban Management and Zoning for Domestic Commerce

The state of domestic commerce in Pakistan is partly apparent by the poor condition of the retail markets in our cities. They are mostly small, cramped and congested areas with limited square feet allocated to every shop. There is an excess demand for not only retail space but also office space, hotels and mixed use areas. Excess demand for office space is evident by the high rent prices. Due to these high prices as well as poor provisions for office complexes, a large number of offices, small businesses, guest houses and salons are operating illegally through residential areas. Besides the lack of proper commercial space, high commercialization fees are also charged that raise investment costs considerably.

Inadequate Transport and Storage Facilities for Agricultural Markets

Pakistan Railways handles only 4% of domestic cargo, a decline from 14% in 1990³⁴. The trucking fleet is aging, truck sizes are small, cargo facilities do not meet internationally certified

³¹Haque, Nadeem Ul. "Awake the Sleeper Within: Releasing the Energy of Stifled Domestic Commerce." *PIDE Working Papers No 11* (2006).

³²GoP (2010) Economic Survey of Pakistan. Ministry of Finance, Government of Pakistan, 2010.

³³Out of a total of 125 countries, Pakistan is ranked 96 for local supplier quantity, 108 for trade barrier prevalence and 100 for property rights protection.

³⁴Economic Survey of Pakistan 2009-10. Ministry of Finance, Government of Pakistan.

standards, and transport efficiency is very low. Both rail and trucking sectors are still heavily regulated.

There is no zoning for warehousing and distribution and Pakistan has few facilities with very little spaces for modern and up to date storage facilities. Grain storage is primarily in the public sector and is the responsibility of PASSCO³⁵. The storage is very basic and ranges from storage in a heap within the home compound to storage in specially constructed mud bins or bags.³⁶

Inadequate cold chain storage and refrigerated vehicles are a serious problem and lead to considerable wastage of perishable goods including vegetable and fruit wholesale and retail markets. According to an estimate, about 30 to 40 percent of the produce is wasted during transportation between the farm, wholesale and retail markets³⁷. Low quality packaging materials and faulty methods of loading and unloading also contribute to wastage of perishable goods.³⁸

The Agricultural Produce Markets Act of 1939, established during the British rule is still in effect in Pakistan (albeit with amendments in Punjab and Sindh). This outdated act places control of the agriculture markets in the hands of the government. Moreover, since it affects small farmers more than the big landlords, it reduces development at the lower income levels.

Legal Issues and Regulatory Environment

Pakistan ranks 85th out of 183 countries in starting and running a business³⁹. With weak property rights, corruption and inherent inefficiencies in the legal system, Pakistan has failed to strengthen its domestic commerce or make a strong impact in foreign markets.

Contract enforcement is very weak and hinders supply chain development. Poor contract enforcement and property rights protection remains a critical hindrance. There exist issues of land titles and consolidation with acquiring land being very difficult, uncertain and time consuming. Commercial development is further discouraged by taxes like stamp duties, property tax and outdated rental laws⁴⁰.

B. Reforms for Markets

Reforms for Markets are divided into macro-level, industry-level and firm-level reforms and we also briefly discuss current laws in vogue that need to be amended or repealed for competitive markets to flourish.

³⁵ PASSCO is a department of the Ministry of Food, Agriculture and Livestock; as well as of the four provincial Food Departments

³⁶ IDS (2006), "Storage", Study for Ministry of Commerce

³⁷ FIAS, Pakistan (2005), "Improving the Performance of Housing, Tourism and Retail Sectors"

³⁸ IDS (2006), "Wholesale Markets", Study for Ministry of Commerce

³⁹ The World Bank and International Finance Corporation, Doing Business database (2010)

⁴⁰ Haque, Nadeem Ul. "Awake the Sleeper Within: Releasing the Energy of Stifled Domestic Commerce." *PIDE Working Papers No 11* (2006). Print

i) Macro-level Reforms

Promoting Trade Openness and Competition

Bringing international quality goods to consumers will promote innovation. Also, competition in value chain development needs to be promoted⁴¹. This entails free entry and exit of participants in the market (without special privileges or licenses) as well as liberalizing policy allowing for mobility with greater fairness and competition for wholesalers. The Competition Commission of Pakistan (CCP) has proved successful in the past few years in dealing with non-competitive activities in various sectors including sugar, cement and textile. There is a further need to maintain and strengthen autonomy of this entity⁴².

Land Reforms

- **Disallowing oral transfer of land:** This entails an amendment to the Transfer of Property Act 1882. Under this act, the oral transfer of land is permitted in Pakistan creating confusion about the ownership of the lands and creates litigations which take years to resolve in the courts. Transferring property through oral gifts should be disallowed.
- **Repealing the Punjab Pre-Emption Act 1991,** disallowing the neighbours to a property the right of first refusal⁴³.
- **Centralizing of land title records:** Consolidating the steps taken when purchasing land (i.e. visiting only one agency instead of several bodies including SECP, Land Registrar, Revenue Department, Excise Department and local Development Authority).
- **Computerization** of the land records, such as initiated in Punjab under the Punjab Land Records and Information Management Systems (LRIMS) project. Setting up a Multi-Listing Service (MLS) to have a computerized record of available land for sale.
- **Auctioning off government held land** and transferring government owned land (on 99 year leases) to full freehold.
- **Tenancy Laws:** Relaxing the tenancy laws and the rented premises ordinances and acts, giving much needed protection to the landlord particularly in the urban commercial areas.
- **Financing for Businesses:** Advising the SBP of possible amendments to the Banking Policy Department circulars affecting mortgage financing for businesses and encourage SBP to enforce the Prudential Regulations by increasing financial sector training requirements on credit risk evaluation.

Taxation Reforms

- **Making amendments to the Income Tax Ordinance 2001 and Sales Tax Act 1990** to limit the discretionary power of the Federal Board of Revenue and improve administration, auditing system and tax refunds system.
- **Simplifying the tax system** and tax administration by creating one-window cells for tax registrations at the sub-national level to cater to all taxes (Federal, Provincial and Local).

⁴¹ Value chain (also known as supply chain) includes the various processes that are involved in producing goods (and services), starting with raw materials and ending with the delivered product.

⁴² Competition Commission of Pakistan website: www.cc.gov.pk

⁴³ The neighbours have the right to purchase the property before it is made available to others for purchase.

- Unifying NTN and GST registration to **one Tax Registration Number** through amendments to the Income Tax Ordinance 2001 and the General Sales Tax Act 1990.
- **Improving technology and e-governance** strategies to facilitate tax registration and tax filing system at the FBR.
- **Time Limits:** Modifying tax laws to include deadlines for speedy disposal of pending and new court cases.

ii) Industry-level Reforms

Agricultural and Rural Markets

- **Improving transport efficiency and storage facilities:** Private storage activity needs to be encouraged and space needs to be made available for warehouses. Moreover, good storage facilities would provide much needed hedging opportunities to farmers and facilitate the development of forward and futures contracts with banks and open exchange markets. The government has announced a number of measures to promote cold storage facilities in the private sector to be implemented through the Pakistan Horticulture Development and Export Board (PHDEB)⁴⁴.
- **Training in Packaging:** Farmers need to be trained in packaging the agricultural produce and loading/unloading in order to minimize damage to perishable goods.
- **Encouraging Private Sector involvement:** The Ministry of Food and Agriculture should focus on repealing the Agriculture Produce Markets Act 1939 and replacing it with a more updated and market friendly set of rules that allow small private farmers to sell their produce directly.
- **Deregulating Agricultural Markets:** This is being done through the Commodities Exchange Market on which wheat and sugar have already been listed. This process should be further strengthened.

Trading Processes

Given the current proposals by the Strategic Trade Policy Framework 2009-12 which focus on looking at specific industries and businesses to develop for international trade, some changes suggested for overall facilitation of importing and exporting are⁴⁵:

- **In-land clearing facilities:** With only 1046 km of coastline, Pakistan needs to establish dry ports to effectively handle import and export. These dry ports can reduce administrative delays and provide more capacity than otherwise available in inland cities.
- **Computerization:** Strengthening of existing customs clearance system (PaCCS) by removing uncertainty and making it compliant with the customs procedures.

⁴⁴ Aftab, Safia, and Sohail J. Malik. "Storage." Study by Innovative Development Strategies (IDS) Pvt., 2006, 3.

⁴⁵ <http://www.commerce.gov.pk>

iii) Firm-level Reforms

Initial setup of business

- **Merge steps and offices:** Consolidation of steps to set up business under either the local registrar or the Chamber of Commerce can help reduce time and effort. Collaboration between the Ministry of Commerce and the sub-national governments would help facilitate the operation of one-window cells to speed up establishment of new ventures.
- **Better construction and planning regulations:** Cities in Punjab have adopted uniform zoning and building regulations, which have reduced the time taken by businesses in cities like Lahore and Sialkot to obtain a construction permit. Zoning laws can be improved through actions by the local development agencies.
- **Tailoring procedures for the business:** Different types of businesses require different procedures. Large city-scrapers and manufacturing units require extra regulation since they are more risky in terms of health and safety of employees and the public. However, small retail outlets do not need much regulation and inspection. The procedures for registration and inspection should keep these aspects in mind, making it easier for small retailers to start and operate a business.
- **Training:** Capacity building of staff working at the offices responsible for registration and issuing permits is a must. Their training can make them significantly more efficient and make them aware on how to handle varied cases.

Enforcing contracts:

Pakistani businessmen claim that current state of courts is one of the key constraints to investment⁴⁶. National Judicial Policy (2009) has tried to bring justice to the local level besides the provincial and federal levels. The new policy aims to guarantee independence of judiciary, clear backlog of cases and reducing corruption. Some further measures may be taken to improve the situation:

- **Commercial courts:** Establishment of commercial courts can provide a specialized environment for the firms to deal with their problems. These courts can either be set up as separate entities or as a separate chamber in the existing courts.
- **Strengthening Alternative Dispute Resolution (ADR) systems⁴⁷**
- **Time limits:** Setting up time limits can lead to the quick handing of commercial cases.
- **Capacity building:** Lawyers and judges should be trained in handling commercial cases effectively and quickly.

In conclusion, we review the three main reforms needed to promote competitive and vibrant markets. First, city zoning laws and building regulations may be reformed to allow land use to respond to market demand. Second, pushing for openness and competition to bring international quality goods to the market, deregulating agricultural markets and promote

⁴⁶<http://enterprisesurveys.org/>

⁴⁷ An example of a successful ADR system is the Karachi Centre for Dispute Resolution (KCDR), that had received over 924 cases (till end 2009) and as a result \$27 million had been released in out of court mediations. <http://www.kcdr.org/>

innovation. And lastly, our legal and judicial framework must be made supportive of the complex needs of market development.

VII. Creative Cities

The spatial changes with in Pakistan have left the distinction between urban and rural irrelevant. The increased mobility of goods and factor services across regions has posed immense pressures on the physical infrastructure in Pakistani cities. Cities provide facilities and encourage interactions amongst people of various age and ethnic groups. These are the hubs of knowledge, innovation, creativity and institutions⁴⁸. Cities have been perceived as the fundamentals of diversity and difference. However, until recently, the economists have focused mainly on the role of firms in cities ignoring the important aspects related to human and social capital that cities host.

The best cities have been places of learning and idea development. Cities such as Paris, London and New York have been the birthplace of modernization and inspiring vision. Creative cities enhance individual and collective productivity, through exchange of ideas and easy access to information. Such cities offer a range of learning experiences for people to grow as individuals and communities. Cities that prosper economically have a mix of three T's; talent, technology and tolerance⁴⁹. These three T's define the winners in a creative age.

The current state of cities in Pakistan is abysmal. The urban population is escalating at a rapid rate of 3 % with the existing urban population of 60 million (36% of the total population)⁵⁰. The city dwellers do not have much say in the running of the city. But a great deal of involvement by the government bodies is apparent in taking managerial and administrative decisions. The prevalent confusion regarding how modern cities should be governed is growing acute. The lack of affordable space and poor commercial laws has hindered the growth of cities.

Furthermore, to create an enabling environment it is essential that the housing sector is efficient and affordable. The affordability and quality of housing is an important factor for location decision of high skilled workers. Businesses also prefer to locate in cities where their rights are protected and they have secure access to backward and forward supply chain processes.

Rapid population growth is pushing demand for affordable housing in Pakistan (Table 12). Middle and higher income groups perceive land and housing as the safest investment at a time of high inflation. With a growing services sector in Pakistan, the demand for commercial space

⁴⁸ UI-Haque, N., and Nayab, D. 2007. "Renew Cities to be the Engines of Growth", PIDE Policy Viewpoint.

⁴⁹ Florida, R. 2002c. *The Rise of the Creative Class: And How It's Transforming Work, Leisure, Community and Everyday Life*. New York: Basic Books.

⁵⁰ UN-Habitat Country Programme Document 2008-2009(Pakistan)

is also rising which is putting pressure on land prices for housing. Housing backlog has increased from 4.3 million in 1998 to an estimated 7.6 million in 2009⁵¹.

Table 12 Basic housing indicators for Pakistan

Description	1998	2009
Total Housing (units)	19.3 million	20.48 million
New housing need resulting from population growth (units)	4.33 million	7.57 million
Annual depletion of housing stock	0.3 million	1.28 million
Total population	132.2 million	167 million
Urban population	32.5% of population	37% of population
Annual growth rate of housing demand in urban areas	8%	8%
Urban housing units	32.3%	32.2%
Average household size	6 people	6.6 people

Source: World Bank 2010

Lack of affordable housing has forced the poor to dwell in slums and katchi abadis alongside large sewers and railways in major cities around the world. These squatter settlements lack decent housing facilities such as water, gas and sanitation. As population residing in these squatter settlements does not possess ownership of the land, financial institutions are not able to provide mortgage facilities to them. Furthermore, these unregulated areas are a major cause of revenue slippages for the government on a continuous basis. At present, it is estimated that 50 percent of the urban population in Pakistan resides in squatter settlements.

One may group the operational predicaments facing Pakistani cities in to issues regarding: commercialization, land and housing, and community development. We may briefly see each of these in some detail below.

Commercialization

- No downtown or city centre development: cities in Pakistan lack densely mixed use areas.

⁵¹ Expanding Housing Finance To The Underserved In South Asia, The World Bank (2010)

- Commercial development is discouraged and punitively taxed for example, in Karachi, commercialization fee in declared commercial areas is roughly 10% of the value of the plot. Whereas, in Islamabad, there is 'no conversion law', thus forcing entrepreneurs to establish businesses in diminutive office spaces and away from the city centre.
- There is excess demand for office space, retail outlets, housing units, schools, leisure places and libraries. The demand of housing for poor and middle class is not being catered adequately.
- The current structure of city centres impedes downtown development.
- Current zoning laws and commercialization policies hinder entrepreneurship. The high commercialization fee makes it difficult for them to compete with the existing entrepreneurs.

Land and Housing

- Expensive and complex land administration system.
- Restrictive zoning and building codes.
- Low quality and supply of rented housing.
- Unproductive use of state land as 40% of land in Pakistan is owned by government agencies.
- Inefficient and unreasonably high cost of construction.
- Shortage of housing finance as 2/3 of households cannot afford mortgage finance.
- Unrestricted growth of Katchi Abadis on prime real estate.

Community Development

- Insignificant number of libraries, training institutions and youth development centres for people to gain knowledge and communicate.
- Education system not catering to market demand. Job centres are non-existent.

The above stated issues need immediate reform efforts so that appropriate economic geography can help Pakistan grow better. We provide here some ideas in this direction.

Commercialization

- Focus policy research on how cities can be made engines of economic growth. There is a need to move towards the development approach while focusing on the software (talent, technology and talent) of cities.
- Development of city centres for dense mixed use. Government ownership of city-centre land needs to be reduced since it is retarding downtown development.
- Decentralization needs to be strengthened to allow city planners adequate control over their land and resources
- Zoning laws should be improved and made transparent⁵².

Land and Housing

- Modernize land registration system by electronically recording all transfers of land title in a centralized data base.
- Housing information system should be established to provide data on housing demand and supply from the district level to the national level. It should also include Housing Price Index and Housing Access Index with the assistance of the Federal Bureau of Statistics.
- A regulatory body must also be established for property dealers to register themselves officially.
- Relax zoning and building regulations to enable dense development of housing and vertical expansion.
- All legislative bodies must review rent laws and remove clauses which unjustifiably favour tenants and restrict the functioning of the rental market.
- Establish a land privatization commission with the task of releasing unproductive land belonging to the State.
- Reduce cost of construction by encouraging foreign developers to compete in the Pakistani market. Facilitate research and development in low cost and energy efficient construction techniques.

⁵² e.g. increase floor to area ratio.

- Increase access to housing finance through sound foreclosure laws and computerized credit information.
- Curtail growth of *Katchi Abadis* by using market based solutions to produce low income housing.

Community Development

- Provide dedicated and purpose-built spaces for recreational activities.
- Release idle State-owned land in favour of dense mixed use places by setting up land banks at provincial level and by encouraging public-private partnerships.
- Create cities of scholarship by allowing greater space for libraries, museums, science centres, parks with interactive physical and mental activities, community centres and internet parks for under privileged areas.
- In regards to heritage and urban conservation, there should be one window opening with all concerned departments working under a unit specially established for the purpose.

VIII. Connectivity

Sustainable economic development, be it through enhanced productivity, better management of cities, integrated internal markets, inspiring youth or invigorating communities, they all depend on robust and adequate connectivity infrastructure. It helps in achieving broad-based growth through efficient flow of goods, services, people and information. Connectivity, in our discussion, includes both the transport infrastructure and Information and Communication Technology (ICT).

Improvement in transport infrastructure creates new opportunities by linking domestic markets and reducing travel time. It reduces production and transactions costs in poor regions which serve as a stimulus for domestic commerce⁵³. Connectivity creates bridges between goods and factors markets. For example provincial roads in Indonesia appear to directly improve the general wage levels of the poor⁵⁴.

A study carried out by LECG quantifies productivity gains for different levels of broadband adoption⁵⁵. It finds an increase in productivity of 0.1% for every broadband line added per 100 people in medium or high ICT countries. In countries with low level of ICT, increase in broadband penetration will itself create the ICT eco-system required to realize productivity gains.

Pakistan carries a score of 1.53 out of 10 in useful ICT related connectivity⁵⁶. This is the lowest in a group of 25 resource driven economies. Useful connectivity highlights the importance of the physical infrastructure with reference to economic growth by looking at who is using it (businesses or consumers) and how well it is being used. Similarly, poor performance of transport sector is estimated to cost the national economy 4 to 6 percent of GDP every year⁵⁷.

More than 30 percent of agricultural output is currently wasted due to inefficient farm to market channels, lack of cold storage facilities and obsolete and underpowered trucking fleet. Furthermore low ICT penetration in rural areas slows down the information sharing process.

Local markets are also not fully integrated. With truck operating speeds on main corridors only half of the truck speeds in Europe and productivity of Pakistan Railway's freight services only 1/8th and 1/3rd of China's and India's respectively, it not only takes longer but also costs more leading to significant price differentials in different markets⁵⁸. Lack of useful connectivity also

⁵³ Gannon, C. and Liu, Z. (1997). *Poverty and Transport*. Washington, DC: The World Bank, Mimeo.

⁵⁴ Ali, I. and Pernia, E. M. (2003). *Infrastructure and Poverty Reduction- What is the Connection?* ADB.

⁵⁵ LECG (2009). *Economic Impact of Broadband: An Empirical Study*.

⁵⁶ Waverman, L. and Dasgupta, K. (2010). *Connectivity Scorecard 2010*, LECG.

⁵⁷ World Bank (2010). *Transportation in Pakistan*.

⁵⁸ World Bank (2010). *Transportation in Pakistan*.

increases the risk of getting into joint ventures for businessmen of different areas. This discourages innovation by forcing people to stick to their traditional ways of doing business.

Low level of broadband penetration is also denying access to modern ways of networking to the youth. Job portals, which can be very useful in signaling the skills required in job market, can also not be of significant use in correcting the direction of future labor force. Connectivity between universities and industry is also very low in Pakistan. Due to this weak nexus, youth is already exposed to a high risk of not acquiring appropriate skills for future jobs. As a starting point we provide here measurable reforms that are possible in railways, aviation and ICT sectors.

Creating Sophisticated Market for Railways

Pakistan Railways can adopt partial privatization measures, e.g. outsourcing stations management, rail hospitals, allowing companies to run their own container trains, letting suburban trains run as separate companies. Gradually Pakistan Railways should be unbundled and privatized completely. Unbundling may include privatization of rail track, station management and services (passenger and freight) separately.

However, for successful results, two important conditions are to be fulfilled. First, to effectively regulate railways sector after privatization, independent regulatory body should be established with sole responsibility of promoting competition and implementing quality control. Second, prices should be deregulated and Railways Corporation should be given full power to charge market clearing price.

An Unbiased and Progressive Aviation Sector

In the aviation sector, Civil Aviation Authority (CAA) should continue pursuing 'open skies' policy in both passenger and cargo traffic. All airlines should be free to operate on routes of their choice. Routes which are congested should be auctioned instead of giving a preferential treatment to the PIA. Similarly on international routes where 'open skies' or 'multiple designations of airlines' is not available, such routes should also be auctioned to all airlines including the national carrier in a transparent manner.

Currently, landing rights fee and timing slots allocated to private airlines by the CAA are also favored towards PIA. CAA, by the nature of its mandate, should not have control over any assets which makes it a player in the aviation industry. However, all the national airports are under its control. Therefore, to create level playing field for all market players, airports should be privatized. This will not only reduce the fees through healthy competition between airports

but will also improve over all efficiency by improving check-in procedures, flight management, and provision of modern facilities.

The right to carry passengers or cargo from a second country to a third country by stopping in one's own country (6th freedom rights) should be introduced. This will make Pakistan more attractive for potential investors and facilitate current players. Singapore and several other airlines use this right extensively to fly passengers between Europe and Australasia. Given Pakistan's strategic location, this can significantly improve connectivity on Central Asia to Africa route and Europe to Australasia route.

Incentivizing ICT Services

In the e-government evolution process, we stand at a nascent stage where government institutions provide limited services using their websites. Recently FBR has taken some key initiatives to provide options for paying taxes online. By providing more services online, government can incentivize broadband usage by reducing waiting time, travel costs and administrative hassle.

In this regard, electronic customs declaration form should be adopted to reduce documentation requirements for trade purposes. Similarly Pakistan Customs Computerized System, which was piloted in Karachi, should be rolled out throughout the country's customs posts. Its successful implementation will provide a comprehensive, user-friendly and interconnected electronic data interchange system.

Furthermore, Electronic Signature Act should be passed to provide legal cover to the use of digital IDs, signature certificates and electronic authentication and verification. The proposed law should ensure that the electronic signature is: uniquely linked to the signatory; capable of identifying the signatory; created using means that the signatory can keep solely under their control; linked to the data to which it relates in such a manner that any subsequent change of the data is detectable.

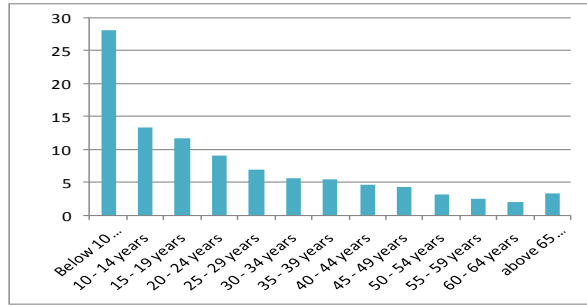
IX. Youth Engagement

Growing Frustration among youth can be well understood from the prevalent educational and skill profile on the supply side and declining job opportunities on the demand side. The reasons and consequences of youth unemployment should be of particular concern within public and private sector. Recent Riots in contemporary France and Britain are an example; so is the involvement of youth in militant activities in Baluchistan and the tribal areas, located along Afghanistan, in the North West territories of Pakistan. The connection between high crime rate and youth unemployment is a well established fact. It also pressurizes the way in which societies are administered; making it difficult to promote social, human and economic capital in a society. As a consequence youth fall for drugs, disease, crime and violence.

With a population of 100 million (63%) below the age of 25 (out of 163.76 Million in 2008-09), and a median age of 21 years, Pakistan is considered the country of young and restless⁵⁹. One third of Pakistan's population is concentrated in the age range of 10 to 24 years; described as the youth cohort. This size of youth cohort in 2008-09 has increased by 1.5 million (1.7% per annum) over 2006-07. If we expand the definition of youth to accommodate people between the ages of 25 to 30 years as well, then 41 percent people are concentrated in the age range of 10 to 29 years in 2008-09. The size of this cohort has increased by 1.8 million (1.7% per annum) over 2006-07.

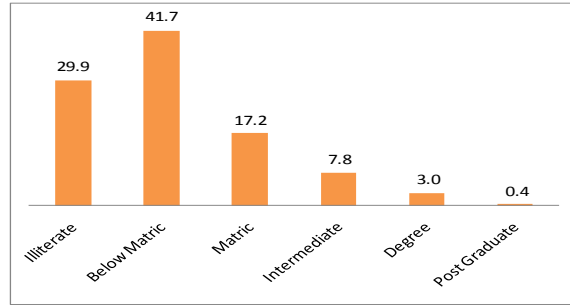
⁵⁹ Based on LFS 2008-09 statistics, almost 2/3rd of the population is below the age of 30. The current estimates of population suggest a total size of 170 million people.

Figure 7: Distribution of Population in Pakistan



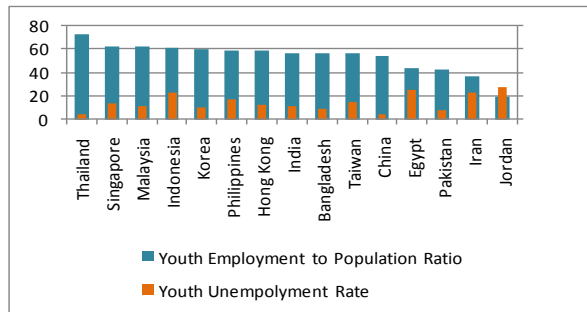
Source: LFS 2008-09

Figure 8: Youth (15-24 year old) Education Profile



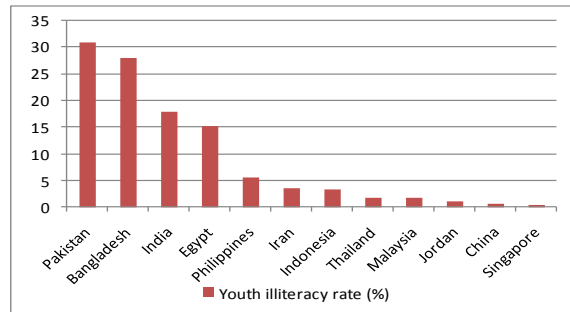
Source: LFS 2008-09

Figure 9: Youth Employment in Selected Countries



Source KILM 6th Edition, ILO

Figure 10: Youth Illiteracy in Selected Countries



Source KILM 6th Edition, ILO

With a Net Enrolment Rate (NER) of 57 percent at primary level, the illiteracy level among youth at 30 percent is the highest in the region posing a serious challenge for policy makers⁶⁰. Hardly 17% of the youth cohort completes secondary education; resulting in more than three quarters to exit from educational system without any foundational or life skills. Barely, less than half of those who complete secondary education make it to college. Moreover, less than 6 percent of youth population (15 to 24 years) has reported to have acquired any technical skills⁶¹. Hence, majority of Pakistan's emerging labor force is either without education and skill or with very little thereof.

While the overall labor force has grown by 3.3 percent per annum in 2008-09 over 2006-07, the youth labor force growth rate is believed to be relatively higher, and increasing, as scores of uneducated, illiterate, and school dropouts join labor force at the age of 10 years⁶². With overall unemployment rate at 2.7 percent in 2008-09, the age specific unemployment rate is the highest among youth cohorts in the age range 15 to 24 years⁶³. Relatively low youth unemployment rate among selected emerging economies of the region does not seem to be comforting as youth employment to population rate in Pakistan is also lower than many other emerging economies (see Figure 9). When compared to India, Bangladesh, Thailand, and

⁶⁰ KLIM, ILO

⁶¹ Calculated by author for youth cohort in age range 15-24 from LFS 2008-09.

⁶² The Labor Force Survey provides information on labor force in Pakistan from age groups 10 years and above (for instance, see LFS 2006-07, 2007-08, and 2008-09).

⁶³ 9.5 percent for 15-19 years; 7.3 percent for 20 to 24 years (LFS 2008-09).

Indonesia the labor force participation rate is rather considered low; however, it is comparable to emerging economies like Philippines, Korea, and Hong Kong⁶⁴.

The reason for low labor force participation rate is that youth entry into labor market is impeded by several factors in Pakistan. These factors include, but are not limited to, the absence of a curriculum that prepares graduates for job market; no internship opportunities for familiarizing Pakistani youth with the world of work; lack of life and work experiences; limited access to financial resources; limited social networking; lack of credibility; and no exposure to relevant role models. Entering into labor market requires skill sets among participants relevant to the job market requirements; however, the formal training programs at vocational and technical training institutes, which are often characterized by teaching outdated skills and are responsible for skill-job market-mismatch, hardly train 6 percent of youth cohort⁶⁵. Added to this, very few opportunities exist for educated youth in the formal sector, which has also been shirking for some time⁶⁶. Similarly, the career counseling and job placement opportunities are almost non-existent, with a few exceptions, leaving many directionless⁶⁷. While sole-proprietorship with no paid employees is a major form of business in Pakistan, inculcating business thinking among school graduates, making youth entrepreneurial or geared towards self employment is missing in most curriculums except for specialized business disciplines in higher education. With fewer employment opportunities on the demand side, a huge bulk of new entrants on the supply side remains underserved in the job market; many are discouraged and hence remain inactive.

Socio-cultural factors are also known to exert strong influences on educated individuals' career choices in Pakistan⁶⁸. Due to lack of mentorship at educational institutions, most mentoring is done through social and communal agents, which includes friends, peers, family networks, local community leaders of religious and political character, small business owners, and social workers. These agents who lack job market experience or a solid entrepreneurship exposure themselves, perhaps with a few exceptions, rather encourage youngsters to take the well trodden path of: seeking favors and employment through political affiliation; seeking nepotism and preferential treatment; networking with religious alliances; or illegal border crossing into Middle Eastern and European countries with the help of spurious recruitment and travel

⁶⁴ Similarly, the overall 'crude' and 'refined' labor force participation (activity) rates of 32.8 percent and 45.7 percent are quite low given large numbers of youth eligible to be counted as part of the active labor force.

⁶⁵ Based on calculations from LFS 2008-09.

⁶⁶ For instance see Labor Force Survey 2008-09.

⁶⁷ For instance, organizations like LUMS and IBA have successfully placed their graduates for private sector apprenticeship and subsequent employment opportunities. Similarly, websites like <http://www.ROZEE.com> and <http://www.CareerPakistan.com> have recently started to cater for the higher end job market. On the other hand, the uneducated and educated youth with no access and awareness of IT remains excluded. The public sector sponsored apprenticeship training program, which focused on mobilizing trainings in organized private sector enterprises, for less educated and skilled youth has miserably failed. For details: Kardar, Shahid. 1999. "Technical & Vocational Training in Pakistan." The Lahore Journal of Economics, Vol.2, No.2.

⁶⁸ There are powerful norms around what economic roles individuals can or cannot perform based on their wealth, education, caste and gender. Preferences for a "White Color Job" are particularly strong among the relatively wealthy and educated. In fact, the society holds a strong inclination for formal employment, especially in the public sector.

agents. Even the educated youth is known to fall for the quakes who offer jobs at home and abroad at premium rents through their so called valuable contacts⁶⁹. Subsequently, Informal pathways clearly dominate the trajectory to job market creating a sense of dependence and helplessness under peer pressure; subsequently influencing youth's career choices. Hence, the informal sector has emerged as a leading absorber of the labor force in the country⁷⁰.

The most intimidating factors preventing youth from entering into the labor market are: a) on the supply side - mismatch of technical and nontechnical skills with the job market, youth dependency, inactivity and late entry, lack of mentorship and; b) on the demand side - slow job-growth in economy, employer discretion - perhaps discomfort and mistrust - towards hiring young and less experienced workers or even opening up their doors for internships, lack of access to physical capital, poor signaling in the economy, and lack of mechanisms for skill-job matching⁷¹. Above all, the public policies lack vision for creating employment and entrepreneurship opportunities.

Since, the public policy framework in past has failed to channel youth energies into a positive force, hence in the aforementioned context, it can thus be argued that the wellbeing of Pakistan's emerging labor force is inextricably linked to the health of the informal sector and private entrepreneurship. Given the presence of a large informal sector, a comprehensive strategy focused on youth education, training, and entrepreneurship, in public private partnership framework, is required for engaging youth both on the supply and demand side. While learning from other countries experience in the region, for instance Indonesia, there is an immediate need to come up with an action plan for youth engagement and employment.

Opening Windows of Opportunities

Young people are the future of Pakistan and their aspirations matter; therefore, a comprehensive youth engagement strategy is required with the underlying objectives of: a) a globalized and socialized youth; b) understanding youth and their needs from society; c) Reviewing policy to provide infrastructure that youth and community might need; d) providing educational and other developmental opportunities to youth; and e) providing economic opportunities as the youth enters the labor force. The youth engagement strategy should be guided by two important principles: a) working with youth not only requires patience, but overcoming barriers to communication as well; b) youth requires, guidance, encouragement, recognition, and above all a chance to reveal their latent energies.

⁶⁹ Anecdotal evidence suggests that a typical youth is willing to spend up to Rs 1 million to land on a job in Middle East or up to Rs 4 million to get illegally transported into Europe in human cargo containers, but are unwilling to invest the same amount in local businesses.

⁷⁰ According to the LFS 2006-07, this sector employs 72 percent of all workers outside agriculture. Furthermore, the skill training needs of a large proportion of country's workforce is also met through this channel since informal employment is typically preceded by informal training, especially in case of '*ustad-shagird*' (master-apprentice) system and immersion in family enterprises for skills acquisitions.

⁷¹ For instance see ILO (2010)

On the Supply side: imparting essential life skills is necessary to channel youth energies into a positive force; especially skills in building team spirit, motivation, sharing ideas, problem solving, conflict resolution, assertiveness, communication and networking, managing workload, time management, decision making, and graduating from fellowship to leadership. On the demand side more jobs need to be created through favorable policy environment. If we assume that people enter the job market at the age of 15 years, then approximately 1.3 million jobs have to be created every year for new job market entrants. The government must ensure a policy framework, which facilitates both public and private sector in providing opportunities.

Working with Youth requires understanding of their issues, barriers to hidden potentials, and pathways to different milestones in life. Therefore, more specific actions entail the following:

1. Introduce a 'Work Study Program' for youth in Pakistan and encourage universities, colleges, and public and private concerns to reserve at least 25% jobs for students.
2. Strengthen functional adult literacy initiatives to help workers increase literacy and learn life skills relevant to job market.
3. Introduce youth entrepreneurship and leadership curriculum in primary and secondary level of education and advanced business skills at higher education.
4. Promote career counseling services at community and school level not only to guide young minds, but to harness their latent energies and help them achieve their dreams.
5. Identify long-term unemployed young people and design labor market entry and participation programs for them.
6. Design access to finance for college graduates to complete their education and for setting up their own businesses.
7. Provide Business Development Services (BDS) such as commercialization and venture financing consulting assistance to young entrepreneurs.
8. Develop a youth focused entrepreneurship program, which helps young men and women in starting their own enterprises by providing an array of business development services in potential areas of economic growth.
9. Reduce direct and indirect cost of setting up small businesses.

X. Way Forward

The new growth strategy focuses on the need to raise growth above its historical average. The new growth strategy is not new growth theory. Rather it is the application of modern growth theory to promote sustained high economic growth. Main argument in the new growth framework is that growth should be market-led and not government-led, Private sector should be the main driver of growth, and if allowed to, the market will generate innovations, entrepreneurship, transformation of cities and youth employment.

How should the role of government be reoriented? Government should move away from activities that compete with the private sector. It will provide public goods - wherever the social rate of return is higher than the private rate of return. The government will administer a well-designed and transparent set of rules governing private economic activities.

Pakistan has no choice but to move in this direction. This is because the old growth model with its emphasis on public investment has not yielded the level of economic growth the country needs. Second, the government finances are a binding constraint. The government simply cannot afford to undertake large-scale capital expenditure without hitting a financing constraint. PSDP will continue to decline and foreign financing is not assured. It is essential to create the space and incentives for the private sector to play the dominant role in the growth process and economic activity.