Re-engineering Economic Structure: A Growth Strategy for the Long Term

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Executive Summary

This paper studies how Pakistan may achieve sustained high economic growth to improve living standards of the people and to reduce poverty. It analyzes the factors that stimulated growth in high performing economies, examines the issues that hold back Pakistan, and recommends a course of action for the future. This document has a near to medium term horizon, up to 2030. It is a policy document, not a research paper, whose target audience are generalist decision makers.

In 1960, USA had a per capita income that was 50 times more than of Pakistan. After fifty-five years, in 2015, that ratio was only slightly better at forty-five. South Korea had a GDP per capita three times of Pakistan in 1960. Today, it is twenty-two times more than Pakistan. During the same period, on the other hand, South Korea radically improved the income level of its citizens by following consistent growth policies. USA’s GDP per capita was fifteen times more than South Korea in 1960. Today, it is higher by just two times and the gap between the two is narrowing.

In recent decades, South Korea and several high performing economies have followed a path to sustained growth that has transformed those nations. At the present rate, Pakistan cannot catch up with the rich economies. It needs a national programme to stimulate economic growth. In a comparison among eight economies, Pakistan had the weakest growth in GDP per capita between 1990 and 2015. The story of high growth economies show that it can be done, though the path is a difficult one. It is entirely up to the leadership of the country.

What holds Pakistan back?

The catalogue of shortcomings is long. Pakistan does not generate enough savings for it to invest in future growth. Resultantly, it has significant infrastructure deficit and low private investment. The
country does not spend enough on workers’ skills development, education, or on other human needs. Government data shows that over twenty-two million children are out of school. A weak macroeconomic framework and low savings and investment have locked the economy in a moderate growth trap. It has a small manufacturing sector that produces low value added goods and contributes just 14% to GDP. Additionally, the country’s institutions and governance do not support economic activity. In fact, they often place a burden on private enterprise. Internationally, Pakistan scores low in governance indicators. Its rank is 144 of 190 countries in World Bank’s Doing Business Index and is 126th of 140 countries in WEF’s Competitiveness Index. It stands at 147 of 188 countries in UNDP’s Human Development Index.

The political economy favours the influential to the disadvantage of the many. In addition, the economy’s limited resources are not allocated efficiently. Forty-four percent of labour is in low productivity farm sector, which contributes about 20% to GDP. Public investment goes to prestige projects. Incentives to promote private investment do not always work. They are sporadically and unevenly provided. In some instances, there is evidence of capture of public decision making by private interests. Other headwinds against the economy include the inadequate security situation, weak macroeconomic framework, and severe power shortages that have led some companies to close operation.

Business as usual is no longer an option. Each year an additional two million people enter the job market. And this number is increasing. We must create more jobs for them. By 2030, Pakistan’s population will touch 260 million. This means the need to educate sixty million more children in addition to those currently out of school. By 2030 also, about half of our population will be in urban centres that are already stressed and cannot provide even minimal services to businesses and residents.

So, what do we do?

From existing literature, it is obvious that there are many measures that high performing economies took for sustained growth. The report distills these to focus on some key levers. While high performing economies strengthened them, Pakistan is mostly found wanting in these areas. These are:

- **Macroeconomic environment**
  Low savings and investment have led to moderate growth. Government revenue is inadequate to meet current and development needs. This leads to high fiscal deficit met from domestic and international borrowing. Domestic borrowing crowds out private investment, while external indebtedness has made the economy
vulnerable. Lack of competitiveness has worsened the structural current account deficit as exports have declined further.

- **Savings and investment**
  Pakistan is severely short here. Most high performing economies invest 25% of GDP or more with an additional 7 to 8% on health and education. Pakistan’s investment to GDP ratio was 15% in 2014. Its public spending on health and education is a total of 3.4% of GDP. The economy cannot rely entirely on cooperation with China to fill these gaps.

- **Efficient resource allocation**
  There are distortions in public investment, flawed incentives, underemployed labour, and sub-optimal distribution of resources between consumption and investment. The report recounts use of industrial policy by high growth economies to upgrade their industrial structure. The tools included tax incentives, low cost credit, subsidy, SEZs, and help with training and R&D.

- **Integration with the world economy**
  Country prosperity today depends on participation in the global economy and performance in global value chains. The question is how does an economy do so. High growth economies have grown by increasing exports to meet the world demand for goods and services. They increased competitiveness and have taken an active part in global manufacturing. This has enabled them the benefit of economies of scale. FDIs have helped as have linkages among businesses and academia as well as access to global talent. Incrementally, they have increased economic complexity by increasing knowledge content in production as well as by having societal arrangements to use these for production. The high growth economies consistently increased exports and maintained a favourable trade balance.

- **Committed and competent leadership**
  It is important for the leadership to provide a long-term development vision and build national consensus to achieve it. Government plays a major role across all competitiveness drivers. It must correct flaws in the political economy and macroeconomic stability to increase credibility and trust among the people. Indicators show that historically Pakistan has fallen considerably short.

**The Restructuring Plan**

The plan centres on a strategy to achieve high economic growth through an interplay of factors that include: a stable macroeconomic framework, policies to stimulate public and private investment in value added sectors, and strengthened institutions and governance. Pakistan may emulate East Asia to follow a development path of export-led growth. The economy’s productivity deficit and surplus labour give considerable room to grow quickly. Specifically, Pakistan must increase the share of manufactures in GDP, which must be part of the global value chain:
1. **Create a robust macroeconomic environment:**
   - Increase government revenue to reduce external borrowing and to increase public goods
   - Implement expenditure reforms
   - Institute policies to enhance savings
   - Keep the twin deficits (fiscal and current account) in check

2. **Increase savings and investments**
   - Reduce or do away with the policy of managing fiscal deficits at the cost of growth
   - Allow positive real rate of return on savings
   - Introduce new long-term saving products and vehicles
   - Strengthen financial intermediation and mechanisms to make it easy for individuals to invest in the capital market
   - Incrementally increase share of public investment as a ratio of GDP. At present, total PSDP budget (federal and provincial) is less than 4% of GDP. Increase it to 7% by 2022. Move from general infrastructure development to targeted support for specific industries

3. **Improve allocation of resources:**
   - Rationalize PSDP portfolio with high priority projects: power supply and transmission/distribution, water storage and efficiency of use, large scale investment in skills training and development, training of government officials, and establish SEZs and industrial parks. Review the power sector policy framework. Provide agriculture research and extension services as well as credit, input, and marketing support
   - Incrementally increase ratio of public investment to GDP
   - Focus on urban infrastructure so that cities support economic activity. In absence of political willingness to devolve governance, federal and provincial governments must invest in physical infrastructure such as power, gas, and water supply, mass transit, and sanitation as well as in high class Wi-Fi connectivity and value added telecommunication. Improve management of air and sea/dry ports. Establish quality skills development centres specializing in technologies that support prioritized industries and services sectors.
   - Use industrial policy to upgrade economic structure and increase value added manufacturing.
   - Increase competitiveness. Building on comparative advantage, support industry’s move to next technology export products. Identify industries that can become part of the global supply chain. Broaden and add value to competitiveness in goods being produced currently as well as in the country’s incipient industries of electrical goods, metal fabrication, and electrical appliances as well as food processing, and downstream chemicals.
• Incentives, both macro-and micro: Macro incentives across all businesses, micro incentives that are targeted to support prioritized industries. They include tax incentives, access to low cost credit, R&D support, dedicated infrastructure, and training of personnel

• Build SEZs and industrial parks and provide infrastructure and services with single window support for them

• Build an effective logistics chain that connects SEZs with and domestic and international markets and promote trade

• Skills training for specific prioritized industries to shift labour from low productivity jobs to manufactures and value added services

• Government may play a pump priming role in industrial development. Recall, the pioneering role played by GoP’s Pakistan Industrial Development Corporation.

4. **Integrate with the world economy:**

• Use trade policy to boost exports and stabilize external account

• Enhance regional and world connectivity:
  • Through logistics corridors including CPEC, transit arrangements, and improved trade facilitation

• Rationalize tariff structure in support of development needs

• Attract FDIs in value added export oriented sectors

• Initiate FTAs with ASEAN bloc or individual member ASEAN countries. In addition to trade in goods, FTAs must include trade in services, trade facilitation measures, and investment agreements

• Resume FTA negotiations with Iran

• Gradually normalize trade relations with India and reinvigorate SAARC

• Build regional integration taking full advantage of China’s Belt Road Initiative. We must make especial effort to improve facilitation, reduce number of clearance documents, and the time taken for clearance of goods.

• Stop reliance on import duty as public revenue and move to a nuanced approach where tariff supports industrial policy.

5. **Committed and competent leadership**

• Government must lead with vision and overall long-term direction to send strong message to all stakeholders about the aims and targets of the reforms

• Incrementally show demonstrable progress

• Remain steadfast to the strategy, despite occasional setback and resistance by interest groups

• Ensure that all incentives will be dispensed without patronage and per criteria. Incentives must not be indefinite and never to industries that do not become internationally competitive.
• Pakistan must have a dedicated team of policy makers and experts to help political leaders make decisions. Policies are to nudge economic activity, not be prescriptive, and will not mean that the government becomes a productive player.
• All plans and policies must be consultative and have stakeholders’ buy-in so that public and private players combine to play their respective roles.
• Government must intervene directly to help the vulnerable and excluded groups who are economically and socially disadvantaged.

Other policies: tax policy, energy policy, land acquisition policy
• Tax policy: increase overall government revenue by targeting tax evasion, ensuring agriculture and services contribute more, and sequentially reduce burden on manufacturing enterprises that presently contribute over 70% of total direct taxes collected.
• Revisit power generation policy to address: a. energy mix, b. generous incentives to new investors in generation, c. reduce line and billing losses, and d. build supply reliability
• Institute especial policies for acquisition of land by businesses. Revisit zoning laws. Make provincial governments responsible for acquisition of all land for SEZs and industrial parks

Skills training: The hunt for talent is a global phenomenon. Availability of trained workforce is the difference between success and failure for a manufacturing or service company. Government must cooperate with industry to develop partnerships for skills and talent development. Government must allocate this function major financial and organizational resources. As past experience shows, skills development programmes have not met with success in Pakistan. NAVTEC, TEVTAs, and other skills development and business support organizations must be restructured for effective delivery. These organizations must develop partnerships with the private sector for effective implementation that show results in better performing enterprises and in value added production.
Re-engineering Economic Structure: A Growth Strategy for the Long Term

Introduction: A known unknown

There are many reasons why Pakistan has not had long term high economic growth on the lines of East Asia. The list is long and past studies have identified them adequately\(^1\). However, it is not possible for any country to resolve all the issues at once. To stimulate growth and to sustain it over the long run, Pakistan must identify and prioritize key policy levers. Once the economy shows progress, it will be possible to phase in other factors.

Taking cue from other countries with successful record of growth may help. But these serve at best as frameworks. Each country must develop policies according to its environment. It must look at the constraints and be realistic about what can be done.

Some factors are a given. Each year, for the foreseeable future, two million young men and women will enter the country’s workforce. Also, an economy’s technical ability improves gradually, which means that Pakistan’s incremental capital output ratio (ICOR) of four will not become better anytime soon\(^2\). For now, the economy’s current account deficit too is structural. The growth strategy must be formulated within these constraints.

Sustained growth requires structural transformation of the economy. It needs long term commitment of decision makers. In fact, there must be a national consensus across party lines and among institutions. It requires energizing society to the goals of development and ensuring appropriate choices about allocation of resources. It calls also for gradual strengthening of institutions and empowering all Pakistanis to participate effectively in economic activities. But, most of all, it requires that the political leadership recognize the rights of all citizens to basic human needs and higher living standards.

Because of potentially large Chinese investment in infrastructure and industrial parks, Pakistan today can make quantum economic progress. However, progress will not come automatically. Our decision makers must seize this moment and convert the optimism and investment into sustained growth\(^3\). Pakistan has received very high amounts of grant and other aid in the past with very little progress to show (see Annex 1). Sustained growth will come about only through policies that leverage these opportunities into long run development and the gradual emergence of a new economic structure.

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1. Among these a comprehensive report is Planning Commission, Government of Pakistan, Final Report of the Panel of Economists, Medium-Term Development Imperatives and Strategy for Pakistan April, 2010
2. Ibid
3. Several international publications are optimistic
Development is an evolving field. Literature is guide, but points out also that as a discipline, it is work in progress. No formula or algorithm exists. The main lessons to draw from the examples of others are:

- That sustained high growth rates can be achieved, though it is not easy, and
- That it is a gradual process. In addition to long term consistent effort, countries must be ready for setbacks. No developing country ‘becomes Denmark’ overnight.

What is long term high growth? What is structural change?

A group of eminent academics and senior level decision makers define it as average economic growth of 7% or above for twenty-five years or more\(^4\). How can it be achieved? A country can achieve it:

*Through a structural shift in the economy in which manufacturing makes the major contribution to GDP. New and diverse industries emerge in the economy that are internationally competitive. They are fueled by movement of low productivity rural labour to higher productivity industry. Growth progressively creates modern industries. This process requires increase in investment, including in infrastructure, and continued enhancement of skills and knowledge for higher productivity. It results in economic development with higher standard of living for all.*

The foregoing paragraph is the essence of the plan for long-term growth. The rest of the document will explain how to get it done. Without structural change, an economy remains trapped in low growth or, at best, gets short bursts of high growth.

This paper will review:

- factors that lead to sustained growth
- issues in the Pakistan economy that prevent long run growth, and will propose
- a growth strategy for the future

This is a policy document, not a research paper, whose target audience are generalist decision makers with influence over policy and strategy.

Why is growth important?

Why is it important? To improve the lives of the people. Pakistan is nowhere close to catching up with the rest of the world in terms of standard of living of its citizens. Despite its

\(^4\) World Bank, Commission on Growth and Development, The Growth Report: Strategies for Sustained Growth and Inclusive Development, page 2, Commission Chair, Dr. Michael Spence, Nobel Laureate. Among its other contributors is eminent economist, Robert Solow, Nobel Laureate in Economics; Institute Professor Emeritus, Massachusetts Institute of Technology, United States. Its list of twenty-one members are all renowned academics and practitioners of economic and development policy.
weaknesses, we will rely on GDP per capita as the symbolic indicator of improved living standards.

Table 1 shows trend ratio of Pakistan’s GDP per Capita against South Korea and USA. Compare this to Korea’s changing ratio with USA.

In 1960, per capita GDP of USA was fifty-two times that of Pakistan. In 2015, this ratio was not much different at 45. South Korea’s GDP per capita was three times Pakistan’s in 1960. It increased steeply to 22 by 2015. This means that each Korean citizen was three times richer than the average Pakistani in 1960. In 2015, she was twenty-two times richer. On the other hand, South Korea’s ratio vis a vis USA improved from 15 in 1960 to 2 in 2015.

At this rate, Pakistan can never catch up with the living standards of OECD countries or may do so in over two hundred years.

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<tbody>
<tr>
<td><strong>Pakistan</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1960</td>
<td>325</td>
<td>560</td>
<td>850</td>
<td>1,150</td>
</tr>
<tr>
<td>USA</td>
<td>17,000</td>
<td>28,500</td>
<td>45,000</td>
<td>51,500</td>
</tr>
<tr>
<td><strong>Ratio</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>USA/Pak</td>
<td>52</td>
<td>51</td>
<td>53</td>
<td>45</td>
</tr>
<tr>
<td>RoK</td>
<td>1,100</td>
<td>3,800</td>
<td>15,500</td>
<td>25,000</td>
</tr>
<tr>
<td><strong>Ratio</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RoK/Pak</td>
<td>3</td>
<td>7</td>
<td>18</td>
<td>22</td>
</tr>
<tr>
<td>US/RoK</td>
<td>15</td>
<td>8</td>
<td>3</td>
<td>2</td>
</tr>
</tbody>
</table>

Source: World Bank DataBank, World Development Indicators

There is consensus that long-term economic growth is necessary to:

- Reduce poverty
- Provide productive employment, which is critical for Pakistan’s large youth population (Annually, more than two million young people feed into the job country\(^5\))
- Improve education, health, and other essential social indicators for realization of the economy’s potential (Pakistan ranks 147 in UNDP’s world HDI\(^6\))
- To move the economy up the technology ladder

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\(^5\) IMF, Pakistan and the Emerging Markets in the World Economy, Christine Lagarde, Managing Director, 24 October 2016

\(^6\) UNDP HDI Report 2015
All above factors are mutually reinforcing. Growth allows an economy to lower poverty and to provide basic needs. Provision of basic needs and lower poverty in turn stimulate growth. They also create social stability.

**Trend of GDP/Capita for selected countries**

How does Pakistan’s income compare with a select set of mostly growth economies? The economies selected below are those that have made substantial progress based on economic and social reforms. Data on USA, is as a benchmark economy. Vietnam and India have not yet had long-term growth, but they have had high growth rates for, at least, a decade each. It is important also to study India, because of similarity in its initial conditions with Pakistan. The gap between the two economies has widened in recent years. This will begin to reflect also on Pakistan’s regional status.

Table 2 and Figure 2, show the ratio by which real GDP has grown between 1990 and 2015 for the selected economies. Apart from USA, which has a very high base number, Pakistan has the lowest ratio of growth in GDP per capita between 2015 and 1990. The ratio suggests how rapidly a country has grown economically. It is important to review why Pakistan’s GDP per capita has grown at a rate slower than the selected economies.\(^7\)

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\(^7\) The GDP per capita data is sourced from the World Bank at constant 2010 US$ (not PPP adjusted).
Table 2
Real GDP per Capita and Growth Ratio

<table>
<thead>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Pakistan</td>
<td>742</td>
<td>1,142</td>
<td>1.5</td>
</tr>
<tr>
<td>India</td>
<td>542</td>
<td>1,751</td>
<td>3.2</td>
</tr>
<tr>
<td>China</td>
<td>731</td>
<td>6,498</td>
<td>9.0</td>
</tr>
<tr>
<td>Malaysia</td>
<td>4,492</td>
<td>10,878</td>
<td>2.0</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1,653</td>
<td>3,834</td>
<td>2.3</td>
</tr>
<tr>
<td>Vietnam</td>
<td>446</td>
<td>1,685</td>
<td>3.8</td>
</tr>
<tr>
<td>Korea</td>
<td>8,795</td>
<td>25,023</td>
<td>2.9</td>
</tr>
<tr>
<td>USA</td>
<td>36,312</td>
<td>51,638</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Source: World Bank, Databank, World Development Indicators

Why is this so?

To understand Pakistan’s inability to catch up, we must look at the sources of sustained economic growth. There is consensus that the following two sources result in growth:

- **Tangible inputs**: these include physical capital (such as infrastructure and plants and equipment). This makes growth a function of investment. Tangible inputs also include labour and land.

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8 Sources of Long-Term Economic Growth, Lawrence J. Lau, Professor, Stanford University, October 15, 2002
• **Intangible inputs**: This refers to technical progress. This in turn comprises human capital, knowledge, R&D, information systems, and all factors leading to increase in total factor productivity for efficient use of capital. Improvement in governance that reduce cost of doing business is also a factor. Intangible inputs result in higher productivity, i.e. they help each unit of investment yield a higher return (depending on the level of technical progress).

**The two givens of tangible and intangible inputs:**

- Higher input gives higher output
- The same input gives higher output with technical progress and better institutions (red line)\(^9\), i.e. efficiency of use of capital

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**Figure 3**

**Technical Progress:**

*The Single-Output, Single-Input Case*

![Technical Progress Diagram](image)

Usually, tangible inputs of capital and labour are important in the early stages of development. These inputs come from public and private investment. However, it is important to allocate these efficiently. For efficient allocation, we must:

- Prioritize public investment to most efficient purpose and minimize rent
- Incentivize private investment to stimulate growth and direct it towards economically desirable ends, as well as focus on export markets

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\(^9\) Sourced from Sources of Long-Term Economic Growth, Lawrence J. Lau, Professor, Stanford University, October 15, 2002, slide 11
Table 3
Tangible Inputs and GDP
Relationship of S, I, and GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>Savings/GDP %</th>
<th>Investment/GDP %</th>
<th>GDP Growth 2015 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pakistan</td>
<td>14*</td>
<td>15</td>
<td>4.7</td>
</tr>
<tr>
<td>USA</td>
<td>18</td>
<td>20</td>
<td>2.6</td>
</tr>
<tr>
<td>Vietnam</td>
<td>29</td>
<td>28</td>
<td>6.7</td>
</tr>
<tr>
<td>India</td>
<td>30</td>
<td>32</td>
<td>7.6</td>
</tr>
<tr>
<td>Malaysia</td>
<td>33</td>
<td>25</td>
<td>5.0</td>
</tr>
<tr>
<td>South Korea</td>
<td>35</td>
<td>28</td>
<td>2.6</td>
</tr>
<tr>
<td>Indonesia</td>
<td>35</td>
<td>35</td>
<td>4.8</td>
</tr>
<tr>
<td>China</td>
<td>49</td>
<td>46</td>
<td>6.9</td>
</tr>
</tbody>
</table>

Source: World Bank data. For Pakistan, SBP Annual Report-Statistical Supplement FY 16, Pakistan’s domestic saving is 8% of GDP, the remaining is net factor income from abroad (remittances).

If growth is contingent on tangible inputs, it is important for the economy to increase supply of capital and human resources. The sources for financial capital are domestic and external savings. Domestic savings are more reliable and sustainable. In Table 3, Pakistan’s savings rate of 14% include workers’ remittances. Our domestic saving is a mere 8% of GDP\(^{10}\). The data for all other countries is for domestic savings only. As stated, “there is no case of a sustained high investment path not backed up by high domestic savings”\(^{11}\). Each unit of capital also crowds in labour.

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\(^{10}\) SBP Annual Report, Statistical supplement, FY 16, Table 2.4

\(^{11}\) World Bank, The Growth Report: Strategies for Sustained Growth and Inclusive Development, Pages 34-35, Commission on Growth and Development, Dr. Michael Spence, Chair, Page 54
So, to sum up, Pakistan lags behind others in economic growth for the following reasons:

- **Low accumulation**: Compared to growth economies, Pakistan has a low investment to GDP ratio based on low savings rate. Rapid growing countries have had Investment to GDP ratio of 25% or more (Table 3), both public and private. Of this, 5% to 7% was in public infrastructure. In addition to investment rate of 25% of GDP, these economies spent 7 to 8% on health and education\(^{12}\). Pakistan has a large surplus of labour. Their employment is limited by insufficient capital inputs. Also, because of low investment in education and skills, the productivity of labour is low, which in turn creates low return on capital.

- **Misallocation of resources**: With respect to public investment, misallocation occurs because of wrong priorities in project selection. Rent in procurement further reduces efficacy. Pakistan has favoured prestige public projects over those with high economic return. In the past, Pakistan sought to industrialize through public sector investment in heavy industry, e.g. KSEW, HEC, PSM, and PMTF. In East Asia, such industrialization was successful because governments created the right conditions, committed high amount of capital, helped with relative prices and incentives, but kept their operation in the private sector. Also, those economies had the human and financial capital to operate them successfully and to make them internationally competitive. There are examples of state owned companies succeeding in new technologies: POSCO in South Korea, Embraer in Brazil, and Airbus in Europe. Misallocation of private investment results from suboptimal markets, low reliance on exports, and inappropriate incentives. An example of the latter are IPPs. IPPs have been given too many concessions and for the life of the projects. Markets must convey prices, but with permanent incentives, this does not happen. Resultantly, we have both high price for power and a shortage in supply, because the economy does not have the means to pay for the power. Also, GoP endlessly continues to treat textiles as an infant industry. Textile manufacturers have no incentive to move up the value chain. With 44% of workforce in agriculture that contributes about 20% to GDP, the economy’s use of labour is suboptimal. However, their shift to more productive vocation requires a massive effort and use of public resources. This report will discuss this factor subsequently.

- **Technical progress**: Pakistan has limited ability to climb up the technology ladder because of low investment in the country’s human resources. Along with this, traditional work ethics\(^{13}\), low R&D, and weak information systems are barriers to technology spillovers. Benefit from imported technology comes at a cost as the economy must pay ‘innovation rent’ (royalties, licenses, IP fees). Technical progress is inherently a medium-term matter, but it is critical for growth.

- **Institutions**: There are many ways to look at this. An ineffective government does not provide the underpinnings for efficient markets. Similarly, an unresponsive public sector

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\(^{13}\) from *Sources of Long-Term Economic Growth*, Lawrence J. Lau, Professor, Stanford University, October 15, 2002, slide 78
results in delays for the firm and increases their cost of doing business. Weak political institutions allow the elite to siphon off wealth. With the elite doing well, there is no incentive to modernize, deregulate, improve business or legal framework, or invest in education and technical ability. Corruption is rampant. There is no evidence of long term commitment to economic growth and to the difficult path it entails. Patch work of incentives handed out sporadically and implemented unevenly cannot replace long term effort.

For example, take the World Bank’s doing business report. Pakistan’s overall rank is 144 out of 190 countries. On some indicators, it is especially weak. These include trading across borders (rank 172), getting electricity (170), registering property (169), enforcing contracts (157), paying taxes (156), obtaining construction permit (150). Despite constitutional provisions, participatory and decentralized governance is minimal. This prevents people to participate in resolving their problems or invest in city infrastructure. History of Western economies reaffirms that these factors were important in their development. Effective institutions depend on societal norms. Eminent economist Atif Mian uses export as an indicator of Pakistan’s economic competitiveness. Since 1992, Pakistan exports have grown at a rate below that of many countries including India and Bangladesh. What is more, the share of export to GDP has fallen. Pakistan’s GDP growth rate also has been modest since 2008. In his view, persistent differences in GDP growth rates with other developing countries is cause for concern. Policy makers must now look beyond economic issues and focus on structural matters: institutional and societal. “The deeper issue is about incentives, human capital, and protection from a rapacious” elite. Pakistan has progressively disconnected from the world with low international and societal linkages. In his view, there is also lack of organizational and professional capacity at the firm level. Pakistani firms do not have regional presence. In terms of competitiveness, they do not capitalize after initial success.

Institutions influence the microeconomic undergrowth and are important for firm level productivity. They create market conditions that promote competition. This in turn forces the firms to adopt better business practices. In productive economies, markets facilitate flow of resources to efficient firms and improve overall resource allocation in the economy.

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14 Discussion in this paragraph is based on 1. ‘Getting Caught in the Low or Middle Income Trap’, Federal Reserve Bank of St. Louis, December 14, 2015, 2. ‘How poor countries seemed to be catching up with rich ones—and why they are now falling behind again’, The Economist, September 14, 2014, 3. The Sources of Long-Term Economic Growth, Lawrence J. Lau, Professor, Stanford University, October 15, 2002
15 The Heritage Foundation, Pakistan’s Economy in Disarray and How to Fix it, James Roberts and Huma Sattar, June 2015, Pages 9-10
18 International Growth Centre, ‘What is holding firms back’, Chris Woodruff, Warwick University
19 International Growth Center, ‘Resource Misallocation and Productive Growth’, Chang Tai Hsieng, Booth School of Business, University of Chicago
• Other headwinds:
  ▪ Fragile security: Security concerns have high economic cost and result in loss of business confidence (both domestic and foreign). Being 14th on the Fragile Index reflects our tenuous security.
  ▪ Power Supply: Whereas all infrastructure services are below par, power supply has been a special concern. The policy and incentive structure here seems misplaced.
  ▪ Weak macro-economic framework:
    ▪ The economy’s trend growth rate is moderate, but confidence in it is reduced by the enduring twin fiscal and current account deficits.
    ▪ High public debt, especially external debt, is a concern. By 2020, external debt could reach USD 90 Billion with servicing needs of USD 20 Billion. Dependence on foreign savings helps government avoid taking difficult, though important, decisions.
    ▪ At 14% of GDP, share of manufacturing in GDP is low. Manufacturing is important for several reasons. It has been the most important cause of economic growth and the path to development and economic power. It creates jobs and stimulates exports. Of the economies selected, Pakistan’s share of manufacturing to GDP is the lowest (Table 4). The 21% shown in the table for Pakistan includes construction and power supply.
    ▪ At 44% of total, agriculture employs more people than it needs. This is for want of opportunities in other areas (manufacturing and services) and because of low savings and skills level. This reduces return from labour to the economy.
  ▪ The challenges are wide scale. In addition to economic issues, they include political and societal issues:
    ▪ Despite transition between governments through elections, political uncertainty remains.
    ▪ Ability to handle security challenges is weak.
    ▪ Democratic institutions are fragile and governments work as oligarchies. Power constraining institutions, parliament and judiciary, do not play their roles.
    ▪ Weak civil society and electorate allow selection of political decision makers from filial and closed networks, and not on ability and propriety.

Be that as it may, institutions in Pakistan can only improve gradually. The economy must work within the constraints of an ineffective government. Most likely, institutions and economy will grow in a mutually reinforcing spiral.

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21 From 2007, there has been consistent international coverage of Pakistan’s security situation including on magazine covers of Newsweek, Time magazine, and a series of reports in major international dailies, NYT, WSJ. Time cover Talibanization was in April 2007, and again in Jan 2012.
22 The Nation, Economy: Three main challenges, Dr. Kamal Monnoo, 21 September 2016
23 Roosevelt Institute, Six Reasons Manufacturing is Central to the Economy, Dr. Joe Rynn, 23 May 2011
25 Points in this para based, in part, on discussions on economic growth by Professor Timothy J. Besley, LSE, Director Suntory International Centre for Economics and Related Disciplines
So, what do we do?

What are the policies that high growth economies followed and how does Pakistan perform in those areas?

Several studies distill the key growth ingredients that were followed by the high performing economies of East Asia. This report summarizes below five key elements of their growth:

1. Creating a robust macroeconomic environment
2. Increase savings for higher investment
3. Improve allocation of resources
4. Integrate with the world economy
5. Committed and competent leadership

Deconstruct it anyway, the country needs across the board reforms for sustained growth. What makes GoP’s task difficult is there is no given formula. Literature is only partial help. Looking at historical trends, we see the ingredients of growth, but there is not yet agreement on the extent to which each component contributes. And they vary for each country and change with time. A growth strategy needs to be nuanced and sequenced.

View Planning Commission’s Vision 2025. In impressive graphics, it sets out a growth framework with seven pillars. The seven pillars include most of the recipe for growth. But what are Pakistan’s priorities? The country does not have the financial means to do everything. More important, we do not have the people to do it all at once. The Vision was approved in May 2014. What have we achieved in the nearly three years since? In terms of at least three pillars, not much. There is no effort to build ‘human and social capital’, or ‘developing a competitive knowledge economy through value addition’, or building ‘water security’ (PSDP allocations for water and for HEC have actually declined since the Vision was launched). With respect to the enabling conditions in the document, the less said the better. Government’s words matter or people lose faith in them. Bombast is neither vision nor strategy.

What we know also is that sporadic incentives do not help. Except for the 1960s, incentives did not stimulate growth or develop any industrial sector. And even then, it was economic liberalization and the dual exchange rate that possibly helped more. Also, Pakistan was an island of stability and government worked better. The 1965 war changed that.

In recent decades, use of concessional credit and fiscal and tax incentives have fallen short of potential. Exporters have not benefited from either LTTF or export refinance, to the extent they could have. This is so in a capital scarce economy, though access to credit should stimulate investment. The same holds true for government’s initiatives to promote investment and exports.

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26 World Bank, The Growth Report: Strategies for Sustained Growth and Inclusive Development, Part 2, Pages 33-68, Commission on Growth and Development, Dr. Michael Spence, Chair, the selected policies are a refined, combined, and extracted version of the list seventeen policies discussed in these pages

27 Planning Commission, Pakistan 2025, One Nation-One Vision, Page 25 gives overall framework, detailed discussion follows for each pillar.

28 Business Recorder, Pakistan Vision 2025 approved by NEC, 30 May 2014
such as tax holidays and accelerated depreciation for plant and equipment. Government has provided also R&D support through cash transfers and tax concession, but to no avail. Pakistan has a liberal FDI policy environment, yet FDI has not grown. It requires a separate study to determine why incentives and policy liberalization have not worked. They may have to do with the design of incentives. This could also be because a liberal policy conceived at the federal level does not get implemented at the operational level of provincial and local governments. Incentives particularly lose effectiveness when application is uneven and full of hurdles. It is often easier for influential people to avail incentives. If tax avoidance and even evasion does not carry cost, tax holidays would not work in many cases.

Sustained effort calls for a holistic approach. We may bear in mind that continued economic growth is a recent phenomenon in history, some two hundred years old. Governance is as old as society. All great civilizations became so on the back of an effective executive. These include the Roman empire, Confucius China, and the Ottoman empire.

While Pakistan’s challenges are extensive, for this report, it is important to identify their relationship with key growth levers and policies. Literature is replete with recommendations and best practices for growth. This report distills these to recommend what it considers most needed and workable. It will stay with key messages and policy levers.

Before we move to the five ingredients listed above, it is important to clarify the role of government in the economy. To begin with, government needs to define its role. Because of ideological belief of some policy makers and academics about the role of government, on the spectrum between laissez faire and intervention, it is important that government’s role in the economy must have broad acceptance. The balance between too much and too little government is delicate. Appropriate policy rather than ideology should be the decision maker’s guide. In any case, what is more important is effective government.

In this report’s view, with weak markets in developing countries, a minimal role for the government is not an option. However, each country has special characteristics, so the solutions have to be customized and well considered. Government must assist private investment and businesses. Yet it must do so by relying on the mechanism of the market. The productive players must always be in the private sector. There must be sufficient competition among them. Government must base its support on criteria for businesses to follow and it must be time bound. There should be no hint of patronage.

**Role of Manufacturing in National Income**

A key component of long term growth is high level of contribution of manufacturing to GDP, especially in the early years. This is almost a constant in all the sustained growth economies
and key to structural transformation of the economy. This report too takes growth in manufacture as an essential feature (see Table 4)\(^29\).

There is high correlation between a country’s manufacturing GDP and total GDP. High manufacturing growth drives higher total GDP\(^30\). “As a nation begins to build the knowledge and capabilities necessary to manufacture goods- and trade those on global markets- its path to prosperity begins”\(^31\).

Goods, of course, do not get produced in a single location. Value addition takes place usually across a number of economies. So, to increase share of manufacturing in GDP requires an economy to be part of the global supply chain of a given product. Manufacture of intermediate goods is key as a product is manufactured in disaggregated locations. R&D, engineering, and manufacturing take place in different locations according to an economy’s competitive advantage. For Pakistan to be able to do so, this requires urgent reform and improvement in a number of areas. Policymakers must, on the one hand, understand the organization of the global industries. On the other hand, we must understand, devise, and implement strategies to position the Pakistan industry in the global economy\(^32\). We must:

- Create manufacturing and supply chain hubs, clusters or SEZs
- Review policies based on continuous dialogue between policy makers, government and private service providers, and businesses
- Intensify interconnectedness with other economies, through trade facilitation, effective logistics, transit arrangements, and trade agreements or FTAs.
- Assist with sharing of information between Pakistan businesses and lead global firms as well as other firms at various stages of production. Policymakers and firms must develop global and local perspectives
- Have policymakers understand where production is taking place today and where it will take place in ten years. It is important to know what determines these trends.

So far, Pakistan has plodded without agility on China’s offer of SEZs. There cannot be business as usual as change is continuous and our government policy makers, service providers, and businesses must adapt at the same pace. Markets and demand quality are shifting as are technology and processes.

Pakistani firms are at a disadvantage. They suffer infrastructure deficit, lack of services from government as well as delays in approvals. Most important, firm level managerial skill is inadequate with a shortage of competent workers. Today, the hunt for talent is global. With

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\(^{29}\) Literature is full of examples. Among the many documents for discussion on the subject, see World Bank, The Growth Report: Strategies for Sustained Growth and Inclusive Development and UNIDO Inclusive and Sustainable Industrial Development Working Paper Series, 2016 ‘The Importance of Manufacturing in Economic Development: Has this Changed?’


\(^{31}\) Ibid Page 8, referring to extensive research by Ricardo Hausmann and Cesar Hidalgo, Harvard and MIT

\(^{32}\) Op.cit 30 Volume 3, all ideas adapted from Pages 7-9
limited talent at home, Pakistani businesses do not have access to world or regional talent and the security situation makes it difficult for them to attract talent to the country. To understand the global value chain, let’s now look at the value added stream of one iPhone4. Notice, that China’s value addition is just $6.54 or 3% of product value.

The iPhone 4 Value Chain

| Final product leaves manufacturing/assembly gate in China for export to USA | $194.04 |
| Total input |
| USA | 24.63 |
| South Korea | 80.05 |
| Germany | 16.08 |
| France | 3.25 |
| Japan | 0.70 |
| Rest of World | 62.79 |

Value addition in China | 6.54

<p>| Table 4 | Share of Manufacturing in GDP |</p>
<table>
<thead>
<tr>
<th>Country</th>
<th>Manufacturing in share in 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pakistan</td>
<td>14*</td>
</tr>
<tr>
<td>USA</td>
<td>21</td>
</tr>
<tr>
<td>Vietnam</td>
<td>37</td>
</tr>
<tr>
<td>India</td>
<td>30</td>
</tr>
<tr>
<td>Malaysia</td>
<td>37</td>
</tr>
<tr>
<td>South Korea</td>
<td>38</td>
</tr>
<tr>
<td>Indonesia</td>
<td>42</td>
</tr>
<tr>
<td>China</td>
<td>43</td>
</tr>
</tbody>
</table>

Source: World Bank data
*The share of industry in GDP, including power generation and construction, is 21%. Manufacturing is 14%

This report now analyzes Pakistan’s performance in the five key ingredients for sustained growth. It will assess how Pakistan figures in these policy areas and what it needs to change. This analysis will help show the way for a growth strategy for the country.

Fast growth economies change their structure over time. New industries come in for old ones in a process of creative destruction. Economies and companies must remain efficient and

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34 World Bank, Databank
35 The term and concept coined by eminent economist Joseph Schumpeter
dynamic. Faced by business cycles, they maintain a “process of industrial mutation that incessantly revolutionizes the economic structure from within”. For example, some of today’s companies in USA such as Apple, Amazon, Google, Verizon, and Microsoft, did not have the dominating presence twenty years ago as they do today. Pakistan’s production structure is the same today as it was fifty years ago.

1. Creating a healthy macroeconomic environment:

   - Why is it important?
     - It is a strong precursor for strong, sustained economic growth and for higher living standards. It also reduces variability in growth rates
     - It provides predictability for firm level decision making
     - It enables the economy to weather external shocks
     - It can target specific objectives: restructuring, creation of decent jobs, provision of infrastructure and public goods, reducing regional economic differences.
     - It creates coherence among sub-set of policies such as industrial, trade, labour, agriculture, and social policies.\(^{36}\)

   - What are its policy instruments and variables?
     - GDP growth and its components
     - Inflation rate
     - Unemployment rate
     - Savings and investments, fiscal and monetary policies
     - External account: international trade and finance (Balance of Payments)\(^{37}\)

The country’s economic framework must support the objectives of steady growth, full employment, stable prices, and a viable external account.\(^{38}\) While Pakistan’s economy has not had volatility or turbulence, there are sufficient concerns about its ability to underpin growth. For the economy to support growth, Pakistan must address following key issues:

a. GDP growth: Pakistan’s low to moderate GDP growth rates means modest improvement in living standards and continued high rates of poverty. Even during the years that Pakistan achieved high growth rates, there was no effort to improve social indicators. Without productivity increase, the economy lost its growth momentum soon as the immediate impetus ebbed (usually foreign aid inflows). On each occasion, periods of high growth rates have not lasted for more than a few years.

b. Savings and Investment: “A long-standing imbalance between national saving and investment has been identified as a contributor to macroeconomic vulnerability”\(^{39}\). This is partly because of

\(^{36}\) Based on 1. WB and IMF Macroeconomic Policy and Poverty Reduction, 2. UN System Task Team, Macroeconomic stability, inclusive growth and employment, 3.NZ government Treasury Department, Statement of Intent, 4. Wikipedia, Macroeconomics

\(^{37}\) Ibid


\(^{39}\) New Zealand Government
government’s negative savings (in the last five years, this has ranged between 0.6% of GDP in FY 16 to 5.1% of GDP in FY 13)\(^{40}\). Low savings is caused by low GDP growth and underemployment, inequity of tax structure, financial exclusion of a large part of the population, and weak financial intermediation. Savings and growth mutually reinforce each other, as growth increases ability to save, which in turn boosts investment. One study finds savings to grow rapidly when a young population finds employment as they have fewer dependents. This finding is especially relevant in view of Pakistan’s youth bulge.

c. **Inadequate public revenue:** At present, GoP’s revenue is not enough to meet current expenditure, leave alone take care of part of the investment programme. Government spending is moderate compared to world average and compared to countries in our sample. GoP’s total expense to GDP ratio is 18% against a world average of 29%. The expenditure ratio for Malaysia is 20%, USA 23%, and South Korea 25%\(^{41}\). Tax reforms have been talked about, but not implemented. Done properly, it will mobilize resources to enable government to meet its public goods obligations. It will reduce fiscal deficit to make credit available for the private sector. Low government revenue results from GoP’s inability to broaden the tax base, enforce a progressive income tax regime, withdraw a host of concessions and exemptions, and to prevent wide scale evasion. Government’s total revenue is 15% of GDP while the tax revenue is 12%\(^{42}\). A tax to GDP ratio of over 15% would allow fiscal space for investment in human capital and infrastructure.\(^{43}\)

d. **Balance of Payments:** Our low domestic savings of 8% of GDP has led to dependence on external savings. Pakistan’s high reliance on foreign cash flows is inherently unsustainable. It has led to vulnerability on the external account. Of great concern is that external borrowings do not just fund projects. A part of foreign borrowing is for budgetary support. During eight months of this fiscal alone, Pakistan has borrowed USD 4.6 Billion, including from commercial sources\(^{44}\). When this occurs over long periods, it places the economy at high risk. Foreign capital must go to public and private projects only i.e. investments that create future returns and tradeable goods. Pakistan’s current account deficit was moderate last year and it is expected to be the same this fiscal. This is largely because of low commodity and oil prices. Though IMF estimates current account deficit to remain within 2.0% of GDP up to 2020 (Twelfth Article IV Review), it will likely be more. Oil price may go up by 2020. Workers’ remittances, an important part of Pakistan’s foreign inflows have begun to fall. Additionally, debt service expense will increase to service recent commercial loans, CPEC debt, and other assistance. IMF estimates that short term external debt will double between 2015 and 2020. All of these factors will strain even more the Balance of Payment. Our balance of payment is a special challenge for economic stability and business

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\(^{40}\) SBP Annual Report-Statistical Supplement FY 16, Table 2.4  
\(^{41}\) World Bank, World Databank, figures for 2014  
\(^{42}\) Ministry of Finance, GoP, Fiscal operations 2015-2016, Tables 1 and 4.  
\(^{43}\) Based on ‘Revenue Mobilization and International Taxation: Key Ingredients of 21st-Century Economies’ by IMF Managing Director Christine Lagarde, 22 February 2016  
\(^{44}\) Daily Times, Pakistan’s mounting debt, 7/2/17, Express Tribune, Pakistan gets $4.6b in fresh foreign loans, 2/3/17
confidence. The level of Pakistan’s foreign exchange reserves moves along with external assistance or borrowing as no sustainable source of inflows exist.

e. **Commitment to long-term growth** means giving up present consumption and investing for future returns. This requires Government to make politically difficult decisions. It means strict enforcement of tax laws and control of evasion (which has created a political economy of its own), removal of tax exemptions, privatizing or closing loss making PSEs, and review of continued protection for some industries. Growth must be based on sound footings. “The import-based consumption-led growth laid the basis for the subsequent balance of payments crisis in 2008”\(^{45}\). There is need also to review Pakistan’s regional relations and its security policy. Defence spending preempts more fiscal space than afforded by economies at similar income level\(^{46}\). Pakistan currently has severe shortage of critical infrastructure, especially power supply and water, and equally of human capital. It is critical for public finance to look at its long-term effect.

f. **Fiscal deficit:** Of late our fiscal deficit has been moderate. Again, this is largely because of fall in commodity prices and inadequate provision of services. There is good reason to reform government expenditure and reorient it to the goal of growth. Once done, we may consider flexible fiscal targets. To sustain public investment, “government revenues need to be high enough to support current expenditures on service delivery and a part of the investment program”\(^{47}\). Stability must not constrain government from meeting the growth target. To support growth, government must be able to tweak the amount of fiscal deficit. Having a slightly elevated fiscal deficit is okay, as long as growth rate is higher. Of courses, this assumes judicious use of the deficit and avoidance of waste so that the spending is for investment and not consumption\(^{48}\).

g. **Price stability:** In the long-term, Pakistan has maintained a moderately high rate of inflation with a long-term average rate of 7.85% for the period 1957 to 2017\(^{49}\). With high dependence on imported energy, world oil prices or change in Rupee value reflect quickly on the CPI. Just before the present low inflation rates, we saw CPI touch 25% in 2009. Similarly, our interest rate averaged a high 11.55% for the period 1992 to 2016, though it hovers below 6% at present\(^{50}\).

Despite the above, GoP claims that it has achieved macroeconomic stability. It is hard to agree with the government. Price stability and control over fiscal deficit has been a function of low commodity prices worldwide. These may just as likely increase in coming years. Balance of Payment concerns remain especially high. The current account would likely be above IMF’s sanguine estimate. Current account deficit is a structural issue. There is no evidence of policies or plans to correct it. IMF forecasts a GDP growth rate of over 5% until 2020. It is not clear how sustainable is the projected growth rate. Nor do we know about the quality of growth, i.e.

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\(^{45}\) PC, Panel of Economists’ report, Page 1

\(^{46}\) The Political Economy of Growth without Development: A Case Study of Pakistan, William Easterly, Page 10

\(^{47}\) The Growth Report, Page 55

\(^{48}\) The Growth Report, Page 24, gives the example of South Korea

\(^{49}\) [http://www.tradingeconomics.com/pakistan/inflation-cpi](http://www.tradingeconomics.com/pakistan/inflation-cpi)

\(^{50}\) [http://www.tradingeconomics.com/pakistan/interest-rate](http://www.tradingeconomics.com/pakistan/interest-rate)
whether it will lead to more and decent jobs and overall development that improves HDI and boosts living standards. In the event, it is hard to agree that government has pursued sound fiscal policy. The real test of macroeconomic stability comes from its effect on functioning of the real economy. Present stability has not translated into major increase in manufacturing or in production of higher value added goods. In addition, government has yet to consider a diverse range of policy tools with countercyclical measures for long term macro stability. Having a stable macroeconomy will foster appropriate microeconomic conditions to help firm level decision making.

2. Increase savings for higher investment, both public and private:

Why is it important?

- Investment inputs growth and savings enable investments. These are key growth elements

What are its policy instruments and variables?

- Fiscal and monetary policies
- Financial instruments and markets
- Public investment and environment for private investment

High growth economies rely on physical and human capital. Public investment helps build infrastructure and skills. Economies with long term economic growth have maintained investment rates of 25% or above (Growth Report). In addition, they spend an additional 7% or more on health, education, and skills training. In high growth economies, governments also encourage private investment by creating favourable conditions. (In a subsequent section, this report makes specific recommendations for encouraging private investment).

With respect to public investment, weak economic fundamentals have meant preference for short run stability over long run growth. As a result, public investment has been considerably below the economy’s needs. World Bank Growth Report considers it a bad idea to “Reduce fiscal deficits, because of short term macroeconomic compulsions, by cutting expenditure on infrastructure investment”. Public investment crowds in private investment, raises return on them, and facilitates emergence of new industries. Investment in transport infrastructure provides logistical efficiencies for the private sector. Investment in telecom connectivity gives similar high returns. It provides access to information, markets, and education and knowledge transfers. Telecom connectivity is fast becoming an efficient means also for delivery of public services.

Spending on health, education and skills training builds human capital for overall higher return on investment. Done over a sufficient period of time, the economy acquires the ability to absorb new technologies, imitate them, and invest in R&D for innovation. It enables an economy to gain most from FDI. Pakistan’s low public expenditure on health and education is a concern.

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51 UN Department of Economic and Social Welfare (DESA), A Broad View of Macroeconomic Stability, José Antonio Ocampo, Working Paper 1, 2005
52 The Growth Report, Page 68
But a greater concern is its quality. Most studies show our students lag in cognitive abilities. Shortage of skills affects efficiencies on factory floors and private and public service provision. Building human capital and overall ability is important for catch up growth. In addition to industrial application, exchange of knowledge with other countries improves government and citizens’ conduct as well as work ethics. In a later section, we will see that Pakistan is considerably behind high growth economies in human capital measurements.

There are questions also about the effectiveness of public spending. Government’s portfolio of projects does not prioritize investment with high economic returns and those that leverage growth. In some cases, there are also concerns about transparency in procurement. Infrastructure investment through PPP make limited budget go a long way. So far, this has not worked well in Pakistan for want of robust and sustainable policy and capacity to manage contracts in the interest of consumers of service. We have seen capture of state decisions by private interests, which hurts economic growth.

GoP is right to focus on CPEC investment to stimulate growth. There are some concerns, though:

- Merely relying on CPEC (public or private) will not increase investment to the desired level of (say) 25% of GDP from the present 15% (Table 3).
- It is most likely tied assistance that does not allow international competitive bidding
- For sustained growth, the economy must make high levels of investment over decades and invest also in productivity enhancement. As CPEC involves substantial debt finance, its projects would need very high levels of return to repay the debt. This policy of relying on foreign savings to increase investment is inherently unsustainable.
- It is hard to confirm if the allocation of CPEC resources are directed to the most economically viable projects. This is especially true of private investment. The power sector has been guaranteed extensive concessions and very high rates of return at a high cost to the economy.
- There is no known obligation on foreign investor to hire and train Pakistan employees, including in management positions. This is necessary if the country is to gain and transmit knowledge from FDI. This will maximize benefits for the society as knowledge flows beyond the limits of a single firm.
- Some experts are concerned also by the environmental effect of coal fired power plants. It is a cost to the economy that government must consider while determining tariff rates.

The next generation of CPEC investment in industrial parks and SEZs should bring greater benefits to the economy. This would depend on how well the industrial parks are managed and how rigorously SEZ tariff incentives are enforced. We may recall the experience of Gadoon

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53 Growth Report Page 42
54 Already, Pakistan is one of the most affected countries from climate change, Dawn, The Perils of Inaction on Climate Change, 27 March 2017
Amozai as well as of EPZA. However, private investment in manufacturing sector has the potential to benefit the economy and create employment.

Since fiscal 2010-11, private investment has been under 10% of GDP\textsuperscript{55}. Partly, this is because structural fiscal deficit and government borrowings crowd out private investment. There are many other hurdles that investors face. These include lack of infrastructure services, especially power supply and cumbersome logistics, and poor facilitation at the border. Firms also face administrative hurdles as noted in World Bank’s ease of doing business and in WEF’s competitiveness index. In later sections, this report will address these issues and recommend ways to encourage private investment.

Apart from increasing government savings, there are limited options with government to increase private savings (households and corporate). Falling remittances may further aggravate this matter. Overall Pakistan’s savings rate responds very little to increase in GDP (it has a low elasticity of 0.06). Private corporate savings is a small part of the total, because of its small size and also because of flaws in measuring it. Low mark ups on deposits, often below CPI, deter individuals from saving. Exceptions aside, returns on one year deposits have been consistently below CPI in Pakistan. Consequently, households use informal modes of savings. Experts recommend better financial intermediation, revisiting real rate of returns on savings, creation of simple mechanisms for individuals to invest in the capital markets and to make investment a part of financial portfolio of individuals. They recommend also wider use of long-term saving vehicles like pension schemes and life insurance; and new products like Housing Societies and Credit Unions. Because of low access to banking, we may encourage also “mobile phone banking”\textsuperscript{56}.

3. Improve allocation of resources:

Why is it important?

- To direct economic resources for growth purposes and to avoid waste

What are its policy instruments and variables?

- An effective and functioning market
- Public intervention to create relative prices

The essential components of growth are well known. These include capital, technology, labour, and is backed by effective governance. What matters is the combination of these inputs. Resources are limited. Their appropriate use is key for growth. Also, the input mix evolves over time and policies must take note.

Misallocation is caused by:

\textsuperscript{55} SBP Annual Report-Statistical Supplement FY 16, Table 2.4
\textsuperscript{56} Most thoughts in this paragraph are from PC Panel of Economists report, Pages 27-33
a. **Public expenditure**: government’s spending does not support growth. The mix between current and development expenditure is skewed in favour of the former (80% of total). Even within federal current budget, expenditure on services for businesses and the people are low with 63% of current expenditure on debt servicing (40%) and defence (23%).

b. **Incentives to inefficient industries and to industries that produce low knowledge goods**: This report has discussed the examples of IPPs. For example, we must ask if private power, in the present policy framework, has been good for the economy. Likewise, we must review continued subsidy and protection to some other industries. Rather than boost growth, continuation of such policies dampens economic activity and increases overall costs. Continued coddling of the textile industry has no economic rationale. New entrants and new businesses create progress and growth in economies, not continued subsidy to existing players. Research suggests that trade has a negative effect on growth in economies that specialize in producing low quality products. Bringing automation to low end manufacturing further risks growth.

c. **Underemployed labour is a major slack in the economy**: This affords high potential for growth. Their continued engagement in low productivity small farms dampens growth. This is an important subject and merits additional discussion in the Paras below.

d. **Investment in the future**: The economy misallocates between current consumption and capital formation for future returns. Household consumption alone is 78% of total GDP. Without sufficient investment, an economy is exposed to boom-bust growth. It may be appropriate to change relative prices of some consumption items for the economy to move towards higher investment.

**Use Industrial Policy**

A myth surrounds economic policymaking in Pakistan that GoP cannot direct private investment. Pakistan must follow the example of East Asia in using industrial policy for developmental ends. In the debate about whether governments should intervene to correct market failures, eminent development economists weigh in favour of intervention. Some go much further. They urge developing economies to target preferred economic activities, industries and technologies, and suggest ways to do so. “The process of upgrading industrial structure to a higher level consistent with factor endowment cannot rely solely on the market mechanism.” It is possible also to draw on the advantage of backwardness, i.e. adopt technologies that are new for Pakistan, but mature elsewhere.

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57 Argument derived, from Schumpeter’s ‘creative destruction’ idea.
58 The relationship between trade openness and economic growth: Some new insights on the openness measurement issue Marilyne Huchet-Bourdon, Chantal Le Mouël, Mariana Vijil, Page 5
59 The Guardian, Automation will end the dream of rapid economic growth for poorer countries, Andrew Norton, 20/9/2016
60 The Growth Report, Pages 48-49
61 ILO_UNCTAD, Transforming Economies: Making Industrial Policies work for development, Justin Y. Lin & Volker Treichel
In fact, East Asian industrial policy went yet beyond. They coordinated complementary investment, enforced entry regulations against competing investment, and ensured economies scale. They regulated technology import to ensure that investors do not import obsolete technology. FDI was regulated to mandate local content, technology transfer, and exports. At times, their governments acted as venture capital fund and incubators for new technology firms.\textsuperscript{63}

Economic development is a process of self-discovery through a well thought out (and well intentioned) process.\textsuperscript{64} An economy’s comparative advantage comes from endowment of labour, capital, and natural resources. However, this is a broad principle. The kind of labour intensive industry an economy employs can vary. And comparative advantage evolves over time. Government policy, though complex, has a key role to play.\textsuperscript{65} There are many examples where government intervention has not helped growth. Yet equally, successful structural change has always come about with government help.\textsuperscript{66}

How to use Industrial Policy

GoP can create incentives to stimulate manufacturing in the country. A properly designed industrial policy will boost export oriented manufacturing and, in time, take it to higher value added and tech intensive investment. The crucial role of exports in the success of high performance economy is beyond dispute. While discussing specific strategies and policies for Pakistan, this report will discuss in a later section how to select industries and instruments.

Although Pakistan does not have a declared industrial policy, the government often relies on individual instruments. It does so sporadically not as part of a large strategy and upon representation of interest groups. Perhaps that is why they have not been effective.

Instruments used worldwide include “tax breaks, direct subsidies, import tariff exemptions, cheap credit, dedicated infrastructure, … and export zones”.\textsuperscript{67} In addition, governments finance education and training to build skills in specific industries. During the development stages, Western and East Asian economies used these tools at different times. These are used today in US and Europe to help the computers, communications, aerospace, and other new technologies, and aerospace. These industries “would not have existed without defence-related R&D funding by the federal government”.\textsuperscript{68} Economies also use exchange rate to promote exports. Pakistan’s dual exchange rates were very successful in the 1950s and 1960s. However, continuous low Rupee value will take away the incentive for firms to compete and upgrade technology.

\textsuperscript{63} Industrial Policy: Can we go beyond unconstructive confrontation? Ha-Joon Chang, Cambridge University, 2009
\textsuperscript{64} The reference to self-discovery draws on the research work ‘Economic Development as Self-Discovery’, Ricardo Hausmann and Dani Rodrik, John F. Kennedy School of Government, Harvard University, March 2002
\textsuperscript{65} Ibid Page 6
\textsuperscript{67} The Growth Report
\textsuperscript{68} Op.cit 52 quoting Ha-Joon Chang, Page 10
Exchange rate is no substitute for productivity enhancing skills and knowledge\(^{69}\). Some economies have also used exchange controls. “Developing countries should maintain the autonomy to impose capital-account regulations”, per UN DESA’s and eminent economic thinker Jose Antonio Ocampo.

**Discipline is key in dispensing incentives**

For it to succeed, discipline must guide implementation of industrial policy. Of particular concern in Pakistan are the legitimate issues of government competence and political influence. Selection of industries and instrument, and design of incentives require detailed study. Also, Pakistan’s patronage politics is now a well-known phenomenon, which would render irrelevant even the best of policies. Incentives must be temporary and must be allowed only to firms that meet carefully prepared criteria. There should be minimal red tape and discrimination so that businesses do not spend time and cost in receiving incentives. Implementation of policies must be evaluated critically and may be given up if they don’t work. Some conditions are particularly important. Incentives and subsidy should not exceed what is required for the industry to find its feet. They must never be permanent. And they must go to the most efficient players based on effective criteria. There must be competition within the industry to ensure best practices. The industry should be in the private sector. (Many of these conditions do not apply to IPPs). Protection and promotion of business does not mean protection of inefficient businesses or of those that seek extra rent. Research suggests that the main difference between successful and unsuccessful intervention was the strict discipline enforced by the former countries\(^{70}\).

**Move labour from farm to industry and urbanize**

Development in East Asia was enabled by movement of large numbers of workers from low productivity farm hands to export manufacturing. Like capital, labour must be put to the most efficient use. Pakistan must have a policy to convert its vast labour resources in agriculture (44% of workforce when the sector contributes 21% to GDP) to more productive use in manufacturing and services. If the economy is reasonably linked to global markets, the limit to growth comes only from inputs of capital and skills.

The two million young people entering the job market each year should become a source of economic growth\(^{71}\). Their number will grow before the youth bulge declines. By not imparting education and skills to them, Pakistan is missing out on the growth opportunity that the young population offers. In addition, a large young population that cannot participate usefully in economic activities is a challenge to social stability. GDP per capita is inversely linked with labour in agriculture activity.

Movement of agriculture labour is aligned also with urbanization in a country. Table 5 below shows a very high inverse correlation between GDP/Capita ranking with urbanization (-0.97),

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\(^{69}\) The Growth Report

\(^{70}\) Industrial Policy: Can we go beyond the unproductive debate, Ha-Joon Chang, University of Cambridge, Page 17

\(^{71}\) Refer earlier citing of IMF MD Christian Lagarde’s talk
and declining rate of agriculture employment (0.89). Agglomeration economies, or cluster of economic activities and services give economies of scale\textsuperscript{72}. The census currently underway may surprise planners. They may find a higher than expected percentage of population in the cities of Pakistan. This requires a new set of policies that requires also the need to correct the politics of urban growth. All high growth economies show that economic activities conducted in urban areas, manufacturing and services, are the lead contributor to growth (see Figure 6\textsuperscript{73}). “Large-scale migration to the cities is part and parcel of the transformation economies must go through if they are to grow quickly. No country has ever caught up with the advanced economies through farming alone”\textsuperscript{74}. Setting up of industrial parks and SEZs will encourage the shift.

However, shift of labour from agriculture to manufacturing and services will take time. Given the importance of agriculture in our economy, it is important to continue with investment that are justified on the basis of economic returns. These investments may include projects to enhance water efficiency (in cooperation with ZTBL). Investment in research and agriculture extension services also carry high rates of return. These are needed for food security, poverty alleviation in rural areas, and to enhance productivity.

<table>
<thead>
<tr>
<th></th>
<th>GDP/Capita Rank 2016</th>
<th>% Labour in Agriculture 2010</th>
<th>% Urbanization 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>18</td>
<td>2</td>
<td>82</td>
</tr>
<tr>
<td>ROK</td>
<td>45</td>
<td>7</td>
<td>82</td>
</tr>
<tr>
<td>China</td>
<td>104</td>
<td>3</td>
<td>56</td>
</tr>
<tr>
<td>Malaysia</td>
<td>70</td>
<td>12</td>
<td>75</td>
</tr>
<tr>
<td>Indonesia</td>
<td>130</td>
<td>34</td>
<td>54</td>
</tr>
<tr>
<td>Vietnam</td>
<td>161</td>
<td>58</td>
<td>34</td>
</tr>
<tr>
<td>India</td>
<td>159</td>
<td>51</td>
<td>33</td>
</tr>
<tr>
<td>Pakistan</td>
<td>171</td>
<td>45</td>
<td>39</td>
</tr>
</tbody>
</table>

Vietnam % labour in agriculture 2006
Correlation: GDP/Capita with % labour 0.89, with Urbanization -0.97

\textsuperscript{72} The Growth Report, Page 58
\textsuperscript{73} The Growth Report, as appearing on Page 114
\textsuperscript{74} The Growth Report, Page 60
Moving to public investment, Pakistan may review expenditure policy and increase space for development expenditure. It may reconsider the preference for prestige projects. It must review also the amount spent on non-growth physical infrastructure and reorient spending to growth needs. Transparency in procurement and better project management will leverage the same investment for higher returns. Increased investment in skills training will prepare human capital for manufacturing and services. In the section to follow, this report discusses the complexity
of the economy. This is a measure of the amount of knowledge that goes in to the goods produced by the economy. It has high bearing on economic growth and national income. Creating skills and knowledge is initially a government function (public expenditure), which at advanced levels is taken up by private sector.

4. **Integrate with the world economy:**

Country prosperity today depends on participation in the global economy and performance in global supply chains. The question is how does an economy play an important role globally. How does it adapt and change to be able to do so?

Why is it important?

- Exports are a source of growth.
- Manufacturing value chains is the new norm
- Benefits of economies of scale with bigger market size
- Increase in efficiency because of competing internationally
- Imports and FDI bring knowledge, technology, and capital.
- Exchange of ideas and values with other countries enriches a society by accessing the “accumulated wisdom of human and social experience”75.

What are its policy instruments and variables?

- Trade policy
- Economic competitiveness
- International finance policy
- FDI environment
- Information sharing
- Business, academic, and societal linkages

**Exports for growth and external stability**

Let us see trade first. Despite modest growth in world trade in recent years, exports are a tried and tested means for economic growth. Relying on the domestic market is not enough. All fast-growing economies have grown by exporting to the rest of the world. The four tigers, Hong Kong, Singapore, Taiwan China, and South Korea, are good examples. Their exports of manufactured goods grew from USD 4.6 Billion in 1962 to 715 Billion in 2004, all in 2000 USDs76. A CAGR of 12.77% over 42 years in constant USD. If Pakistan exports achieved this rate, our USD 23 Billion exports will become 76.5 Billion in ten years. To be able to replicate it, Pakistan must be competitive in producing a range of goods for export. At present, its main exports are almost entirely low value added textiles and rice.

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75 The Growth Report, Page 41
76 The Growth Report, Page 23
Will trade openness lead to exports and growth?

Research suggests ambiguity between trade openness (Trade/GDP) and economic growth. There is a range of findings. They range from no relationship between the two, to the circumstances that exist in each country and on how openness is measured. One research says that “new estimates reveal that export alone correlates with income, not import. Ceteris paribus, countries with high export intensity (but not high import penetration) have high income per capita.” Even here there are nuances. The quality of export products matter. Export stimulates growth when the economy specializes in high quality products, and the higher the quality the greater the effect of export on growth. However, it is equally possible that the reverse may be true, they say. An IMF document suggests possibility of reverse relationship, i.e. growth and production of diverse products lead to high exports. On the other hand, “trade may have a negative impact on growth when countries have specialized in low quality products”. Clearly, measurement difficulty has much to do with such a wide range of views. Likely, the relationship between export and growth is iterative. One reinforces the other.

About import, one important research says “once institutions are controlled for, trade is almost always insignificant, and often enters the income equation with the “wrong” (i.e., negative) sign”. “So, a necessary condition for countries to gain productivity growth through international trade may very well be the existence of institutions of a certain quality”, says another source. Since 2008, such doubts have taken further root. As a UN DESA document of 2015 states, “The best vision is a development-centric approach to trade rather than a trade-centric approach to development”. The experience of East Asian economies clearly shows that while they focused on export led growth, they opened the economy selectively, often protecting next generation tariff lines as part of their industrialization plans.

All above findings seem valid in certain circumstances. Economies that are part of the global manufacturing value chain (see the section titled Role of Manufacturing in National Income), however, must import to export. In fact, they must have good understanding of the organization of global value chains and distribution of tasks. To achieve these goals, Pakistan must be closely connected with other manufacturing economies. Trade policy must support the objectives of development.

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77 The variable relationship between trade and GDP, Jeremy Smith, Policy Research in Macroeconomics (PRIME), London.
78 The Link between Trade and Income: Export Effect, Import Effect, or Both? Syracuse University
79 IMF, Growth in East Asia What we and What we Cannot Infer, Michael Sarel, Page 14
80 The relationship between trade openness and economic growth: Some new insights on the openness measurement issue, Marilyne Huchet-Bourdon, Chantal Le Moué, Mariana Vijil
83 UN Department of Economic and Social Affairs, The Role of International Trade in Structural Reforms, Charles Gore, Slides 3 and 20
Table 6
Indicators of integration with global economy 2015

<table>
<thead>
<tr>
<th></th>
<th>China</th>
<th>Malaysia</th>
<th>Indonesia</th>
<th>India</th>
<th>Vietnam</th>
<th>Pakistan</th>
<th>RoK</th>
<th>USA</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Export Billion USD</strong></td>
<td>2,282</td>
<td>200</td>
<td>176</td>
<td>264</td>
<td>162</td>
<td>23</td>
<td>527</td>
<td>1,504</td>
</tr>
<tr>
<td><strong>Export % of GDP</strong></td>
<td>21</td>
<td>68</td>
<td>20</td>
<td>13</td>
<td>87</td>
<td>8</td>
<td>38</td>
<td>8</td>
</tr>
<tr>
<td><strong>Trade % GDP</strong></td>
<td>36</td>
<td>127</td>
<td>41</td>
<td>31</td>
<td>169</td>
<td>24</td>
<td>70</td>
<td>21</td>
</tr>
<tr>
<td><strong>Trade Bal % GDP</strong></td>
<td>3.5</td>
<td>7.65</td>
<td>0.25</td>
<td>-2.53</td>
<td>0.79</td>
<td>-6.4</td>
<td>6.96</td>
<td>-2.89</td>
</tr>
<tr>
<td><strong>Market Penetration Index</strong></td>
<td>49.1</td>
<td>13.08</td>
<td>13.8</td>
<td>26.3</td>
<td>11.6</td>
<td>7.5</td>
<td>20.3</td>
<td>42.3</td>
</tr>
<tr>
<td><strong>No. of Products</strong></td>
<td>4,906</td>
<td>4,119</td>
<td>3,937</td>
<td>4,424</td>
<td>3,688</td>
<td>2,846</td>
<td>4,286</td>
<td>4,559</td>
</tr>
<tr>
<td><strong>Weighted Average Tariff</strong></td>
<td>4.52</td>
<td>1.28</td>
<td>2.37</td>
<td>6.34</td>
<td>3.14</td>
<td>9.6</td>
<td>5.72</td>
<td>1.69</td>
</tr>
<tr>
<td><strong>Duty free tariff lines % of total</strong></td>
<td>26</td>
<td>76.2</td>
<td>33.99</td>
<td>4.1</td>
<td>45.6</td>
<td>3.3</td>
<td>64.8</td>
<td>54.4</td>
</tr>
<tr>
<td><strong>Trade Across Border Rank</strong></td>
<td>96</td>
<td>60</td>
<td>108</td>
<td>143</td>
<td>93</td>
<td>172</td>
<td>32</td>
<td>35</td>
</tr>
<tr>
<td><strong>Logistics Performance Index Rank</strong></td>
<td>28</td>
<td>25</td>
<td>53</td>
<td>54</td>
<td>48</td>
<td>72</td>
<td>21</td>
<td>9</td>
</tr>
<tr>
<td><strong>GDP/Capita Rank</strong></td>
<td>104</td>
<td>70</td>
<td>130</td>
<td>159</td>
<td>161</td>
<td>171</td>
<td>45</td>
<td>18</td>
</tr>
</tbody>
</table>

**Source:** World Bank World Databank and WITS

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84 Market Penetration Index is calculated as the number of countries to which the reporter exports a particular product divided by the number of countries that report importing the product.

85 It scores and then ranks countries on six dimensions of trade -- including customs performance, infrastructure quality, and timeliness of shipments -- that have increasingly been recognized as important to development.
### Table 7
Trade Growth and Management

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>Tariff Avg. Weighted %</th>
<th>Maximum Applied Tariff Rate %</th>
<th>% of duty-free Tariff lines</th>
<th>Mkt Penetration Index</th>
<th>Exp/GDP %</th>
<th>Imp/GDP %</th>
<th>Trade Bal %</th>
<th>GDP Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Korea</td>
<td>1988</td>
<td>13.95</td>
<td>1296.5</td>
<td>0.71 0.02% in amount</td>
<td>5.33</td>
<td>30</td>
<td>25.5</td>
<td>6.62</td>
<td>48</td>
</tr>
<tr>
<td>Korea</td>
<td>2015</td>
<td>5.72</td>
<td>887</td>
<td>64.8 55.5% in amount</td>
<td>20.3</td>
<td>38</td>
<td>31.7</td>
<td>6.96</td>
<td>45</td>
</tr>
<tr>
<td>China</td>
<td>1992</td>
<td>32.77</td>
<td>220</td>
<td>1.27 3.5% of total</td>
<td>12.2</td>
<td>21</td>
<td>19</td>
<td>1</td>
<td>163</td>
</tr>
<tr>
<td>China</td>
<td>2015</td>
<td>4.52</td>
<td>3,000</td>
<td>26 50% of total</td>
<td>49.1</td>
<td>21</td>
<td>15</td>
<td>3.5</td>
<td>104</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1992, 2015</td>
<td>9.33</td>
<td>3,000</td>
<td>19.45 16.9%</td>
<td>5.61</td>
<td>69</td>
<td>67</td>
<td>1.36</td>
<td>70</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1992, first 3 cols. 1993</td>
<td>1.28</td>
<td>90</td>
<td>76.2 51%</td>
<td>13.08</td>
<td>69</td>
<td>59</td>
<td>7.65</td>
<td>70</td>
</tr>
<tr>
<td>Vietnam</td>
<td>2001</td>
<td>15.29</td>
<td>100</td>
<td>33.86 13.7</td>
<td>5.49</td>
<td>43</td>
<td>46</td>
<td>-3.31</td>
<td>182</td>
</tr>
<tr>
<td>Vietnam</td>
<td>2015</td>
<td>3.14</td>
<td>135</td>
<td>45.6 50.3%</td>
<td>11.6</td>
<td>87</td>
<td>85</td>
<td>0.79</td>
<td>161</td>
</tr>
<tr>
<td>Pakistan</td>
<td>2003</td>
<td>16.71</td>
<td>709.16</td>
<td>0 0</td>
<td>6.18</td>
<td>14.6</td>
<td>15.6</td>
<td>0.59</td>
<td>157</td>
</tr>
<tr>
<td>Pakistan</td>
<td>2015</td>
<td>9.6</td>
<td>830.4</td>
<td>3.3 1.3%</td>
<td>7.5</td>
<td>8</td>
<td>16</td>
<td>-6.4</td>
<td>171</td>
</tr>
</tbody>
</table>

**Source:** World Bank

**Trade growth Vs balanced trade**

Table 7 compares Pakistan’s trade indicators with four East Asian economies from the sample above. It compares trade for 2015 with a selected past year. All economies have brought down

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86 World Integrated Trade Solutions, data for respective countries
their weighted average tariff rates and have increased the number of zero tariff lines. Notice the following:

- All East Asian economies have maintained a stable trade balance. Their trade balance has been positive in all cases and is substantially higher in 2015 than the base year. Most economies are net exporters of capital.
- All economies have greatly increased market penetration. The lowest increase of 111% is by late entrant Vietnam and the highest of over 300% by China. Pakistan’s market penetration increased by 21%.
- They have also improved their world ranking in GDP per capita (Malaysia has remained the same). Pakistan’s rank has declined.
- More importantly, the economic complexity score of all Asian economies, except Pakistan, has improved. Pakistan’s complexity score has worsened since 1990 (see Table 9). This idea is discussed further.

Maintaining a stable current account balance goes against economic orthodoxy usually advocated by international institutions. But as demonstrated by research, the linkage between trade openness and growth are weak at best. There are two issues:

- Import does not lead to exports automatically. Many other factors are important to increase exports. Where economies specialize, and become part of the global supply chain, imports help input into exports.
- Also, import may not allow domestic industry to become competitive. The economy remains locked in to export of low value added and a limited range of products.

**Key messages from above**

Trade liberalization is not an end. It must have linkages with development. This report does not advocate trade restriction or mercantilism. Sustainability of the current account is important for growth and to avoid the kind of debt crises that affected some fast-growing economies in recent decades. Import for exports is a valid consideration. Export led growth has positive effect on other indicators and allows the economy to import goods and technology.

We advocate a nuanced, rather than ideological, approach that is development oriented. In Annex II, all economies have reduced tariff rates. They have done so while maintaining positive trade balance and increasing competitiveness. This can be seen from the change in import and export structures of the East Asian economies:

1. By 2015, most economies have increased the share of value addition and knowledge in their top export products. Malaysia, a producer of natural resources has not done so. In terms of value addition, Pakistan’s composition of top exports has not changed. For all economies, except Pakistan, capital goods accounted for a minimum of 35% of total

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87 This is validated by several studies, including UN-DESA’s The Role of International Trade in Structural Transformation, Charles Gore, Slide 22, November 2015
exports. Pakistan’s export of capital goods was 3% of total. Likewise, Pakistan lags behind in import of capital goods. Pakistan also has the highest tariff rate on capital goods.

2 In most economies, there is relationship between import and export products. Many of the imported products input into exports (see Annex 2). This is a sign of specialization and manifestation of the global value chain that has resulted in very high volumes of trade in intermediate goods. World trade in intermediate goods exceed combined export of finished and capital goods. Domestic content accounts for just about half of China’s manufacturing exports. Essentially, this means a conceptual shift from ‘trade in goods’ to ‘trade in value added’ or ‘trade in tasks’. East Asia has managed its trade policy very well with respect to its high level of integration with global supply chains. These chains are drivers of growth in jobs and GDP. FDI may have helped. Korea is different. Currently its top imports are raw materials. This may be an indicator of the strength of its manufacturing sector. There is no such relationship between Pakistan’s import and export. Even in Pakistan’s strong suit of textile goods, there are no major inputs of accessories or materials. That is perhaps the reason why Pakistan’s product line, within textiles, has not broadened.

3 Reorientation of markets: As world trade gradually picked up after the 2008 crisis, emerging economies became the main growth engines. Between 2005 and 2010, merchandise imports of EU and USA grew by 27% and 14% respectively. During the same period, imports grew rapidly in the South. Imports to Brazil grew by 147%, India 129%, China 111%, and South Africa 51%.

4 The amount of Pakistan’s imports that enter without duty is 1.3% of total. In other economies, fifty percent or more of imports enter duty free. Pakistan continues to consider import tariff a source of revenue, while other economies take a nuanced approach in line with their policy of industrialization.

5 All economies have balanced their trade and maintained a surplus. Pakistan is the only economy whose negative trade balance has increased and exports to GDP ratio has declined substantially reflecting a major drop in the economy’s competitiveness.

Knowledge products or Economic Complexity

Economic Complexity is a measure of the society’s knowledge that is translated into the product it makes. It virtually reflects the level of development of a country. Its index measures both the knowledge and diversity of export products as well as the norms and institutions that combine to produce the product. Among our sample economies, the correlation between ECI and GDP/Capita is almost perfect, India being the only outlier (see Table 8).

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89 http://atlas.cid.harvard.edu/about/glossary/
90 The Observatory of Economic Complexity, MIT
## Table 8
ECI and GDP per Capita

<table>
<thead>
<tr>
<th>Country</th>
<th>ECI Rank</th>
<th>GDP/Capita Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>5</td>
<td>18</td>
</tr>
<tr>
<td>ROK</td>
<td>6</td>
<td>45</td>
</tr>
<tr>
<td>China</td>
<td>37</td>
<td>104</td>
</tr>
<tr>
<td>Malaysia</td>
<td>25</td>
<td>70</td>
</tr>
<tr>
<td>Indonesia</td>
<td>79</td>
<td>130</td>
</tr>
<tr>
<td>Vietnam</td>
<td>93</td>
<td>161</td>
</tr>
<tr>
<td>India</td>
<td>50</td>
<td>159</td>
</tr>
<tr>
<td>Pakistan</td>
<td>106</td>
<td>171</td>
</tr>
</tbody>
</table>

**Statistical correlation 0.9**

**Source:** ECI Rank: The Observatory of Economic Complexity, MIT Media Lab.

Let us move from comparison based on rank to a comparison of economic complexity scores between 1990 and 2014 for the Asian economies from the selected group of economies.

## Table 9

<table>
<thead>
<tr>
<th></th>
<th>ROK</th>
<th>China</th>
<th>Malaysia</th>
<th>Indonesia</th>
<th>Vietnam</th>
<th>India</th>
<th>Pakistan</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>EC Score 1990</strong></td>
<td>1.01</td>
<td>0.47</td>
<td>0.26</td>
<td>-0.45</td>
<td>-0.67</td>
<td>0.32</td>
<td>-0.57</td>
</tr>
<tr>
<td><strong>EC Score 2014</strong></td>
<td>1.74</td>
<td>0.74</td>
<td>1.04</td>
<td>-0.24</td>
<td>-0.46</td>
<td>0.41</td>
<td>-0.7</td>
</tr>
</tbody>
</table>

**Source:** Observatory of Economic Complexity, MIT

The scores of each country has improved between 1990 and 2014. Pakistan’s score has declined. Economic complexity score measures the amount of knowledge that goes into making of products. As modern day products need a diverse range of knowledge, the score measures also knowledge diversity. For example, producing a computer requires a group of people with knowhow of “battery technology, liquid crystals, microprocessor design, software development, metallurgy, milling, lean manufacturing, and human resource management, among many other skills”\(^91\). And these diverse experts must work through a complex social network to make a computer. There are other components, but the idea is that knowledge and

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\(^91\) The Atlas of Economic Complexity, Mapping Paths to Prosperity, Hausmann, Hidalgo et al. MIT, Center for International Development, Harvard University, and Kennedy School, Harvard
the ability to use diverse knowledge raises complexity score. “Economic complexity, therefore, is expressed in the composition of a country’s productive output and reflects the structures that emerge to hold and combine knowledge” 92. Pakistan’s worsening score suggests that knowledge levels and the social organization to use the knowledge has not improved in twenty-four years. This is disturbing.

The role of trade enablers

Some experts also consider trade enabling indicators as necessary for export growth. World Bank ranks economies in its indices for ‘Trading Across Border’ and ‘Logistics Performance’ (see Table 6). These trade enablers have high correlation with GDP/Capita. World Bank considers logistics performance an important component of development93. However, these indicators have low correlation with both total trade to GDP ratio and export to GDP ratio. Though this needs further study, it appears that their causality with trade is hard to establish. It is equally uncertain if trade/GDP ratio leads to high GDP/capita as there is low correlation between the two ratios. It is possible that the two trade enabling indices reflect the strength of institutions in an economy and, therefore, correlate with income, but not with trade.

It seems fair to conclude that the real constraint to Pakistan’s growth comes from lack of diversity and knowledge in production as well as from the governance environment. In the present circumstances, trade concessions from other economies is of marginal help. With respect to open imports, the real benefits arise from ability to use and proliferate technology. For developing countries to gain productivity growth from trade liberalization, it is necessary to invest in, e.g., education facilities, to ensure property rights, and to build up institutions94. Continued incentives to produce low value added goods do not help growth.

Connectivity

In the circumstances, with few value-added exports and no likelihood of opening of multilateral trade, Pakistan’s present focus must be to use high infrastructure investment being undertaken with help of China for effective connectivity for intra-country and regional trade. Transit arrangements, multimodal connectivity, and trade facilitation will increase efficient movement of goods and information, and reduce their cost. Our businesses must have the best avenues to enhance productivity and meet world demand.

Internationally, progress on multilateral trade liberalization has been on hold for about two decades. Since 1995, there has been little progress on a multilateral trade agreement. Bilaterally, Pakistan has MFN with WTO members. In addition, it has a number of FTAs with largely Asian economies. Pakistan has decided to lock itself out of the large and rapidly growing Indian market, and by extension SAFTA. For now, that must be taken as a given.

92 Ibid, Page 18
93 World Bank, World Integrated Trade Solution, LPI definition
94 USITC The Link Between Openness and Long-Run Economic Growth, Lill Andersen and Ronald Babula
Likewise, FTA with Iran is a victim of politics. Pakistan may begin FTA negotiations with East Asian economies to create an interconnected and interdependent industrial structure.

A new form of threat to trade comes from populist movements in the West. There are concerns that “the system of world trade is under threat as never before” and that “there are terrific parallels between today and the run-up to the second world war”95. This populism could affect trade and investment flows. This is a major risk to economies world over.

**Does Foreign Direct Investment Help?**

Moving to FDI, though it augments host country resources, but the benefits from it vary and do not flow naturally in all cases. FDIs are a source of non-debt long term capital, often of newer technology, and different management practices. They can create jobs, upgrade skills and improve work ethics. FDIs affect balance of payments positively from one-time capital transfers, from possible import substitution, and export creation. FDIs crowd in domestic investment and by generating input supply industry, they add to economic activity and jobs96.

FDIs could also have adverse effect. Foreign investors’ dominant position can capture state decisions. Regulatory capacity in Pakistan hasn’t kept pace either. Privatization FDI too has shown indifferent results. Service quality has not improved since PTCL went into private hands. The buyers allegedly have not met their part of the commitments. Effect of FDIs on balance of payment often shifts, especially when profits and equity sale proceeds are transferred overseas.

This list of flaws is not meant to discourage policies to attract FDIs. They have their role in economic growth. These are listed so that we have appropriate policies to draw full benefit. For example, Pakistan has not had yet FDIs that boost exports. Most FDIs into Pakistan are in search of markets (mobile telephony and IPPs) or for market entry, as in the case of autos where Pakistan has had very high tariff levels. Even these create advantages. Mobile telephony has stimulated economic activity in many ways. What is needed is the intersect of policy and regulation in Pakistan with the strategy of investor. Pakistan should be ready with the right policies for the planned SEZs and industrial parks with Chinese assistance. As tariff areas with special duty rates, SEZs are also a market entry mechanism. It is critical that these leverage growth and boost exports and bring higher value addition to the country. All FDIs have an initial stimulus effect from capital infusion. Host country policies decide their long-term benefits.

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96 The discussion in the Paras on FDI are drawn from 1. IMF Foreign Direct Investment in Developing Countries Padma Mallampally and Karl P. Sauvant, 2. OECD Foreign Direct Investment for Development, Maximising Benefits, Minimising Costs, 3. The Effects of Foreign Direct Investments for Host Country’s Economy, Selma KURTISHI-KASTRATI, 3. Economy Watch, Benefits of Foreign Direct Investment.
Economic orthodoxy Vs Pragmatism

Development is a painstaking process. Policies must suit country situation. The debate between free market orthodoxy and intervention is extraneous. Typically, ideology has no role. Market must operate, but intervention must take place where necessary. That is the experience from the fast-growing Asian economies. It is a never-ending debate. One view “recognizes that government must often choose firm-specific, highly complex, and nonuniform intervention”\(^97\). Governments often create relative prices through tax incentives, cheap credit, tariff protection, and other profit enhancing mechanisms. Government helps also with public investment\(^98\). What is important is that these incentives should be well considered and must serve overall economic interest. They must be based on approved criteria of performance and must have a sunset. There should be no hint of patronage.

Pakistan must also consciously develop institutional and societal linkages with other countries, especially in East Asia and the West. This could open the society to new ideas and progressive behaviour. It will improve knowledge, business practices, and the institutional growth seen in other countries. Foreign education and exchange of trainers and experts create an international knowledge network. Awareness about other societies will raise peoples’ expectations for better government performance. The society must direct its energies to the right avenue. Recall advice of Professor Atif Mian above. The most important benefit from deepening linkages with other countries will come from exchange of technology.

5. Committed and competent leadership: Or the Shallow Government

Why is it important?

- Largely, all above factors depend on government leadership and competence. Government is the key facilitator of structural change
- Because governments articulate political choice and determine strategic direction for the economy
- Governments make policies, implement them, provide public goods and services (including security), and enforce the law

What are its policy instruments and variables?

- State effectiveness
- Rule of Law
- Regulation
- Participation

\(^97\) IMF, Growth in East Asia, What we can and we cannot infer, Michael Sarel, Page 9, September 1996
\(^98\) Ibid, quoting an earlier World Bank report.
Projects do not equal development. No economy will grow without long term good policies to set it in the right direction. This requires a committed and inspiring political leadership. Pakistan has had such leadership in spurts, but even during these periods development was not a declared priority. For one, Pakistan’s security narrative distracts from complete focus on growth and development. Our security and law and order challenges make complex an already array of issues. More important is an endemic shallowness in government. Important words that have centuries of thought behind them (such as democracy, development, and governance) are used without meaning. Policies are started and celebrated without the input of knowledge, experience, and appraisal.

There is no magic or silver bullet for good public policy. It comes from belief, commitment, and competence. In an ideal world, we could have wished for such a government. But that will happen gradually and we must work within this constraint. On the other hand, government’s role is very important in growth. “Government actions and public policy play a critical role in shaping the competitiveness of both nations and the individual companies.” It generates direct benefits for the economy. “The strategic use of public policy as an enabler of economic development will intensify, resulting in competition among nations for policy effectiveness.”

None of the above four issues of a. healthy macro economy, b. increase in savings and investment, c. efficient allocation of resources, and d. integration with the world can be effective without the visible guiding hand of government. Leadership is needed to:

- Provide long-term vision, build national consensus on development, allot it priority, and follow up with a realistic plan of action
- Provide public goods: law and order, essential services (policing, property rights, health and education), and infrastructure. Government plays a significant role across all competitiveness drivers
- Correct deep set political economy issues to minimize misallocation of resources and to realize the economy’s potential
- Have well thought out policies to incentivize investment and business activity by creating relative prices
- Provide macroeconomic stability, by exercising fiscal discipline and mitigating the effects of the political economy
- Create credibility and faith among the people of a responsive government that is a partner not an adversary to extract rent

So far, the government is nowhere close to fulfilling its role as a support to business. Indices are one way to assess how government performance affects businesses. Two indices capture

99 The name, but not the exact thought taken from The Shallow State, David Rothkopf, Foreign Policy, 22 February 2017
100 WEF Report in collaboration with Deloitte Touche Tohmatsu Limited, Volume 1
well the economy’s competitiveness and its ability to enable businesses to perform. Table 10 below ranks the eight selected economies on these indices and correlates with GDP/Capita. We find high degree of correlation between each of the two index and GDP/Capita of our sample countries. By themselves, each index is based on many factors and criteria. In such a case, a high correlation is especially significant. Pakistan’s performance is particularly weak in some specific areas such as registering property, getting electric connection, trading across border, paying taxes, and getting construction permit.

<table>
<thead>
<tr>
<th>Country</th>
<th>World Economic Forum</th>
<th>Doing Business</th>
<th>Human Development Index</th>
<th>GDP/Capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>3</td>
<td>8</td>
<td>8</td>
<td>18</td>
</tr>
<tr>
<td>ROK</td>
<td>26</td>
<td>5</td>
<td>17</td>
<td>45</td>
</tr>
<tr>
<td>China</td>
<td>28</td>
<td>78</td>
<td>90</td>
<td>104</td>
</tr>
<tr>
<td>Malaysia</td>
<td>18</td>
<td>23</td>
<td>62</td>
<td>70</td>
</tr>
<tr>
<td>Indonesia</td>
<td>37</td>
<td>91</td>
<td>110</td>
<td>130</td>
</tr>
<tr>
<td>Vietnam</td>
<td>56</td>
<td>82</td>
<td>116</td>
<td>161</td>
</tr>
<tr>
<td>India</td>
<td>55</td>
<td>130</td>
<td>130</td>
<td>159</td>
</tr>
<tr>
<td>Pakistan</td>
<td>126</td>
<td>144</td>
<td>147</td>
<td>171</td>
</tr>
</tbody>
</table>

Source: Relevant indices
Correlation: HDI: GDP/Capita 0.98, WB Ease of Doing Business: GDP/Capita 0.96

A World Bank project also estimates overall governance ability along five indicators, see Table 11. Pakistan has the lowest rank in four of five criteria. On some, it is lowest by far. This suggests that Pakistan’s ability to actively support business, enforce the law, or provide services to the people, is severely limited. Security and law and order are of special concern. Pakistan’s low governance indicators are a constraint on GoP’s ability to support business and develop the economy.
Governance shows in the public investment programme. Pakistan may reconsider its preference for prestige projects. It must review also the high amount spent on non-growth inducing physical infrastructure and reorient spending to growth needs. Transparency in procurement and better project management will leverage the same investment for higher returns. Increased investment in skills training will prepare human capital for manufacturing
and services. This report has discussed earlier economic complexity and the amount of knowledge that goes in to the goods produced. It has high bearing on economic growth and national income. Creating skills and knowledge is initially a government function (public expenditure).

**Link between security and growth:** Research is ambiguous on the channel by which security affects growth, but there is consensus that lack of security has a negative effect on security. Various research find terrorism’s negative effect on economic growth in Pakistan. “Among the various variables that were used, terrorism is most significant and major contributor in reducing the economic growth.” Economic consequences include reduction in FDI, destruction of infrastructure, appropriation of public investment funds for security, or limiting trade. Other violence is equally debilitating. Areas reporting high levels of homicide are statistically associated with reduced progress. Another study finds that terrorism concerns divert public fund from investment to security and reduces investment. Yet another expert calls for “unrelenting commitment … (to) improving the security situation” for Pakistan to realize its potential even with its present economic structure. Providing security is one of the fundamental (and oldest) government function that affects all economic activity.

**Link between growth and education** (skills and training): this linkage is obvious and natural. As noted in Figure 3, technical input gives a higher return/growth rate from the same unit of investment. A number of research reiterate this finding. Even in USA, a high-income knowledge economy, education has a positive effect on growth and income. Spending on research increases the number of patents. Another research finds that education quality and cognitive skills “are powerfully related to long-run economic growth”. A comparison of the selected economies for input and quality of education is given in Tables 12 and 13.

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102 Impact of Terrorism on Economic Development in Pakistan, Shabir Hyder, Naeem Akram, Ihteshamul Haq Padda
103 ECONOMIC CONSEQUENCES OF TERRORISM IN DEVELOPED AND DEVELOPING COUNTRIES: AN OVERVIEW By Todd Sandler* School of International Relations University of Southern California and Walter Enders Department of Economics, Finance and Legal Studies University of Alabama
104 Geneva Declaration on Armed Violence and Development, More Violence, Less Development Examining the relationship between armed violence and MDG achievement, September 2010
105 ADB Institute, The Impact of Terrorism and Conflicts on Growth in Asia, 1970–2004 Khusrav Gaibulloev and Todd Sandler
106 Dawn, An Undervalued Economy, Rashid Amjad, 20 February 2017
107 The Causal Impact of Education on Economic Growth: Evidence from the US, P. Aghion, Harvard University and CEPR, L. Boustan, UCLA and NBER, C. Hoxby Stanford University and NBER, J. Vandenbussche, the International Monetary Fund, see discussion on pages 33 to 37
108 Ibid Page 38, the discussion is a little more nuanced than reported above
109 Education and Economic Growth, Eric A. Hanushek (Stanford University and Hudson Institute) and Ludger Woesmann (University of Munich), Pages 60-67, abstract of paper
Table 12
Comparison of Quantity Education Indicators

<table>
<thead>
<tr>
<th></th>
<th>Literacy Rate &gt;15 Yrs %</th>
<th>Pop with some education %</th>
<th>Gross Enrollment Rate</th>
<th>Primary School Dropout</th>
<th>Primary Teacher Student Ratio</th>
<th>Public Expenditure On Education %/GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>USA</td>
<td>NA</td>
<td>95</td>
<td>98</td>
<td>94</td>
<td>94</td>
<td>--</td>
</tr>
<tr>
<td>ROK</td>
<td>NA</td>
<td>82.9</td>
<td>103</td>
<td>97</td>
<td>98</td>
<td>0.8</td>
</tr>
<tr>
<td>China</td>
<td>95.1</td>
<td>65.3</td>
<td>128</td>
<td>89</td>
<td>27</td>
<td>--</td>
</tr>
<tr>
<td>Malaysia</td>
<td>93.1</td>
<td>52</td>
<td>101</td>
<td>71</td>
<td>37</td>
<td>0.9</td>
</tr>
<tr>
<td>Indonesia</td>
<td>92.8</td>
<td>44.5</td>
<td>109</td>
<td>83</td>
<td>32</td>
<td>11.0</td>
</tr>
<tr>
<td>Vietnam</td>
<td>93.5</td>
<td>65</td>
<td>105</td>
<td>--</td>
<td>25</td>
<td>5.5</td>
</tr>
<tr>
<td>India</td>
<td>62.6</td>
<td>42.1</td>
<td>113</td>
<td>69</td>
<td>25</td>
<td>35</td>
</tr>
<tr>
<td>Pakistan</td>
<td>54.7</td>
<td>33.2</td>
<td>92</td>
<td>38</td>
<td>10</td>
<td>37.8</td>
</tr>
</tbody>
</table>

Source: HDI 2015

Table 13
Comparison of Quality Education Indicators

<table>
<thead>
<tr>
<th></th>
<th>Performance of 15-year-old students</th>
<th>Primary % Trained Teachers</th>
<th>Primary Teacher Student Ratio</th>
<th>Patent applications in thousands</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Reading</td>
<td>Mathematics</td>
<td>Science</td>
<td></td>
</tr>
<tr>
<td>USA</td>
<td>498</td>
<td>481</td>
<td>497</td>
<td>--</td>
</tr>
<tr>
<td>ROK</td>
<td>536</td>
<td>554</td>
<td>538</td>
<td>--</td>
</tr>
<tr>
<td>China</td>
<td>570</td>
<td>613</td>
<td>580</td>
<td>--</td>
</tr>
<tr>
<td>Malaysia</td>
<td>398</td>
<td>421</td>
<td>420</td>
<td>--</td>
</tr>
<tr>
<td>Indonesia</td>
<td>396</td>
<td>375</td>
<td>382</td>
<td>100</td>
</tr>
<tr>
<td>Vietnam</td>
<td>528</td>
<td>511</td>
<td>528</td>
<td>--</td>
</tr>
<tr>
<td>India</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Pakistan</td>
<td>--</td>
<td>--</td>
<td>85</td>
<td>43</td>
</tr>
</tbody>
</table>


In both input driven and quality comparisons, Pakistan has the lowest indicators among the sample economies. Pakistan and India do not have records of student performance. They are weak in teacher student ratio and in patent applications. In Pakistan, a total of 51.5 Million
people over the age of 15 years were ‘illiterate’\textsuperscript{110}. This is about a quarter of the country’s population. Youth literacy (15-24 years) was 71.6\% in 2012-13. Overall, the country has a literacy level of 56\%\textsuperscript{111}. A review of Government’s ‘Education for All’ programme attributes low achievement to scarce resources and weak management\textsuperscript{112}. The latter points to low political priority.

Equally, linkage between all human development indicators and growth as well as between poverty and growth have been established. For example, research informs that malnutrition leaves a lasting effect on a child’s cognitive ability\textsuperscript{113}. A vulnerable and disadvantaged population cannot contribute to the economic life of a country. Within our selected sample of countries, the population living on under USD 1.25 per day is 6.3\% for China and 2.4\% for Vietnam. The equivalent ratio for Pakistan is 12.7. India is higher still\textsuperscript{114}.

**The Political Economy:** To an extent, the political economy is at play. Between 1950 and 1999, Pakistan had an acceptable 2.2\% per year growth in GDP per capita. Yet social indicators remained low. An economy can grow for a while on the back of financial capital input, but its growth rate suffers in the face of high imbalance between GDP and social indicators\textsuperscript{115}. Political economy has much to do with such outcomes. Decision makers have found the money for ‘big ticket’ items, including nuclear weapons and motorways.

But the country falls abysmally short on social indicators relative to economies at comparable levels of GDP per capita, initial income level at 1960, or similar growth rates\textsuperscript{116}. Referring to countries that have similar social sector challenges as Pakistan, the research says “that an oligarchy will oppose widespread education because educated people are more likely to demand political power”\textsuperscript{117}. Resultantly, it is possible to have “growth without development” and frequent “boom bust” cycles. This happens in economies with concentrated land ownership. As labour and land are abundant and capital is scarce, there is low return on investment in mass education. With development, industry requires skilled labour and they demand investment in massive education. “Pakistan appears stuck at the early stage of development where land is abundant relative to physical capital and ownership of the land is highly concentrated”\textsuperscript{118}. Devolved governments are more responsive to education and health needs of the citizen. Yet, powerful political interests favour centralized governance over

\textsuperscript{110} Ministry of Education, Trainings and Standards in Higher Education Academy of Educational Planning and Management, Pakistan, Education for All Review Report 2015 for the World Education Forum, 2015. Table 3.4b

\textsuperscript{111} Ibid Page 26

\textsuperscript{112} Ibid Pages 23 and 25

\textsuperscript{113} Growth Report, Page 40

\textsuperscript{114} UNDP HDI Report Pages 228 and 229.

\textsuperscript{115} The Political Economy of Growth Without Development: A Case Study of Pakistan, June 2001, William Easterly for the World Bank

\textsuperscript{116} Ibid.

\textsuperscript{117} Ibid, based on Bourguignon, Francois and Thierry Verdier, Oligarchy, democracy, inequality and growth, Journal of Development Economics

\textsuperscript{118} Ibid Page 4
decentralization. Growth in digital technology could divide our world further between efficient and outdated economies. We must have the people and technology to remain relevant.

The political economy works at many levels. Politics affect data and statistics. That is why the census doesn’t take place on time or the numbers generated by the national organization that compiles data and statistics are considered suspect\textsuperscript{119}. Notice the discussion that takes place in the public space each year as soon as the National Accounts are made public.

Our regulatory environment and policies, especially land use policy, discriminate in favour of the powerful. There is no transparency in granting approvals and service provision and the time taken to do so is one of the highest in the world. One of the most difficult things to do in Pakistan is to use land for productive purpose.

“It is our belief that equity and equality of opportunity are essential ingredients of sustainable growth strategies”\textsuperscript{120}. An economy cannot realize its full potential without equal opportunity for all. This means access to nutrition, education, and health. Some economists consider asset distribution important. The first step of the economic miracle in East Asia began with land reforms. This created high yielding farms, which led to high savings, which in turn financed industrial investment. In present circumstances, it will be challenging to consider redistribution of land as politically possible\textsuperscript{121}. However, it is conceivable to move towards equality of opportunity.

\textsuperscript{119} See the extensive work by Nobel Laureate Angus Deaton including his Nobel lecture ‘Measuring and understanding behavior, welfare and poverty”, Stockholm, 8 December 2015
\textsuperscript{120} The Growth Report, Page 60
\textsuperscript{121} Joe Sudwell, How Asia Works: Success and Failure in the World’s Most Dynamic Region, Profile Books and an article of the same title in China Economic Quarterly, March 2013
A Plan to Restructure

Below is a plan to restructure the economy for long-term high growth. To connect with analyses in the preceding sections, it begins with a strategy followed by objectives, indicators, and measures.

Strategy for a new economic structure

Achieve the objective of high economic growth through an interplay of factors including: strong macroeconomic indicators, policies to stimulate public and private investment in value added sectors, and strengthened institutions and governance. The economy’s productivity deficit and surplus labour provide considerable space to grow quickly. Pakistan may emulate East Asia to follow a development path of export-led growth helped by urbanization. Use the following combination of policy levers:

1. Create a robust macroeconomic environment:
   - Increase government revenue to reduce external borrowing and improve provision of public goods
   - Implement expenditure reforms to increase share of development expenditure, provide better services, reduce waste such as subsidy to PSEs and divert it to productive expenditure. Focus on long-term growth over current consumption
   - Institute policies to enhance savings, including through better intermediation
   - Keep the twin deficits (fiscal and current account) in check even when world commodity prices increase. Support price stability

2. Increase savings and investments
   - Reduce or do away with the policy of managing fiscal deficits at the cost of growth
   - Allow positive real rate of return on savings
   - Introduce new long-term saving products and vehicles
     Strengthen financial intermediation and mechanisms to make it easy for individuals to invest in the capital market
   - Incrementally increase share of public investment as a ratio of GDP. At present, total PSDP budget (federal and provincial) is less than 4% of GDP. Increase it to 7% by 2022. Move from general infrastructure development to targeted support for specific industries

3. Improve allocation of resources
   - Build effectiveness in public investment and rationalize PSDP portfolio to align with high economic priorities and move away from prestige projects: power supply and transmission/distribution, increase water storage and improve efficiency of use, large scale investment in skills training and development, and training of government officials for service provision, set up SEZs and Industrial Parks.
• Review the power sector policy framework. Provide agriculture research and extension services as well as credit, input, and marketing support

• Focus on urban infrastructure so that cities support economic growth and serve as service clusters. The best way to do so is through devolution. As the political appetite for devolution is limited, federal and provincial governments should do this. Cities need physical infrastructure such as power, gas, and water supply. They need efficient mass transit and sanitation. They need high class Wi-Fi service and value added telecommunication as well as efficiently managed air and sea/dry ports. In addition, there must be good quality skills development and R&D centres specializing in technologies that support prioritized industries and services sectors. Urban development needs a focus hitherto denied to our cities.

• Use industrial policy to upgrade economic structure and strengthen exports through fiscal incentives, tariff policy, preferred access to capital and foreign exchange, regulation, and soft and hard infrastructure support.

• Criteria for selection of sectors: Build on comparative advantage to move to next technology, having export potential, with high socio-economic returns. Identify industries that can become part of the global supply chain. Country prosperity today depends on participation in the global economy and performance in global supply chains. Broaden and add value to current competitiveness in textiles and garments. Move to other low technology products for exports, such as toys and home use plastic and metal goods. Build on country’s incipient industry of electrical goods, metal fabrication, and electrical appliances as well as food processing, and downstream chemicals.

• Incentives, both macro-and micro: Macro incentives across all businesses, micro incentives that are targeted to support prioritized industries. They include tax incentives, access to credit, low cost credit, R&D support, dedicated infrastructure, and training of personnel

• Build SEZs and industrial parks and provide infrastructure and services and single window support to them

• Build an effective logistics chain that connects SEZs with domestic and international markets and promote trade

• Skills training for specific prioritized industries to shift labour from low productivity jobs to manufactures and value added services

• Government may play a pump priming role in industrial development. Recall, the pioneering role played by GoP’s Pakistan Industrial Development Corporation. PIDC set up new businesses, usually manufacturing, but including mining and gas transmission, and handed over these to the private sector by selling equity. Today, to reduce risk in greenfield private projects GoP may aid financial close by taking limited equity position and offering credit guarantee support. Once in operation, GoP may divest its equity holdings. These projects must be in identified industrial sectors with shares tradeable on the PSX, and with known sponsors.
4. Integrate with the world economy:

- Use trade policy and foreign exchange policy to boost export and stabilize trade balance
- Enhance regional and world connectivity:
  - Through logistics corridors including CPEC infrastructure, transit arrangements, and improved trade facilitation
  - Rationalize tariff structure in support of development needs and export led growth
- Attract FDIs in value added export oriented sectors
- Initiate FTAs with ASEAN bloc or individual member ASEAN countries. In addition to trade in goods, FTAs must include trade in services, trade facilitation measures, and investment agreements
- Resume FTA negotiations with Iran
- Gradually normalize trade relations with India and reinvigorate SAARC
- Build regional integration and take full advantage of China’s Belt Road Initiative to strengthen relations with economies of the region. In addition to infrastructure, we must make especial effort to improve facilitation, reduce number of clearance documents, and the time taken for clearance of goods.
- Stop reliance on import duty as public revenue and move to a nuanced approach where tariff supports industrial policy, so that technology products we plan to export are protected and duty on needed imports is reduced.

5. Committed and Competent Leadership

- Government must lead with vision and overall long-term direction to send strong message to all stakeholders about the aims and targets of the reforms
- Incrementally show demonstrable progress
- Stay steadfast to the strategy, despite occasional setback and resistance by interest groups
- Ensure that all incentives will be dispensed without patronage and per criteria. Incentives must not be indefinite and never to industries that do not become internationally competitive.
- Pakistan must have a dedicated team of policy makers and experts to help with political decision making and policy formulation. Policies are to nudge economic activity. They are prescriptive and do not mean that the government becomes a productive player. Some caveats are important:
  - These experts must have deep knowledge of conditions in the country and high level academic or policy making experience. We must avoid the ‘Tyranny of Experts’\(^\text{122}\). Economic issues do not always have technical solutions. In fact, they need holistic response that have a mix of incentives, better governance, technology, and social choice. Development is a painstaking labour of love done by people who, through trial and error, understand what works and what does not work in a country.

\(^{122}\text{See earlier reference to the writing of William Easterly}\)
International experts, whether from international organizations or Pakistanis with overseas experience, can suggest pointers, but are fundamentally unable to support decision making.

- This team must have experts from diverse areas. They must be engineers, IT specialists, economists, trade specialists, lawyers, and those with knowledge of industrial development and manufacturing processes. They must include also experts with experience of R&D and design, finance, economic policy, public policy, and governance, and more as needed.

- There is a tendency to include all good ideas into one plan. GoP must be able to tell between what is fundamental for growth and what is merely useful. They must also be able to sequence and judge which initiative should come when. Can a country low in capital and human capital accumulation begin building a knowledge economy at once?

- All plans and policies must be consultative and have stakeholders’ buy-in so that public and private players combine to play their respective roles:
  - Consultation must be across stakeholders. A policy is as good as its implementation. So, it must have buy-in of private firms as well as of individual departments, including provincial, such as property registrars, utilities, tax authorities, and members of the legal fraternity. Support of leadership of provincial administration is key as most implementation must take place there, especially land acquisition.
  - For continuous growth, consultations must include new and emerging private industries not merely established sectors
  - Plans must have targets, standards for service delivery, specific needs (infrastructure, training, credit), and an estimated budget. Performance must be accountable. Government may set up teams to hear appeals by firms for approval delays and high handed conduct of officials. These teams should have legal authority, such as by attaching with federal and provincial Ombudsman. Firms may appeal directly to them so that the cases are settled within a few days. These teams must include individuals of stature and high-level experience with ability to access high administrative levels.
  - Government must intervene directly to help the vulnerable and excluded groups who are economically and socially disadvantaged.

**Other policies: tax policy, energy policy, land acquisition policy**

- Tax policy: increase overall government revenue by targeting tax evasion, ensuring agriculture and services contribute more, and sequentially reduce burden on manufacturing enterprises that presently contribute over 70% of total direct taxes collected\(^\text{123}\). Reorient tax policy to support manufacturing growth. With broadening of

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\(^\text{123}\) Dawn, Pakistan’s tax crisis, Sakib Sherani, 7 August 2015
tax base, bring down marginal corporate and individual tax rates and intensify tax on capital gains. Increase ratio of direct taxes.

- Revisit power generation policy to address: a. energy mix, b. generous incentives to new investors in generation, c. reduce line and billing losses, and d. build supply reliability
- Institute especial policies for acquisition of land by businesses for productive use. Revisit zoning laws. Make provincial governments responsible for acquisition of all land for SEZs and industrial parks

**Government’s organization of skills training:** The hunt for talent is a global phenomenon. Availability of trained workforce is the difference between success and failure for a manufacturing or service company. Government must cooperate with industry to develop partnerships for skills and talent development. This is a key element of the economic development strategy. Government must give it major financial and organizational resources. As experience shows, skills development programmes have not met with success in Pakistan. NAVTEC, TEVTAs, and other skills development and business support organizations (SMEDA) must be restructured for effective delivery. These organizations must develop partnerships with the private sector, and if possible, with credible and resourceful international organizations. We must take care to ensure that:

- Training needs are demand driven and meet the differentiated needs of Pakistani businesses.
- The partner organization has the resources to meet goals. GoP and private sector must develop new organizations
- The partner organization is recognized in the industry so that its certificates have value or it may seek affiliation with international organizations for the purpose
- Training must be delivered near or in SEZs and urban centres where the identified industries are being set up.
- Where training has a broad target audience, its delivery may use electronic systems, especially videos over internet.
- High level supervision of the organizations is necessary to monitor progress.
- Partnership must source funding from government, industry, and other sources
- Internationally, the following partnership organizations have been successful in supporting industries in their countries. Some have also cooperated in cross-border arrangements. They specialize in diverse skills and meet diverse needs:
  - Agency for Science, Technology and Research, Singapore
  - Commonwealth Scientific and Industrial Research Organization Future Manufacturing Flagship, Australia
  - Fraunhofer-Gesellschaft, Germany
  - SkillsUSA, United States
- Br FFI – Strategic Vehicle Research and Innovation, (Programme of VINNOVA), Sweden
- Brazilian Agricultural Research Corporation (Embrapa), Brazil
- Innovation Network Corporation of Japan
- The Manufacturing Institute, United States
- National Research Council Canada

Expected country situation in 2030

- Population: Given that our estimated population size is 200 Million in 2017, by 2030 it will grow as follows:
  - Growth rate @ 2.0% per year, 260 Million
  - @ 2.2% per year, 275 Million
  - @ 3.0% per year, 295 Million

- The additional population will be 13 years or younger. This requires additional schooling for between 60 to 95 Million by 2030. Already there are 22.6 Million out of school children.

- The economy also needs to invest in skills and knowledge in addition to literacy
- By 2030, total estimated population in cities will be 130 Million to 150 Million requiring urban planning and large investment in city services

- Estimated size of GDP by 2030:
  - Growth rate @ 4% per year, 55.8 Trillion
  - @ 5% per year, 63.2. Trillion
  - @ 5% to 2022 and 7% to 2030 77.2 Trillion (Target)

Objectives

- Restructure the economy for sustained high economic growth and holistic development that increases living standards and welfare for all, through a combination of higher capital input, stronger institutions and policy, improved skills, and technology:
  - Build national consensus on development among all federal and provincial governments, state institutions, and public and private stakeholders. Economic development must be the highest national goal that prevails over all other objectives.
  - Aim for progressively higher GDP growth rates reaching 7% in five years
  - Enhance the complexity score of the economy
  - Improve human capital quality by investing in skills, education, and knowledge, improve redistribution in the economy.

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124 Some ideas and names of international partner organizations taken from Manufacturing for Growth Strategies for Driving Growth and Employment, Volume 2, WEF in collaboration with Deloitte Touche Tohmatsu Limited
125 Dawn reporting Pakistan Education Statistics for 2015-16 compiled by NEMIS, 22.6m Pakistani children still out of school: report9 March 2017
Gradually increase share of value added processing in the economy, especially in the manufacturing sector. Aim for diverse industries that are internationally competitive based on the economy’s comparative advantage.

Enhance productivity so that the same amount of capital gives higher returns. Incrementally, increase knowledge inputs to move up the value chain.

Improve government performance to ease cost of doing business and competitiveness

Re-allocate resources from surplus-rent industry and low productive agriculture to higher efficiency manufacturing, services, and agriculture

Increase access to capital

Establish nuanced external economic relations

Create a stable macroeconomy for a secure economy to withstand external shocks and manage technological disruption

Through inclusive development create a strong national identity

Constraints

- Lack of a committed leadership
- Lack of a development vision and plan with long term perspective. Incomplete national vision, based mostly on security concerns. Lack of progressive social values and lack of national cohesion
- Weak governance, modest competence, ineffective institutions that increases cost of doing business, inefficient markets, political economy favouring the elite.
- Low level of human development results in low productive capacity in society, with high poverty (29%\textsuperscript{126}), and significant inequality
- Unsupportive macroeconomic environment with structural twin deficits, low savings and investment, moderate GDP growth rate, high ICOR (incremental capital output ratio), distortions in access to capital as well as resource allocation
- No dedicated industrial or manufacturing policy or strategy. Pakistan is not part of the global value chain
- Security and law and order concerns
- Weak international linkages, in part because of security concerns. Lack of efficient connectivity with the region and the world
- Inadequate infrastructure, especially energy deficit and stressed water situation. Significant managerial and skills deficit in public and private sectors
- Slow GDP growth rates in industrial and emerging economies, populist messaging in the West against trade and investment, signs of belligerence in international relations, and emergence of disruptive technologies with potential to substitute labour intensive industries.

\textsuperscript{126}Dawn, “Govt’s new poverty line to classify up to 59m as poor: Planning Commission report”, 31 May 2016
Essential areas that need strengthening

- Create a robust macro-economic framework
- Improve savings and investment (especially domestic savings)
- Improve governments’ performance in support of businesses in the areas of rule of law, enforcement, and provision of public goods and services
- Improve Human Development Index and reduce poverty
- Build efficient and functioning cities
- Build and manage effective SEZs, industrial parks and clusters
- Stimulate manufacturing and build international competitiveness
- Continually invest in people to reduce literacy gap, enhance skills, and knowledge
- Reduce the effect of the binding constraints that hold back the economy.

Policy that invests in human capital and knowledge contribute in a major way to long term economic growth. Continued investment in human resources will enable these endogenous forces to reduce the effect of diminishing returns on capital and yield long-term growth. Develop programmes by consulting all stakeholders: federal government, businesses and entrepreneurs, field experts and academia, provincial and local governments, especially the departments dealing with businesses. All political parties as well as media and civil society must be on board. This is a national effort. Implementation of such wide scale reforms need work on several fronts at the same time.

Quantitative Milestones

- GDP growth rate: Ensure GDP growth rate of 5% and above to reach 7% by 2022, until 2030 and beyond
- Improve Pakistan’s Economic Complexity rank by 25 positions by 2022
- Increase share of manufacturing in GDP from 14% to 18% by 2022, and 25% by 2030. Immediately institute a national manufacturing strategy
- Set a target for manufacturing GDP growth to be 2% higher than overall GDP growth rate.
- Increase government revenue/GDP ratio from 15% to 20% by 2022, and to 25% by 2030, largely by increasing tax/GDP ratio from 12% to 20% by 2030
- Increase savings to GDP ratio: Savings from 14% to 18% by 2022, and 25% by 2030, investments from 15% to 20% by 2022 and 25% by 2030
- Reduce twin deficits, increase export to GDP ratio from 8% today to 12% by 2022 and 20% by 2030
- By 2022, improve Pakistan’s ranking by twenty-five positions in the three indices: HDI, WB Ease of Doing Business, WEF Competitiveness Index, and attempt to improve continuously

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• Reduce number of out of school children to 15 Million by 2022 and to a minimal level by 2030, bring down poverty from the present 29% to 20% by 2022 and to single digit by 2030. Reduce malnutrition on an emergency footing.
• Reduce share of labour in agriculture to 20% or equal to its contribution to GDP, by 2030
• Establish industrial parks and SEZs comparable to those in the region to increase manufacturing investments, including single industry parks. These may act as clusters that serve industries with dedicated logistics and skills development facilities. Connect them to ports effectively.

Specific measures:
Incentivize increase in private investment (private tangible inputs) through access to capital, tax breaks, and other reform measures

• Access to capital and new financial products across all businesses:
  1. Reduce markup rate of Export Refinance Facility and reduce benchmark for export performance
  2. Reduce markup rate of Long Term Financing Facility. Make it available to all manufacturing, not just for exports with no cap on ceiling
  3. To attract back funds of Pakistanis from their overseas bank accounts and other holdings, GoP may offer immunity for those funds that are invested in industries, services, and other businesses, either as sponsor or through the capital market. Such a plan may already be under government consideration.
  4. Allow unsecured issue of long-term corporate bond. This will build an efficient (and sophisticated) bond market. Credit agencies will play their role in assessing credit quality for investors as in the case of equities. SECP may screen bond issues.
  5. Support creation of private equity firms for provision of long term equity finances:
      a. Liberalize regulations to permit funds to enter bilateral agreements after screening for investor eligibility
      b. Allow funds to create new financial products
      c. Remove tax exemption sunset
      d. SBP to formulate rules for banks to invest in private equity
  6. Create an infrastructure fund. GoP to lead with formation and contribution of equity. Source equity also from IFIs, private home financial institutions, and foreign governments. Allow the infrastructure fund to take pre-IPO positions in projects.
  7. Create a fund specifically for overseas Pakistanis to be managed by NIT. This fund too may be eligible for pre-IPO positions. GoP may keep green-shoe option.
  8. Create an industry consolidation fund and encourage separation of management and ownership
  9. GoP may start mortgage financing in the country. SBP may allocate funds to commercial banks and stipulate mark-up ceiling. Banks will assume credit risk. This will serve as a rolling fund where recovery will finance future borrowing.

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10. Revise existing legislation to treat REIT as stock investment
11. Incentivize banks to offer long term fixed rate project finance for business, including SMEs, by using tax and SBPs regulatory incentives. For their financing needs, government may rely more on long-term PIBs in addition to MTBs. This will help develop a Yield Curve in the market, which the banks may use to determine lending rates for long-term fixed rate project finance.

- **Tax incentives, all industries:**

  1. Remove sunset for income tax credit of 10% of investment in P&M and make it indefinite until review (Clause 65 B)
  2. Remove sunset for 5 year 100 % tax credit for new industrial undertaking. Make it indefinite until review (Clause 65 D)
  3. Remove sunset for 100% tax credit for capacity additions and/or BMR P&M and make it indefinite until review (Clause 65 E)
  4. Issue Bonds to clear refund of sales tax refund back log
  5. Issue Bonds to clear duty drawback backlog
  6. SRO 327 provides the criteria to declare a manufacturing plant as an export-oriented unit. Amend SRO 327 to reduce to 50% from 80 to 100% the share of export in total production of the manufacturing plant.
  7. DTRE scheme may be modified
  8. Provide drawback of local taxes and levies on exported processed fabrics, leather goods, textile goods, and garments.

- **Tax measures, Sector Specific:**

  1. Polyester and Yarn: impose 10% regulatory duty on imports to ward off dumping threats
  2. IT firms:
     - Remove tax exemption sunset until future review
     - Exemption from provincial tax
     - Tax exemption for freelance exporters
  3. Oil and Gas Exploration and Production companies: harmonize their corporate tax rates with overall corporate sector

- **Other Policy Measures:**

  1. Correct REER for the Pakistan Rupee (already in process) to improve export competitiveness
  2. Make special forex provision for import of prioritized technology
  4. SBP may issue a policy for non-performing loans of closed businesses or those made (temporarily) uncompetitive.
5. Through tax incentives and SECP facilitation, promote separation between management and ownership of firms and encourage firm consolidation
6. Expand into new sectors, e.g. real estate, retail and wholesale, and information technology
7. Remove remittance condition with respect to disinvested FDIs. Currently, remittance is limited to break-up value of the firm. To permit remittance of capital, introduce third-party valuation on need basis.
8. Incentivize IT firms with:
   - Facilitation of visas for access to markets
   - Facilitate import of hardware
   - Simplify their registration process
   - Support patent registration
   - Facilitate remittance of overseas earnings by freelancers through electronic marketplaces such as PayPal
   - TDAP may support them with international trade fair participation
   - Technology funds (such as USF and ICT R&D fund) may extend credit for incubation centres.
   - Institute data protection and privacy laws
9. Petrochemical industry: To realize the high potential for value added exports in this sector, allow ‘bonded’ raw material imports.
10. Set up a fast-track dispute resolution process for IPPs
12. Accountability of businesses and their owners and management must be under relevant laws and by the concerned law enforcing authorities. Private businesses must not come under the purview of NAB.
13. Likewise, a spirit of support to businesses must be inculcated in government departments, especially at provincial and local levels.
14. Bank officials to be trained by SBP and FMU in spotting suspicious remittances from overseas to avoid delays and follow up of genuine business transactions

- **Prioritize growth generating public investment:**
  1. Rationalize PSDP project portfolio to prioritize growth generating public investment
     - Increase PSDP budget
     - Upgrade countrywide IT connectivity infrastructure. Begin by offering high quality Wi-Fi services in cities
     - Plan transport infrastructure as connected multimodal network under an overall logistics support programme.
     - Increase provision for hydro power generation, transmission, and distribution infrastructure.
2. Prioritize efficient use of water and water security. For the former use ZTBL concessional window as incentive for farmers. Accompany with policy on pricing of water.

3. Invest in IT infrastructure to enable distance learning. HEC and skills development organization may work with international MOOCs for the purpose. Pakistani youth must catch up on technology and skills. Partner with IT MOOCs to create mass training courses in Pakistan (Udemy, Udacity, Code.org). Plan on training millions of young Pakistanis each year. Where possible translate instructions to Pakistani languages. This could be a transformational initiative.

**Sustained development measures (medium term)**

- Rationalize multiple taxes on businesses
- Subject to progress on tax reforms and to broaden tax base, GoP may cautiously consider reduction in direct and indirect tax rates
- Work with provincial governments to enforce and enhance collection of agriculture taxes
- These measures will reduce GoPs fiscal deficit and provide resources for increasing PSDP.
- MoF and SBP must study how to increase savings/GDP ratio in country.
- Rationalize power sector policy, energy mix, governance (especially of DISCOs), and IPP concessions progressively to reduce cost of power
- Reinvigorate relations with Iran for energy security, revive work on IP pipeline
- Separate PSEs from their ministries and create a holding company
- Renew Pakistan Remittance Initiative focusing on white collar Pakistanis to revive falling overseas remittances
- Strengthen governance to:
  1. Improve Pakistan’s competitiveness and ease of doing business rankings (WEF and WB).
  2. Work with business associations OICCI, ABC, PBC, FPCCI, and city chambers, industry, and trade associations, including P@SHA to find and remove specific irritants
- Gradually increase total PSDP and ADPs (federal and provincial) allocations and focus on education, skills training, health, urban centre upgradation. PM must review such projects in CCI meetings for knowledge sharing with lagging provinces.
- Build capacity and specialization among civil servants so that GoP and businesses work as development partners. Revive Government’s role as an effective player in policy making, provision of services, and enforcement of the law.
## All Assistance from USA to Pakistan 1948 to 2010

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**Total USD 96,471 Million**
## Details of Trade Structure

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<th>% of duty-free Tariff lines</th>
<th>Mkt Penetration Index</th>
<th>Exp/GDP %</th>
<th>Imp/GDP %</th>
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<tr>
<td><strong>870322 Autos</strong></td>
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<td>RM 3 %</td>
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<td><strong>Petroleum &amp; Oils</strong></td>
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<td>RM 25 %</td>
<td></td>
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<td>6.21</td>
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<td>1.6 B</td>
<td>Intermediate 20 %</td>
<td></td>
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<td></td>
<td>16.46</td>
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<td>1.5 B</td>
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<td><strong>420310 Leather Apparel</strong></td>
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<td></td>
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<td><strong>854211 Monolithic ICs</strong></td>
<td>0.99 B</td>
<td>Capital 37 %</td>
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<td></td>
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<td><strong>880240 Aircrafts</strong></td>
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### Tariff Avg. Weighted %

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### Annex 2 Page 2

<table>
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<th>% of duty-free Tariff lines</th>
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<th>Exp/GDP %</th>
<th>Imp/GDP</th>
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<td>32.77</td>
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#### Top 5 Exports

<table>
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<th>Duty %</th>
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<tr>
<td>270900 Petroleum</td>
<td>270900 Petroleum &amp; Oils</td>
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</tr>
<tr>
<td>100590 Maize</td>
<td>847989 Machines &amp; mechanical app</td>
<td>33.59</td>
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<tr>
<td>640399 Footwear</td>
<td>310210 Urea</td>
<td>63.76</td>
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<td>950390 Toys nes</td>
<td>870323 Autos</td>
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#### Top 5 Imports

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<th>% of duty-free Tariff lines</th>
<th>Mkt Penetration Index</th>
<th>Exp/GDP %</th>
<th>Imp/GDP</th>
<th>Trade Bal %</th>
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</thead>
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#### Top 5 Exports

<table>
<thead>
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<th>Duty %</th>
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<tbody>
<tr>
<td>852520 Transmission apparatus</td>
<td>854219 Monolithic ICs</td>
<td>1.37</td>
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<tr>
<td>847120 Digital auto data process</td>
<td>270900 Petroleum</td>
<td>3.55</td>
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<td>854219 Monolithic ICs</td>
<td>260111 Non-agg iron ores</td>
<td>10.14</td>
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<td>851790 Parts of electrical app</td>
<td>901380 Optical devices</td>
<td>4.75</td>
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<tr>
<td>851782 Telegraphic apparatus</td>
<td>851790 Parts Elect apparatus</td>
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<td>Tariff Avg. Weighted %</td>
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<td>847330 Parts and acc of automatic data processing</td>
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### Top 5 Imports

<table>
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<td>270900 Petroleum oils</td>
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### Annex 2 Page 4

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<th>Imp/GDP %</th>
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#### Top 5 Exports

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<tr>
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<td>871120 Motorcycles</td>
<td>Intermediate 8 %</td>
<td>11.29</td>
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<td>100630 Semi or wholly milled rice</td>
<td>621710 Clothing accessories</td>
<td>Consumer 44 %</td>
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#### Top 5 Imports

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<tr>
<td>852520 Transmission apparatus for teleph</td>
<td>RM 11 %</td>
<td>3.98</td>
</tr>
<tr>
<td>851790 Parts for above</td>
<td>Intermediate 13 %</td>
<td>2.67</td>
</tr>
<tr>
<td>847120 Digital auto data process mach</td>
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<td>5.94</td>
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<td>230400 Oil Cake and --</td>
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#### Top 5 Exports

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### Annex 2 Page 5

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<td>Consumer 28 %</td>
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<td>Capital 21 %</td>
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<th>Imp/GDP %</th>
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<td>Consumer 57 %</td>
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<td>7.02</td>
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<td>Consumer 31 %</td>
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<td>Capital 21 %</td>
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### Annex 3

<table>
<thead>
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<th>Country</th>
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<td>ROK</td>
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<td>China</td>
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<td>Malaysia</td>
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<tr>
<td>Indonesia</td>
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<td>Vietnam</td>
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<td>India</td>
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<td>Pakistan</td>
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*Source: Individual country pages*