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Improving Lives: Can Pakistan Adopt the East Asian Economic Model?

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This paper is about long-term economic growth. The aim is to find the policy path to raise the living standards of all Pakistanis, enhance their self-esteem and respect among nations, as well as to reduce Pakistan's dependence on other economies. It is based on evidence and facts on the ground

For whoever has will be given more, and they will have an abundance. Whoever does not have, even what they have will be taken from them", Matthew 25:29, The Bible

Government is an institution which prevents injustice, other than such as it commits itself. Ibn Khaldun The Muqaddamah

"In economics...anything that could be called anecdotal or case study types of methods are simply ruled out. To my mind this is a serious methodological bias that is blinding the profession to very important phenomena." Janet Yellen, Wall Street Journal, 2 November 2018

"Holy warfare's appetite for men and money could be ruinously expensive for royal treasuries … ultimately Spain's inability to control military spending proved catastrophic. Incredibly, it became a serial defaulter on its debts" Peter Frankopan, Silk Road A New History of the World

"The individual human being cannot accomplish all the things that are necessary …. there must exist a group, the members of which cooperate to acquire many different crafts and (technical) skills. In this way, each individual accomplishes something from which his fellow men can profit". Ibn Khaldun The Mugaddamah

"Most of the people in the world are poor, so if we knew the economics of being poor, we would know much of the economics that really matters". T. W. Schultz, Nobel Prize lecture

"Pakistan's persistent GDP growth difference with India will lead to very large gaps in economic output. Pakistan's economic policy hasn't dealt with the deeper issues of institutions, incentives, human capital, and of a society that is insulated from the world". Atif Mian, South Asia Conference 2014 (not exact quote)

Can the East Asian Economic Model Help Pakistan?

Objective:

This paper explores why Pakistan has not achieved sustained economic growth as seen in East Asia. Can the East Asian growth model help Pakistan? Our research finds that the short and simple answer is ‘yes, but’. That is clearly an insufficient answer and that is why this paper is long. Development is a long and arduous process. It is a process set in motion by a committed leader with a competent team. They lead the process through discipline and well thought out action that involves the whole population of the country. There are many nuances and many possible paths to choose from. In the pages to follow, the paper discusses its determinants, the choices, and their pros and cons.

To navigate the above broad and challenging task, the paper will review the following:

- Review of literature on economic development.
- Review of literature on East Asian growth, summarizing its essential contents.
- Economic growth trends in Pakistan, especially of the last twenty years
- Evaluate whether the East Asian model is relevant for Pakistan. What relevant lessons can Pakistan draw from it?
- Does Pakistan have an effective state, which can support development?
- The paper will find how Pakistan can achieve sustained high economic growth. Integrating literature, data, and policies, it analyzes the present drivers of GDP growth in Pakistan. It will review also why Pakistan’s macro indicators, especially BoP have been so weak.
- Recommendations

1. Introduction:

The Institute for Policy Reforms views this as a major study. There are a number of quality studies on the broader subject of development in Pakistan. The Planning Commission’s two studies of the last decade offer good analyses and a way forward. There are also several books value by that discuss growth and the political economy holding it back.

This paper’s focus is the East Asian model. And though there may be an overlap with the above, with East Asia as its lodestar, this paper adds new ideas to the literature on Pakistan’s economy. It is necessary for Pakistan to graduate from decades of low to moderate growth and boom-bust cycles. It will:

- Make recommendations for long term high growth of the economy.

- Propose a way to exit from the endless loop of macroeconomic instability and external dependence into which the economy has locked itself.
- The end goal is to improve citizen wellbeing and to increase the respect and esteem of all Pakistanis.

All this will be in the context of Pakistan's political and social realities. While economic theory and principles are important, the economy works in the marketplace. This means working with imperfections and failures. Also, government policies greatly affect the economy. Limiting the study to one discipline compromises its robustness. This is practical policy research that crosses boundaries. The study will spawn enough ideas to stimulate a discussion on a possible future path for policy makers[1].

As a result, this paper will go beyond the usual slew of economic cures. For years, Pakistan has been told to enhance competitiveness, strengthen macro indicators, reduce poverty and the like. If the economy could achieve all that, it would not be seeking advice or aid. We must study not just what needs to be done, but how they should be done. Government usually receives a long list of things to do. We must move on to finding why Pakistan has not started to implement those things, even though by now everyone knows at least the broad parameters of the route fast growing economies have taken.

We must find out why there isn't enough technology in the economy. Or, why is it that we are way behind others in capital accumulation[2]. This takes us to the political economy in Pakistan. It is common knowledge that labour, capital, technology, and governance contribute to economic growth. Why then has Pakistan not done enough to build their stock. Perhaps Pakistan is too heavily inclined in favour of security goals. If so, it comes at the expense of economic growth and citizen welfare. We will review also the extent to which elite capture and lobbies limit efficiency gains in the economy.

A question this study asks and tries to answer is "why societies make different technology and capital accumulation choices"[3].

In their writings, Acemoglu and Robinson have often compared oil rich Nigeria with South Korea[4]. The history of postwar Nigeria stands in sharp contrast to that of South Korea. Nigeria has had "civil war, military coups, extreme corruption … (with no) incentives to businesses to

[1] In fact, in his The Strategy of Economic Development, the brilliant public intellectual and economist Albert Hirschman promoted the idea of coming to terms with the idea of development in pragmatic ways. I feel that we need both rigour and modeling and a practical approach to policy making across disciplines.
[2] Capital accumulation is the process of acquiring additional capital stock, used in the productive process. It includes building physical assets infrastructure, factories, or machines etc., as well raising quality of human resources. It also includes portfolio investment or raising other assets such as housing. This paper mostly means increase in physical and human capital stock. Adapted from Economics Help.
[3] Daren Acemoglu, Introduction to Modern Economic Growth, Princeton University Press, 2009, Page 20
[4] Darren Acemoglu and James A. Robinson, Why Nations Fail, 2012, Crown Publishing Group, a Division of Random House Inc. They have made this comparison also in Introduction to Modern Economic Growth

invest and upgrade their technologies"[5]. Recovering from Japanese occupation and division of the country, South Korea chose a different route to progress.

Two developments especially call upon us to take a deep look at Pakistan's policy choices. This paper sees them through the prism of economic growth. The first is short term. And it relates to the present extreme despondency about the state of the economy. How we respond to the problem could change dramatically the country's strategic preferences both in economic and security terms. That is, if we are willing to draw lessons from it.

The second is about the shift of economic and technology power from the West to China and India. Until recently, this was a possibility. It is now an inevitability. This shift could lead the region to a cataclysm, or it could be a boon. That depends on how world leaders act. Without being a central player, Pakistan will be embroiled in any crisis if one were to happen. This is because it is a major power and has an important role to play. Pakistan must have a very clear idea of where it wants to be in the coming decades. The logic of that idea should be mainly economic interests and the welfare of the people. How that reflects in its regional economic relations should be a priority for Pakistan. This paper will discuss our economic interests and trade and investment relations in the region.

Growth is key:

It is apocryphal, but that is why it is so powerful, says Peter Thiel. "Albert Einstein … stated that compound interest was "the eighth wonder of the world," "the greatest mathematical discovery of all time," or even "the most powerful force in the universe". Whichever version you prefer, you can't miss Thiel's message: never underestimate exponential growth.[6]

What is true for a firm or a person is true for nations. East Asia made economic growth a priority. However, before embarking on growth, they did not wait for perfect conditions to come about. Whether as colonists or colonies, in the 1950s, East Asia was recovering from brutal wars and massive social upheavals. In fact, Korea was split into two. Undeterred, they focused on the economy and better living standards for their people. Economic growth helped East Asia combat its fragility borne from war time.

The essentials that underpinned their rise were political and economic stability, social cohesion, and (managed) economic integration . Upgrading industrial structure was a key priority. Notably also, each economy became deeply linked with the region and globally. But most of all, they had political leaders fired by the will to catch up with the West.

Their approach was not formulaic. They tailored policies to the needs of the individual economy. For the late comers, FDI became the main growth instrument. This helped transfer knowledge and integrated their industry with regional and global supply chains. The East Asian

[5] Acemoglu, Introduction to Modern Economic Growth, Page 20
[6] Peter Thiel with Blake Masters, Zero to One, Page 62, Crown Business, 2014

model does not follow a fixed menu of international best practices. Underlying the model, is a determination to compete globally and to become a respected member of the world community[7].

This paper will follow the sequence below:

- Section two examines what is development. This will take us through an evolving stream of ideas and models of development.
- Section three discusses in detail East Asian approach to growth. Given the vast spatial spread of the region, the study will review also similarities and differences in their policies and in initial conditions.
- Section four reviews the trend of Pakistan's economic growth and what ails our economy. We will determine causation. In the policy space, there is enough discussion about the economy's weak macro indicators. Very little is said of their underlying causes. Section four will lay before us the policy choices by decision makers. These choices are why the economy is where it is. We seem to be fixed in our methods on how to deal with each economic emergency as they reappear periodically. We are using the same methods as before, and hoping for a different result.
- Section five will relate East Asia's policies with Pakistan's strengths and frailties. Can the state build a business climate for development? Does the world
- The last section will give recommendations.

In a Preface to one of his works, Albert Hirschman uses a quote that "Elucidation of immediate experience is the soul justification of any thought"[8]. This paper is based on the writer's modest experience along with his thoughts and those of others.

[7] The National Graduate Institute of Policy Studies, Tokyo, Japan. Contents of the paragraph based on various research papers. By Kenichi and Izumi Ohno, Watanabe, and others.

[8] Hirschman Albert, The Strategy of Economic Growth, Preface, quoting the 19th Century philosopher and mathematician Alfred North Whitehead.

2. What is development and why must we pursue it?

As noted already, this paper's goal is to study why Pakistan has not achieved sustained economic growth as seen in East Asia. Can the East Asian model help Pakistan? In Asia, many millions have come out of poverty with greatly improved standards of living. All indicators of human development are vastly better than before. This has raised their citizens' self-esteem and enriched their lives. Sustained economic growth is the means for development. Without economic growth, it is not possible to reduce poverty or improve living standards for the majority of citizens.

There are many theories of development. The discipline has evolved over time. Each proponent has given their own advice. They range from the specific and narrow to those that involve broad based social and political transformation. Yet, there may be more in common among these theories than meets the eye.

Because of its multidisciplinary nature, development economics was faced with the problem of showing causal relationships. In the last twenty or so years there have been attempts to correct this. So, the field has evolved from Adam Smith's near philosophical treatise to Schumpeter's analytical framework, and then to the rigours of modeling. Our focus here is to improve growth in Pakistan. Thus, the spotlight of this paper is on theory that can be into practice.

I request those who find the next few pages prosaic, to skip the rest of the section and go to its key takeaways.

We now look at how Western development literature has evolved. We will then analyze if the East Asian development model is much different from Western thinking.

Development as a sub-discipline of economics evolved in fits and starts. According to classical economists, higher investment and increase in production capacity bring economic growth. Adam Smith was the first to state what became a truism later. Economies pass through stages of development. And in doing so, societies are transformed. Changes in the way societies organized themselves lead to their long-term growth. He may have sown the seed of the idea of human capital. He defined four types of fixed capital of which one was "the acquired and useful abilities of all inhabitants or members of the society"[9].

Market size enhances prosperity. Increase in production of goods enlarges market size. Division of labour leads to specialization and to more productivity. As investment grows and market size increases, the economy sees greater division of labour. The invisible hand will keep markets stable. An economic agent will pursue always her self-interest. Yet, in doing so she contributes to the general good by producing at the best price possible. Adam Smith's fourth stage of

[9] Four hundred years earlier, Ibn Khaldun wrote something similar "The individual human being cannot accomplish all the things that are necessary …. there must exist a group, the members of which cooperate to acquire many different crafts and (technical) skills. In this way, each individual accomplishes something from which his fellow men can profit". Ibn Khaldun The Mugaddamah

‘commercialism’ is the stage of ‘opulence’. At times, the stages were inverted as commercialism led to manufacturing of goods.

Other classicists did not agree entirely with Adam Smith. There was not enough reason to believe that growth in supply increased demand. In fact, like Keynes to follow a century later, Malthus, considered growth dependent on effective demand. Smith also believed that returns on investment will keep growing. On the other hand, Malthus, Ricardo, and Marx, believed that capital has a diminishing rate of return.

David Ricardo focused on viability of growth. Availability of subsistence labour on a given amount of land led to growth. With economic growth, pressure on land increased. Fixed resource was a constraint to steady growth. Trade allowed comparative advantage and specialization and new markets increased demand. He warned of the dangers of mercantilism.

Smith’s belief in continuous growth in productivity and profit jarred with later economists’ theories of how the market functions. They said that competition would drive prices to their marginal cost. International trade expands markets or scale and creates competition. As the progenitor of neo-classicism, Alfred Marshall shifted the discipline’s focus to markets. He explained equilibrium through supply and demand and marginal utility. For a while the spotlight on growth and development took a back seat. However, trade’s centrality stayed. And it has not changed to the present day, as seen in global supply chains and production sharing arrangements.

In the 1930s, Schumpeter brought the focus back to development. Contrary to theories espoused so far, he did not think that capital accumulation drove economic growth. Innovation and entrepreneurs did. To succeed, they needed government to create a business climate that sanctified private property and ensured competition. To grow, firms also needed an efficient financial market.

Yet old themes kept coming back. In the 1950s, Arthur Lewis (Nobel Prize 1979) affirmed that a shift of subsistence labour to goods production was needed. The low cost of labour yielded high returns for investors. These are reinvested employing more labour. As output grew, increase in production absorbed surplus labour. This would lead to an increase in their wages. The duality between the capitalist and subsistence economies would end. This self-sustaining process leads to development. There are other ideas inherent here. One is capital accumulation. More production needed capital, which in turn needed more savings. Though not stated explicitly. transfer of subsistence labour to manufacturing also brought about structural transformation of the economy.

In the 1950s also, Kuznets (Nobel Prize 1971) came up with modern economic growth, ideas that today are part of our daily lexicon. Dwelling on factors that comprise GDP, Kuznets spelt out the drivers of growth. Among others, they included “rate of rise in productivity”, that is to get more output from a given input. Another feature was structural transformation of the economy. The latter involved a shift from agriculture to industry and to services. A key indicator of growth was transfer of workers to cities and global integration[10].

Adam Smith's stages of growth found new shape in the middle of the 20th Century. Walt Rostow revived the stages of growth with emphasis on long-term growth. Here too, capital accumulation was a driver of growth. Where domestic capital was constrained, external support should help. One can say that it was his version of magnificent dynamics. He was also perhaps inspired by the success of the Marshall Plan and creation of donor institutions.

Yet, while savings was a necessary condition for growth it was not a sufficient condition. Later proponents added more growth inducing variables. Concern for causal analyses and other refinements in methods seeped in. Capital accumulation and savings rate (but also aid and FDI) have mostly stayed as a key function of growth. Technology was added to capital accumulation as a factor.

Further, institutions, both economic and political, "are the underlying determinant of economic performance"[11]. Institutions are constraints made by humans to "structure human interaction". There are formal and informal constraints. Formal institutions are laws and the constitution. Informal constraints are "norms of behavior – codes of conduct". Together they make up the "incentive structure of societies and .. economies". For Douglass North, the assumption that all economic players base decisions on rationality was flawed. He said that "ideas, ideologies, myths, dogmas, and prejudices matter". These are the soft areas that affect economic performance. This is a key area that remains undefined in many developing countries.

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[10] Simon Kuznets, Nobel Prize Lecture 1971

[11] North, Douglas, Nobel Prize Lecture, 9 December 1993

Box 1

What is capital accumulation?

As it is an often-used term, an explanation is necessary.

Capital accumulation is the process of building more stock of capital to use for productive process. Traditionally, it included physical fixed assets such as machines and structures for setting up plants. It also includes infrastructure. More recently, accumulation of human capital is considered of equal importance, if not more so. Physical capital is measured by change in value of assets as also by the amount of gross fixed capital formation minus depreciation.

How does accumulation take place? Business profits get reinvested. Innovation enhances productivity and better quality of human capital gives more output for each unit of input. Also, increase in savings and FDI raise investment. Capital accumulation has been considered key to growth, from the classical economists to their modern-day avatars. According to endogenous growth models, it increases long-run growth rates. For this, an economy must increase its savings rate.

A recent World Bank report on Pakistan counsels that "Accumulation of human and physical capital is necessary for accelerating and sustaining high growth". It emphasizes that physical capital will boost output and jobs, as it builds an economy's capacity to produce. Infrastructure and human capital both are vehicles. "Given (Pakistan's) abundant labor supply, investment in human capital and its utilization is critical to stimulating growth".

From the last quarter of the 20th Century, institutions and governance are recognized as key factors for economic growth[12]. Education also made a presence and has been front and centre for some years.

In recent years, Darron Acemoglu has forcefully urged about the role of institutions. Their importance is borne out by data showing a deep link between effective institutions and development. There may be questions about whether Acemoglu's logic is not circular. That is, does growth lead to better institutions or vice versa? Whether it is one or the other, national leaders would do well to give this question deep consideration.

Even if causality is not clear, the state plays a critical role in how institutions work. Political economy too is key. Those states that targeted interests of all and not just of the select few, performed better. Therefore, accountability of governments was important. This leaves a dilemma. If institutions are key, how does one make policy to improve them. Because, improvement to institutions has to be brought about by people who head them, and they may be the source of the problem.

[12] Acemoglu and Robinson have been its big proponents. See Introduction to Modern Economic Growth, Daron Acemoglu, Princeton University Press, 2009

Some years before, Gunnar Myrdal's famous Asian Drama had an answer to the issue of lack of development. Soft states that are marred by incompetence and corruption are their own obstacles. He had studied the Indian economy. Regardless of the chicken and egg inherent in this debate, Myrdal concluded that governments had to reform and lead development. How to make the state a useful player was a big question then as it is now. Myrdal also did not recognize the debilitating legacy of colonialism and the deeply ingrained extortionist policies it leaves behind. The new elite are often reluctant to let go these policies.

Experts also studied allocation of resources. Markets were the best at this. But there were market failures. Governments had to step in to correct them and move the economy to a higher equilibrium.

This brought in the role of planning, which soon fell into disfavour, even before its use spread. Experts agree that planned allocation of resources "were all conclusive failures[13]". However, Japanese scholars were nuanced. "As for Japan's pre-war economy, studies …. find that some 20% to 50% of Japan's pre-war TFP growth was attributable to inter-industry resource reallocations"[14]. Others suggest that even pre-war flawed allocations helped accumulate capital that Japan's post war growth used. "Policies by the Meiji government are usually credited as successful in laying the foundations for sustained growth"[15].

Yet, socialist type planning was a failure. Even mixed economies struggled. In Pakistan, five-year plans led to a decade of high growth. Yet, the inequality it is said to have caused became a source of discontent. This should not have been a surprise given the thinking at the time. Through the inverted 'U' curve, Kuznets showed initial increase in inequality[16]. Yet, the country went through a turbulent era. Also, the Indian economy, given to similar five-year plans, barely grew until it gave markets a bigger role.

The Growth Report accepts that in high growth economies of East Asia, "governments were more hands-on". They gave "tax breaks, subsidized credit, directed lending and other such measures"[17]. This way they discovered their comparative advantage. Government's guiding role did not mean that the markets did not function. East Asia shows that, while development planning does not work, development policy does.

A deceptively simple but profound argument about development was put forth by Rosenstein-Rodan in 1943. There was complementarity between investment. Investment in one industry or sector may not take place because of a lack of investment in another industry with which it is linked. And the latter may not have occurred because the first investment did not happen. If this

[13] The Growth Report, Page 25

[14] Okazaki Tesuji, "What drives innovation? Resource allocation inadequacies and diminishing effects", Research Institute of Economy, Trade and Industry, Tokyo Japan

[15] Takatoshi Ito, Japanese Economic Development: Idiosyncratic or Universal? Chapter 2 Page 28, Contemporary Economic Issues, Volume 1 Regional Experience and System Reform, Edited by Justin Yifu Lin, International Economic Association in association with Palgrave MacMillan. 1998

[16] In the 1950s, Kuznets developed a hypothesis that when an economy first grows, as an economy develops, inequality increases. However, inequality later declines.

[17] World Bank Commission on Growth and Development, Chaired by Dr. Michael Spence, The Growth Report: Strategies for Sustained Growth and Inclusive Development, Page 25

were true, incremental investments would not work. So, perhaps the secret to development lay in a “big push’. This idea was likely the basis of the post war Marshall Plan. Expectation of one investor about the other investor becomes a determinant of growth. So, developing countries too needed more capital. Or else, coordination failure will cause a slowdown[18].

This idea was refined by Albert Hirschman a decade or so later. A developing economy may not have the capital, its own or foreign, for a big push. It could possibly get the same result with less capital. The economy may prefer to invest in fewer number of industries. But the ones in which it does, will be key ones. These key industries will have linkage with other sectors. Later, investment would follow in those linked sectors also. Both ideas had implications for policy. Whether it is big push or unbalanced growth, how does policy select which sectors to invest in?[19]

Allied to these theories on development of low-income economies, was the idea of ‘convergence’. In the past, there was unfounded faith that all economies will converge towards a steady state. Low income economies differ from industrial economies in their ratio of capital to GDP per capita. They have less savings. More capital in low income economies will give faster growth than those taking place in advanced economies. This is because developed economies were beset by diminishing returns.

The idea was questioned before long. Economies need social capacity to catch up. These come in the shape of an ability to learn new technology. Catch up also depends on how well an economy can attract capital. There are also endogenous factors arising from government policy that affect the rate of growth[20].

Study of growth and development had come a long way from its historical base to analyses, and to modeling. The latter came about because of increased demand for rigour. Also, more and more variables were added into the mix.

For a while in the post war years, the Harrod Domar model was a favoured tool. It studied the relationship between growth and unemployment. However, developing economies used it because it also focused on capital accumulation. The model concluded that economic growth in advanced economies could not guarantee full employment. The economy would stay in disequilibrium in the long run. This led experts to search for answers.

The neo-classical Solow model (of exogenous growth) showed that long run growth was sustainable. Substitution between factors of production took care of Harrod Domar’s constant capital production ratio. The sources of growth were more than just labour and capital. Increase in productivity, or technological progress was also a cause of growth. According to Solow (Nobel 1987), because capital has a diminishing rate of return, long term growth will occur only with continuous technological progress. So, a poor country will not catch up with an advanced

[18] Debraj Ray, Development Economics, Princeton University Press, 1998, Chapter Development Traps: Multiple Equilibrium, Pages 150 to 162
[19] Ibid
[20] Contents of this para based on writings of Debraj Ray, Moses Abramovitz, Nagaoka, and others (from internet).

economy simply by infusing more capital. It will grow over long periods only if it acquires new technology – 'conditional convergence'. This will give more return or output from the same input. Solow assumed that the workforce comprised the whole population. So, increase in population meant decrease in capital per worker. Which meant that growth will decline if population increased.

However, there was need to explain the Solow residual. In the pursuit of what drives economic growth, we now move to two other models. For Robert Lucas (Nobel 1995), growth depended on human capital. More skill levels gave higher worker productivity. The quality of human capital determined productivity of both capital and labour. In addition to personal return from education, there were also social returns. Human capital created externalities. The consequent externalities helped the economy grow even more. This came from accumulation of human capital. Low level of human capital in an economy will have lower growth. One with high levels of human capital will grow faster.

For Romer (Nobel 2018), economic growth was caused by a number of factors. They include the rate at which new capital goods enter an economy. Growth also results from the quality of human capital, and institutional framework in which the economy operates. Combined, they will give continued and higher rates of returns. More skilled workers created more ideas. While objects (capital and labour) are finite, ideas are infinite and non-rivalrous. Use by one firm does not diminish its usefulness for another firm. New ideas, technology, and the institutional arrangements in which an economy operates are causes of growth. One-time investment in a new idea would reap long term gains. This is because an idea does not have to be reinvented. Doubling inputs would give us more than twice in output. So, the returns on objects increases when used with ideas and there is continuous return. Ideas "are fundamental to the future progress of development"[21]

The above models of growth have been discussed because growth leads to development. As mentioned already, there are many definitions of development. They range from the narrow, such as a per capita increase in income to the broad. In their textbook of 1957, Meir and Baldwin defined economic development as a process where national income grows over a long period. If its rate of growth is more than the population growth rate, there will be increase in income per capita.

That it is a process means it is an interaction between factors. These factors include labour, capital, government, better techniques, better skills, government working, and changes in the way societies are organized. There are also demand driven considerations. They include the nature and size of markets. Also, how income is distributed and how institutions evolve affect growth.

While growth means more output and more efficiency, development suggests long term gains in the wellbeing of the people. Over the years, the measure for development has evolved from increase in income to social indicators. At various times it has been represented by HDI or

[21] Gerald Meir, Introduction: Ideas for Development, Frontiers of Development Economics, The Future in Perspective, Gerald M. Meier, Joseph E. Stiglitz, editors, Page 1, A Co-publication of The World Bank and Oxford University Press 2000.

poverty reduction. At others, by the level of capabilities, by freedom, and the sustainability of development[22].

Nobel laureate Amartya Sen defined development as freedom. Its five components are political freedom, economic goods, opportunities, transparency, and security. On the other hand, Francis Fukuyama's ideas are very broad. He describes development as "change in human societies over time"[23]. on the length and quality of that life, or on the "entitlements", "capabilities" and "functionings" of persons.

Development suggests focusing on the big issues. Leaders must lead societal change to make the economy grow. In turn, this means that the role of the state is key. This is so, as the state and its policies work through institutions to relate with markets[24]. In the 1950s, there was belief in government's ability to bring change by "directing investment". When this didn't work, there was wide embrace of markets. In many economies, "market reforms … have been, an engine of growth". But markets need "sound institutions and good governance, … (or else) they can stall or fail[25]".

What are the key takeaways for the policy maker from the above review?

There is need to summarize the above long journey through the maze of literature on development. Experts agree that development comes from growth. Below is a summary of growth and development theories.

- *Increase production and specialize*: The causes of long-term growth has been the subject of study for two hundred years. Adam Smith said more production of goods caused economic growth. Production also led to division of labour and then to specialization. Markets were important. They were the invisible hand that kept stability. Market size too was important.

- *Need to increase effective demand, including through more trade:* With increase in production, the ratio of labour to capital (or land) grew. Limited resources was a constraint to growth . Also, it was not enough to increase production. More goods needed more effective demand to buy the increased production. Trade enhanced market size. It also helped an economy discover its comparative advantage. Inherent in the Classicists' link between production and growth, is the idea of higher investment. This needed more savings. An idea that is central to growth.

[22] Gerald Meir, Introduction: Ideas for Development, Frontiers of Development Economics, The Future in Perspective, Gerald M. Meier, Joseph E. Stiglitz, editors, Page 3, A Co-publication of the World Bank and Oxford University Press 2000.
[23] Fukuyama, Francis. Political Order and Political Decay: From the Industrial Revolution to the Globalization of Democracy (Kindle Locations 137-138). Farrar, Straus and Giroux. Kindle Edition, Location 145.
[24] Nicholas Stern, Forward to Frontiers of Development Economics, Gerald M. Meier Joseph E. Stiglitz, editors, A Co-publication of the World Bank and Oxford University Press
[25] Ibid

- *Ensure a sound business climate*: Production needs entrepreneurship and innovation. Firms need a good business climate that the state must provide. There must be respect for private property. Markets, including for capital, must function efficiently.
- *Shift from agriculture to manufacturing and more savings*: Transfer of subsistence labour to the capitalist economy of goods production also gave growth. In time wages would rise and the dual economy would reduce or end. Also, production needed investment, for which savings must grow.
- *Foreign aid can supplement capital in developing economies:* To move up to higher stages of development an economy needed more capital. Where domestic capital was scarce, external infusion helped. Must be used with much caution.
- *Structural transformation and higher productivity:* Growth comes from structural transformation as well as rise in productivity.
- *Complementarity:* Because one investment depends on another, an economy needs to invest in all areas at once in a big push. Foreign savings can supplement domestic capital.
- *Unbalanced growth and linkages:* One way to do with scarcity of capital is to first invest in the sector with the most linkages in the economy. Such investment would stimulate growth also of the sectors that are linked. The question was how to allocate resources to the desired end. There were imperfections and failures.
- *Development planning and development policy:* Control over production in a planned economy was doomed to fail. Policies that nudged investment to the desired areas helped. East Asia is an example.
- *Technology progress for catch up growth:* As capital had a diminishing rate of growth, developing economies can catch up with the industrialized West through technological progress.
- *Human Capital:* The quality of human capital increased productivity. This gave more output per unit of capital and labour. There are also social returns. The externalities thus created, gave higher rates of return.
- *Rate of new capital goods, quality of human capital, and institutional framework:* Together they yielded ever higher returns. Developed economies did not have to face diminishing returns. With better human capital and government policy they could grow indefinitely. This was also how developing economies could catch up with the industrialized West.
- *Institutions and governance:* Institutions that support economic activity and ensure rule of law create growth.

We move now to actual experience of growth in East Asia. A caveat is in order. William Easterly once justifiably said that we pay too much attention to the success of the tigers and not enough to “development disasters”. There is merit in the argument. One would be hard pressed, however, to find enough studies on the disasters to draw credible lessons from them. In the 26 years between 1969 and 1995, Professor T.N. Srinivasan of Yale University could find 717 articles on Singapore in economic journals. He found just one on the Central African Republic[26]. Which example does one study, then?

3. East Asian Growth Model: A case of theory catching up with practice?

This section is different from the one before. Studying East Asian growth is more a review of policies that lead to GDP growth. It is also a study of the logic of government intervention. That is not to suggest that East Asian economists lack rigour. Theories of capital accumulation, comparative advantage, incentives, and institutions equally apply in East Asia. Their economies are also concerned about finding equilibrium, marginal costs, and endogenous growth for long term sustainability. Yet what we want to know is how these ideas were used to achieve the miraculous growth[27].

There was a time when Japanese success was considered unique. Japan was the first to reach the wealth and technology levels of the West. Many thought that this was because of its unique culture and traditions. Hence, it was not possible for others to replicate Japan's success.

Morishima refers to the initial post-war years in Japan as a "democratic planned economy". The Japanese society still was invested in prewar nationalism. That meant that it accepted state advice. Japan was different from others. Because of its history, "Japan's economy is very different from the free enterprise system of the West"[28]. "It is a mistake therefore to consider uncritically … Japan as potential model for backward countries[29]". A country's history cannot be ignored. Economic policy without context is "hazardous". Just because a policy worked in Japan, does not mean that it would do so in another country[30].

Of course, there were exogenous factors too such as the industrial policy. In later years, the tools at the disposal of economists evolved to give a more robust understanding of the 'miracle'. Also, other East Asian economies followed Japan. Clearly, its success had to do with factors in addition to culture.[31]

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[26] Takatoshi Ito and Anne Kreuger, Growth Theories in Light of the East Asian Experience, National Bureau of Economic Research, University of Chicago Press, 1995, Page 298

[27] Several publications helped to capture the story of East Asia's economic miracle. But the writers I rely mostly on are Takatoshi Ito and Kenichi Ohno.

[28] Morishima, Michio, Why has Japan succeeded? Western technology and the Japanese ethos, Page 201. Cambridge University Press 1982 (Via Internet Archive).

[29] Ibid, Page 201

[30] Lest this one quote paint him in a particular hue, it is important to say that Michio Morishima was globally one of the leading intellectual and economist of the second half of 20th Century. His idea of development was complete, extending economics to political and societal realities. A thoughtful bio is "Michio Morishima: an economist made in Japan", Janet Hunter, London School of Economics, Japan and Britain: Biographical Portraits IX. Renaissance Books, London, UK, © 2015

[31] Ito Takatoshi, Japanese Economic Development: Idiosyncratic or Universal? Contemporary Economic Issues, Volume 1, Regional Experience and System Reform, Page 18, Editor Justin Yifu Lin, International Economic Association in association with Palgrave MacMillan, 1998

This paper relies mostly on literature on East Asia from the period 1950 to 2000. This is because our goal is to draw lessons for Pakistan's long-term growth. The effect of any policy varies with the stage of development of the economy. Starting early on the East Asian learning curve, aligns more closely to conditions in Pakistan[32].

There is more in common between Western and East Asian economies than people first thought[33]. So, what drove their success?

The idea of the flying geese is a good place to start. East Asian growth is a process of continuous upgrading of industry. It moved from light to heavy industries, then to chemical and then high technology. Each industry began by relying mostly on imported content. From there it moved to sourcing more domestic content. Also, initially they sold mostly to the domestic market. Later, their products gained in quality to begin exporting. Moving through its product life cycle, after some years of exports, the industry loses competitiveness, as it reaches saturation and decline in sales. This is the end of the product's life cycle[34]. The country stops producing the product domestically. It may decide to do so in another low-cost economy.

There are two kinds of flying geese. The first is within an economy. It was initially described by Akamatsu Kaname[35]. An industry within an economy moves from import based to exports (imagine it is plotted on a reverse V chart). When a series of industries do so "in formation" repeating the pattern, "this is loosely called the flying geese pattern"[36]. This is the first type, Figure 1.

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[32] WB Annual Bank Conference on Development 1997, Edited by Boris Pleskovic and Joseph E.Stiglitz, Page 203

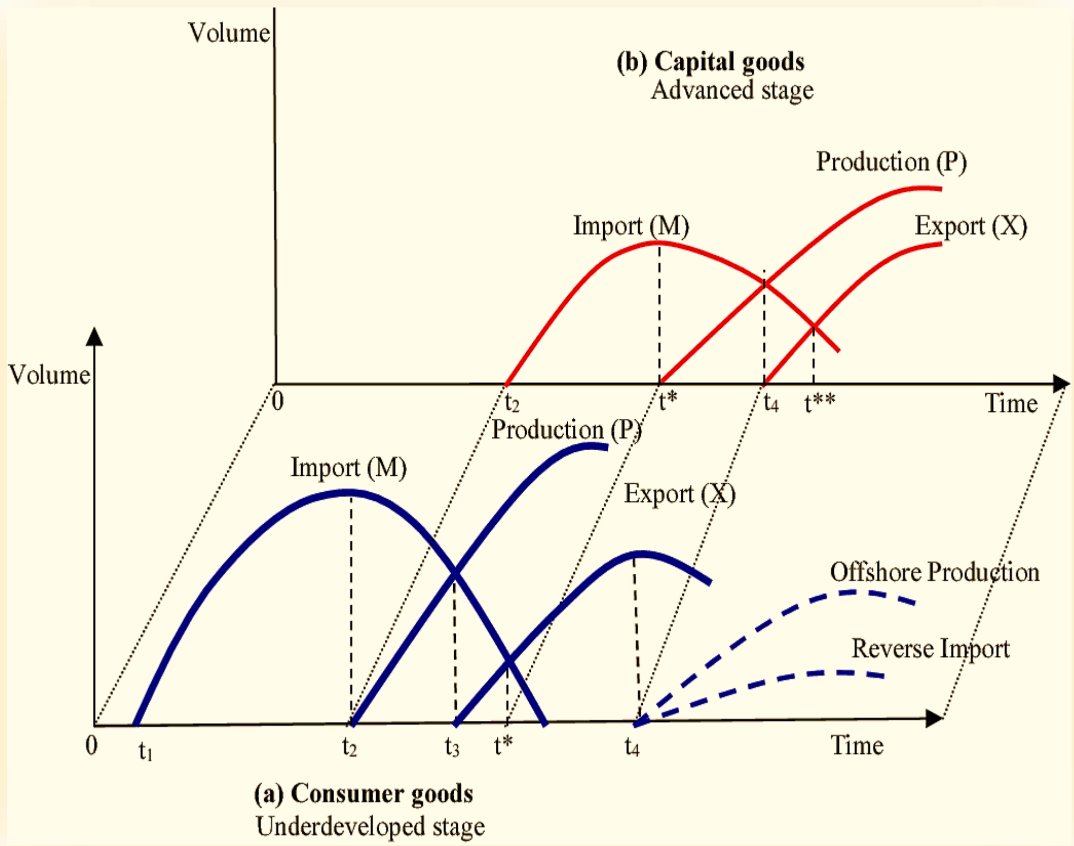
[33] Ito Takatoshi, Japanese Economic Development: Idiosyncratic or Universal? Page 18

[34] Raymond Vernon

[35] Dr. Sabro Okita's Presentation, GRIPS Development Forum, Flying Geese Model, Ch.4 Vietnam's PRSP Experience -Strong Ownership and Growth-Orientation

[36] Ito Takatoshi, Japanese Economic Development: Idiosyncratic or Universal? Page 19

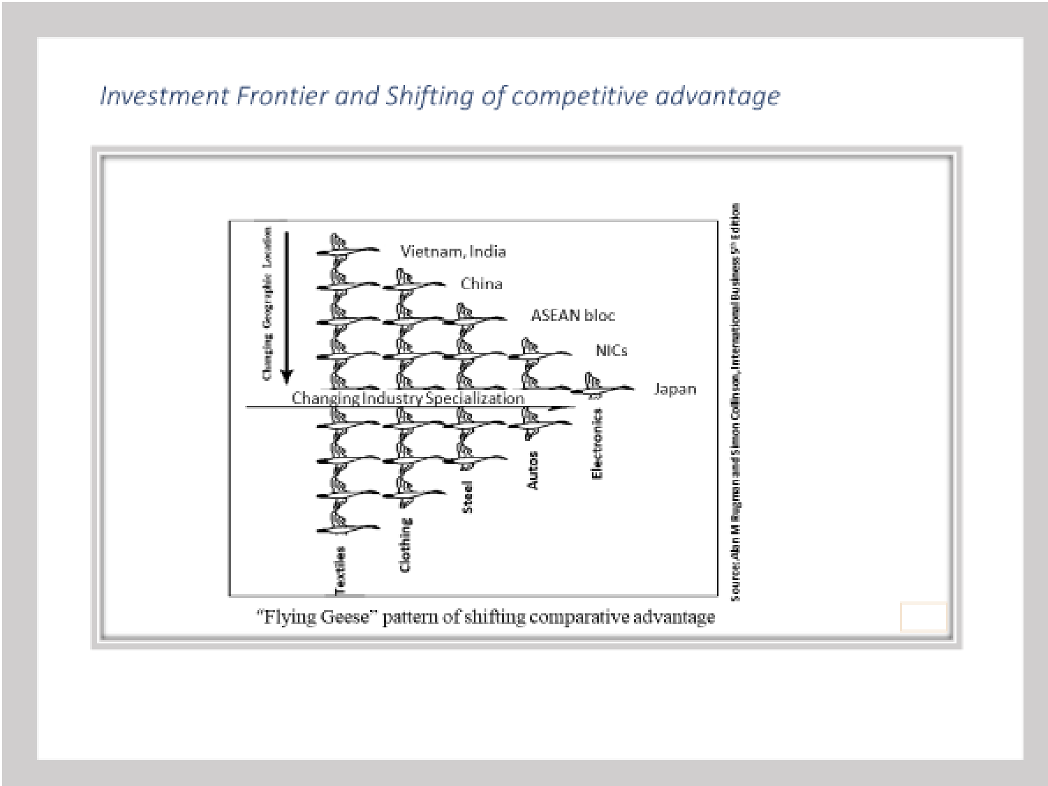
Figure 1: Akamatsu's Original Flying Geese Paradigm[37]



When that industry relocates to another country and there too it goes through the stages of import to export and then decline, it shifts to a third country. The second is the regional flying geese. Each country climbs up the value addition ladder and lets go the mature industry. The economy's structure is constantly moving higher. This is industrial sequencing. Figures 2, 3, and 4 below show how the industry of each economy sequenced up the value chain. Understanding the elements behind the flying geese, explains well some East Asian policies. See Figure 2 below for the regional flying geese.

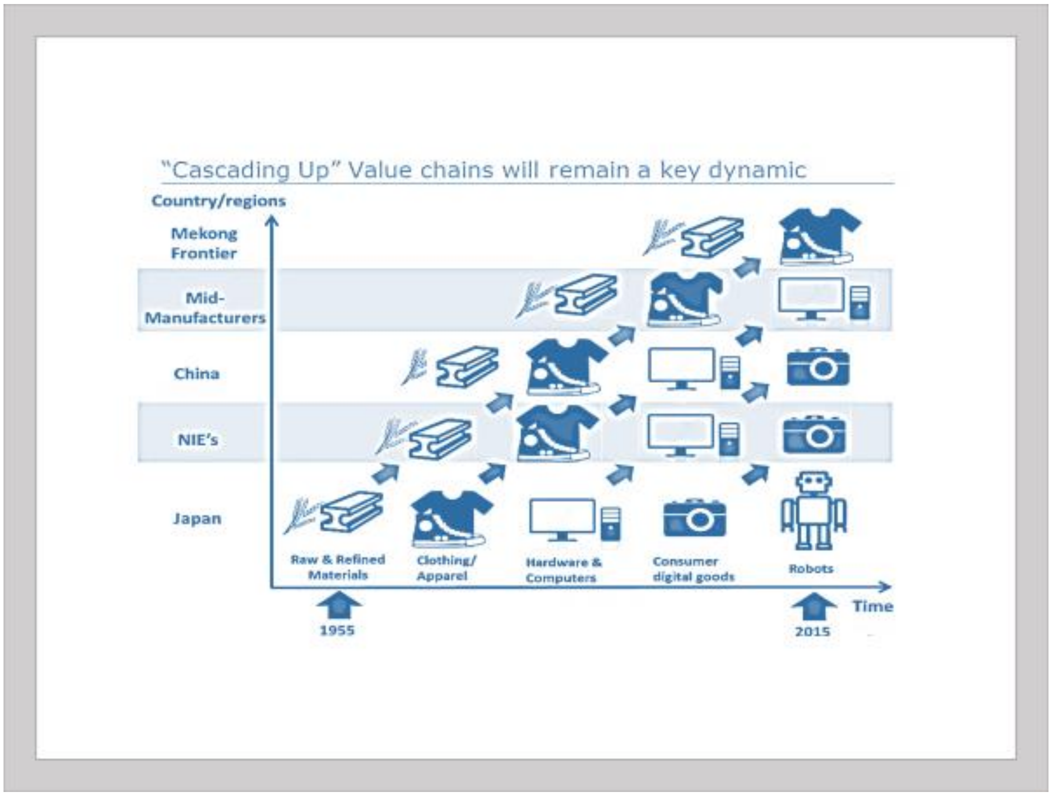
[37] Tri Widodo, Rini Setyastuti, and Sri Adiningsih, "Flying Geese" Paradigm: Review, Analytical Tool, and Application, Center for Southeast Asian Social Studies (CESASS), Gadjah Mada University, Indonesia, 4 June 2018, Page 5

Figure 2: East Asian Flying Geese Model of Growth with Japan in Lead[38]



[38] Kiyoshi Kojima, The Flying Geese Model of Asian Economic Development, Professor Emeritus Hitotsubashi University, Tokyo

Figure 3 Structural Transformation in East Asia[39]



[39] ASEAN The Next Horizon: Implications for New Zealand, Glen Maguire, Chief Economist ANZ Bank, 2015

Figure 4: Industrial sequencing

	Japan	*Korea*	*Taiwan*	*Hong Kong*	*Singapore*
Textile	*1900-30 & 50s*		*1960-70s*	*1950s*	*1960-70s*
Clothing, Apparel	*1950s*		*1960-70s*	*1950s-1960s*	
Toys, Watches, Footwear	*1950s*		*1960-70s*	*1960s-1970s*	
Refining		*1960s*			
Steel	*1950s-1960s*	*1960s*			
Chemicals	*1960s-1970s*	*1960-70s*	*1970s*		
Shipbuilding	*1960s-1970s*	*1970s*	*1980s*		
Electronic	*1970s*	*1970-80s*			*1970s*
Automobile	*1970s-1980s*	*1980s*			
Computers, Semiconductors	*1980s*	*1980s*			*1980s*
Banking and Finance				*1970-80s*	

If we look closely at the flying geese, we see many elements of the growth models discussed in the foregoing section. The formation of the flying geese is based on the ideas of capital accumulation and structural transformation. Continuous investment in human capital, industrial policy, and business climate aligns with endogenous growth models. Industry selection also considers linkage with other sectors. And the combination of industrial policy, trade, and FDI networks ensure comparative advantage. Government's autonomy (from influences) and high ability offers businesses supporting institutions.

Below are the key elements of the Flying Geese:

- Increase in share of manufacturing to GDP and continuous upgrading of industry to higher value added, results in long-term economic growth.

- Government supports this process through an industrial policy. The goal of the industrial policy is to promote exports and industrial sequencing (continuous upgrading of industry). The industrial policy selects and prioritizes some industries. To stimulate production in the selected industries, government provides a range of incentives.

- The government also maintains an investment friendly climate by:

    - Ensuring macro stability
    - Providing public goods (infrastructure, education, training, and health).
    - Access to credit. Policies for high savings rate and special channels to guide them to desired investment (including via FLIP and Japan Development Bank).
    - Ensuring a well-functioning markets of goods and capital, though with policy that guides allocation
    - Managed opening up of the economy for trade and technology opportunities
    - These are the pre-conditions for take-off[40].

- When such conditions are met mostly, particular industries flourish and economic development through the manufacturing sector takes off . To begin with, the economy does not have comparative advantage in that industry. However, comparative advantage "endogenously changes as the economy develops" . The flying geese happens after "initiation of economic growth" in an economy.

- The pattern of the flying geese emerges when an industry begins production, initially for home use. At this stage, the industry produces with high level of imported content. It then gradually adds more value within the economy. Soon it begins to export most of its products. Such exports power economic growth. After some years of exporting, the industry matures and declines. That is when it moves to a low-cost producing country. Usually, this will be done through FDI.

[40] Ito Takatoshi, Japanese Economic Development: Idiosyncratic or Universal? Page 23

- Though the selected industry initially receives import protection, they are not meant to substitute for import. They must become exporters before long. Also, despite protection from imports, the state ensures that there is enough competition among domestic firms for the finite incentives offered by government.

- Both Akamatsu's single country intra-industry flying geese and the later regional flying geese models conceptually rely on the actual physical characteristic of flying geese. Flying as one formation they traverse longer distances than if they were to go alone. Perhaps because the geese at the back benefit from the air current of those flying ahead. So, it is that teamwork and synergies between industries and economies account for higher growth[41].

- There are three factors that cause industrial sequencing and regional production sharing. To invest in high-tech industry, developing economies need capital infusion. FDI can fill this gap. Second, high-tech industries need reliable parts suppliers. Relation between end goods manufacturers and suppliers is critical. A regional network of parts supply is needed. Third, human capital accumulation is key to industrial sequencing. Trained factory floor workers and managers are necessary. When they have worked in less tech intensive industries, they can be trained for the next level of value-added industry.

As economic growth spread among East Asian economies, the replicability of the Japanese model became an accepted idea. It seemed then that industrial policy was more important than Japan's unique traditions. Though we cannot rule out importance of culture and norms. Industrial policy in support of priority industries has been the means for promoting manufacturing and economic development.

Below are key features of industrial policy:

1. Supply of public goods by government. This puts in place conditions for take-off.

2. Industrial upgrading. Government helps allocate resources towards selected industries.

    a. This comprises selection of industries to be promoted. They are offered incentives.
    b. Usual incentives are: Tax breaks, access to credit (sometimes with subsidy), other subsidies, export promotion measures. The latter is through exchange rate management, protection from import, and workers training. R&D support is also a tool to build the industry. Government also helps with managing labour relations.
    c. An economy where capital and forex are scarce takes special measures to invest in priority areas. This may be via credit rationing (government guidance of

[41] Kiyoshi Kojima, The Flying Geese Model of Asian Economic Growth, Slide 3

lending firms). To counter foreign exchange constraint, its allocation for imports too is managed by government. Government also controls entry and exit of firms into an industry.

d. The method used is equally important. Incentives are for a selected industry, not for a specific firm. Within an industry, several firms must compete. Incentives and tariff protection is for limited time, not forever. When an industry is in decline, its exit must be managed. It must be treated with care. But further subsidies at taxpayers' expense, without hope for its upgrading is not an option.

3. Four principles underpin industrial policy:

   a. A reward system for firms to act as good economic agents[42]. Incentives are offered to firms to compete globally. This way they produce quality products for the export market.
      i. To avail incentives, firms must meet targets and the eligibility criteria set by government. Incentives gradually reduce over time and finally reach sunset.
      ii. A critical criterion for availing incentives, is for the firm to meet export targets. This is a key part of the plan. Exports ensure that the economy earns the forex it needs to import inputs for an upgrading industrial structure. Also, success in the global market is a good test of the quality and price of the product.
   b. Ensure close monitoring of the policy's implementation. This makes sure that incentives go to those who meet criteria. It prevents cheating.
   c. Existence of enough firms in an industry so that they compete among themselves within the economy, and
   d. A bureaucracy free from influence enforces the industrial policy promptly, but strictly. Also, having institutions in the country that promote checks and balances and offers feedback for correction.

b. How does industrial policy help?

   a. It corrects market failure and guides resource allocation.
   b. It uses scarce resources to leverage future growth. These scare goods are credit, foreign exchange, public goods, and incentives that come at the expense of the taxpayer and or the consumer (fiscal incentives or import protection).
   c. It boosts economic growth with higher rates of return on capital. This is in line with accepted growth models. Ever increasing return on capital was possible through better human capital.

c. Observing the flying geese model helps decision makers meet the challenge of which industry to select. It is useful to pick an industry that is in decline in an economy that is

[42] Ito Takatoshi, Japanese Economic Development: Idiosyncratic or Universal? Page 27

just ahead. That economy must also have similar business climate and factor endowments. Selecting an industry from within the region works better. The supply chain may be there already. Also, countries within a region compete among themselves and put peer pressure to succeed.

d. Used well, the industrial policy becomes a proxy for the market. The four principles in '3' above, ensure efficient resource allocation and avoidance of political intrusion or corruption. Market failures are a norm in most economies. Government helps with public goods, R&D, risk mitigation, and by maximum leveraging of scarce capital and forex. Government also ensures that export goods meet quality and set standards. This is how Japan earned its reputation as a source of quality goods.

In Japan, the goal of industrial policy changed with each decade. In the initial years, its target was energy supply and critical inputs for industry. The selected industries were coal and steel. Shipping followed soon after. Capital accumulation through preferred credit, fiscal incentives, foreign exchange availability, and import of technology was promoted. The next decade saw a series of industries that, in sequence, became export engines. To make them stand on their feet, Japan gradually lifted import restrictions. In 1961 Japan removed protection for buses and trucks. In 1964 it did so for colour TV, in 1965 for passenger cars, and so on to integrated circuits and computers.

Japan opened up even more upon becoming an OECD member and gaining access to IMF Article VIII status. It further removed controls on imports and on currency conversion and capital movement. However, government always ensured that the domestic market stayed orderly. It kept an eye on firms' efforts to increase capacity to reach economies of scale. It also managed exit of mature industries. In subsequent decades, Japanese industry moved to high tech production. The tools now used were more sophisticated than before, such as joint R&D with industry.

Export promotion is a critical part of industrial policy. Each industry was tested in the global marketplace. It became an engine of growth. Targets were set for each product. Exporters and governments agreed on activities to promote the products. Those firms that exceeded their target received more incentives. Other than earning forex for the country, a key goal for forex scarce economies, exports allowed economies of scale to the firm. Governments selected products for export with high elasticity to income in the importing country. This way exports grew as income grew in the importing economy. Each economy set up special bodies for trade promotion, such as JETRO and KOTRA.

In fact, Takashito Ito believes that forex earning was the main goal of industrial policy[43]. To earn forex, any kind of export was encouraged. Imports were as raw as possible, so that the country spent the least amount of forex and ensured most value addition within country. The latter meant more forex earning and more jobs.

Japan, NIEs, and later entrants defied neo-classical theory of diminishing returns. They did so by using the Solow residual. They improved quality of human capital and nudged resources towards

[43] Ito Takatoshi, Japanese Economic Development: Idiosyncratic or Universal? Page 32

more desirable use. The Solow residual includes also other factors such as knowledge accumulation, new ideas, and learning new techniques. In Japan and the NIEs perhaps, all this happened intuitively. These decisions of policy makers were explained later through endogenous growth models.

We will leave the discussion on Japan with the lucid and excellent review of the path that Japan took from a developing to an industrial economy by Kenichi Ohno[44]. The book relies on the Ohno's dialectic view of history. Japan used its interactions with external institutions and forces to create capacity within. His work is an economic history of Japan with much political and societal overlap.

Post war, Japan took major decisions to shift away from the world of subsidies and control. It pursued productivity improvement through investing in new technology and machinery. This meant cost cutting with better quality. "This became the national economic goal in the early 1950s"[45]. Japan prioritized two industries for production, as their high prices had affected all other industries. Steel became competitive, while coal- fired power plants lagged.

Industrialization was a key goal. Though priority industries received support under the industrial policy, they had to keep improving performance. "They were asked to become more efficient or exit"[46]. We have discussed already the several policy instruments Japan used to stimulate industry.

Government encouraged domestic savings, which permitted high levels of investment. For public and quasi-public goods, was (FLIP) the Fiscal Investment and Loan Programme. The programme channeled postal and pension savings into off-budget projects. These off-budget projects were coordinated with those in the general budget to complement them.

Another government essential was macroeconomic management. Budget stayed surplus (see Figure 5). No government bonds were issued. With defence expenditure low, and many projects off budget, this was perhaps not too hard to do. In those years of capital control, balance of payment difficulties were caused by trade deficit alone. In most years, Japan was trade surplus (see Figure 6). While Yen-Dollar exchange rate stayed fixed, BoP challenges were dealt through monetary policy. Increase in short-term interest rates and credit rationing reduced BoP pressures. Foreign borrowings were small and FDI did not exist. In most years, exports financed imports. World Bank loans, about 1% of total investment, financed major infrastructure projects such as highways, power plants, and the rapid train service (Shinkansen). They were routed and repaid through the Japan Development Bank. Japanese reserves stayed small (Figure 7), but they were stable. In the initial decades, the Bank of Japan did not have to intervene in the market.

Economic links with the world also had a key role in development. Yet, there were policies in place to regulate the market. Tariff protection was practiced in the 1950s and 1960s. Their

[44] Ohno, Kenichi, The Economic Development of Japan The Path Traveled by Japan as a Developing Country, GRIPS Development Forum, National Graduate Institute for Policy Studies, Tokyo 2006, Japanese original 2004.
[45] Ibid 164
[46] Ohno, Page 165

subsequent correction, upon Japan joining GATT, was gradual and linked to industrial promotion plans. Trade liberalization also became an instrument of industrial policy. Japanese government's international commitments served as deadlines for industry to improve efficiency and competitiveness. Openness of the Japanese economy later played a part in development of a trade, FDI, and production network in East Asia.

The role of government in development has been a subject of much inquiry. Neo liberals often decry its importance. In fact, they suggest that the government achieves the opposite of what it sets about to do. Yet, MITI's role in Japan is the stuff of folklore, though there are some dissenting views.

Kimura (2009) opined that though bureaucracy tried to promote industrialization, their efforts are not consistent with economic logic. So, perhaps by definition they would have failed. Yet, he grants that industrial policy had "mixed results"[47]. Ohno takes a more nuanced approach.

In some areas, such as consumer electronics, promotion wasn't direct. Government helped through R&D and access to capital. Some industries which government actively promoted did not succeed. But there are some industries where promotion helped. "Private dynamism was primary, but policy also played a useful role"[48].

In fact, measures used by Japan were not very different from those employed by others before or since. What was different, and certainly one to take a leaf from, was the effectiveness with which they were implemented. That these measures were part of an economic strategy and were used with strict discipline is key. Japanese government led through its "Vision" each decade. Industry specific deliberation councils and continuous exchange of ideas and information were important. Retired MITI and Finance officers found work with companies, which became another source of communications with the private sector. These enhanced trust and cooperation and avoided too many mistakes.[49]

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[47] Kimura Fukunari, Japan's Model of Economic Development, Relevant and Nonrelevant Elements for Developing Economies, UNU-WIDER April 2009, Page 11
[48] Ohno Page 171
[49] Kenichi Ohno, Page 170

Figure 5: Japan kept a budget surplus for macro-stability % of GNP

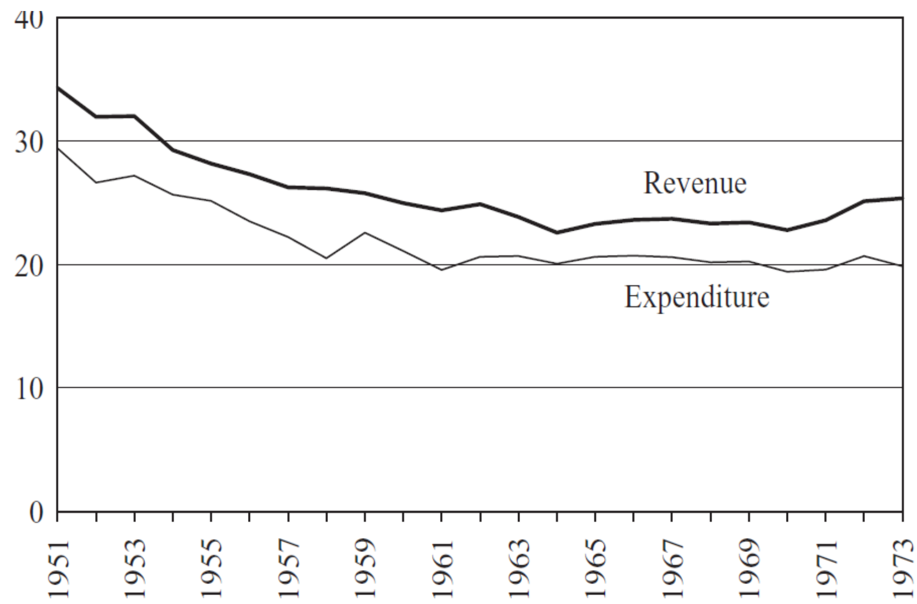
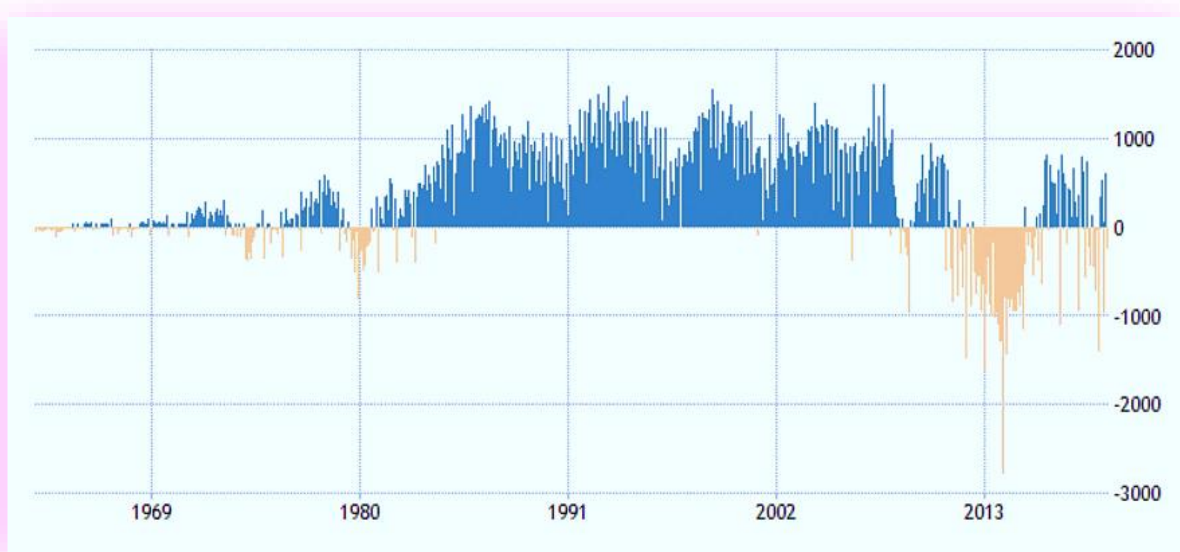


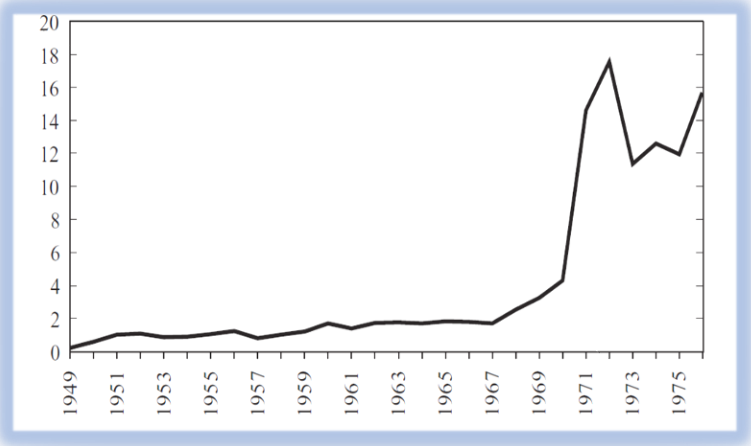
Figure 6: External account stability in Japan: Trade Balance in Billion Japanese Yen[50]



[50] Trading Economics data, based on Ministry of Finance, Japan

Japan always had a small forex reserves. This was based on the policy of stability. Yet growing exports financed the needs of higher imports.

Figure 7: Japan Forex Reserves (Billion USD)[51]



Different strokes: NIEs and ASEAN

The most important goal in East Asia was rapid economic growth. Growth of the economy takes care of many needs, from investment to reducing poverty. Growth creates more savings that is invested in the economy and so on. Poverty reduction happens via the market channel of shared prosperity, i.e. labour mobility as well as through policy channels. The latter come into play to supplement the market channel, when the latter does not work[52].

East Asian policy makers prioritized growth despite the advice from Western experts. Despite their counsel about poverty reduction and the like, East Asia preferred overall development. In their view, development was “a dramatic process of total transformation of a nation which can be experienced only once in its history”[53]. They were imbued with the idea of modernization and transformation.

[51] Ohno, Page 169
[52] Ohno, Kenichi, The Role of Government in Promoting Industrialization under Globalization: The East Asian Experience, National Graduate Institute for Policy Studies (GRIPS) Tokyo, Japan, page 15, November 28, 2003
Ohno, The Role of Government
[53] Ohno, Kenichi, The Role of Government in Promoting Industrialization under Globalization: The East Asian Experience, National Graduate Institute for Policy Studies (GRIPS) Tokyo, Japan, page 15, November 28, 2003

Production sharing networks were important in East Asia. They especially boosted manufacturing among the late entrants. They also served the interests of the economies of the North East as they relocated mature industries. Each new entrant to Asian dynamism became a "crucial link in this production network"[54]. Their industrial structure moved up the value chain. Each state showed a strong desire to improve national living standards and to compete in the global markets. The region offered each entrant an economic, political, and social model. Corporations and governments set up a dynamic network of trade and investment relations. This network extended to US and EU. China's massive scale further strengthened this[55].

East Asia is not a monolith. While they learned from each other, there were also differences in the policies adopted and in their initial conditions[56]. In order to analyze if the East Asian approach can apply to Pakistan, we review the drivers of growth in different East Asian economies. There is more than one view about the many policies employed there. Experts differ on whether state intervention and industrial policy helped. Their views vary also on whether productivity gains or the high levels of investment in their economies caused growth. There is even a question about whether exports gave their economy the greater boost or was it imports that stimulated growth by bringing in technology[57]. Most of all, we must determine whether these policies work only in a developmental state, with an autonomous bureaucracy, as opposed to one where lobbies have a say on government decisions.

At the start, East Asian economies varied in term of their endowments, institutions, and colonial legacies. Anne Booth of SOAS categorizes the economies on the basis of their base income level and how rapidly they have grown since. Causes and character of growth vary. In some areas, economies of the North East and South East followed a common path. In other ways, they were apart[58].

In the North East, investment in human and physical capital was high. This enabled their industry to compete globally, with exports as the engine of growth[59]. In South East Asia too, investment levels were high. While initially they lagged, their investment levels caught up and surpassed the North Eastern economies. Investment moderated post the 1997 crisis (Table 1)

Some experts place great emphasis on high investment levels. In fact, many experts allude to the "rapid rates of growth of factor inputs" (capital and labour), as the real driver of GDP growth.

[54] Ohno, The Role of Government, Page 3
[55] Ibid, page 3
[56] Ito Takatoshi, Japanese Economic Development: Idiosyncratic or Universal? Pages 22-23 gives a very succinct discussion on the subject
[57] World Bank, Rethinking the East Asia Miracle, Joseph E. Stiglitz and Shahid Yusuf, Editors, Chapter 10: Trade And Growth: Import Led Or Export Led? Evidence From Japan And Korea Robert Lawrence and David E. Weinstein, World Bank and Oxford University Press, Page 381, 2001
[58] Booth Anne, Initial Conditions and Miraculous Growth: Why is South East Asia Different From Taiwan and South Korea? SOAS, University of London
[59] Booth Anne, Initial Conditions and Miraculous Growth: Why is South East Asia Different From Taiwan and South Korea? SOAS, University of London

According to them, growth in total factor productivity accounted for much less[60]. There is understandably less unanimity of view on the last point.

Data bears the experts out with respect to investment rates. Investment almost perfectly correlates with GDP growth (see Table 1, last columns). Yet, the relationship is mutually reinforcing. High investment gave high GDP growth, which in turn allowed high investment. Why were investment rates so high? The misplaced assumption is that it was led by FDIs. Though not small, FDI did not play a major role in East Asian investment, except in Singapore (Table 2). Its role in bringing technology and management practices was more important. In all economies domestic savings played a key role. Foreign borrowings were small, except in South Korea in early years. Soon channels developed for intermediating savings to efficient investment. This was possible as East Asian governments gave the right incentives to boost savings and always kept a favourable investment climate.

Table 1: Gross Domestic Investment, Selected Asian Economies

% GDP

	1961-70	1971-80	1981-90	1991-1996	2016	**GDP Growth Rate 1961-96**	**GDP Growth/capita 1961-96**
Hong Kong, SAR China	25.43	26.78	27.25	30.24	21.54	***7.77***	***5.64***
Republic of Korea	20.10	28.90	30.92	37.39	29.25	***8.09***	***6.24***
Singapore	22.68	41.24	41.48	35.72	27.03	***8.81***	***6.63***
Taiwan, China	17.08	26.39	23.18	NA	NA	***8.04***	***7.37***
Indonesia	10.40	22.45	27.51	29.87	33.85	***6.57***	***4.37***
Malaysia	19.87	26.27	30.85	39.92	25.83	***7.26***	***4.41***
Thailand	21.54	26.17	30.66	41.06	21.10	***7.75***	***5.44***
Average	19.59	28.31	30.26	35.55	26.43	***7.33***	***5.73***

Source: World Bank data, Table adapted from Growth and Poverty: Lessons from the East Asian Miracle Revisited, M.G. Quibria, ADB Institute Research Paper 33

[60] Ibid Page 10

Table 2: FDI to Gross Domestic Capital Formation	
	%
Hong Kong, SAR China	0.975
Republic of Korea	1.90
Singapore	7.3
Taiwan, China	19.6
Indonesia	8.0
Malaysia	11.9
Thailand	3.4
Average	7.58
Source: Booth Anne, Initial Conditions and Miraculous Growth: Why is South East Asia Different From Taiwan and South Korea? SOAS, University of London, Table 4	

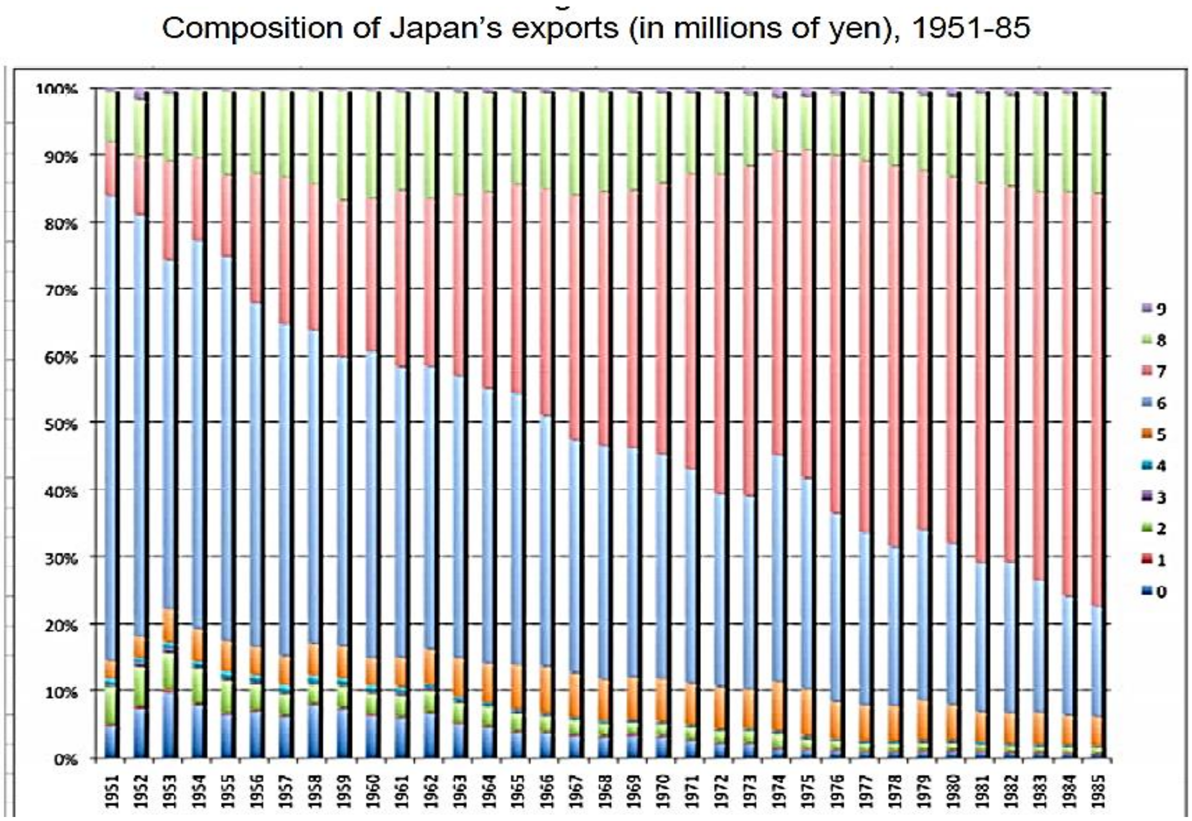
Other experts consider efficiency gains important also. We will view this matter in a later part of this section. As noted already, exports were a strong driver of East Asian growth. East Asian economies developed policies to encourage exports. Firms were encouraged to produce for export. A virtuous circle of investment, GDP growth, exports, and more investment led to structural transformation. In Thailand alone, exports per capita grew fifty times between 1960 and 1990. Share of manufacturing in exports rose from below 20% to over 70%. Economies could produce on scale.

The economies equally relied on imports (Table 3). Imports were strategically managed to access new technology and upgrade industrial structure. Change in the products that these economies exported and imported also confirm gradual upgrading of economic structure and competitiveness[61].

[61] For Japan, see Kimura Fukunari, Japan's Model of Economic Development, Relevant and Nonrelevant Elements for Developing Economies, UNU-WIDER April 2009

Table 3: Imports to boost exports % GDP			
	Exports % GDP Average 1960-2000	Imports % GDP Average 1960-2000	Exp + Imp Average 1960-2000
Hong Kong, China	104.7	102.0	206.7
Rep of Korea	25.8	29.5	55.3
Singapore	160.8	163.0	323.8
Taipei, China	41.8	38.8	80.6
Indonesia	22.4	20.6	43.0
Malaysia	59.9	56.2	116.0
Thailand	26.7	29.0	55.7
Average	63.2	62.7	125.9

Figure 8: Composition of Japan's exports 1951-1985 in Million Yen[62]



Note: SITC 0	Foordstuffs and animals	1	Beverages and tobacco
2	Nonfood raw material (excl. mineral fuel)	3	Mineral fuels, lubricating oils, etc.
4	Animal, vegetable oils and fats	5	Chemical products
6	Manufactured goods by material	7	Machinery, transport equipment
8	Miscellaneous	9	Special goods

Consequently, we see structural transformation in all high growth East Asian economies. This is evident from the change in Japan's export composition in Figure 8. The share of agriculture in GDP fell radically through the decades. This is visible in the Table 4 below. In the case, of Pakistan and India the transformation has barely happened. Notice the flat lines for the two countries in Figure 9 below, that gives share of manufacturing in GDP. In these two economies, though share of agriculture has declined, but not to the extent of East Asia. Services not manufacturing has picked up the agriculture decline. In Pakistan, services produced are not internationally

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[62] Taken from Kimura Fukunari, Japan's Model of Economic Development, Relevant and Nonrelevant Elements for Developing Economies, UNU-WIDER April 2009, Page 9

competitive. Their measurement is amorphous and a considerable part of increase in services is accounted for by growth in the size of government.

Table 4: Change in Economic Structure
Share of Agriculture

%

Economy	Agriculture share 1970	Agriculture share 2017
Republic of Korea	36.2	1.9
Singapore	3.7	0.0
Malaysia	43.7	8.8
Indonesia	24.1	13.5
Thailand	36.4	8.7
Vietnam	40.0 (1983)	15.3
China	34.8	7.9
India	39.3	15.6
Pakistan	33.4	18.5 (2019)

Source: The Global Economy database

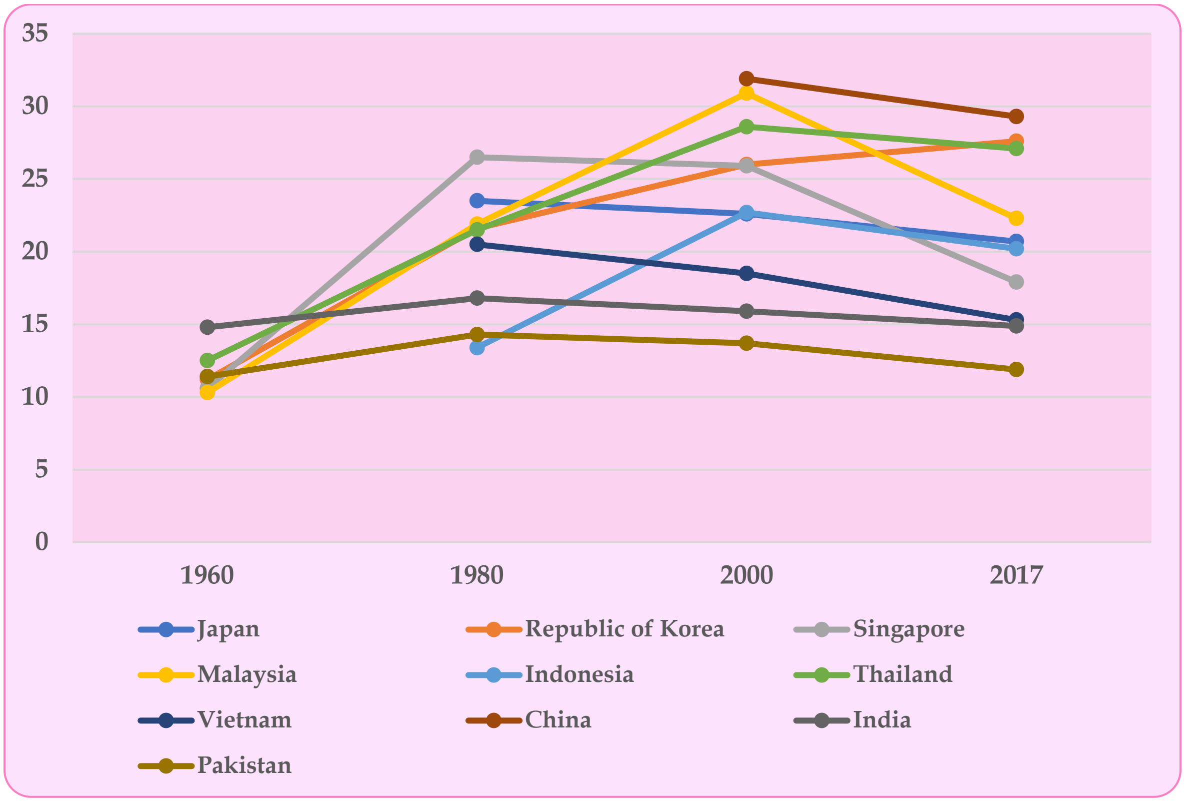
Table 5: Change in Economic Structure
Share of Manufacturing

%

Economy	1960	1980	2000	2017
Japan	--	23.5 (1994)	22.6	20.7
Republic of Korea	11.2	21.6	26.0	27.6
Singapore	10.6	26.5	25.9	17.9
Malaysia	10.3	21.9	30.9	22.3
Indonesia	--	13.4	22.7	20.2
Thailand	12.5	21.5	28.6	27.1
Vietnam	--	20.5	18.5	15.3
China			31.9	29.3
India	14.8	16.8	15.9	14.9
Pakistan	11.4	14.3	13.7	13.5

Source: The Global Economy database

Figure 9: Change in Economic Structure, Share of Manufacturing % of GDP



A competent and 'insulated' bureaucracy managed industrial policy and the distribution of incentives in the North East. And though there are many views about the effectiveness of government policies in economic development, the major contribution made by government in East Asia is beyond question. Their bureaucracy coordinated and implemented development policy, subsidies and incentives. Their well-recognized independence and probity has been key to success. "The sternest discipline was imposed by the Korean government" regardless of the firm's political connection (Amsden 1996)[63]. Amsden further says that "in subsidy-dependent industrialization, growth will be faster the greater the degree to which the subsidy allocation process is disciplined"[64].

Governments supported efficient functioning of markets, including the capital market. They created quasi market institutions such as development banks for targeted industrial growth. They used the many instruments already discussed above to guide investment. There were clear criteria

[63] Quoted by Anne Booth
[64] World Bank, Rethinking the East Asia Miracle, Joseph E. Stiglitz and Shahid Yusuf, Editors Page 9, 2001

and performance targets for firms to access these incentives. Exports were a major benchmark. They "provided a performance-based criterion for allocating credit, encouraged the adoption of international standards, and accelerated the diffusion of technology" (Stiglitz 1996)[65].The methods of extending support evolved also. Initial years saw direct support and concessions. In later years, government helped through indirect and soft means.

The situation in South East Asia was somewhat different. Led by equally committed leaders, the government, as in the North East, created good investment climates through macro stability, provision of public goods, increasingly efficient markets, and a favourable exchange rate. They intervened to remodel their economies. Thailand ran a coherent industrial policy. Singapore had well-run state-owned enterprises, increased large savings through compulsory provident fund deductions, and involved itself in wage setting between labour and management. In Malaysia, state enterprises did not deliver. Their privatization, as recommended by many Western economists, too did not show good results. Influential lobbies captured the privatization process.

Some experts in the West and in Asia concluded that South East Asian growth was "ersatz" or fake. They say that it was too dependent on foreign technology and FDI. According to them, domestic businesses grew on cronyism and rent seeking. These fears seem to have been exaggerated. Such warnings were heard first in the eighties. Yet, South East Asia has progressed well since then and it has sustained growth. Acquisition of technology is a painstaking and incremental process when its base is weak in an economy. South East Asia has moved up the value chain. Government support including through education and training was important[66].

In his detailed study on East Asian growth and its effect on poverty, Quibria (2002) arrives at similar conclusions. The main driver in East Asia was capital accumulation, especially human capital[67]. Improvement in quality of human capital stimulated growth rates. It enabled innovation and adoption of new technology.

Referencing research on the subject, the paper examines whether growth came from high investment rates alone or also from efficiency gains and TFP. It says that the belief of some experts that only a small fraction of growth could be attributed to TFP, does not seem plausible[68]. Citing Bosworth and Collins (1996), Quibria finds that TFP growth in East Asia was higher than previously thought.

Like the economies of the North East, underpinning this progress were market-based policies with guiding institutions. As discussed before, openness gave the economies limitless access to the global market and to technology. That interfaced with excellent domestic climate for investment and production. The process gained strength with emergence of regional production networks.

[65] Quoted by Anne Booth
[66] Booth, Anne Pages 30-32
[67] M. G. Quibria, Growth and Poverty: Lessons from the East Asian Miracle Revisited, ADB Institute Research Paper Series No. 33, February 2002, Page 15-17
[68] Ibid, Page 16

Macro stability, economic governance, labour policies, overall institutions and legal arrangements, all contributed.

China

Numbers lose meaning, such are the achievements of China.

Its GDP was USD 40 Billion in 1952, it has grown 350 times to cross USD 14 Trillion in 2019, at nominal exchange and USD 24 Trillion PPP. China's share in global GDP grew from 1.8% in 1952 to 16% at present. In thirty years, China has lifted 700 million people out of poverty. It has seen the largest movement of people from the countryside to cities in history. Education levels have seen an equally astounding rise. R&D is more than 2% of GDP, with public sector R&D making a major contribution. Industry has transformed itself many times over, with share of agriculture reduced from 50% of GDP in 1952 to 7% in 2017. It now manufactures 27% of world manufactured goods. In recent years, China has created more than 13 million jobs annually.

In less than three decades, between 1992 and 2017, China's foreign trade grew from USD 166 Billion to USD 4,107 Billion or 25 times. Its product mix has changed, though it has retained dominance across the board. In Figure 10 below, manufactured goods were 25% of China's total exports in 1985. They were 89% in 2016, with high-tech goods one-third of total exports. Such structural transformation is hard to equal[69].

[69] Kunwang Li and Wei Jiang, China's 40 Years of Reform and Development: 1978–2018, Australia National University

Figure 10: Structural Transformation in China

China's structural transformation

		1985	1990	1995	2000	2005	2010	2016
Low-tech	China	17.0	40.2	46.4	41.2	15.9	29.3	30.9
	World	14.1	16.6	16.7	14.7	9.7	13.0	15.5
Medium-tech	China	4.9	20.8	18.9	19.6	23.0	24.0	24.5
	World	32.4	33.5	32.6	29.6	26.8	27.6	29.4
High-tech	China	2.1	5.3	13.0	22.4	41.0	34.9	32.6
	World	13.3	15.6	19.6	23.0	18.6	19.6	21.3
Others	China	76.1	31.6	21.1	16.1	19.9	11.4	11.3
	World	37.5	31.1	27.3	27.6	44.6	33.9	27.7

Source: Calculated from UN Comtrad database

As it shifted from a non-market economy to a market economy, China pursued policies that was appropriate to the circumstances in which it found itself. From 1978 to 1991 its industrial policy aim was to "rationalize the industrial structure", which meant balancing the goods produced in the economy. Until then, the state decided goods to be produced. The next period of industrial policies between 1992-2001, the focus was to upgrade the industrial structure. This is when production of higher tech goods began to grow. The third phase of policies was between 2002-2008 with continued upgrading the industrial structure. Government also focused on managing resources, land, energy, and the environment. China fundamentally made the 'transformation of industrial development from quantity to quality". Industrial policies "focused more on the functions of market mechanism and incentive mechanism, as well as providing guidance for market entities". Post 2008, China faced the challenge of reduced demand globally as well as at home, and also of changing exchange rates. It realized the need for more innovation, efficient use of energy, and environmental conservation. It now focuses on technology advancement, high value added, and clean and safe technology.

What should new entrants do?

A caveat is needed for those low- income economies wishing to draw lessons from East Asia. They must keep new developments in mind. Global trade rules have changed since the last century. Subsidy and government support attract trade remedy measures. Also, policies of one economy cannot be adopted as-is by another economy. Political and societal norms matter.

Moreover, adopting these policies is no easy task. They call for a shift in approach to governance. Political considerations and expediency must take a back seat to disciplined and strict enforcement by governments. At all times, of course, they do the best to support businesses. But they must never make especial allowance for a particular firm. Such decisions compromise the whole development agenda.

South East Asia shows that it is possible to adapt policies even when government is not fully insulated. Yet, there is a limit there to the level cronyism.

In adapting East Asian lessons, an economy must ensure that its policies relate to the reality of government and private sector capacity, and the industrial structure. Policies also work according to the stage of economic development[70]. Thus, this paper has focused on studies from before the year 2,000.

Especial conditions in an economy may necessitate governments to postpone economic growth in favour of other national priorities. For example, before prioritizing economic growth, Malaysia tried to set right disparities in income between regions and ethnic identities. In East Asia, many countries limited defence expenditure as USA took care of their security needs.

In terms of defence needs, Pakistan cannot be compared with East Asia. Its defence expenditure has been high, preempting resources (See Table 11). Yet, Pakistan does not have the option of cutting defence in a turbulent neighbourhood. This may change in the future. But for now, the twin fiscal and current account deficits reflect our security concerns. This naturally affects macro stability.

In the past, East Asian economies too faced "life-or-death" threats. Their response was the opposite. "To maintain national unity and military readiness, economic growth was considered imperative"[71]. As a consequence, East Asia has achieved both peace and security.

As in the North East, South East Asia also was captivated by the idea of catching up with the industrialized West. National consensus on growth and institutions in its support soon emerged.

[70] John Jullens , Lessons from the East Asian Development Model What are the paths to economic growth for today's emerging markets? Strategy and Business, July 8, 2014

[71] Ohno, The Role of Government, Page 1

State's involvement was not just backed by its political authority. It also used economic power. The latter comes from state owned development banks. This was an important tool for qualitative control. Other incentives and (in early years) Forex rationing were strong instruments in the state's hands. As a result, firms were subjected to twin disciplines. First, as exporters they had to compete in the global market. Second, they had to meet government's performance criteria[72].

So, how does a new entrant make a break from its weak political and economic structures to a government that is committed to growth. The prerequisite is political stability and social cohesion. Without these two conditions nothing else works.

An effective state must have a national leader to lead this effort. The country must develop national consensus around an ideology of growth and material well-being. This must be the highest national goal. All important and influential parts of the state must agree on this goal. There must also be support for it at the popular level. Progress in achieving growth will invoke and build further the needed support. The leader must have a capable and knowledgeable team. Decision making at all levels of the government must be aligned to deliver coherently in line with the goal. This is in addition, to the economic and governance policies given above.

As noted above, external competitiveness is key or else an industry cannot grow merely from competing in the domestic market. Without exposure to global markets, it cannot be expected to be internationally competitive. Yet there must be practical policies consistent with global trade rules to manage external competition. Environmental challenges and income equality would need active government intervention.

East Asian practices are not directly transferable. Each country must adapt and modify them. There is need for competence and discipline. The latter is needed to ensure that there is no compromise of fundamental principles. The economy must also link growth policies with factor endowments and its political and social situation. Its selection of priority industries must accord with the above.

FDI is an important route to industrialization and building exports. New entrants must attract FDI and link local firms with foreign investors to absorb technology and management skills. Tariff policy and SEZs are credible supporting tools.

Investment in human capital is key. Also, economic growth encourages labour mobility across regions and industries. Domestic demand grows, productivity increases, and it leads to more investment. Government can supplement these with specific policies to assist the less privileged. Poverty alleviation will occur naturally[73].

[72] Economic Catch-up and Technological Leapfrogging, The Path to Development and Macroeconomic Stability in Korea, Keun Lee 2016, Chapter 2

[73] Most of the foregoing ideas in this section are from Chapter 2 "Japanese Economic Development: Idiosyncratic or Universal?' by Takashito Ito from the book "Contemporary Economic Issues, Volume 1, edited by Justin Yifu Lin,

The goal of sustained growth is usually part of long-term plans and programmes[74]. The true miracle of East Asia is not a magic formula. It is the outcome of a very clear idea about the future of the state by committed leaders. These ideas led to plans based on deep thought about policies and issues. East Asian leaders show an unusually profound concern for catching up with the West and improving the standards of living of all citizens. Usually the plans have value based societal goals. Their main instrument, though, is almost always long-term growth. Led by Japan's ten-year vision, East Asia has several examples.

Malaysia is an apt case of a major societal and economic change. Its New Economic Policy of 1971 was a twenty-year plan with three main goals. These were national unity, restructuring of society and economy, and poverty reduction. It mostly achieved the targets. The NEP was succeeded by the thirty-year Vision 2020. Three successive polices supported the Vision. A national development plan (1990-2000) targeted 7% annual growth. This led to a National Vision Policy 2001-2010 and the New Economic Model 2011-2020. The latter is in essence a national transformation programme[75].

The Vision was set to overcome nine national challenges. They are normative in nature such as building a united Malaysian nation that is secure and developed, moral and ethical, liberal and tolerant. Malaysia also planned to become a just society with equitable wealth, prosperous, and competitive. For Malaysia, these plans virtually became the country's ideology. There was an attempt to align each state policy and government action to these goals.

China's stellar transformation is especial given where its economy stood in the early eighties. Deng Xiaoping gave a three-step development strategy. In the first phase, China planned to eliminate poverty and become a moderately prosperous nation by 2020. The plan targeted that in each ten-year period, China would double its GDP. Beyond 2020, Deng's vision was for China to pursue further modernization. In the third phase, starting in 2035, China plans to become a world power by 2050. Four 'modernizations' supported the vision. They are economy, agriculture, scientific and technological development, and national defense. China began opening up its economy. Often

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International Economic Association, 1998 and from Kenichi Ohno paper "The Role of Government in Promoting Industrialization under Globalization: The East Asian Experience" by Kenichi Ohno, National Graduate Institute for Policy Studies (GRIPS), Tokyo, Japan, November 28, 2003, as well as his book The Economic Development of Japan The Path Traveled by Japan as a Developing Country, GRIPS 2006

[74] Joe Studwell, How Asia Works: Success and Failure in the World's Most Dynamic Region, 2013, Grove Press

[75] Based on 1. Wikipedia: Vision 2020, 2. Wits School of Governance, University of the Witwatersrand, Johannesburg, Comparative Country Long-Term Development Planning: Lessons for South Africa, 24 July 2014, 3. Malaysia's New Economic Policy and 'National Unity', K. S. Jomo, Chapter in the book Racism and Public Policy, edited by Yusuf Bangura, Rodolfo Stavenhagen, United Nations Research Institute for Social Development, Palgrave McMillian 2005, Pages 182-214, 4. Wikipedia: Malaysian New Economic Policy

the plans have been adjusted. More recently, President Xi Jinping has added regional equity and domestic demand, with very high focus on technology, as his goals[76].

Long term plans and industrial policies were also followed by South Korea and Taiwan. Like Japan, South Korea selected industries to develop and chose winners and losers.

In all cases, a lot of work went into preparation of the plans. Even more so, effort was put into building political consensus. In each case, there was inspirational leadership with the backing of the entire political spectrum.

[76] . China US Focus, Society and Culture, What can we Learn from China's Long-Term National Plans?, Dec 05 , 2017, Zhao Jiayu, 2. Three-step development strategy, http://www.china.org.cn/english/china_key_words/2018-10/29/content_68860874.htm, 3. Wikipedia: Deng Xiaoping., 4 Wikipedia: Four Modernizations, 5. Institute of New Economic Thinking, China vs. the Washington Consensus, By Adair Turner

4. Trends in Pakistan Economy

We now turn to Pakistan, the actual subject of this study. The Tables and Figures below show the trend of its macro indicators. This section will then analyze the main issues that have beset slow growth. Literature describes an economy in sustained economic growth as one that grows annually at 7% or more for 25 years[77]. "At that pace of expansion, an economy almost doubles in size every decade."[78]

Between 1952 and 2018, Pakistan achieved GDP growth rate of 7% or more in just twelve out of sixty-six years. The years of 7% growth were far apart. They did not cause any meaningful growth momentum. On just two occasions, in over six decades, Pakistan has had two successive years of GDP growth rates of over 7%[79]. This was in the years 1964-66 and in 2003-2005. In the 1960s, Pakistan was close to reaching the stage of sustained economic growth, when in eight years out of ten, its economy grew at above 6% annually. We then opted to go to war. Then and later, bust has always followed boom.

As Figures 11-14 below show, the Pakistan economy has had both weak growth as well as economic instability.

It is not hard to find the reasons for Pakistan's poor economic performance. The country plods ahead without a vision of where it wants to be. There is no sense of the future. Did the trends that emerged just happen because there was no strategy for the economy? That is possible, though not having a strategy is also a choice. So, the question is, whether the political economy of Pakistan favours the idea of not having a growth plan. Could it be that while those in power have privileged themselves to surplus rent they prefer to let the economy stay as- is? If it is as suggested above, reform will be hard to conceive. There may be no will to do so.

This is clear from the discourse about the economy. In Pakistan, we frame the discussion about the economy in the language of inevitability. Our premise for discussion of the economy is that its frailty is destined. That it is a consequence of where the country is today in terms of history, society, and polity. Yet, our current situation did not just come out of nowhere. It results from decades of government's priorities and policies . Our current situation is by choice. Two examples below bear this out.

First, the received wisdom on capital availability is that it is scarce in Pakistan. Similarly, foreign exchange availability. Generally speaking, that is true as seen by our low savings rates. Yet, twice in the last two decades, Pakistan has received large sums of money. On one occasion that money had a lot of grant content. Recall the question raised at the beginning of the paper. If we know that increasing the stock of capital, human resources, and technology leads to growth, why did government not guide the resources to those ends.

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[77] World Bank Commission on Growth and Development, The Growth Report: Strategies for Sustained Growth and Inclusive Development, 2008, Chair Michael Spence

[78] Ibid Page

[79] Pakistan Bureau of Statistics, National Accounts, Table 1

A second point to examine is the country's primary focus on security. We have been in a virtual state of war for four decades if not for seven. That preempts resources from public goods for growth to weapons. Why is it that no one has done anything about reducing temperature in the region? It is time to deliberate about the kind of society that we want to be and our place in Asia and the world. At present, outsiders incorrectly see us as intolerant and violent.

Economic trends of the last twenty years

Figure 11: GDP growth trend 1953-2019 %

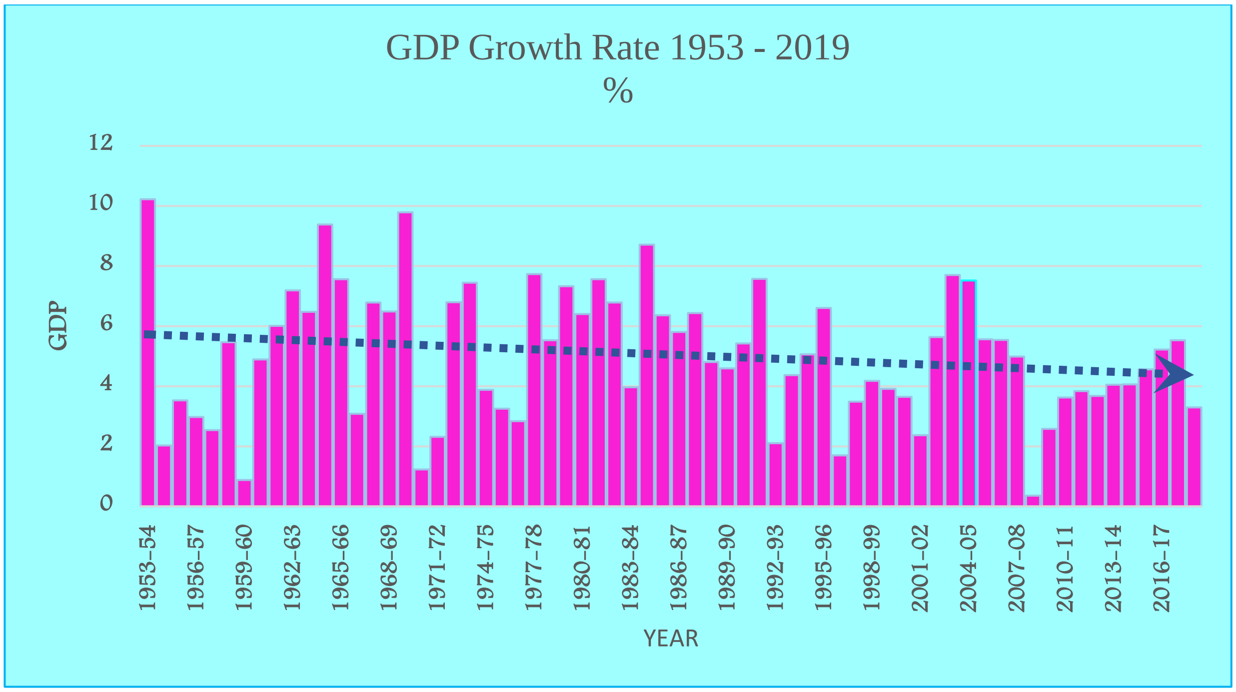


Figure 12: GDP growth twenty years

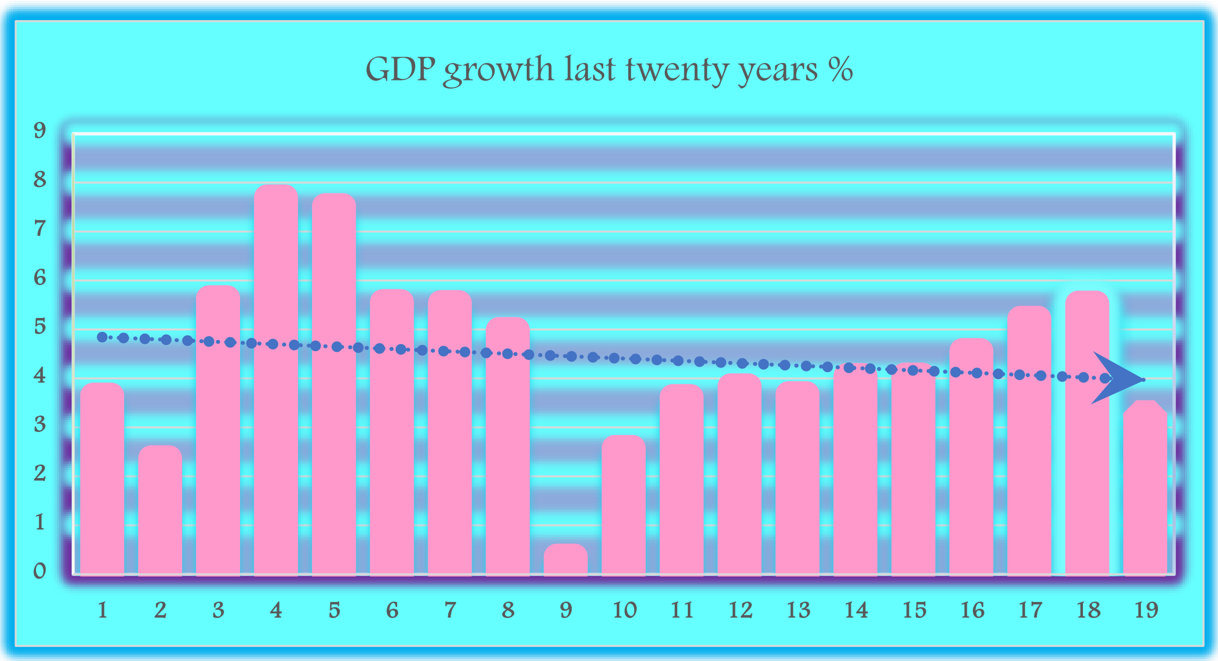


Figure 13: Budget Deficit % of GDP

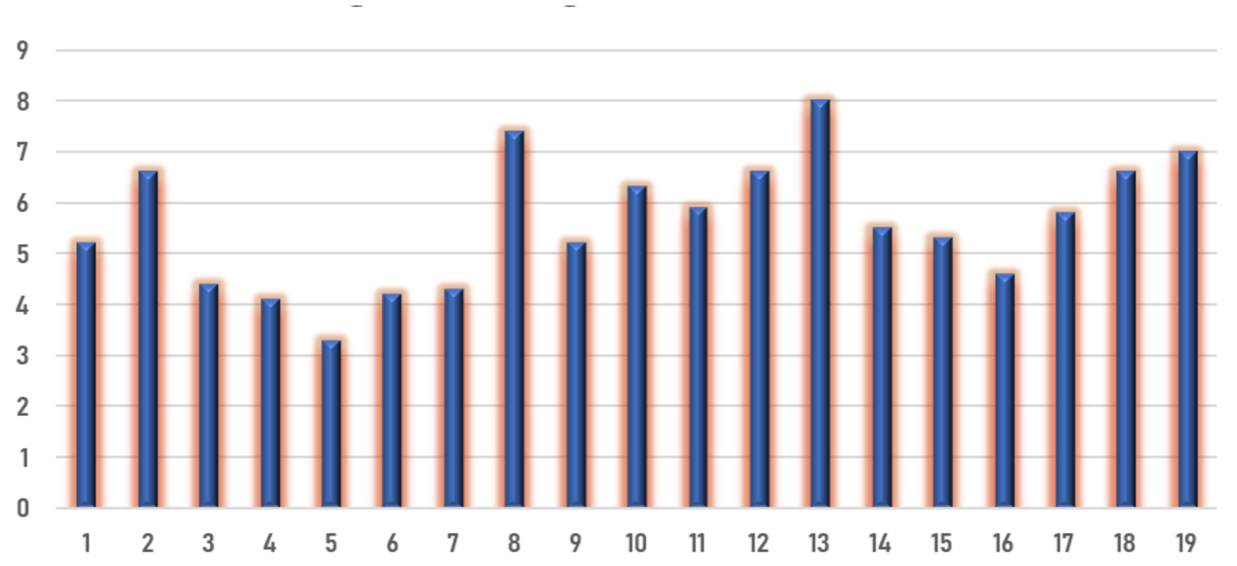
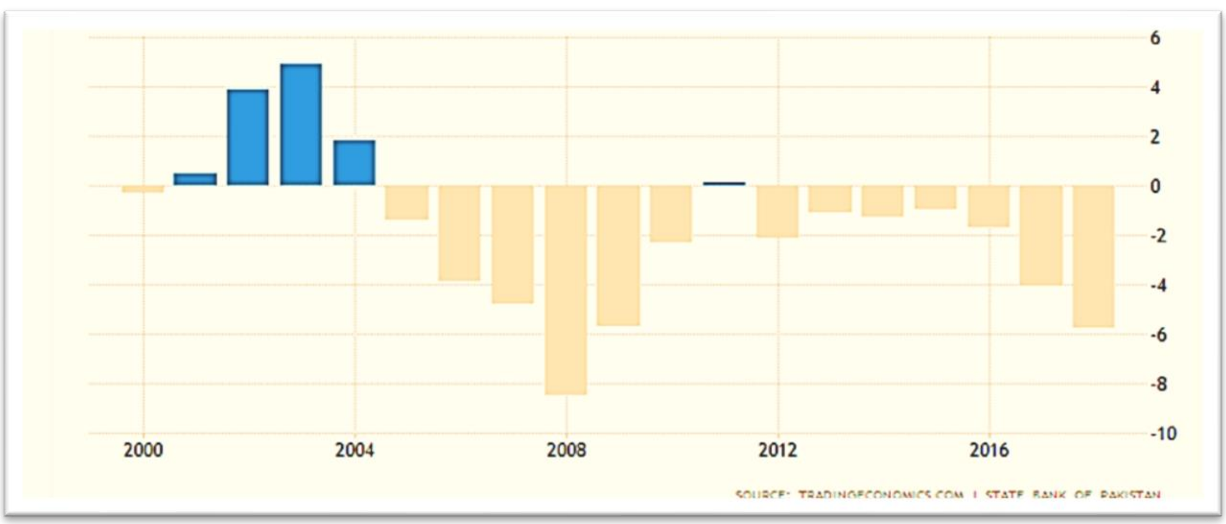


Figure 14: Current Account Deficit % of GDP



Refer Figures 11 to 14 above. In 66 years as well as in the last two decades average GDP growth rates have declined, as seen from the trendlines. Nor have macro-economic indicators been stellar. Growth was fragile at best and other economic indicators were weak. Even in the years when growth was more than 5%, its quality was questionable. Growth resulted from inflow of foreign aid and loans. These inflows were not used to build productive capacity in the economy that would give sustained growth.

The twin fiscal and current account deficits were especially vulnerable. Figures 13 and 14, show the twin deficits. They are almost identical reflection of each other. Where fiscal deficit is high so is the current account deficit.

The country's questionable economic, political, and security choices have caught up with it. In nineteen years since 2000, Pakistan's GDP growth rate was below 5% in eleven years. In eight years, it was below four percent. The budget has been in deficit every year in the last twenty years. Figure 14 shows that the current account has been in deficit for 15 of 19 years.

The issues below are both at the base of Pakistan's economic problems and an outcome of its performance:

- We didn't produce enough. Contribution of the commodity producing sector to GDP fell, Figure 15.
- Often, we wasted resources made available to us, as there was no economic strategy.
- We have been at war for forty years, with the consequent toll on the economy in terms of cost, priorities, and opportunities foregone.
- We have not laid the foundation of a growth economy: increasing savings, investment, manufacturing, and human and physical capital, or macro stability.

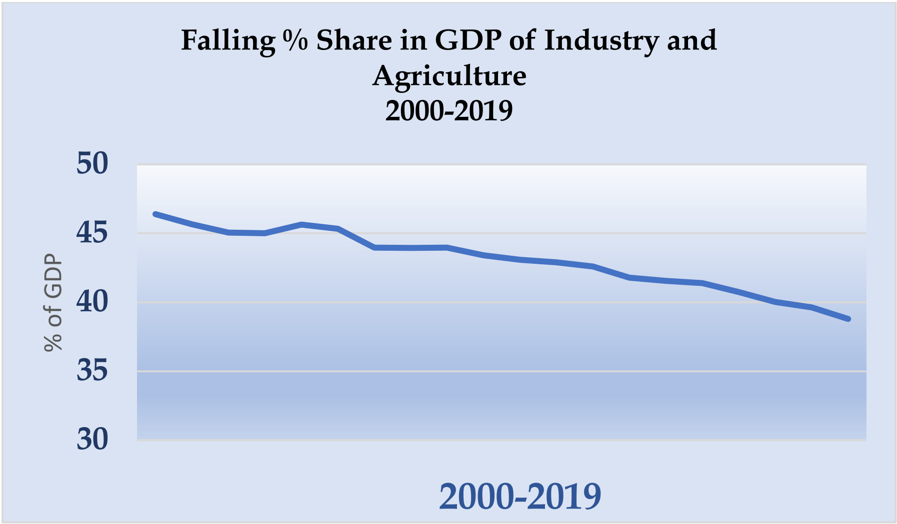
Growth is not a number. There are many factors that shape it. It is the outcome of a reinforcing relationship between production, growth, and macro indicators. It also depends on government choices. Pakistan can exit its economic troubles through long-term quality growth. The question is how and also whether we want to do so?

Three trends below are noteworthy:

I. We didn't produce enough

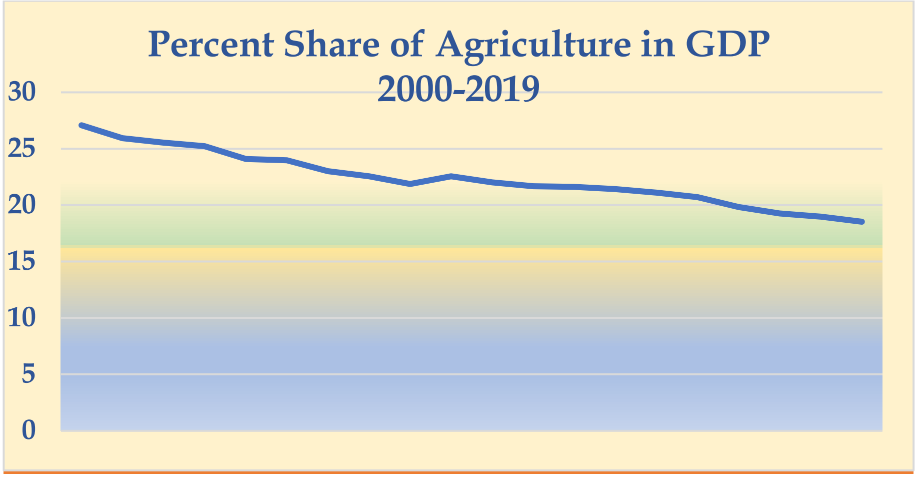
Government's national accounts bears out adequately that we do not produce enough. Table 7 of the National Accounts gives percent contribution of each sector to the GDP. The Commodity Producing Sector in Pakistan (agriculture and industry) has declined consistently for over two decades. As a percent of GDP, its contribution was over 46% in 2000. It fell to 38% in 2019, Figure 15. The decline is a serious matter, as in order to grow an economy must produce more. Yet it is not even a subject of discussion among policy makers. It is no surprise that our exports have been stagnant.

Figure 15



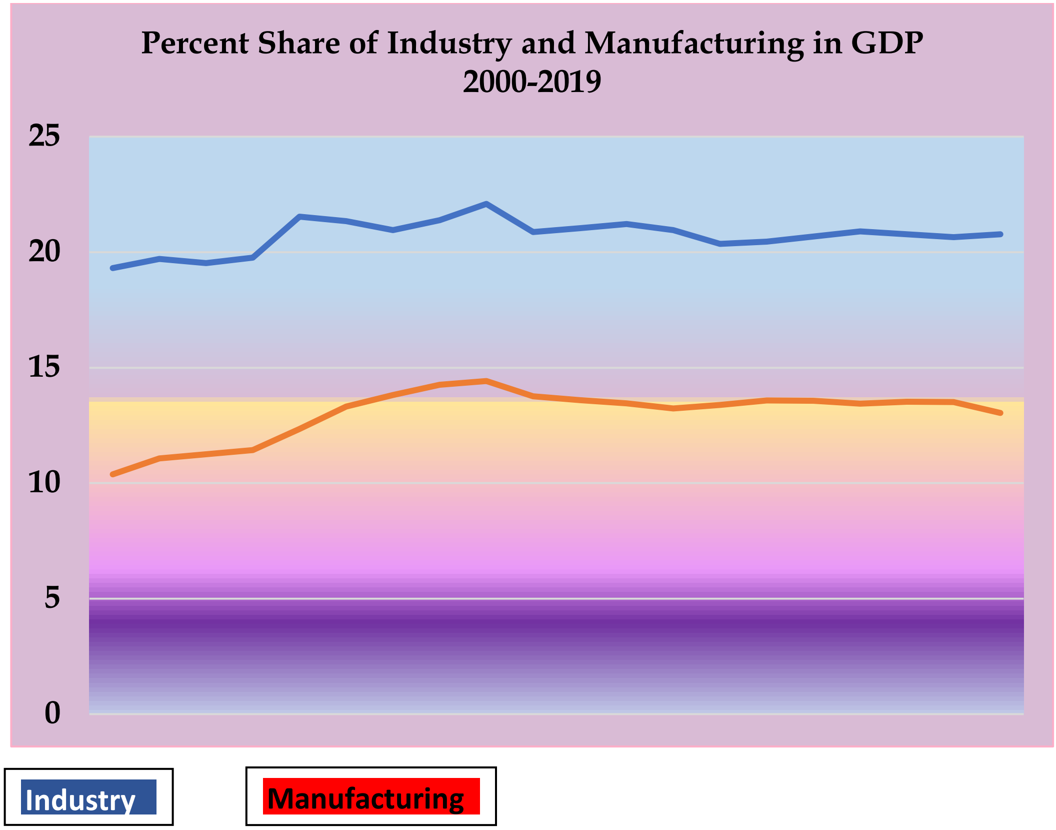
Agriculture seems to be responsible for the decline. Its contribution to GDP has fallen by almost ten percentage points. In 2000, its share in GDP was more than 27%. In 2019, it was 18.5%. This decline could have signaled a process of structural transformation. But that isn't so, as agriculture's loss is not manufacturing's gain.

Figure 16



While manufacturing hasn't suffered from the same precipitous fall, it hasn't grown either. Manufacturing grew between 2000 and 2008. Since then, its performance has been uneven, peaking in 2008 and falling since (Figure 17). Compared to about 13% of GDP in Pakistan, manufacturing's share is 17% in India, 18% in Bangladesh, and 30% each in South Korea and China. Our modest performance in this area shows in our export. Moreover, Pakistani firms produce the same products as they have for several decades. There is hardly any growth in value addition in Pakistan. Resultantly, exports have suffered.

Figure 17:



The modest growth that Pakistan has seen in the last twenty years comes from increase in services. As said, measurement of services is questionable. Also, what Pakistan produces is not exportable. While share of services in GDP has grown from 53.5 in 2000 to 61% in 2019, export of services as % of GDP has fallen (Figures 18 and 19).

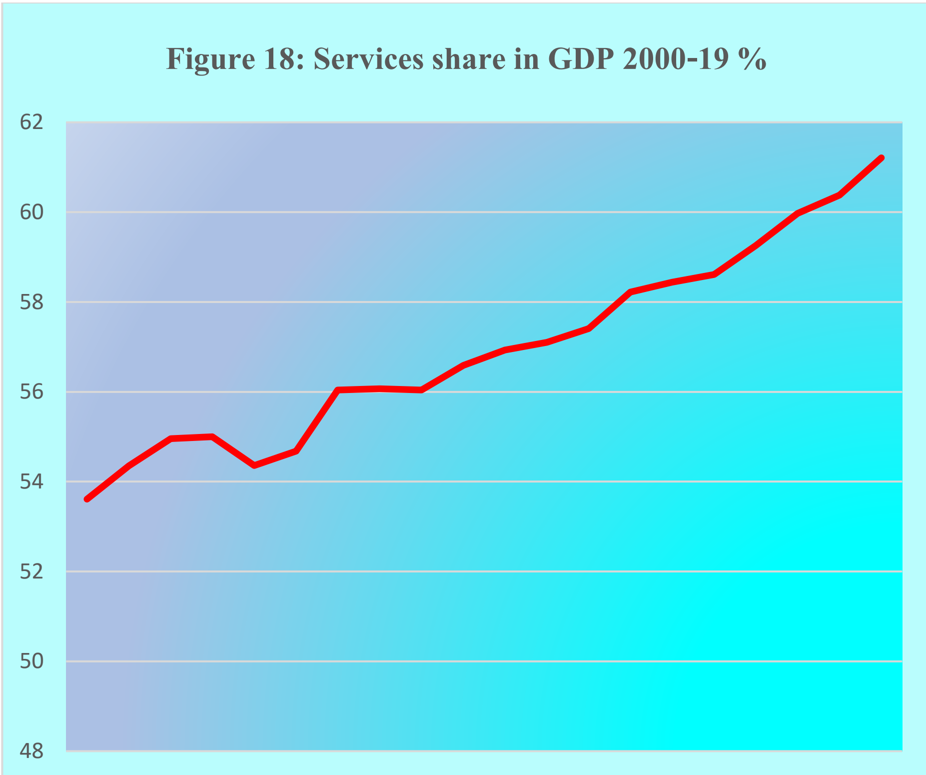


Figure 18: Services share in GDP 2000-19 %
62
60
58
56
54
52
50
48

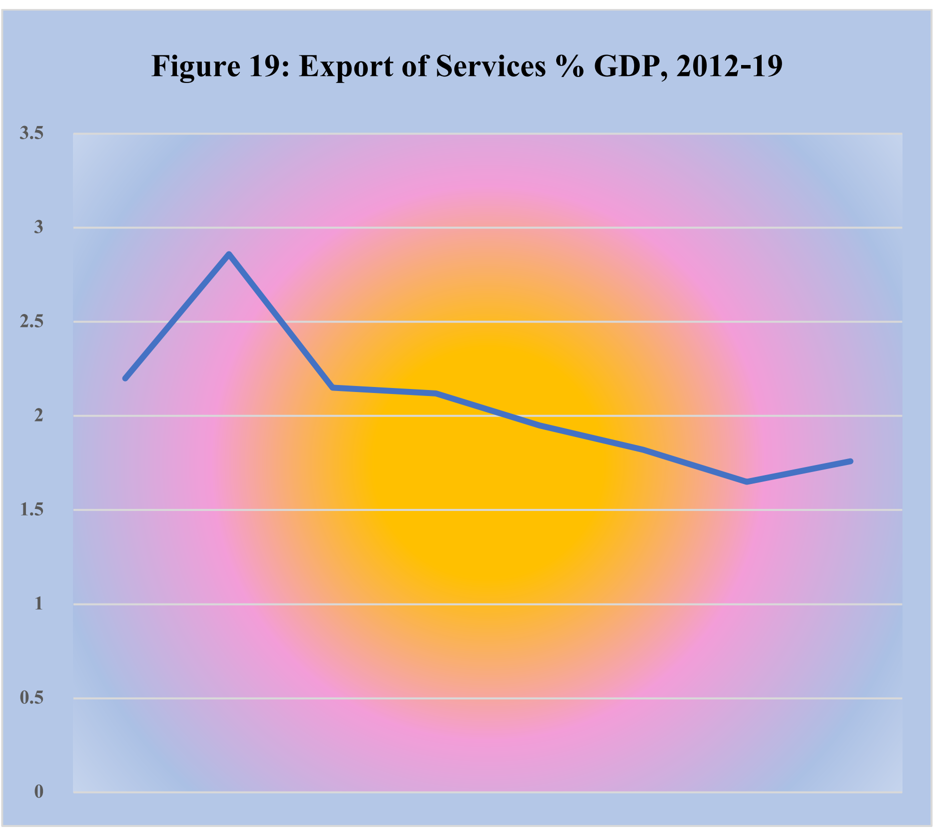


Figure 19: Export of Services % GDP, 2012-19
3.5
3
2.5
2
1.5
1
0.5
0

Consequently, there should be no surprise that our exports have fallen consistently:

Fig 20: Pakistan's declining exports as percent of GDP

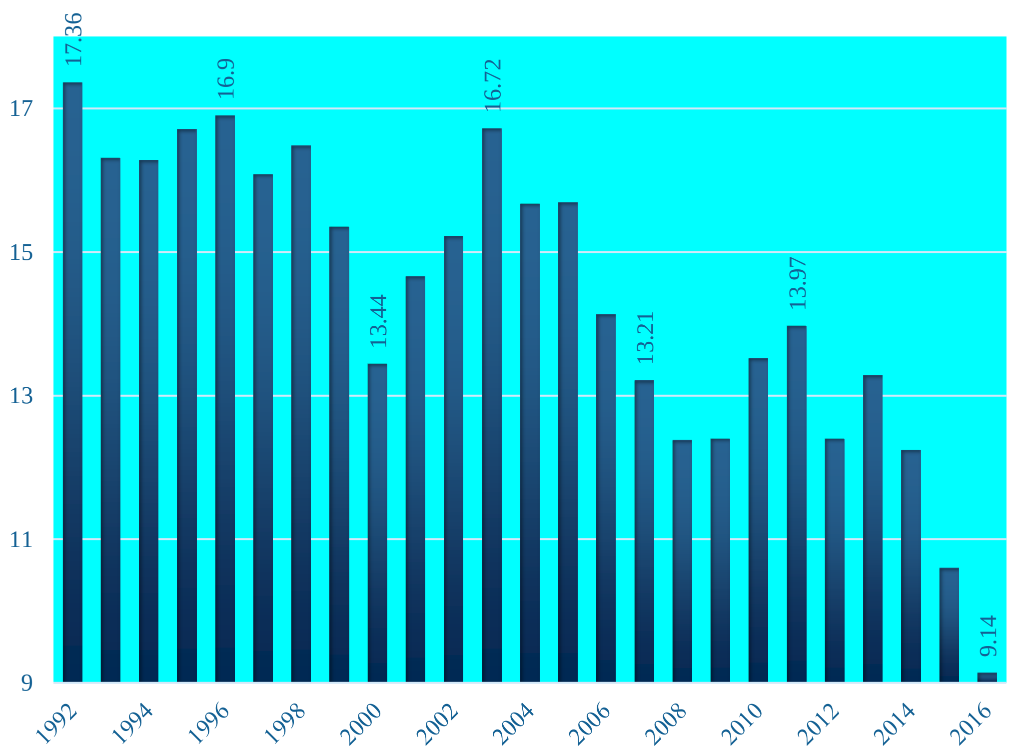
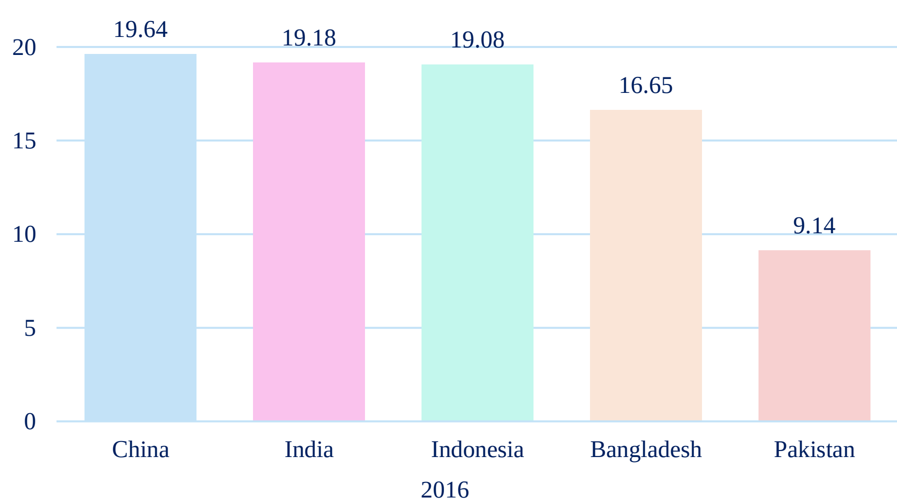
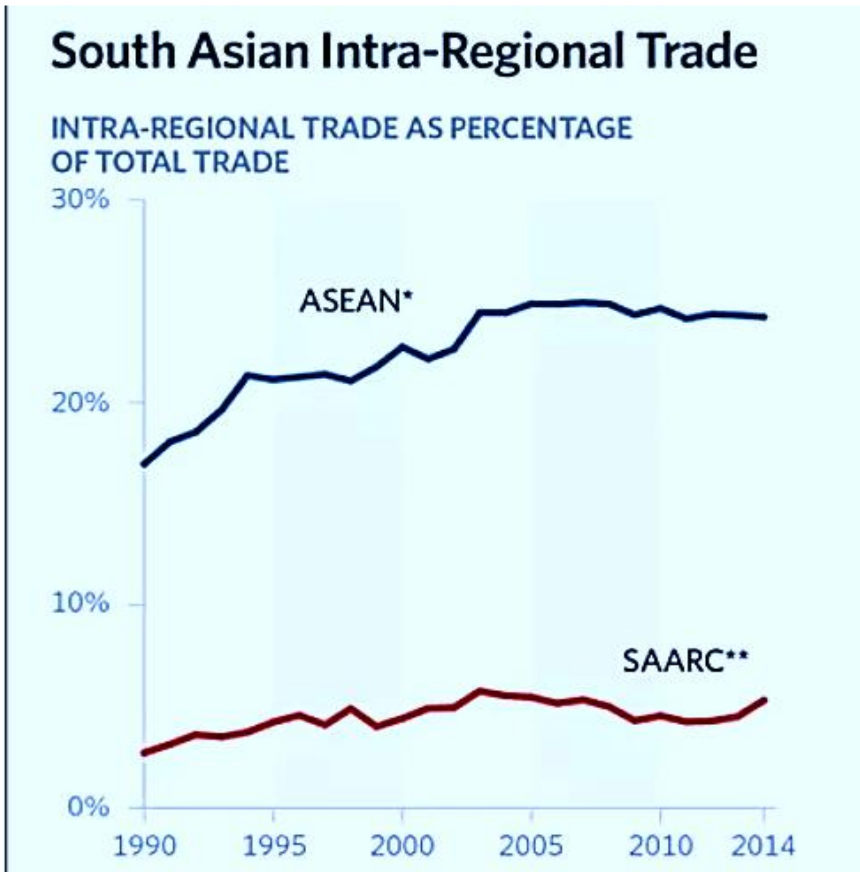


Figure 21: Exports as percent of GDP is low compared to other economies



Pakistan and South Asia are trending in the opposite direction to rest of Asia, in intra-regional trade. This affects our ability to enter into production sharing and supply chains. Figure 22[80]below explains. While ASEAN trade has grown since 1990, and is about 25% of their total trade, the SAARC curve is flat and does not go beyond 5%.

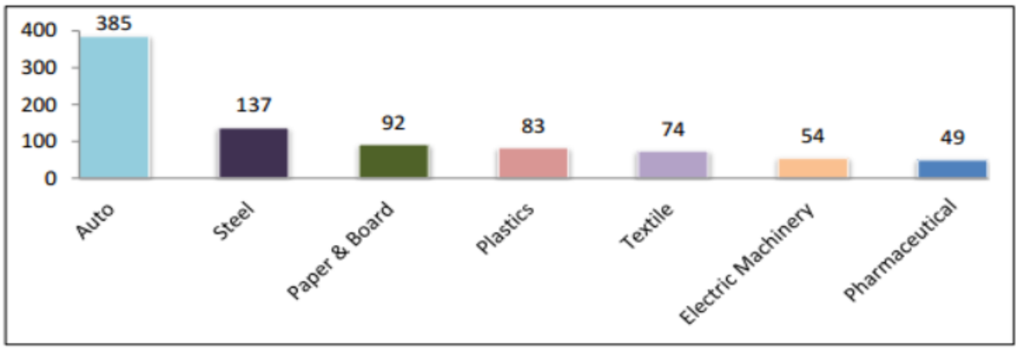
Figure 22: Intra-regional SAARC trade is low



Pakistan has persisted on basing trade relations with India on protection and security concerns. By giving into special interests, it may be hurting its manufacturing sector. See Figure 23, for number of items on Pakistan's negative list. That these items often enter our market via Afghanistan, defeats the purpose of such ban.

[80] Euro Review and the Heritage Foundation, South Asia: Regional Integration And Greater Economic Freedom Will Boost Growth And Prosperity – Analysis, James M. Roberts and Huma Sattar, December 2016

Figure 23: Number of commodities on negative list

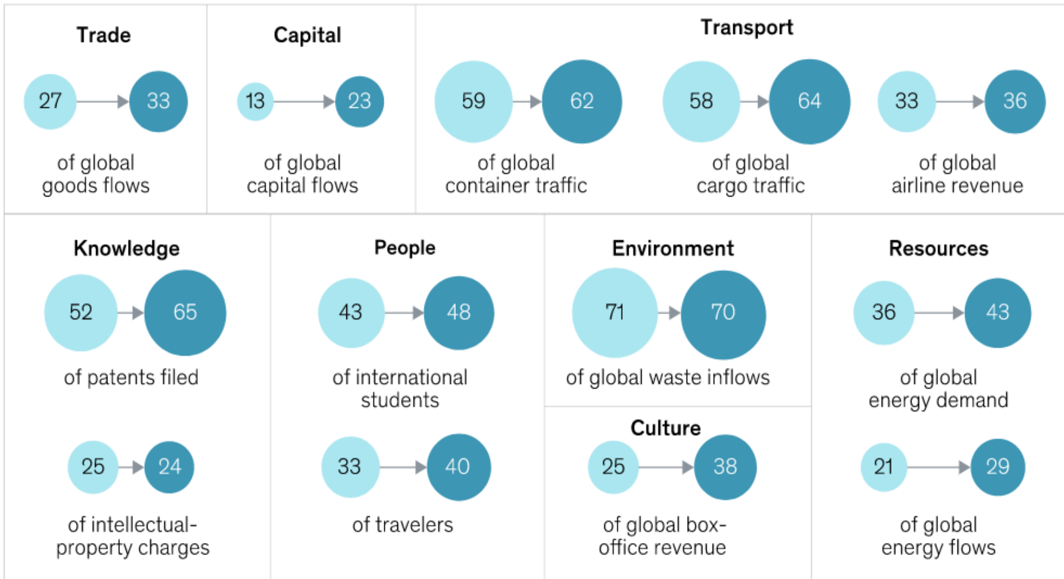


Source: Ministry of Commerce, Pakistan

Pakistan has a history of slow growth and too frequent boom-bust cycles. As seen in Figures 11 and 12, the volatility is a constant with a trendline that has a downward slope. We see that Pakistan has had repeated boom-bust cycles. The booms have coincided with periods of abundant foreign assistance. The busts with its withdrawal. Episodes of high growth were never sustained and always reversed within a few years.

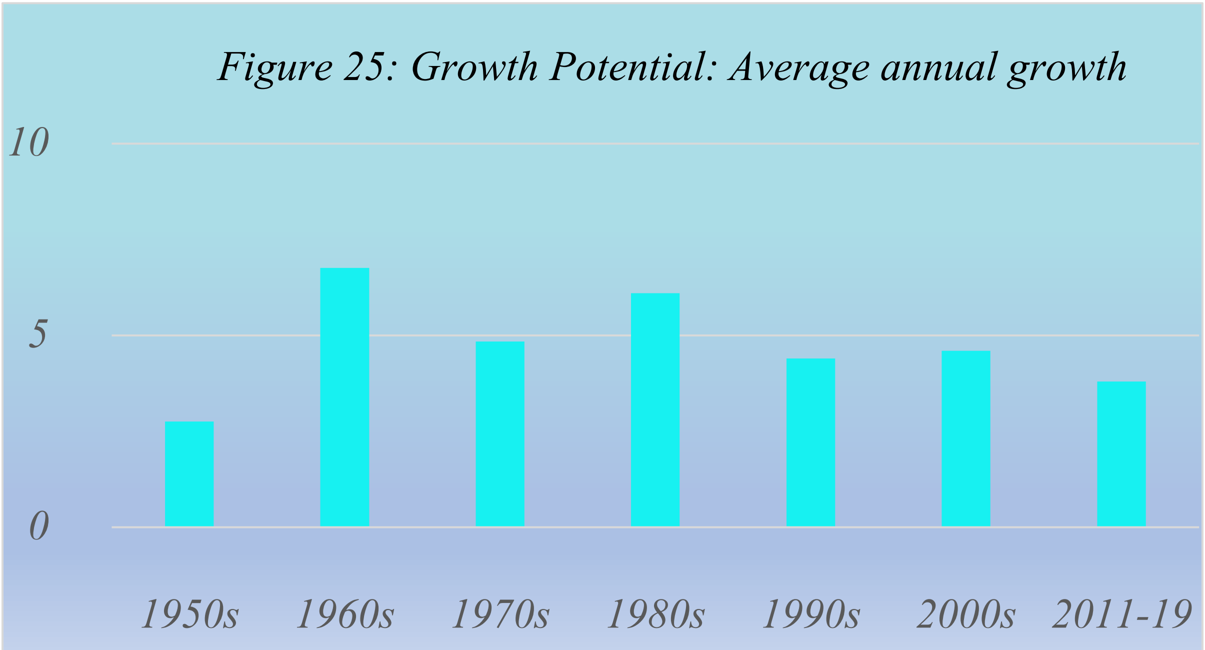
The reason for this volatility is that the Pakistan policy makers have not prioritized creation of the preconditions for economic growth. The economy has never had macro stability (Figures 11-14). We have had current account deficits even when large amount of post 9/11 aid to Pakistan in the 2000s (Fig 14). Provision of public goods is unreliable. Education and health services are dismal and governance a hindrance to investment. This runs contrary to the trend in rest of Asia. In trade volume, capital flows, energy flows, people flows, and share of knowledge, rate of increase in rest of Asia has grown faster than any other region of the world (Figure 24). The lighter colour % of Asia’s flow in 2005-07. The dark shade shows flows for 2015-17.

Figure 24: Asia's Share of global flows, 2005-07 vs 2015-17, %



[1]Includes both conventional and renewable energy sources.
[2]In some cases, used alternative periods because of data availability or volatility.
Source: International Monetary Fund; Organisation for Economic Co-operation and Development; UN Conference on Trade and Development; World Trade Organization; McKinsey analysis; McKinsey Global Institute analysis

Access to capital is a challenge and almost non-existent for new entrants. While banks prefer the low risk of lending to government, the capital market does not act as a source of private project finance. Government owned financial institutions, DFIs, have mostly shut down on foreign advice. On foreign advice also, government does not intervene to guide resource allocation. Consequently, the economy's growth potential has fallen consistently. Figure 25 shows average growth for each decade starting from the 1950s. The important element to take note of is that Pakistan's growth potential has declined. In the 1960s, average annual growth was 6.8%. It fell to 4.8% in the 1970s. the 1980s saw increase to 6.1% but because of foreign aid. GDP growth rates for the succeeding three decades were 4.4%, 4.6% and 3.8%. With population growing at 2.4% per annum, means that per capita growth rates have been about 1.5% . The aid went to consumption and did not build productive capacity.



Perhaps past experience is a deterrent for government to actively encourage capacity. Government invested in domestic production of steel, machine tools, and heavy machinery. That failed. However, this is because their ownership in the public sector was a mistake. Having a large state-owned sector is different from policies that nudge private investment into export or export supporting sectors. With government now a bystander, the private sector has preferred surplus rent investments in textiles, power generation, autos, and fertilizers, with continued high subsidy and protection. Because of security concerns, regional trade almost does not exist.

To sum up, we lack the drivers of growth have not built up:

- Accumulation of physical capital that support private business activities
- Human capital or available effective labour. Effective labour is the size of work force multiplied by years of schooling (low in Pakistan).
- Total factor productivity: technological progress that enhances the efficiency with which physical and labour inputs are used to give output[81].

For the future, Pakistan must greatly increase its rate of investment based on domestic savings. "Increasing investment from 15 to 25 percent of GDP is critical to unlocking Pakistan's growth potential"[82]. Raising its productive capacity will increase output and jobs. It must introduce new machinery into the economy and train workers to use them. This will make possible a self-sustaining growth process.

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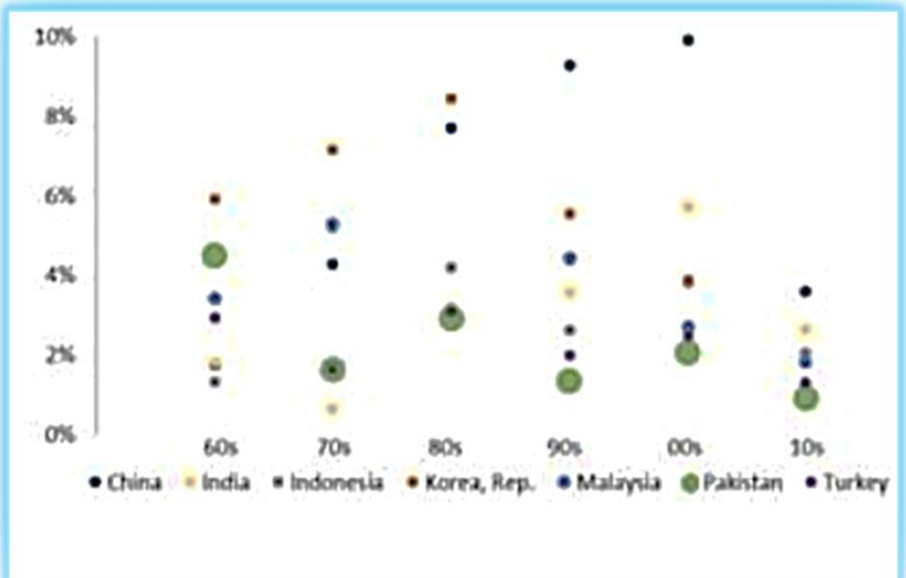
[81] World Bank, Pakistan @100: Shaping the Future, 2019, Page 14
[82] Ibid, Page 13

Figure 26[83]: From the highest growing to the lowest growing economy: Average Growth of Pakistan and peers



The same facts are presented differently in Figure 26. Other than the 1960s, Pakistan has been the slowest growing economy among its comparators (Fig 24). Many things happened. Political and security situation have been unstable and aid flows stayed volatile. This, along with widespread issues of political economy "have undermined the state's strength to implement reforms"[84]. These have added to the missing three drivers of growth: investment/GDP ratio, human capital[85], and improvement in total factor productivity.

[83] WORLD BANK. Pakistan@100: Shaping the Future, Page 12
[84] Ibid
[85] WORLD BANK. Pakistan@100: Shaping the Future, Page 12

Why has production declined?

Most analysts in Pakistan focus on sub aggregate issues related to production of specific agriculture and manufacturing items within a specific time frame. What we must study is why is there a decline in production across most sectors.

It is necessary to recall that economic development is a process of transformation. Its prerequisites are stable political and social arrangement. East Asian experience shows that these two essentials must precede economic policies for growth[86]. Also, the role of government is important in other ways. Our economy is locked in a 'vicious circle of low income, low savings, and low technology'. Development cannot be left to the private sector. They need to be empowered with a supporting environment.

While the role of East Asian governments has been important in building their economy's production capacity, GoP has been focused entirely on macro indicators. And that too, in reaction to an impending crisis, usually in the external account. But macro indicators will improve if agriculture and manufacturing grow. And they won't if the two stay stagnant. We do not have a plan to boost output and production.

Successive governments have tried to reduce fiscal deficit by increasing indirect taxes or by raising taxes on those already paying. But how will revenue grow if the economy is sluggish? Also, FBR's approach comes at the cost of dampening investment and consumption. Today, their approach has brought transactions and the economy to a halt. An economy is the sum total of all transactions. Fewer transactions mean slower economy.

A similar approach has been employed to deal with the external imbalance. External borrowings and import barriers have been used to deal with the current account deficit. What is more, hot money in portfolio debt and equity investment is being lauded as external stability. Such absurd antics must end. Soon as the IMF programme ends, we will be in a worse situation than we were before. These tried and failed ways have done nothing to deter policy makers from trying the same recipe over again. What the country needs is more foreign exchange from a boost in production, productivity, and exports. With an ever-upgrading industrial structure, it must export more higher value products.

Below are some of the reasons that fall within public policy ambit:

- *Bureaucratization of decision making. Need for politicians to lead recognizing the difference between finance and development.*

  For many years now, since the 1980s, Pakistan has bureaucratized economic decision making. Further, they have blurred the boundary between managing public finance, on the one hand, and industrial and agricultural growth, on the other. The latter is the real route to economic prowess. But Pakistan remains focused on the first. Our policy has been financial engineering for survival. The assumptions behind this policy are entirely

[86] The East Asian Experience of Economic Development and Cooperation, Kenichi Ohno, National Graduate Institute for Policy Studies (GRIPS), December 2002.

reasonable. Economic stability should be the first priority. Yet, without any growth in manufacturing, how will government increase revenue to reduce budget deficit or export to close the trade deficit? It hasn't worked in the past and it won't work now or in the future.

- *Human capital to get more output for the same input*

Despite repeated avowals, Pakistan has not invested in raising human capital quality. Labour productivity is low. The country is way behind comparable economies. In fact, the gap may have grown over the years. In HDI and overall social indicators, Pakistan has fallen behind South Asia. It now compares with sub-Saharan Africa[87]. These indicators feed into productivity of working women and men.

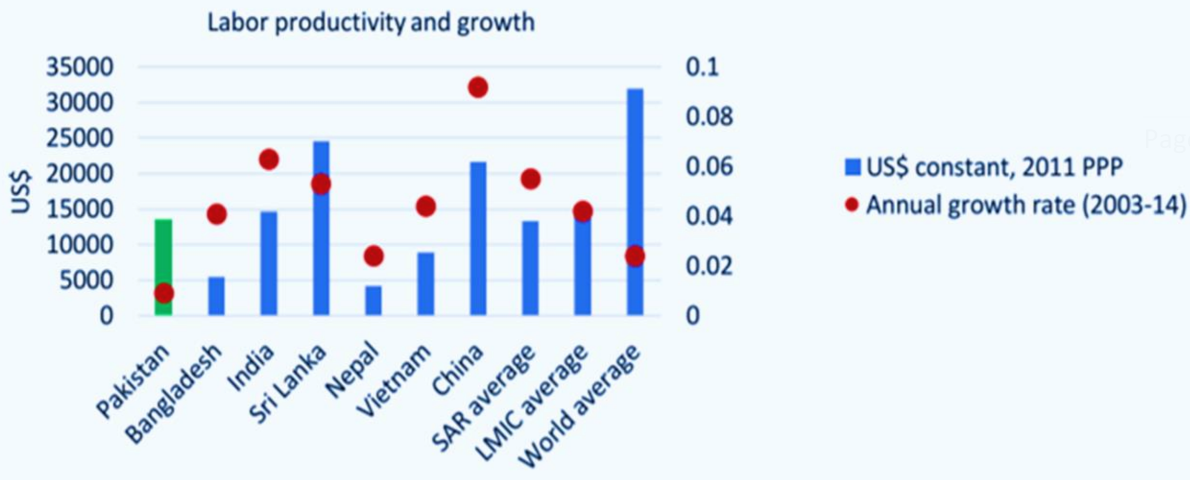
Productivity of labour is a source of competitiveness. With the social indicators being where they are, no surprise that growth rate of Pakistan's labour productivity[88] is lowest among like economies in South Asia (Figure 27). It is also well below the average for low middle-income economies[89]. Against a growth rate of 6.3% for India and 9.2% for China, Pakistan's productivity growth rate was virtually stagnant at 1.5%[90]. The average for LMICs is 5%. This is alarming.

Experts repeatedly stress that human capital quality and skills added to the number of working people affect growth. Moreover, we must create good quality jobs.[91].

For growth, investments in human capital (health, knowledge, and skills of people) are as important as physical assets[92]. Because of the many indirect ways in which it affects the economy, it is not easy to prove it with data. "Every country that sustained high growth for long periods put substantial effort into schooling its citizens and deepening its human capital"[93]. Education makes good claim on public resources as it is credibly known that the social benefits are more than return to the person being educated. Also, more knowledge in the society creates the ability to absorb and disseminate technology within the economy. This way an economy produces more value-added goods. "Nearly 75 percent of the GDP per capita gap between Pakistan and the United States is explained by the gap in TFP"[94].

Figure 27: Labour Productivity and Growth over time[95]

[87] Raftaar (Research and Advocacy for the Advancement of Allied Reforms), a project of Consortium for Development Policy Research, Pakistan's Public Expenditure Insights and Reflection, Page 7, 2015
[88] Measured as GDP per person employed.
[89] The World Bank, Pakistan @100: Shaping the Future 2019, Page 23
[90] Ibid Page 24
[91] Pakistan@100: Page 17
[92] The World Bank, The Growth Report: Strategies for Sustained Growth and Inclusive Development, Commission on Growth and Development, chaired by Michael Spence, Page 37
[93] Ibid, Page 37
[94] Pakistan@100, Page 41
[95] Pakistan @100, Page 24



Source: World Development Indicators.

- **Physical infrastructure**

"No country has sustained rapid growth" without high levels of public investment in health, education and infrastructure[96]. Infrastructure development, if done right, crowds in private investment. "It paves the way for new industries to emerge" by improving returns to private firms. Investors benefit "from healthy, educated workers, passable roads, and, reliable electricity"[97].

With the economy's focus entirely on macro stability, pace of physical investment has been uneven in Pakistan. This was especially so between 2008 and 2014. Since 2015, CPEC investment increased infrastructure investment, though there are questions about quality of project selection.

The effect of Pakistan's chronic under investment in infrastructure reflects on its quality. The quality of service provision has declined since 2011-12, arrow in Figure 28. More so, Pakistan is well behind comparable economies. When categorized by infrastructure type, we have done better than the average low middle-income countries in just one area, seaports, Figure 29. Although our roads are good, the quality of logistics support to businesses is below that of other countries. In fact, service quality has fallen between 2011 and 2015 (Figures 28 and 29). Economic activity in Pakistan suffered particularly from shortage of electric power. Flawed policies since 1994, under WB guidance, and our inability to correct them in more than twenty years has cost the economy dearly. The sector has become a haven for crony capitalism and rent seeking.

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[96] The Growth Report, Page 5
[97] Ibid, Page 6

Figure 28: Quality of Infrastructure Compared to Like Economies[98]

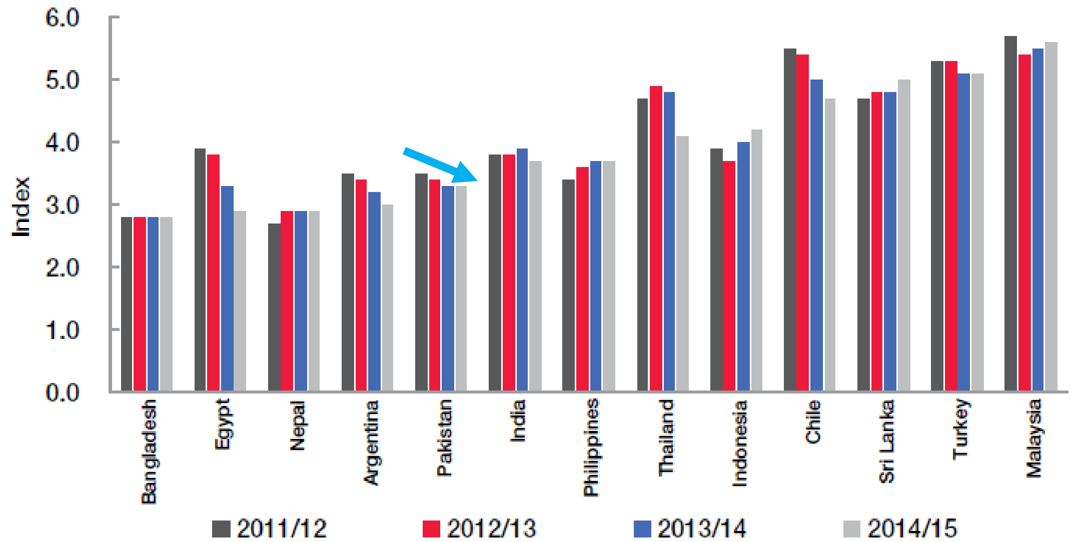
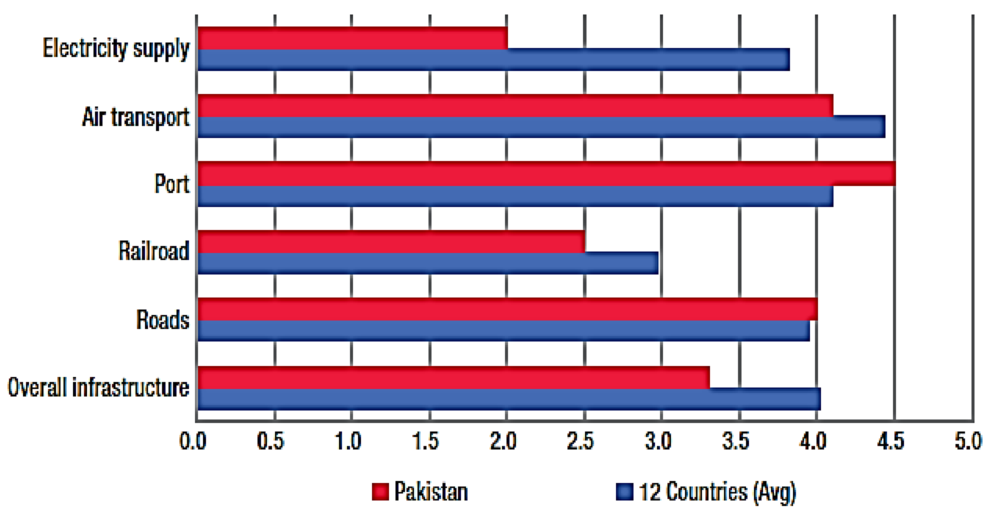


Figure 29: Sector-wise Quality of Physical Infrastructure[99]



At present, Pakistan is the weakest among comparators in electricity supply. Railways is equally dismal. Pakistan is worse than others also in airport infrastructure and in the density of paved roads and networks. We are the least connected country in the region. Hardly any major foreign airline, apart for those from the gulf airlines, touch all three major airports of the country.

[98] Raftaar (Research and Advocacy for the Advancement of Allied Reforms), a project of Consortium for Development Policy Research, Pakistan's Public Expenditure Insights and Reflection, 2015, Figure 9, Page 24
[99] Raftaar (Research and Advocacy for the Advancement of Allied Reforms), a project of Consortium for Development Policy Research, Pakistan's Public Expenditure Insights and Reflection, 2015, Figure 10, Page 25

Access to safe drinking water and sanitation is well below others in the region. Our cities cannot support business and manufacturing growth.

Accumulation of human and physical capital is critical for growth. Pakistan is particularly weak in its human capital and has much work to do in physical infrastructure. They cannot support production in the economy. Even where it has caught up with regard to quantity of infrastructure (motorways and recently power), the quality and cost of service provision work against competitiveness.

In addition, there are immediate reasons for the fall in output. The reasons below are symptoms of the deeper reasons that drive choice and priorities. We recount them more as what needs to be done once we have sorted out the deeper malaise.

- Agriculture decline is a major issue for Pakistan. It would not have been a concern if this were part of structural transformation. The reasons for fall in crops production are:

  - **Availability of water**: Since 2012, water available to the farmer has declined at an average annual rate of -0.6%. During the decades of the 1990s, it had grown by 1.1% per annum. Between 2008 and 2012, there was no additional water available to the farmer. Consistent decline in PSDP funds for water and delay in building storage in the country is a major reason. Underground aquifers have depleted from excessive use. Nor have governments addressed the issue of indiscriminate water usage[100].
  - **Terms of trade**: The ratio between cost and income from major crops has declined significantly[101]. With increase in gas prices, price of fertilizer increases has grown.
  - **Credit for farmers**: Difficulty in accessing agriculture credit by farmers, especially small farmers.
  - **Link between research and production and productivity**: In the 1960s, Pakistan became self-sufficient in wheat by using the Mexi-Pak variety. This was foreign researched made implementable by a research institute in Faisalabad. Studies show a 40% return on investment from research. Connection between research and farmer use has become tenuous, of late. This must be restored, and the extension service staff must be better connected with research.

- Manufacturing: The main reason is that growth in manufacturing has not been a goal for about half a century. The combination of a security state and elite capture has advanced industries at high cost to the economy, with no efficiency gains. Later in this section we discuss elite capture that shows in tax policy, enforcement, water supply to farms, protection of losses in SOEs, patron client relations in social sector and in cronyism. We also review this while discussing the country's approach to macro-economic management:

  - **Rentier:** In Pakistan, those industries have grown that receive protection (e.g. auto assembly) or have especial financial incentives (e.g. power generation). There is no study

[100] Growth and Inequality in Pakistan, Agenda for Reforms, Hafiz A. Pasha, Friedrich Ebert Stiftung, 2018, Page 114-116

[101] Ibid Page 116

on why manufacturing is at a standstill. This paper may be the first to fill the gap. The rest of the points below are outcomes of poor decision making and choices.

- **Energy supply**: Since 2008, power shortage has exacted a very high cost on industry. Many have reduced operations. Cost of power is high compared to the region.
- **Access to credit** is restricted, has high cost, and given to uncertainties of monetary policy. New entrants and SMEs are at a particular disadvantage. State owned DFIs were a good source of predictable private project finance. We can trace the decline in growth of manufacturing value added to phasing out of DFIs.
- **Low competitiveness**: Human and physical capital is below needs. All indicators that account for support to businesses are weak. Need to have a comprehensive industrial policy that supports businesses.
- **No regional trade**: Pakistan has locked itself out of the regional markets in South Asia. Afghanistan is marred by violence and war, while Iran has been under US sanctions. Because of political differences with India, we have kept ourselves out of the rapidly growing the SAARC market. Apart from ensuring that Pakistan manufacture products that sell globally, better integration creates efficiencies through production sharing (refer discussion on East Asia).

Consequently, Pakistan's trade-to-GDP ratio was close to that of its South Asian neighbors in the early 2000s, but then fell. Pakistan did not leverage its advantages in export trade as an engine of growth Figures 20 and 21[102]. Professor Atif Mian refers to 1992 as the critical year when our competitiveness began to take a hit[103]. “From 2005 to 2017, India's exports of goods and services increased by 216 percent, Bangladesh's by 250 percent, and Vietnam's by 519 percent. In comparison, Pakistan's exports increased by only 50 percent, from US$19.1 billion to US$28.7 billion”[104]. We are also behind all these economies in creating new products. In Figure 32, there are several economies with GDP per capita below Pakistan, but have greater innovativeness. They produce new and more processed goods for home and away markets. The World Bank says that “evidence suggests that Pakistani firms do not seem to be innovating much”[105]. The government must determine why this is so.

[102] Pakistan @ 100, Page 49
[103] IGC Conference 2014, presentation by Prof Atif Mian
[104] Pakistan @ 100, Page 49
[105] Pakistan @100: Page 43

Figure 30: Manufacturing as % of GDP 1990-2015

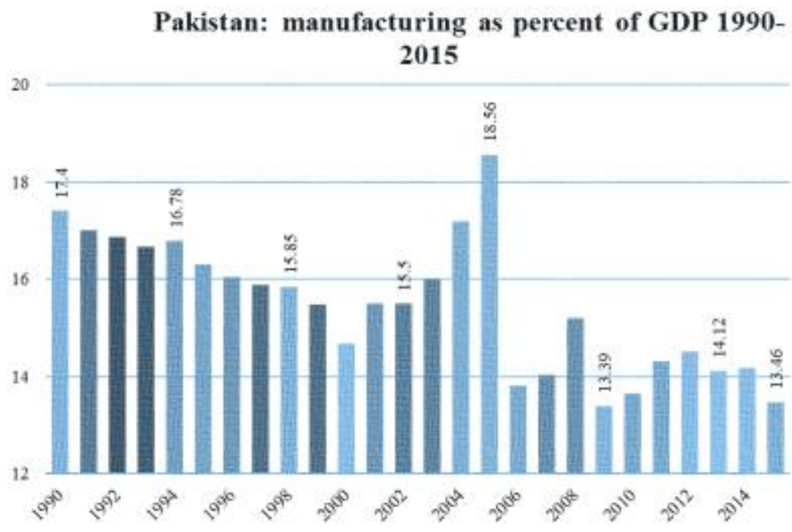


Figure 31: Country Comparison: Manufacturing/GDP 2015

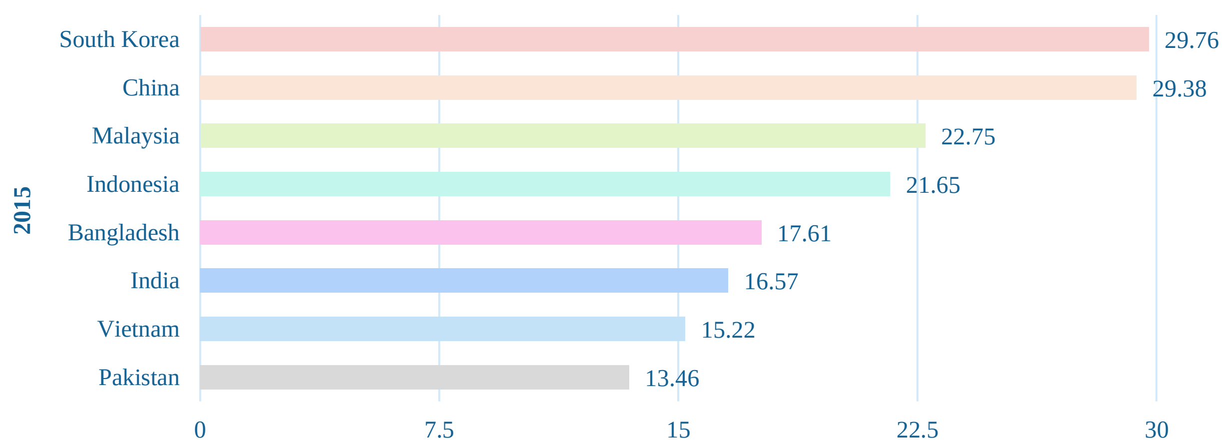
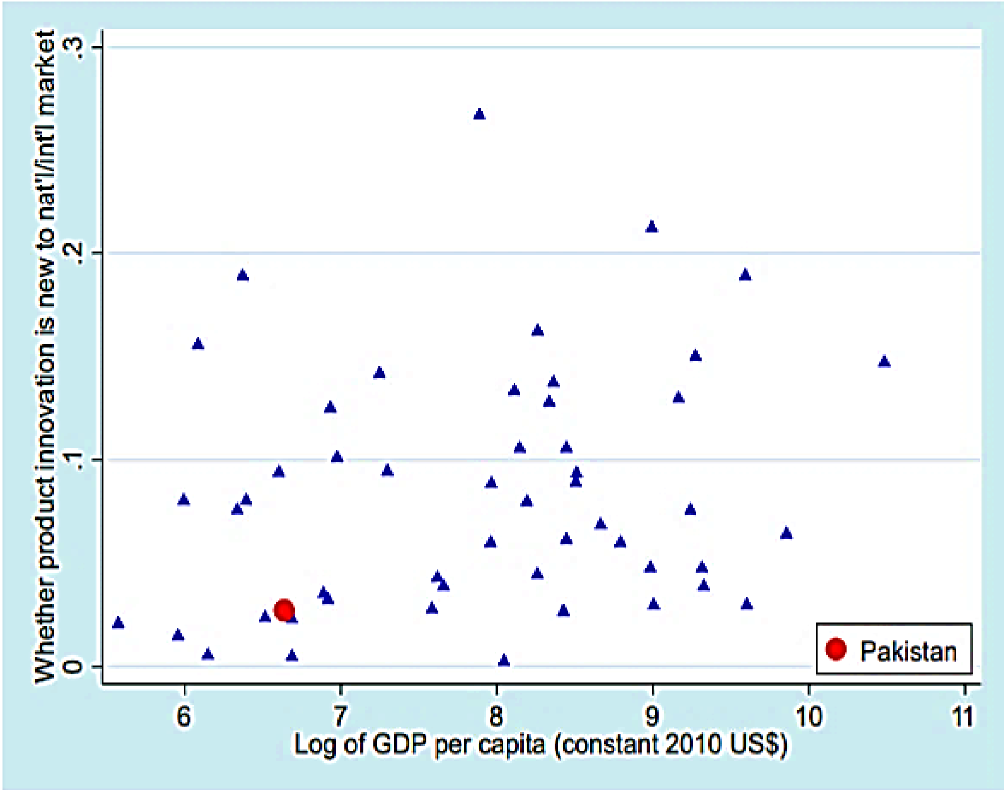


Figure 32[106]: Pakistani firms are not introducing enough new products relative to income levels. The red dot is Pakistan.



Very low Savings and Investment:

Government's high budget deficit contributes to low savings. There are other constraining factors. The percent of adult Pakistanis with a bank account is just 14 %[107]. Also, during times of high inflation, the real return on savings is negative.

World Bank's Growth Report states that "high, sustained growth requires an impressive saving rate"[108]. Where labour is abundant and trade links intact, the pace of investment decides the rate and level of growth[109]. However, investment is possible only if the economy has enough savings. Foreign capital is fickle, and when FDI is low, it comes at high cost and raises indebtedness. If investment doesn't result in exports growth, BoP

[106] World Bank, Pakistan @100, Page 44

[107] FinancialInclusion.Org, a Kantar's Financial Inclusion data tool in partnership with Bill & Melinda Gates. According to Karandaaz: The Unbanked: A hundred-million question, 15 March 2019, the figure is 21% and. SBP's Financial Inclusion Strategy of 2016, puts it at 10.3% but based on 2011 data.

[108] The Growth Report, Page 28

[109] Ibid Page 3

pressures are severe. Pakistan knows this only too well. As the Growth Report says, "foreign saving is an imperfect substitute for domestic saving, including public saving".

Our economy has not accumulated sufficient amount of human and physical capital to generate strong growth. Policies that encourage savings would give a fillip to investment.

Table 6: Pakistan's savings and investment % GDP

Table 6: Falling Savings and Investment as % of GDP					
	2003-04	2007-08	2012-13	2017-18	2018-19
Investment	16.4	19.2	14.96	16.7	15.4
Savings	17.7	11.0	13.9	10.4	10.7
Domestic	15.7	9.1	8.7	5.1	4.2
Foreign Savings	-1.2	8.2	1.1	6.3	4.7

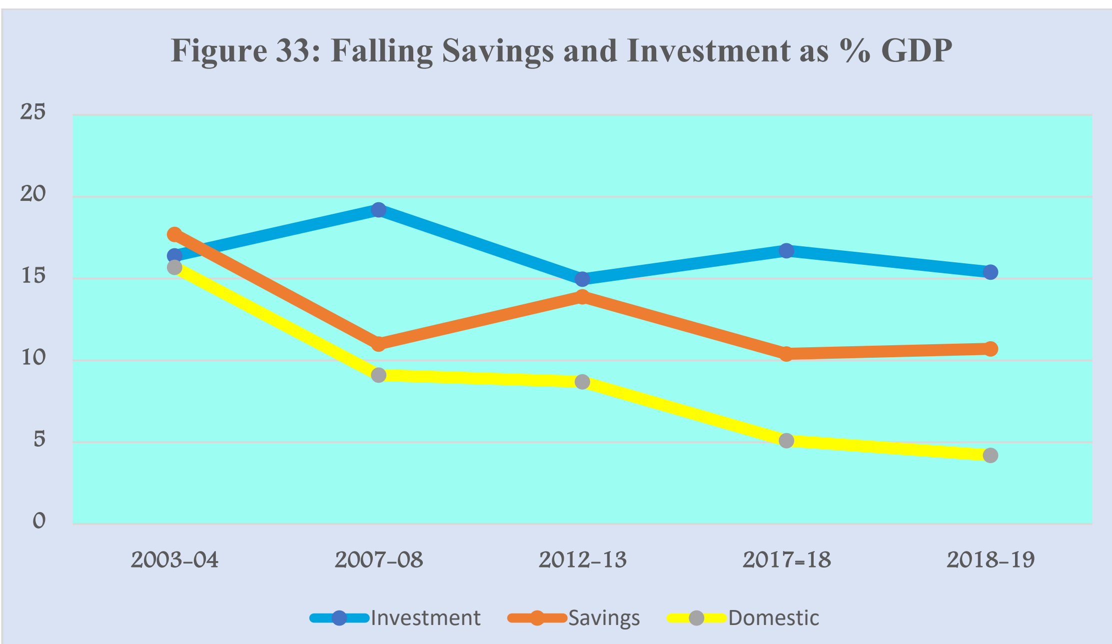
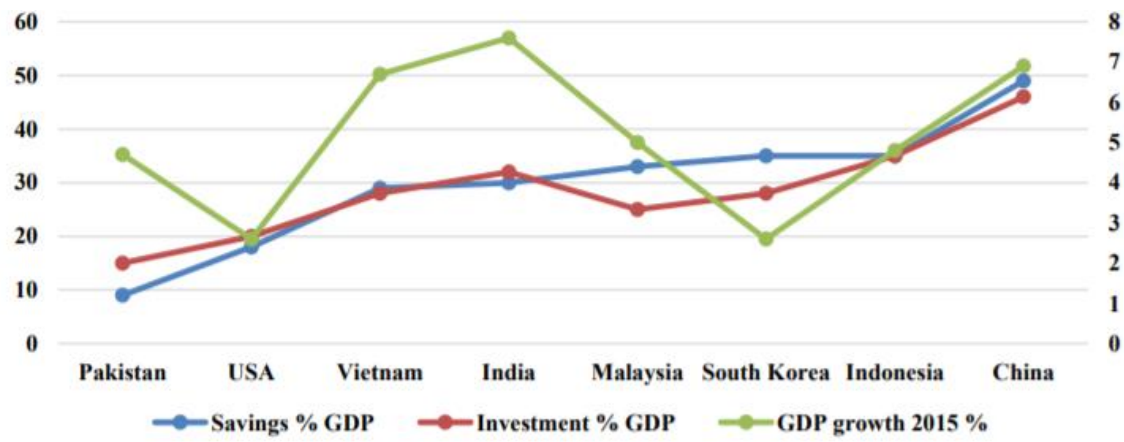


Figure 34: Relationship between savings, investment and GDP growth rates



- SBP has not enforced borrowing limits on government placed by the monetary policy. This allows government to run as much budget deficit as it wishes. And often they do so with abandon. Government's negative savings rate is a dampener for investment. Discipline is better during the years of IMF supervision. Expenditure on defence, debt servicing, and subsidies (including pensions) total 92% of current expenditure and 80% of total federal expenditure, Table 9. They equal about 12% of GDP.

- As already noted, DFIs were a good source of capital for businesses. They raised their own capital from the market through savings instruments. Closing them has dealt a major blow to private investment.

- Pakistan has borrowed heavily from external sources to meet normal government expenditure. This is an abject failure of management of public finances. It is done under the myth that any foreign borrowings creates exports that would allow repayment. Policy makers who make decision to borrow spread the myth, knowing fully well that it isn't true. It is more a reflection of their negligence and inability to manage the budget. This also gives them easy funds rather than find ways to improve resources. That this is permitted and even encouraged by IFIs in the garb of elaborate policy frameworks that no one intends to implement is an affront. External debt should only be for feasible projects or for meaningful technical assistance.

- Compared to growth economies, Pakistan has a low investment to GDP ratio based on low savings rate. Fast growing countries have had Investment to GDP ratio of 25% or more, 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. 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.

- A binding constraint to increasing investment levels is low domestic savings. That in turn follows from GoP's high fiscal deficit and borrowings, low domestic savings (about 7% and 13% with foreign remittance), high ratio of dependent population to working age population, low fiscal inclusion (just 21% have bank accounts), shallow capital market, and frequent macro-economic volatility. All this means that both private and public investment is low and cannot support growth. In fact, some indicators show that, progressively, savings, investment, and private access to credit have fallen. Figures 33 to 37 below show the trend.

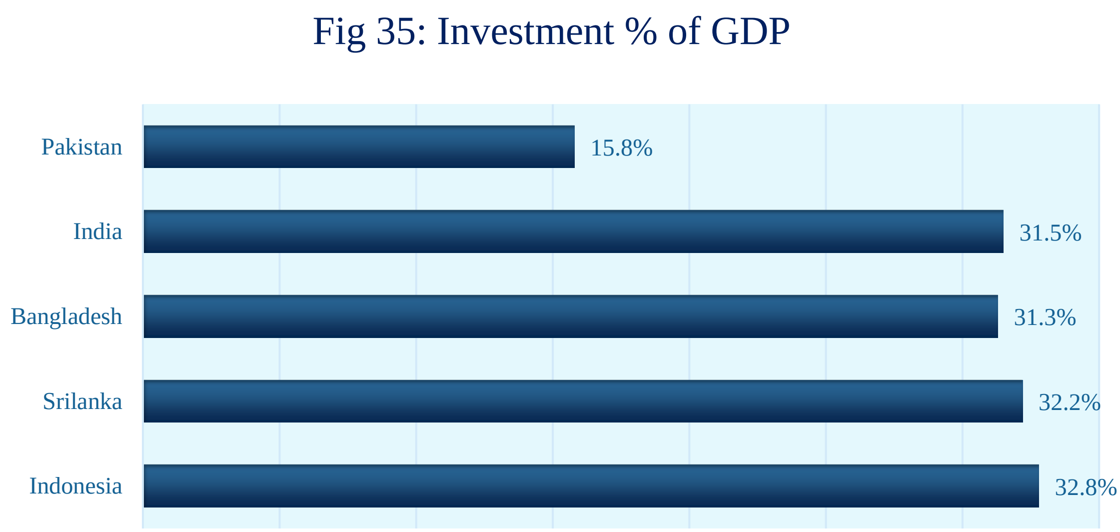


Figure 36

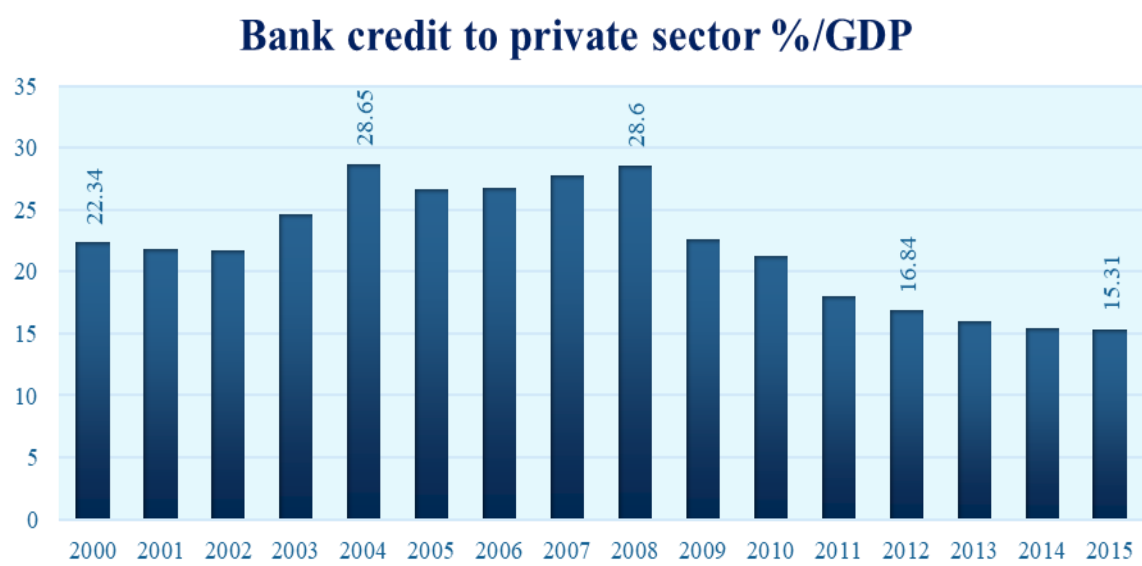


Figure 37

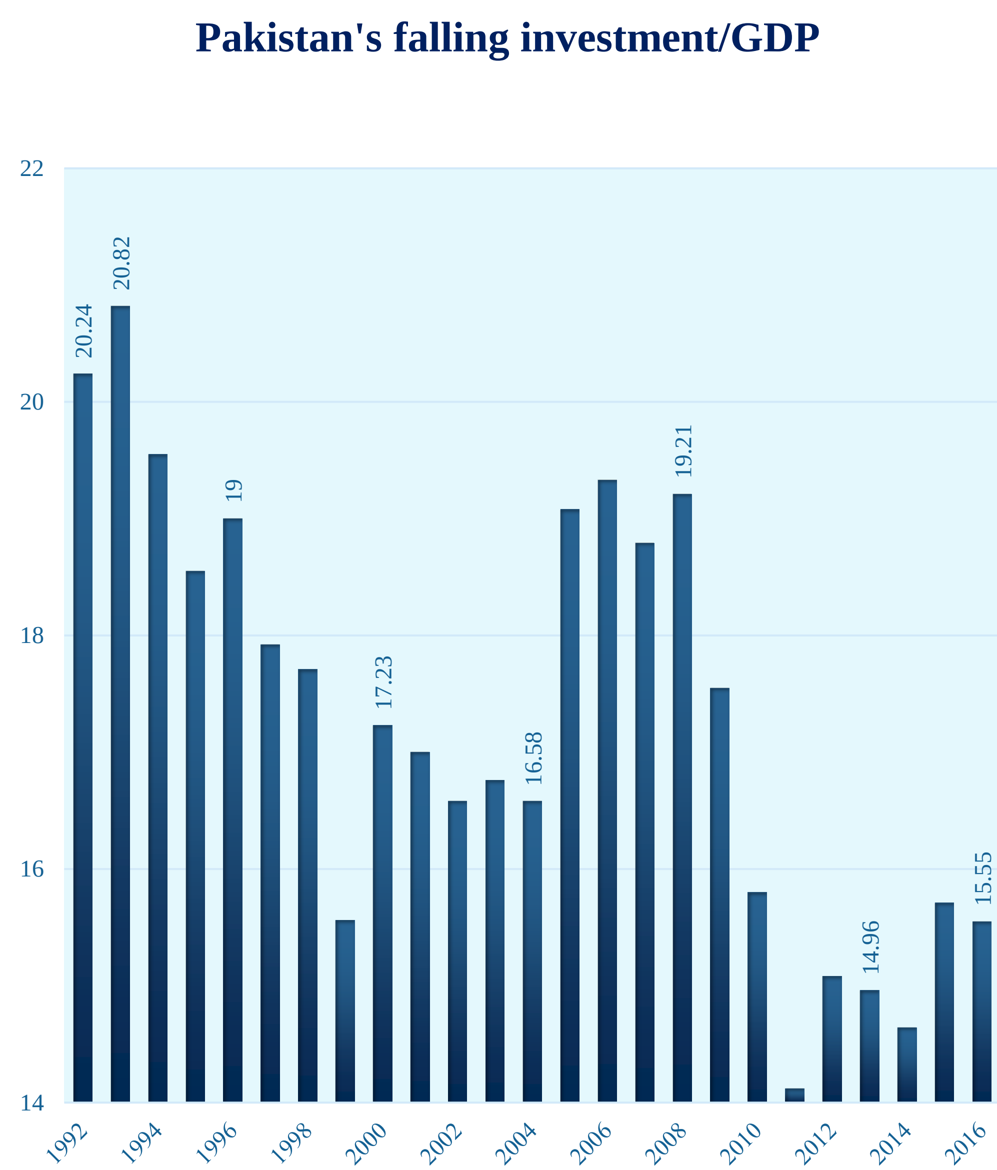
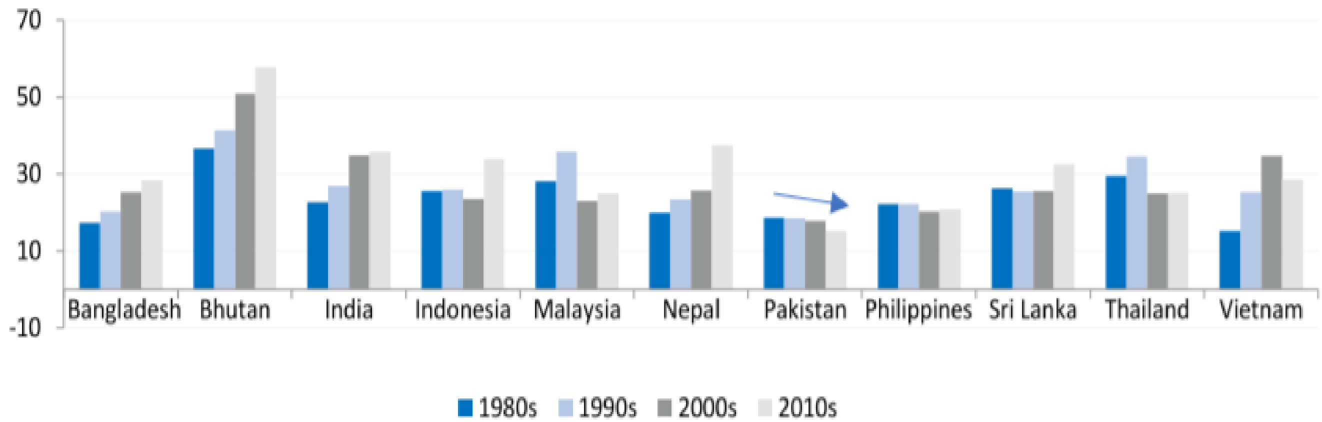
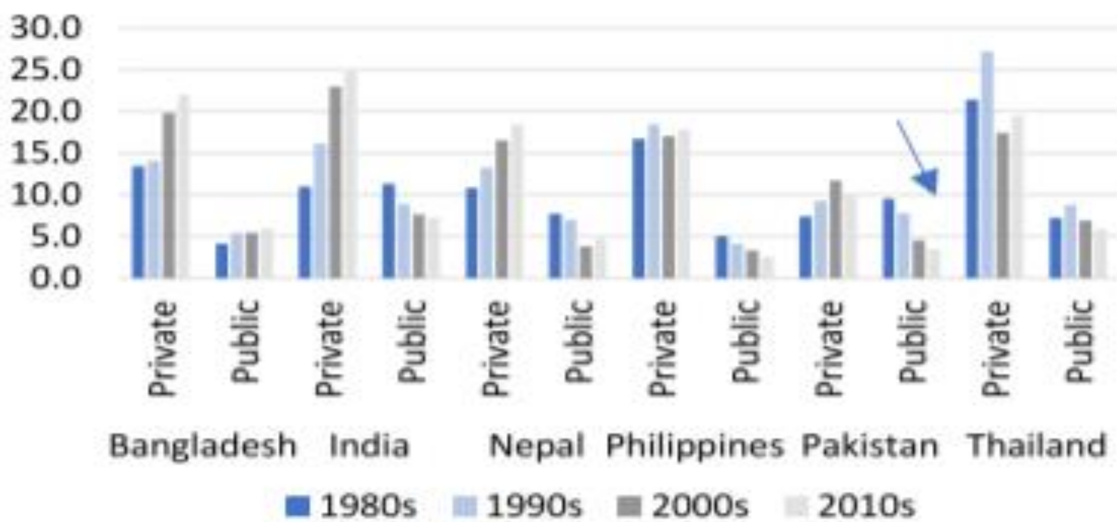

Pakistan's falling investment/GDP
22
20
18
16
14
20.24
20.82
19
17.23
16.58
19.21
14.96
15.55
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
2012
2014
2016

Figure 38: Comparison of Investment to GDP Ratio %



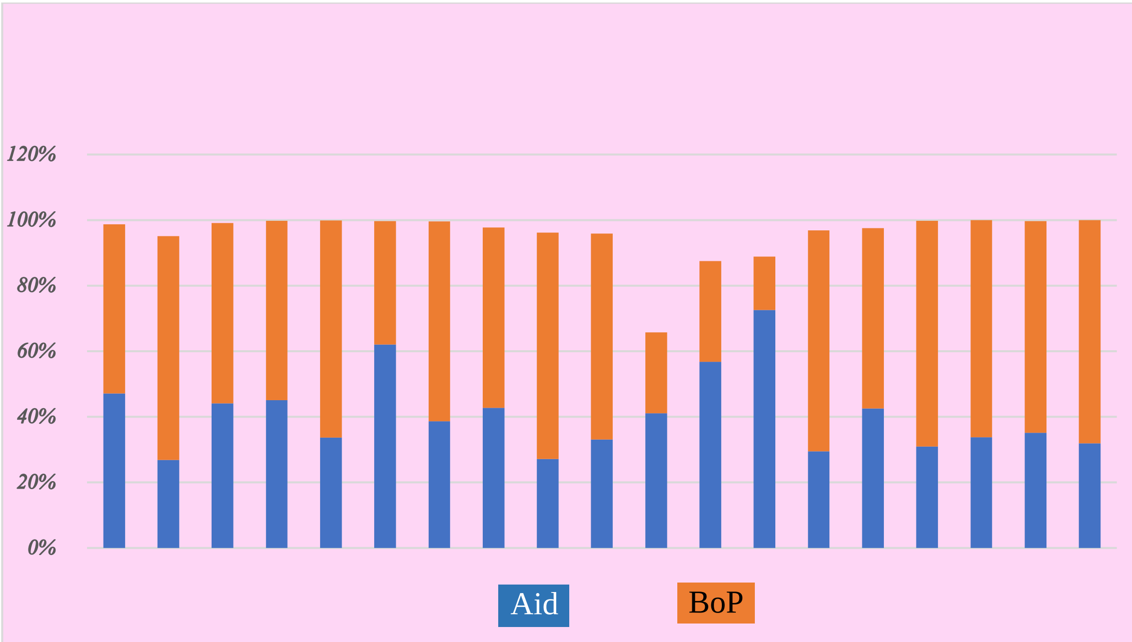
Source: Haver Analytics

Figure 39*:*



Source: World Development Indicators and World Bank staff calculations.

Figure 40: Most of the aid is for BoP support. Project aid is a small part of total aid



Foreign aid must only finance much needed projects that directly stimulate GDP. It should be a small percent of gross domestic investment. Foreign borrowings that meet operational budget or BoP needs is an unacceptable deviation from prudence. In the decade of 2000s, project aid was 39% of total aid, Figure 40. Between 2011 and 2019, its share fell to 37%. Foreign loans incurred by Pakistan do not yield growth and exports. Yet, GoP does not say how does it plan to repay. Figure 41 below is instructive. In twelve years, between 2009 and 2017, external det and liabilities grew eight-fold. Yet, exports grew 1.36 times and total foreign exchange earnings including remittances and FDI 1.6 times.

Figure 41: Unsustainable level of debt

Indicator	*Multiples in 2019 since 2007*
Total debt and liabilities	*8X*
As % of GDP	*1.8X* *From 58% to 104%*
Domestic debt	*8.5X*
External debt	*6.7X*
GDP Current Rs.	*4.2X* *From 9.2 T to 38.5 T*
Exports current USD B	*1.36X, From 16.9 B to 23.2 B*
Total Forex Earning	*1.65X, From 32B to 53 B* *Includes export of goods and services, remittances, FDI*

Elite capture

There are several ways in which economic control by influential interests is visible. Its negative effects on growth, productivity, and citizen welfare are seen widely. This has prevented formation of physical and human capital:

- Agriculture: For reasons of food safety and because a large part of our population depends on income from farms, Pakistan cannot agree with the WB to let the agriculture sector operate entirely on market principles. Yet, there is need to remove those distortions that harm the sector as a whole, though they benefit powerful farmers

- Water pricing is resisted by powerful interests, especially those on canal heads, at the expense of those who are downstream.
- Government does not penalize farmers for water wastage despite impending water crisis and reduced overall agriculture production. With the largest network of canals in the world, Pakistan has one of the lowest water efficiency anywhere[110].

- Tax reforms is especially elusive with collection relying on indirect taxes and higher rates on those already paying. We have yet to see results from renewed efforts to curb tax evasion by the powerful.

- SOEs: By one estimate, SOEs preempt 33% of the federal current budget[111]. SOEs have been a puzzle for Pakistan. The crux of the matter is not whether they are state owned or in the private sector. Their preemption of large amounts of resources is one issue. A bigger issue is whether they serve the object for which they were formed. State owned power supply, travel, or telecom have been a source of poor service. Yet, even after their privatization, the efficiency or innovation in service delivery hasn't happened. K Electric and PTCL are prime examples. Even privatized banks have not improved credit availability for private investors.

- Manufacturing: Protection and overly favourable fiscal incentives have created inefficient sectors. Pakistani businesses pay higher tariff for power than their competitors and yet receive unreliable service. We allow high level of subsidies or protection to exporters of low value-added products which is a disincentive for them to produce new products (Figure 32).

- Patron-client relationship between public officials and political leadership: This is especially seen in the education and health sectors with high absenteeism and low-quality service. Political leaders do nothing to correct the situation. Lack of quality education and other services shows up in workers skills and managerial abilities[112].

Efficient allocation of resources are undermined when leaders promote policies and incentives to select special interests. They may do so to obtain campaign financing or for personal gains. But it comes at the cost of public goods for firms and the people. This means a higher cost of service to the people (power and other utilities) or low-quality service (education, health, sanitation). It exacts high cost on competitiveness and productivity.

Ideally, incentives between political leaders, public officials, and citizens must align totally. This is how the economy will transform. To begin with, there should be some correction in the preponderance of elite interests. We must also be cautious of 'reforms' advised or required by MFIs. Their recommendations about financial liberalization, market prices for farm and utility prices, or trade and exchange rate polices would do more harm than good. WB's private power

[110] Pakistan@100, Page 21
[111] Ibid, Page 19
[112] Ibid page 20

reforms have devastated our economy and broken the sector irredeemably. IMF's advice to do away with DFIs have stalled and reversed industrialization in the country. And their one size fits all insistence to privatize all PSEs runs contrary to evidence on ground.

Macro-economic factors

There is a mutually dependent relationship between macroeconomic stability and growth. Weak macro indicators prevent growth while low growth preclude improvement in these indicators. "The origin of Pakistan's frequent and recurring macroeconomic crises is structural, not cyclical"[113]. It means that it cannot be treated through short-term measures of cut and paste solutions. It needs a well-studied policy aligned with domestic situation, and one that balances growth with stability.

So far, our approach has been to avoid the next default, one that could likely occur in the next few weeks. No thought is given to avoiding a future crisis altogether and to focus on growth. This explains our record setting 22 visits to the IMF. Elite capture is part of the story and until such factors are treated with the same urgency as default and indebtedness, we will not rid ourselves of macro vulnerabilities. The fragile macro indicators result from:

- A revenue system that is unable to meet the government's financing needs
- Consumption-led growth that relies on external flows (remittances, aid) for its sustenance and is therefore very vulnerable to changes in flows
- Low savings and investments prevents capital accumulation

  - Pakistan must prioritize a set of steps that help remove the binding constraints on growth. External debt to meet operational expenditure must stop. Also, investment based on external debt that do not generate exports in required amounts, very quickly brings about a crisis.
  - Pakistan economy does not save enough to increase investment without resorting to foreign savings, nor does it manufacture enough goods to export and earn foreign exchange. Within its present framework, the economy can avoid an external crisis only if it functions at a low equilibrium with modest levels of savings, investment, imports, and exports and low GDP growth.
  - Growth when it has occurred in recent decades, has been one time only. It resulted from foreign aid flows. The economy does not have the factors in place to generate growth on a sustained basis. Resultantly, economic boom in Pakistan is followed soon by bust.

The weak macro indicators reflect in rising debt and debt servicing, Table 7-9. We have seen repeatedly that the economy cannot sustain this level of external debt. When plotted on a graph, it is a steep line going up with time. Total debt and liabilities was more than 100% of GDP by 2019. This is happening with no growth in output.

Because of the above many factors, Pakistan has been unable to create the pre-conditions for structural transformation of the economy. After meeting debt services and other essentials, the federal government is left with very little to support economic activity, Table 9. The table shows

[113] Pakistan@100, Page 4

also the challenges of increasing revenue. The Tables 7 to 9 and Figures 42 to 45 show the precarious debt and debt servicing situation.

Table 7:Pakistan Total Debt and Liabilities

Billion Rs.

	June 2007	June 2013	June 2018	June 2019
Total Debt and Liabilities	**5,024**	**16,228**	**29,879**	**40,215**
YoY Growth	**--**	**--**	**19**	**35**
% of GDP	**58**	**71**	**87**	**104**
Domestic Debt	**2,597**	**9,833**	**17,483**	**22,123**
YoY Growth				**26.5**
% of GDP				**57**
External Debt	**2,341**	**5,698**	**10,935**	**15,625**
YoY Growth				**43**
% of GDP				**40**
Total Debt	**4,935**	**15,531**	**28,437**	**37,748**
YoY Growth			**18**	**33**
% of GDP			**82**	**98**
Liabilities	**89**	**697**	**1,442**	**2,467**
Domestic	*--*	*470*	*820*	*756*
External	*89*	*227*	*622*	*1,710*
Source: SBP Pakistan's Debt and Liabilities Profile, All domestic liabilities are commodity operations				

Figure 42:

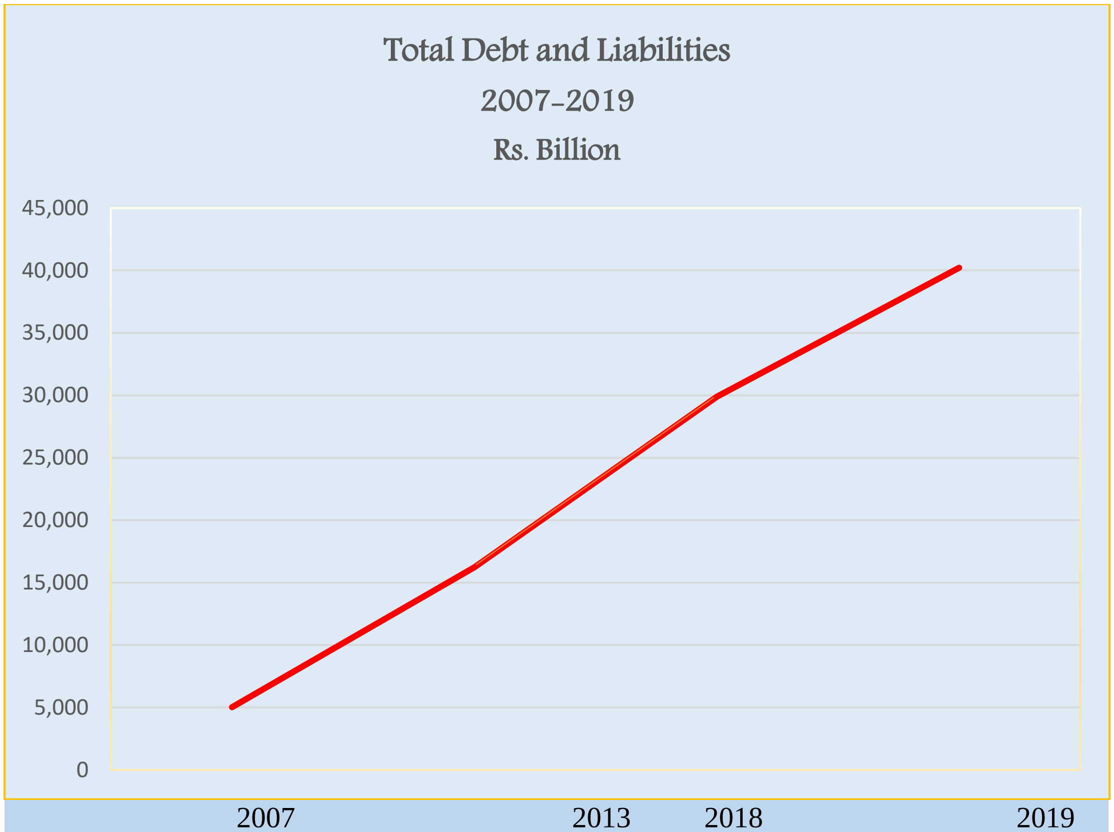


Figure 43:

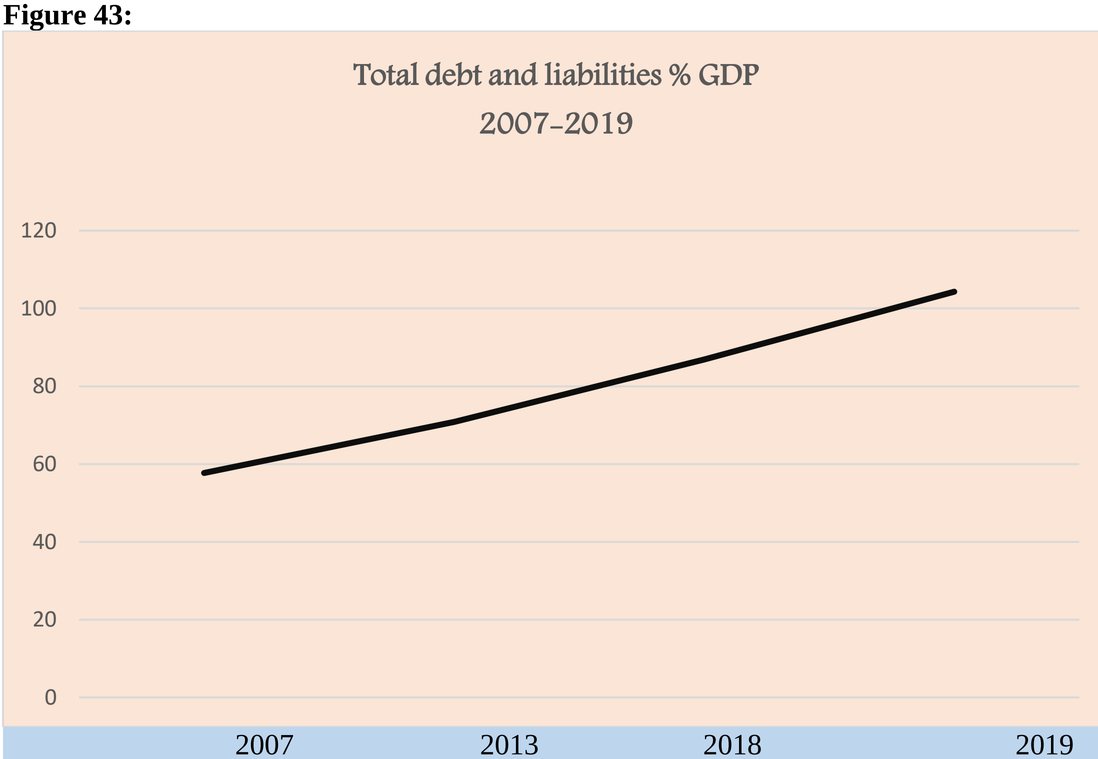


Table 8: External debt servicing FY 18 and 19								
	FY 18			**FY 19**			**+/- Principal**	**+/- Interest**
	Principal	Interest	Total	Principal	Interest	Total		
Public Debt	4,190	1,787	5,977	7,357	2,288	9,645	76	28
Private, PSEs, Others	988	530	1,588	1,297	645	1,943	-9	-1
Total	5,178	2,317	7,495	8,654	2,933	11,588	67	27

Figure 44

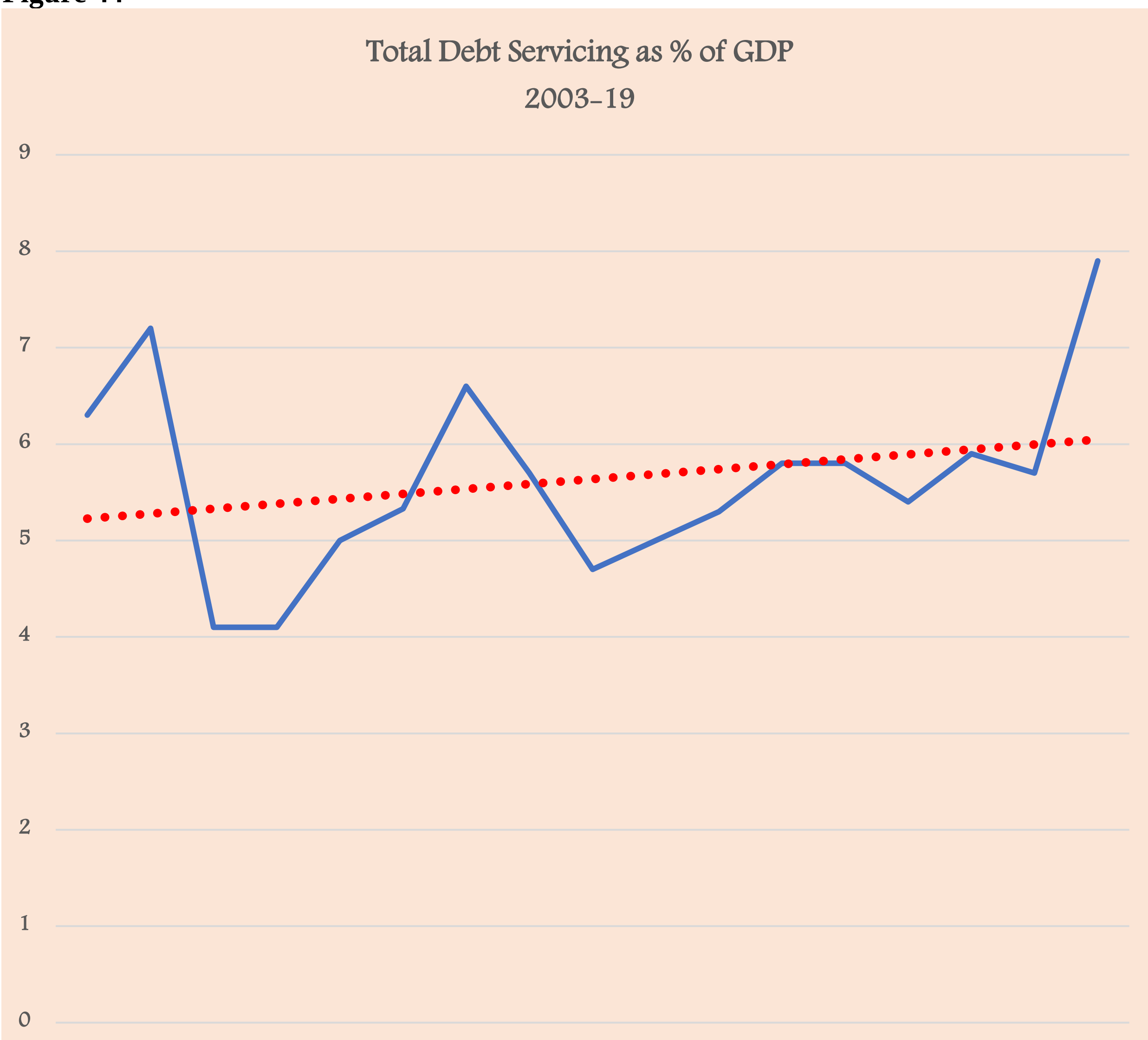
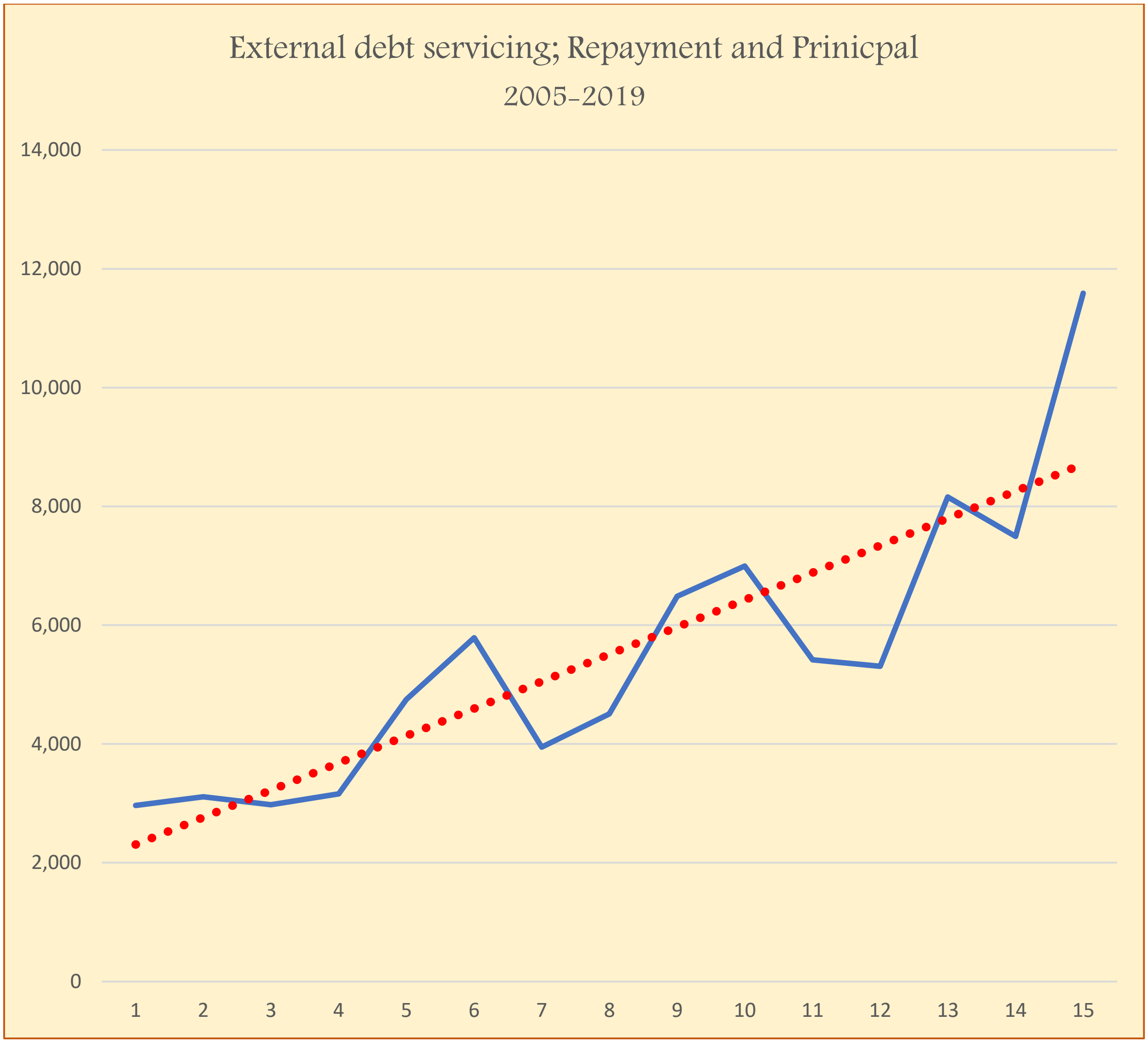


Figure 45:

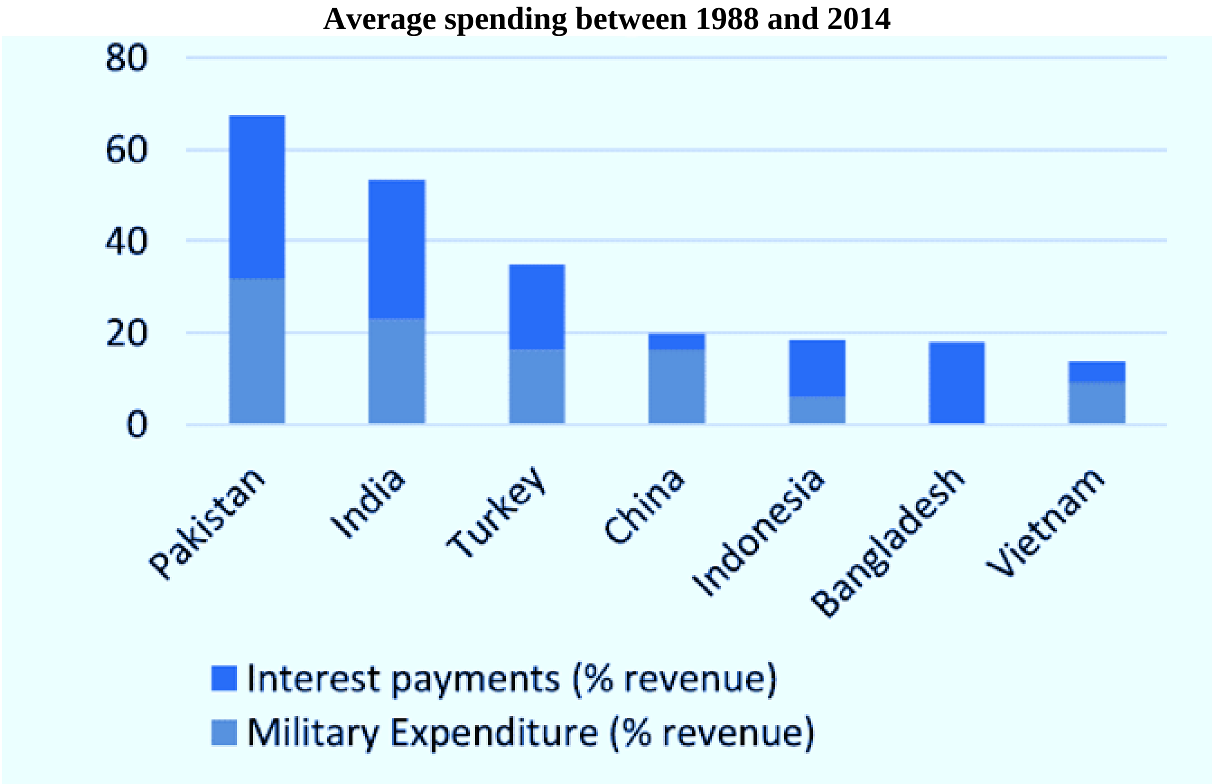


External debt servicing; Repayment and Prinicpal
2005-2019
14,000
12,000
10,000
8,000
6,000
4,000
2,000
0
1
2
3
4
5
6
7
8
9
10
11
12
13
14
15

Table 9: Expenditure and Revenue[114]				
		Expenditure		**Billion Rs**
	FY 18	**FY 19**	**% +/-**	**% of total FY 19**
Total Exp Federal **% GDP**	4,704 **13.7**	5,599 **14.5**	19.0	100
Current Exp. Fed **% GDP**	3,814 **11.0**	4,804 **12.5**	25.9	86
• Debt servicing	1,500	2,091	39.4	*44*
• Defence	1,030	1,147	11.4	*24*
• Pensions, grants, others	961	1,182	23	*25*
Sub-total	3,491	4,420	27	*92*
Balance for civil government Including grants, pension, and subsidies	323	384	19	*8*
PSDP	890	795	-11	14
		Revenue		**Billion Rs**
	FY 18	**FY 19**	**+/- %**	**% Share**
Total Revenue **% GDP**	4,066 **11.8**	4,072 **10.5**	0	
Total FBR **% GDP**	3,842 **11.2**	3,829 **9.9**	-0.35	100
Indirect	2,306	2,384	3.38	62
Direct	1,537	1,446	-6.0	38
Non-tax revenue	630	364	-53	

[114] Source MoF, fiscal operations data

Figure 46: Does Pakistan have the revenue to support its spending on debt services and the military[115]?



[115] Pakistan @ 100 Page 52

Inefficient allocations hinder structural transformation

Allocation of resources:

Pakistan needs policies to improve allocation in order to build productivity and competitiveness. This, as said before, has two steps. Allocation of government funds to more public goods that support businesses. Second, incentives through an industrial policy to move up the value chain to enhance productivity. Inherent in these measures is efficiency in public spending, so that it directly supports business activity. Also, it calls for effective and fairly enforced industrial policy to reward high performers. These two steps can bring about structural transformation in the economy. Government has a role in ensuring that resources go to the most productive uses. The whole purpose here is to enhance productivity through efficient allocation.

There are many sources of misallocation in Pakistan:

- Pakistan's public spending is meager, and what it spends is poorly used. For example, selection of projects is flawed, and priorities distorted. Services to firms and citizens are hobbled by a lack of priority by political leadership and patronage of officials. These factors reflect in our ranking in WEF's competitiveness index and in HDI.

- Pakistan has never had an industrial policy that incentivizes efficient industries to move up the value chain. Export promotion is not a key goal. Western experts, whose advice is important because of dependence on external savings, usually discourage this. Yet, East Asia shows that this is clearly a path to growth. Even in the West, state support through R&D and clusters is widespread[116]. "US is quite possibly the world's most complex economy. It supports a vast array of industrial sectors, operates through a thicket of government agencies and policy regulations that differ across industries and at subnational levels", [117]

- Lack of regulatory transparency in giving subsidies, and interventions to serve particular interests distort the economy. They hinder efficient allocation and disincentivize investment. Incentives do not create efficiency while imposing a cost on taxpayers.

- Despite assertions of probity, we have yet to see if the strong commitment to enforcing tax laws will be implemented uniformly. Tax policy is regressive, relying on indirect tax. It dampens demand, does not encourage investment, and still allows far too many exemptions. Import tariffs favour special interests. Frequent imposition of regulatory duties on import have the object of increasing tax revenue.

- Protection and continued liberal incentives to favoured industries that do not build exports, exact a high cost on the economy. They do not encourage firms to become

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116

117 Matthew R. Keller and Fred Block, Do as I say, or as I do? US innovation and industrial policy since the 1980s, Chapter 7, Page 221, Development and Modern Industrial Policy in Practice, edited by Jesus Felipe, Co-Publication of the Asian Development Bank and Edward Elgar Publishing, 2015

efficient or internationally competitive. Ineffective governance of key economic sectors, especially the financial, energy, autos and fertilizers sectors, may have reduced productivity, rather than enhance, by depriving firms in other sectors of crucial inputs. "Pakistan's economic policies have often been designed by a small elite such that the market is rigged in its favor, leading to inefficient outcomes"[118]. Governments in Pakistan have failed consistently to correct market failure in all these areas. In fact, they may have introduced distortions. It has not been able to coordinate between sectors.

- Other government intervention to address market failure, such as to provide training, technology adoption, or SEZs support almost do not exist. The capital market does not work to offer financing.

- SOEs receive subsidy even when they perform poorly. This drives up the fiscal deficit. Financing from the federal budget for SOEs have been high (Figure 47) and takes away much needed resources from public goods for business or citizen welfare. Debt guarantees further exposes government. The debt is not for capacity enhancement, but to meet operating losses.

- For a government that forever decries the poor state of revenue collection, it is remarkable how much money we spend on interest and on subsidy for PSEs and the power sector. Together they total about 2% of GDP. Military, debt servicing, and subsidies total over 10% of GDP, Figure 48.

- Hence, priority sectors of social services and infrastructure suffer. With these expenditure guaranteed, there are few incentives to improve spending efficiency. Additionally, Pakistan has also continued with skewed public expenditure that does not help growth.

- Policy response to the massive issues in say the power or water sectors is missing. Problems continue for decades.

We must also take a leaf from the East Asian book to better integrate the economy with the region. For example, the Republic of "Korea in the 1960s reformed its economic policy toward an outward-oriented strategy, emphasizing trade and the promotion of commercialization of agriculture"[119]. The Bank's assertion that "structural transformation in Pakistan .. seems to have stalled" is not surprising[120]. Trade facilitation is weak. According to the World Bank, Pakistan's trade with the region could triple. It estimates that compared to present trade levels of USD 18.5 Billion with the region, Pakistan's trade could go up to USD 58 Billion. Exports to India could grow by 45 times[121].

[118] Pakistan@100, page 46
[119] Pakistan@100, Page 16
[120] Ibid, Page 41
[121] Ibid, Page 51

Figure 47: Subsidy to SOEs

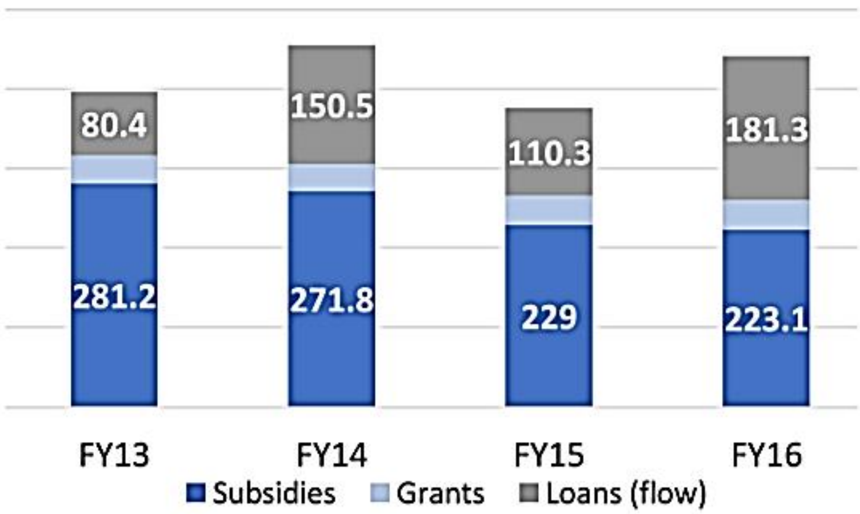
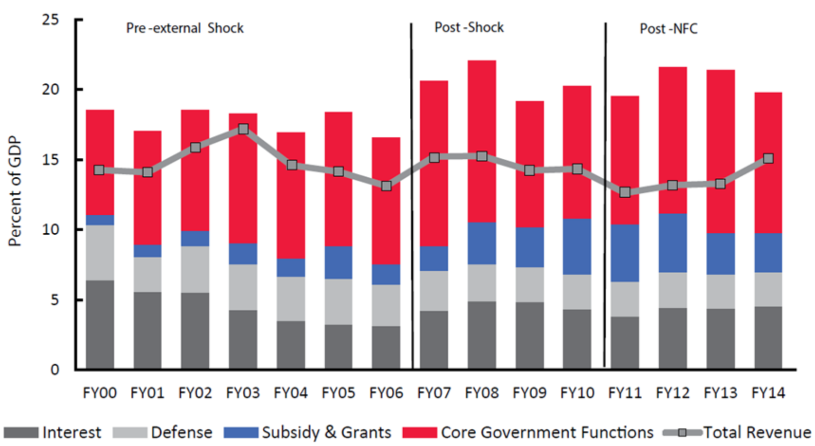


Figure 48: Breakup of government expenditure by %



II. Often, we have wasted available resources and that is because of our approach to economic policy

There is a myth that Pakistan's inability for sustained economic development is because the economy is starved of capital. Our low savings rate is certainly a factor. Of more concern, however, is how was the capital used when it was available. Several times since the 1950s, Pakistan has received extensive foreign aid. US has been a major donor , whose assistance is often grant, or with high grant content. Except for the 1950-60s, we have not seen its productive use in later years. On the other hand, CPEC assistance has added to the stock of physical assets. Chinese aid has come at the expense of a vulnerable external account. That is because commodity production declined even while we received the assistance with no increase in export that would help repay the assistance. It reflects a knee jerk approach to development.

Clearly, more than capital scarcity, our problem is how we use it. And that takes us to the issue of political economy. Where do we use the capital and to what end? Example of Kerry Lugar, CPEC and the rest. It is for all parts of the state to understand and agree on.

Pakistan benefited from capital inflows in the 1950s and 1960s. We rapidly industrialized, became self-sufficient in food grains, and built large storage dams after signing the Indus Water treaty. Pakistan set up institutions of learning and governance. These formed the basis of a dynamic economy. Since then, aid flows to Pakistan do not have much to show in terms of growth and development. They have been used to tide over external deficits.

In this century alone, on two occasions, Pakistan has received large sums of money. We did not allocate it to stimulate long term development. In the first decade, Pakistan completed three IMF arrangements (the PRGF and two standby). They equaled about USD 2.5 Billion. In addition, Pakistan received large grants from USA, post 9/11, and from other bilateral and multilateral partners. The grant amount was USD 7.850 Billion[122]. The sum of grant and aid committed was USD 37.7 Billion. Of this amount, USD 28.186 Billion were disbursed[123].

But there was more. Saudi Arabia allowed deferred payment for oil imports. This lasted five years and was never repaid. Paris Club agreed to reschedule the debt. In a liberal gesture, it rescheduled over USD 12 Billion with fifteen years grace and repayment in a total of 38 years[124]. Total amounts available to us between 2001 and 2007 was about USD 50 Billion. This is a massive sum.

With such fiscal space available to us, we were back to the IMF in 2008, with a 40% devaluation of the Pak Rupee against the US dollar. Between 2002 and 2008, our GDP growth rate never

[122] MoF Pakistan Economic Survey 2009-10, Page 88 Table 8.7 of Statistical Appendix
[123] MoF Pakistan Economic Survey many years and Tables
[124] Nayadaur.TV, Nothing Naya About IMF Deal: Pakistan's History Of Sleep Walking Into Debt Trap, Muhammad Ziauddin, May 29,2019

fell below 5% and peaked at 7.7% in FY 04. In the subsequent five years, our growth rate ranged between a paltry 0.36% and 3.8%. Why couldn't we use the resources of the first decade to build a production capacity to stimulate long-term growth?

That has to do with both donor priorities and a lack of any strategic economic direction by Pakistan. We "sleepwalked"[125]. Of the over USD 28 Billion grants and loans disbursed in the first decade, USD 11 Billion, less than 40% was project aid[126]. The rest was budget, policy reforms, or balance of payment support, money that was merely consumed and not invested. Lending agencies too have much to answer for such errant conduct.

We did this because there was no political will to reform to correct the massive structural imbalances in the economy (see the section titled Elite Capture). We have become used to the easy life of dependence on others and transferring debt to the next generation. Also, we chose to be caught in a "war of terror", the political and economic cost of which was huge. From trying to end terrorism in the region, we ended up being its victim.

The donors had their own agenda. USA helped to win our hearts and minds so that we would act as a "reliable ally in Afghanistan"[127] Most of the aid was for the military, including the euphemistically called, Coalition Support Fund. Between 2002 and 2010, USA budgeted USD 5.7 Billion in economic assistance and USD 13.1 in military assistance. Disbursed amounts were much less. But that balance between economic and military aid shows the development priorities of both governments[128]. (The numbers are in 2009 USD).

In the last twenty years, World Bank committed to Pakistan aid of over USD 24 Billion. Of this, USD 12.9 Billion, 59% was non-project aid. Project aid was USD 9.4 Billion or 41%. While project aid stimulates the economy, non-project finances go towards meeting the budget deficit. Pakistan's easy access to these funds have incentivized us to not reform and address the endemic elitism in the economy. World Bank's non-project aid come in many forms. They include PRESO, DPL, a budget support facility, and other policy reforms[129]. What this has meant is increase in debt burden, with no way to have the returns to repay them.

Yet, interest payment has continued to rise. In FY 19, debt servicing, defence, grants and subsidy was 81% of total current expenditure. Debt servicing alone was almost 40% of current expenses. Total debt and liabilities was 104% of GDP[130].

Since 2000, total loans and grants (including guaranteed loans) disbursed until 30 June 2019, was USD 86.9 Billion. Just 36% of this, USD 31 Billion, was project aid[131]. This is imprudent management of public finance. It reflects poor priorities and willful neglect of economic

[125] Ibid
[126] MoF, Pakistan Economic Survey 2009-10, Page 83, Table 8.3
[127] Center for Global Development, Beyond Short-Term Thinking: How to Spend Billions Well in Pakistan, for Them and for Us, Nancy Birdsall, Wren Elhai, Molly Kinder, September 2010.
[128] Guardian Data Blog, Sixty years of US aid to Pakistan: Get the data, July 2011
[129] PRESO is Poverty Reduction and Economic Support Operation, DPL is Development Policy Loan. Behind their high-sounding nomenclature, they merely tide over budget deficit.
[130] IPR Comments on Pakistan Economic Survey 2018-19, Page 8
[131] SBP Annual Report FY 19, Statistical Supplement Table 8.8

development in favour of coddling special interests. This approach leaves a majority of the population alienated from its own government. It also reflects poorly on the donors. In addition to skewed expenses, businesses see increased risks and common people see their welfare decrease through inflation, frequently devalued currency, and high interest rates.

All this happens because unlike the 1950s and 1960s, when Pakistan had a clear strategy to industrialize and improve human resources, our sole economic goal has been to avoid default on external account. Even here we have largely paid lip service. This is because, despite large inflows, our macro indicators have stayed weak at most times.

As we have not had a clear development strategy, the economy lacks also some fundamental elements of economic growth. Rather than pursue a major goal with national consensus, we have had a project-based approach to development. Examples of national goals are to industrialize, reduce external dependence, or invest in people.

Above goals cannot be achieved overnight. Work has to go on beyond the limits of an election cycle. Done seriously, pursuit of development goals must be regardless of short-term interests. East Asia has usually pursued long term plans over several decades.

Pakistan has relied on foreign assistance, not only for financial aid, but for ideas. Thus, donor strategy papers are written in foreign capitals not in Islamabad, as were the power policy (1994) or the social sector plans (SAP). Development is a belief. It cannot be outsourced to another country, as when we heard that CPEC was a 'game changer'. There "is an endemic shallowness in government" conduct[132]. That is entirely unhelpful for development. In fact, Pakistan has yet to build national consensus about how much of the pie must go to economic progress and how much to security. It has yet to have a clear policy about regional economic relations to support growth or to secure borders.

Nations have been impelled by their security concerns to quickly develop their economies. According to Albert Hirschman, the existential threat to a nation imparts greater urgency to stand on one's feet as an economically sovereign nation. This was the route to security that Japan, Korea, and Taiwan followed. Yet, Pakistan a nuclear power, has been comfortable in compromising its sovereignty because of a weak economy[133].

Instead, it has progressed on a single dimension of relying on external funds to pursue a mix of security and development. If this continues, we will be at IMF's doorstep forever. Aid money has been a major source of Pakistan's economic management. At present, Pakistan's external debt stock is over 40% of the Rupee GDP. It has been one of the highest recipient of aid in the world. And perhaps for the longest duration. We are in the company of some questionable economies, as one of the large recipients over many years. This has to change. Loans and credit must be used for a limited number of objects. For technical assistance, for export oriented private investment, and for large development projects with major economic impact.

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[132] Institute for Policy Reforms, Re-engineering Economic Structure: A Growth Strategy for the Long Term Ashraf M. Hayat*, Page 36

[133] Hirschman, Albert The Passions and the Interests, Political Arguments for Capitalism before Its Triumph, Princeton University Press, 1977

"Aid money can fuel corruption, enrich elites, and create resentment"[134]. Aid must support the country's economic strategy and not be guided by donor's agenda. This needs both competent Pak negotiators who have knowledge and skillful diplomacy.

Table 10: Stock of External Debt as % of GNI 2017

Pakistan	India	BD	Indo-nesia	Sri Lanka	Thai-land	Vietnam	South Asia	LMIC
40 (2019)	19.8	18.1	36	59	29.8	48.8	21	25

World Bank, International Debt Statistics, 2019, Table Pages 16-21

Figure 48: Project Aid is a small part of total aid received % 2000-19

Table 10 above compares Pakistan's stock of external debt with other South and East Asian economies. Pakistan's ratio of debt to GNI is way higher than the average for South Asia and for Low Middle Income Economies.

[134] Center for Global Development, Beyond Short-Term Thinking: How to Spend Billions Well in Pakistan, for Them and for Us, Nancy Birdsall, Wren Elhai, Molly Kinder, September 2010.

III. We have been at war for fifty years and that has taken its toll on the economy in terms of cost and opportunities foregone.

There is a mutually reinforcing relationship between national and economic security. They work together. Protection from external threats is necessary for an economy to function. A strong economy helps national security. Economic growth gives us the funds to make the necessary investment in armed forces and equipment.

More investment in public goods raises growth rates. This allows more funds for security. According to SIPRI, in 2018, India spent a total of USD 66.6 Billion on the military. The number given is in constant 2017 USD. Against this amount, Pakistan spent USD 12.7 Billion,19% of India's total (Figure 50). Yet, in terms of percent to GDP, Pakistan spent far more than India. Pakistan spent 4% of GDP on defence. India spent 2.4% of GDP (Figure 51). Spending five times more than Pakistan, the cost for the Indian economy is 40% less. As a percent of GDP, Pakistan is one of the highest spenders on military in the world. That is not because we are especially profligate. It is because the size of our economy is small compared to our security needs. We also spend a much higher amount per capita on security than India (Figure 52). This means a much higher cost for every Pakistani than for each Indian.

To secure the country, we must grow faster. But that cannot happen if we are forever under security threat. Fragile security affects us in several ways:

- It preempts resources away from providing public goods
- It discourages FDI inflows into the country
- It prevents regional trade, which as we see in East Asia, was key to forming the flying geese and production sharing.

Pakistan must rethink its regional policy and relations with our neighbours, to secure our borders.

Figure 50: Military Expenditure in Million USD: 1957-2018

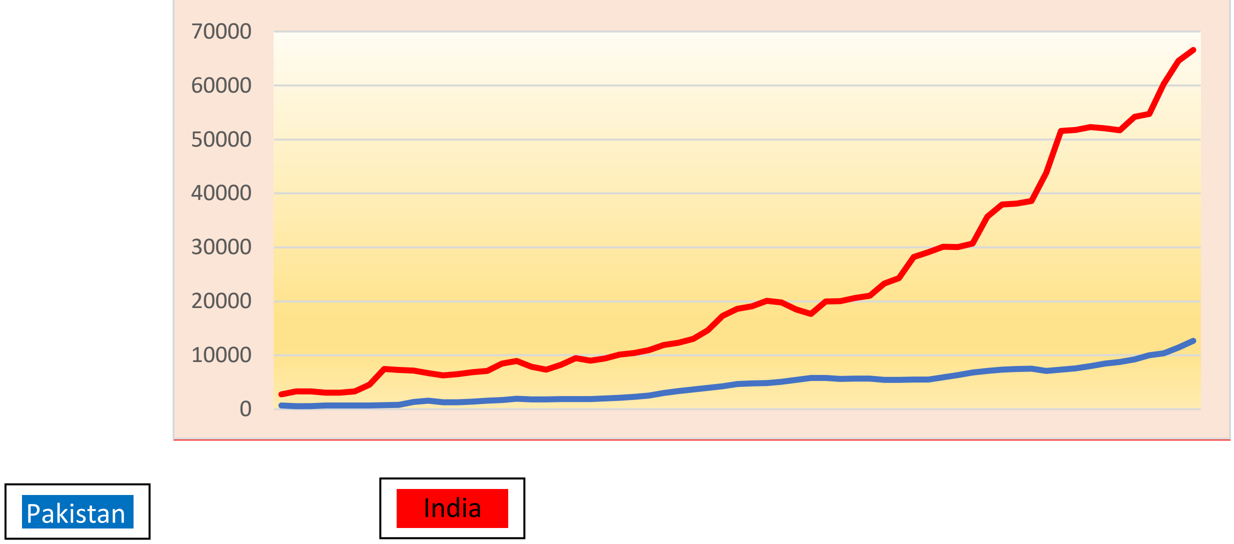
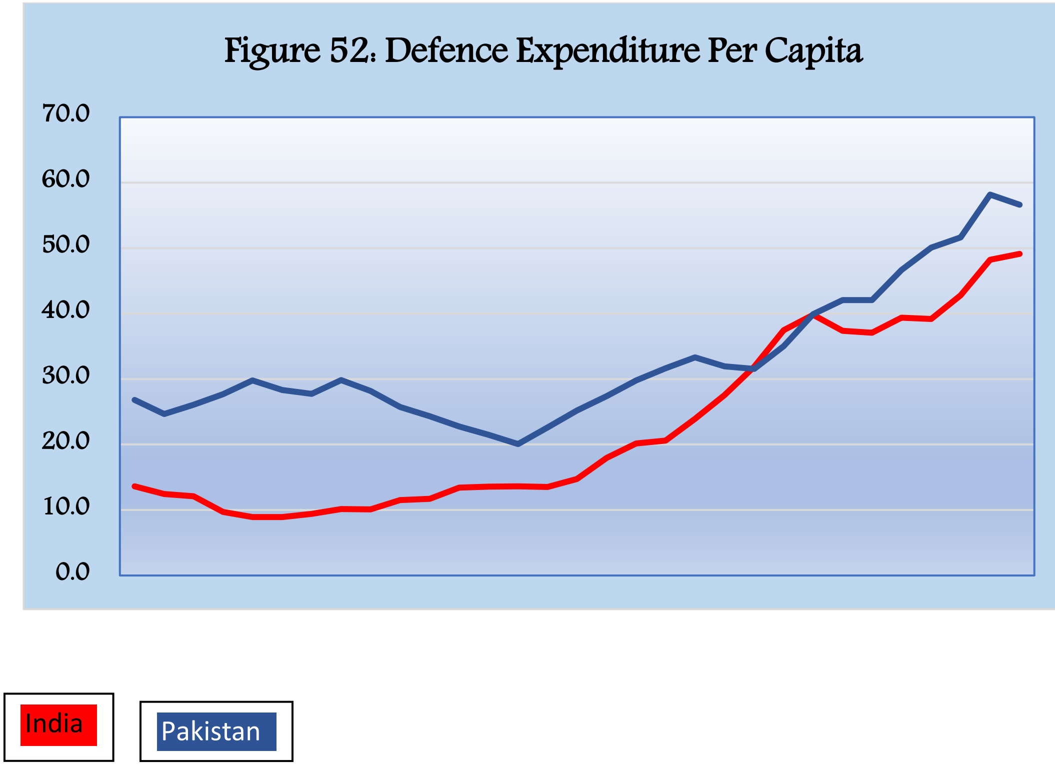


Figure 51: Defence Expenditure as % of GDP



While much needed, resources for defence must come at the expense of other investments in human and physical capital. However, before we blame national security for the dire state of our human development, I must refer to what Nobel Laureate Amartya Sen recently said about how this has played out in India. According to Professor Sen, "the neglect of education, health care, and social safety net has been so foundational in India, so deeply rooted in the class structure of the society, that to blame it all on national security would be a mistake[135]." The same is true for Pakistan. We do not prioritize human development sufficiently. And whatever funds we allocate it is not very well spent. That is because our political leaders do not consider it important enough and that reflects on the state of our economy.

However, being in a state of war has its price. Since the 1980s, we have been at war continuously. Even before, we had two major engagements in 1965 and 1971. The expense of our engagement in 1980s was met fully by US and Saudi Arabia. The 1990s saw frequent incidents in Afghanistan which invoked our presence at our cost.

After the Soviet pull out in 1989, the United States withdrew from the region and with it the attention of international agencies dwindled. Pakistan was left to bear the expense of hosting four million Afghan refugees that came to Pakistan to escape conflict imposed by the Soviet invasion.

There were also near confrontation situations on the Eastern border. In 1999, Pakistan also took the Kargil initiative. Since 2001, we have been deeply affected by regional instability. Unlike the 1980s, during 2001 to 2010, Pakistan had to keep an eye on its border with India in addition to the Afghan imbroglio. We were constantly harassed by the TTP. This resulted in several

[135] The Hindu, Amartya Sen: National security is one component of human security, September 6, 2016

operations, the Raahe Rast, Khyber I to IV operations, Zarbe Azb, Ruddul Fassad, the Swat operation in 2009 and many other skirmishes. This costs money. There is reason to believe that a different policy may have helped us avoid or exit from such security challenges.

To distance the forces from direct conflict, we raised parallel capabilities. This too happened at some cost. Added to all this is our nuclear programme. Again, this was necessitated by the regional security situation, but comes at a price regardless. Though we can safely say that, by keeping us safe, the benefits from the programme exceed its cost. Finally, we had a direct, though short confrontation with India in February 2019 when India breached our territory to attempt a bombing raid on Balakot.

Government has estimated the effect of the war in Afghanistan and ensuing terrorism on our economy. The Pakistan Economic Survey, June 2017-18, estimates total cost at USD 127 Billion[136]. This far exceeds the assistance paid to us by USA of which we are frequently reminded. And, there are other higher estimates of the cost. One expert estimates that the direct and indirect cost to Pakistan of the war in Afghanistan 2001 to 2108, was USD 252 Billion. This estimate includes direct military costs, security, law and order expenses, loss to infrastructure and property, and resettlement of IDPs. Indirect cost include loss in investment and the resultant loss in GDP, lower economic activity, especially because of lower travel into Pakistan and tourism, lower growth in market capitalization[137].

Moreover, it is hard to put a cost on the loss of 70,000 Pakistani lives, both security personnel and civilians. This is just one war. Pakistan has seen continuous belligerence on its borders for decades and has had to deal with its consequences. Nor can we quantify the cost of human hardship faced and the psychological effect of trauma on people, especially children.

Constant conflict and friction in the region has meant that Pakistan has not been able to integrate its economy with the region. This is the opposite of how East Asian economies progressed through production sharing and trade. The South Asia region is the least integrated region of the world. This naturally affects regional growth and industrialization.

Experts have studied the effect of military expenditure on a number of macro indicators. They include aggregate demand, inflation, trade balance, use of foreign exchange, and industrialization. When tested “against third world realities, the economic effects of military expenditure has been negative”[138].

Even where military expenditure boosts demand and therefore GDP growth, we must look at the quality of growth. There is a difference between growth from one-time spending and from increase in production capacity. The latter reduces poverty, promotes industrialization and exports, provides better services, and civilian jobs. Development leads to higher standards of

[136] MoF, Pakistan Economic Survey 2017-18, Annexure IV, Pages 247-248
[137] Hafiz A. Pasha, Growth and Inequality in Pakistan: Agenda for Reforms, Friedrich Ebert Stiftung, 2018, Page 48
[138] Nicole Ball, Military Expenditure, Economic Growth and Socio-Economic Development in the Third World, Ibero-Americana, Nordic Journal of Latin American Studies, Vol. XII 1-2, 1983, pp. 5-20

living for the majority of people. Even if military expenditure stimulates growth “the poorest members of developing societies are the least likely to benefit”[139].

Inequity is especially pronounced where military expenditure is high. This is shown by several research conducted in vastly different environments. They have been carried out in USA, Turkey, and Pakistan. All of them come to similar conclusions with a few things established beyond doubt. That higher defence expenditure increases income inequality[140] and also increases poverty[141]. One research also finds that while increased military spending increases poverty, personnel expense reduces poverty. Military procurement and O&M enhances poverty[142]. Virtually identical results were seen in a research in Turkey[143]. Similarly, research on defence expenses in Pakistan finds that “that higher military expenditure leads to higher income inequality in Pakistan”[144].

Role of military or any elite group in growth has had varied effect. East Asian economies have all been authoritarian developmental states. The successful ones among them, never lost sight of their commitment to development. In other countries, elite capture has worked to the detriment of the economy. “the bulk of the available evidence suggests that, on average, democracies do not grow much faster than nondemocracies”[145]. Be they democracies or otherwise, those that achieved growth were inclusive and gave their people good governance. They invested in a major way in raising human capital. In Pakistan, both democracies and other governments did not focus on human capital.

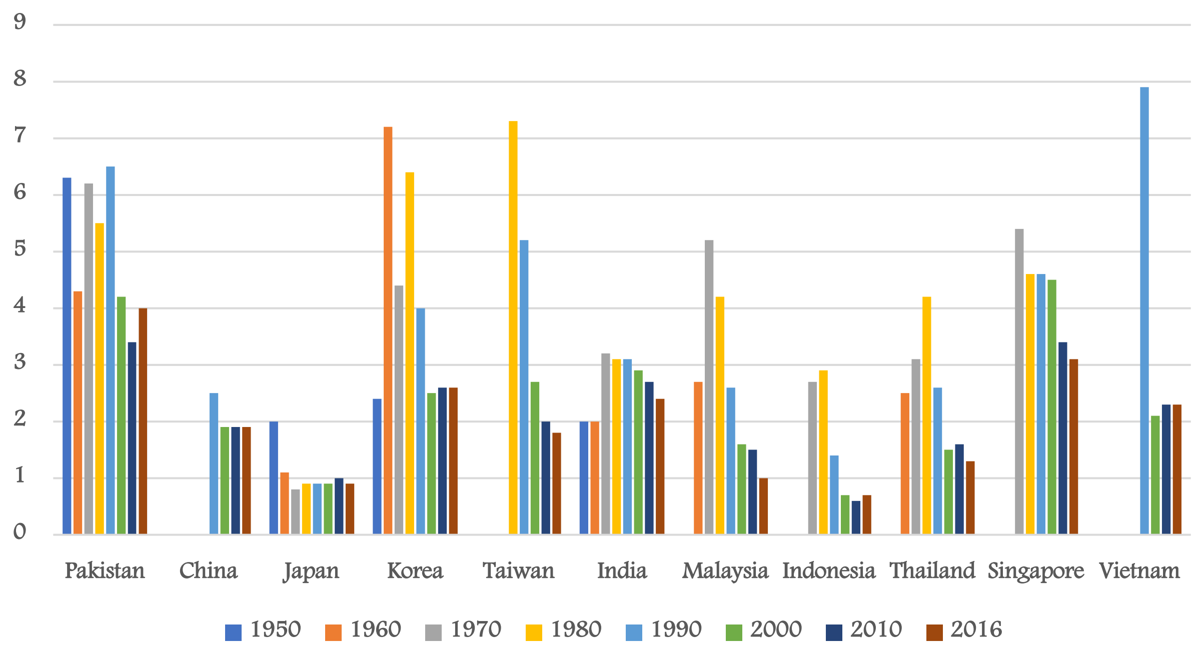
These are important considerations for development. To paraphrase Amartya Sen, “security ultimately is a matter in which the leading concern should be around human life. So, if we are speaking of security, it has to be human security. Since this also means security from external threats and violence, what we call national security is only one of the constituent factors in human security.[146]”

[139] Ibid: Page 19
[140] Abell, John D., Military Spending and Income Inequality, Journal of Peace Research, vol. 31, no.1, 1994, pp. 35-43
[141] Henderson, Errol Anthony, Military Spending and Poverty, The Journal of Politics, Vol. 60, No. 2 (May 1998), pp. 503-520
[142] Ibid
[143] Unal Tongur and Adem Y. Elveren, Military Expenditures, Inequality, and Welfare and Political Regimes: A Dynamic Panel Data Analysis, University of Texas Inequality Project Working Paper No. 61, June 12, 2012
[144] Syed Ali Raza, Muhammad Shahbaz, Sudharshan Reddy Paramati, Dynamics of Military Expenditure and Income Inequality in Pakistan, Springer/Researchgate, April 2017
[145] Acemoglu, Daron Introduction to Modern Economic Growth, Page 833, Princeton and Oxford University Press, 2009
[146] The Hindu, Amartya Sen: National security is one component of human security, September 6, 2016

Table 11: Military Expenditure % GDP
Selected Asian Economies

Country	1950s	1960s	1970s	1980s	1990s	2000s	2010	2016	Avg
Pakistan	6.3	4.3	6.2	5.5	6.5	4.2	3.4	4.0	5.1
China	--	--	--	--	2.5	1.9	1.9	1.9	2.5
Japan	2.0	1.1	0.8	0.9	0.9	0.9	1.0	0.9	0.9
South Korea	2.4	7.2	4.4	6.4	4.0	2.5	2.6	2.6	4.0
Taiwan	--	--	--	7.3	5.2	2.7	2.0	1.8	3.8
India	2.0	2.0	3.2	3.1	3.1	2.9	2.7	2.4	2.9
Malaysia		2.7	5.2	4.2	2.6	1.6	1.5	1.0	2.7
Indonesia		--	2.7	2.9	1.4	0.7	0.6	0.7	1.5
Thailand		2.5	3.1	4.2	2.6	1.5	1.6	1.3	2.4
Singapore		--	5.4	4.6	4.6	4.5	3.4	3.1	4.3
Vietnam		--	--	--	7.9	2.1	2.3	2.3	3.7

Figure 53: Military Expenditure % GDP



5. Findings: Developing a model for Pakistan

In our long journey to this point, we have seen how ideas on the subject of development evolved and put to practice in many parts of the world. We saw also how, based on an accepted role for the government, East Asia used these ideas for rapid growth. Industrial policy was their preferred path to development. This was buttressed with macro stability, open markets, and production sharing. The goal was to upgrade the industrial structure.

This paper's chosen method is to look at causal relations to find out why some economies do well, and others don't. We have reviewed the "structural factors (that) distinguish the experience of those who enjoy high … standards of living" from those who are not there yet[147]. The effort is to analyze if and how these relationships can be reproduced in Pakistan. It does not help to cherry pick best practices. We must understand and apply the process of economic growth. Certain conditions underpinned success of the East Asian model. These as we know already are political and macro stability and international trade.

Development through industrial policy is a rigorous path that calls for state effectiveness. It needs also great discipline in policy formulation and execution. At the base of government polices lies the institution of the nation state. East Asia provided their citizens an effective state with essential services and rule of law. Largely, most of the states are perceived as just and fair by citizens.

So, let us see if Pakistan as a state has the ability and means to promote growth. With development literature in mind (Section 2), we compare what East Asia did (Section 3), and how Pakistani policy is framed (Section 4).

Has Growth ever been a priority, why Pakistan has not pursued capital accumulation, technology, and a business climate for growth? Can the Pakistan state embark on a programme of economic growth and development?

The Table below compares Pakistan's approach to the East Asian approach. It is separated into two. We first look at issues at the level of the state. This part of the table compares political, social, and security indicators. The second part compares economic policies of Pakistan with East Asia.

The two parts are inherently linked, and they may overlap at times. But separating the indicators into two helps clarify the roles needed to be played by all parts of the government.

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[147] Christopher B. Barrett, Cornell University, Development Economics: An Overview, Researchgate, June 2008

What East Asia has Done	Pakistan's Approach
Readiness of State	
East Asia actively pursued: ▪ Political stability ▪ Social Cohesion ▪ Regional economic integration It has been keen to leave behind the pre-war baggage, even if it keeps showing up every now and then.	▪ No monopoly on violence ▪ Writ of the state absent in some areas ▪ Frequent shocks and protests, often inspired ▪ Friction among ethnic groups. No statesmanship to build harmony ▪ Trade with neighbours not possible The Pakistan state has done nothing to reduce political and other friction. In fact, it may have aggravated it.
▪ A strong commitment to regional peace and stability. Internally, high level of political stability and orderly transfer of power	▪ Very fragile security environment in Afghanistan, Gulf and on the Eastern border. ▪ High military expenditure ▪ Fragile democratic institutions ▪ Weak accountability
▪ In several countries very strong autonomy for decision making bureaucrats. In other countries influence peddling limited	▪ No bureaucratic autonomy. Civil servants always under political pressure and affected by lobbies.
Approach to Economic Policy	
What East Asia has Done	**Pakistan's Approach**
A favourable business climate for firms based on: ▪ policy support ▪ macro stability ▪ access to credit ▪ provision of public goods ▪ close regional trade relations and, ▪ a legal framework that encourages well-functioning markets and respect for private property	Unhelpful business environment: ▪ Macroeconomic indicators that are perennially weak and on life support. Figures 11-14 ▪ Frequent external account emergencies. ▪ Credit to private sector as % GDP has declined, Figure 36 ▪ Weak support from public goods. In fact, lack of power, energy, water supply work as impediment to businesses. We have one of the lowest human development indicators in the world, Figures 27,54,55 ▪ Pakistan is entirely disconnected with the region. South Asia has the lowest regional trade levels. Figure 22 ▪ Lack of governance support and frequent surprises for businesses
▪ Capital accumulation with especial emphasis on domestic savings[148]	▪ High reliance on foreign savings even for operational expenses. Capital accumulation last preference ▪ No priority for improving human capital quality ▪ Whimsical approach to building physical assets Even the minimal capital accumulation is without strategy
Well thought out agenda for development: ▪ Industrial policy paramount instrument	No economic strategy exists nor is there consensus about growth: ▪ Policies respond to situations and lobbies; they don't serve long-term purpose. ▪ Conceptually, episodical projects are equated with growth.
▪ Manufacturing and its continuous upgrading a key goal	▪ Manufacturing as a share of GDP has declined (Figure 30)

[148] Capital accumulation is the process of acquiring additional capital stock, used in the productive process. It includes building physical assets infrastructure, factories, or machines etc., as well raising quality of human resources. It also includes portfolio investment or raising other assets such as housing. This paper mostly means increase in physical and human capital stock.

▪ Industrial sequencing	▪ We have made no progress in productivity or innovation (Figure 27 and 32) ▪ Goods produced have not changed, nor has export products improved ▪ Our key export products are no longer competitive in global markets. Industry needs exchange rate support and fiscal support to export. We have infant industries that re six decades old. ▪ For decades, many products are manufactured with high tariff protection. They cannot compete with imports. ▪ Government support is sought by industry as entitlement. They are not linked to performance
▪ Government and private sector in constant exchange of ideas and information ▪ Government very active with policies in support of growth and welfare.	▪ Policy stasis in Pakistan in all areas. Policy is reactive and looks for temporary and quick fixes ▪ Government and firms do not work as equal partners in the national cause of development ▪ Firms have rentier approach. No incentive to upgrade for influential firms. ▪ Others receive no support ▪ No trust between firms and government
▪ Continuous increase in production	▪ For twenty years, production of goods has declined in the economy, see Figure 15 ▪ No awareness of the dire situation ▪ Growth in economy is from services. Pakistani services are not internationally competitive.
▪ Deep regional and global trade linkages, good logistics, and facilitation ▪ Efficient supply chains between upstream and downstream manufacturing ▪ Close production sharing arrangements ▪ High levels of FDI to transfer new skills and technology	▪ Cut off from South Asian region. Restricted trade with Afghanistan because of security issues, and with Iran because of sanctions. ▪ No links between industries of the region (not even with China) ▪ Very low FDI and not in export-oriented manufacturing
▪ In several countries very strong autonomy for decision making bureaucrats. In other countries influence peddling limited	▪ No bureaucratic autonomy. Civil servants always under political pressure and affected by lobbies.

The above Table reconfirms, if confirmation was needed, that we are up against a herculean task. There is much work to do if we want to go beyond lip service to growth. To summarize, the Pakistan state does not:

- Offer the political, security, and social cohesion, which is the first step needed for long-term growth. The fragile region does not encourage trade and product sharing arrangements.
- The business climate is less than encouraging with frequent macro-economic emergencies, lack of public goods, poor access to credit and weak governance. Enforcement of contracts or issues of property rights are slow and uneven, especially for those with no influence.
- There is no growth strategy, nor an industrial policy to encourage manufacturing and gradually upgrade to new products.

- Added to this are new challenges (but also opportunities) for low-income early stage economies[149]:

    - Digital technologies are a threat to labour intensive manufacturing
    - Climate change challenge low income economies the most
    - Some low-income economies, including Pakistan, still have rapid population growth.

These changes are taking place along with shocks to the multilateral world trading system. Still, it is never too early to begin a reform programme and progress, even in gradual steps, to meeting the above challenges. No country can meet these huge challenges in the short term. We cannot postpone the growth programme. It has to be an incremental approach. For now, Pakistan may:

- Express clear resolve to remove state's fragilities
- It should also begin to improve governance
- It should begin work on the business climate
- Announce an earnest growth strategy

These shifts in approach would instill confidence. Pakistan is a populace country of dynamic people. The state must show resolve and commitment.

State and the nation state

For economic growth we need an effective state as well as a national identity. Several East Asian states are predominantly single ethnic entities. They have a unitary form of government. Malaysia, a state with more than one identities, made especial effort to correct inequities between the majority Malays and the city elites.

In a multiethnic country, it is easier to build a state than a nation state. Becoming a nation states requires wisdom and extra effort. To build a state requires setting up organizations, such as the military, parliament, judiciary, tax collection agencies, the police and other parts of the executive.

Creating a nation state means that all identities within the state have a stake in the supra entity. So that each person is willing also to rise above their ethnic identity. The latter calls for creating "symbols, shared historical memories, and common cultural points of reference".[150] This in turn depends on the state's policies on "language, religion, and education"[151]. Often poets, musicians, and philosophers would create symbols of a nation. Pakistan's great Sufi traditions found in each province can be a great binding force.

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[149] Spence, Michael, The world's next big growth challenge, according to a Nobel laureate, World Economic Forum with Project Syndicate, 3 May 2019
[150] Fukuyama, Francis. Political Order and Political Decay: From the Industrial Revolution to the Globalization of Democracy (Kindle Locations 3380-3381). Farrar, Straus and Giroux. Kindle Edition.
[151] Ibid

"Nation building is critical to the success of state building"[152]. Examples abound in Pakistan of how we may have fallen short. It has been forty years since government announced its plans to build the Kalabagh storage dam. The dam would have helped the economy of the whole country. Not building it, has reduced the benefits of the Indus Water Treaty. The dam hasn't been built because two of four provinces objected. While building the Gwadar port, the central government had to commit to Baloch politicians that the majority of recruits and works contracts in any government project would be from within the province. This flies in the face of merit considerations and labour mobility. Yet, it was a wise leader who preferred harmony at the cost of efficiency.

It is not that the identities that oppose such moves are less patriotic. It shows a lack of trust. Only when the leadership begins to understand the perspective of all parts of the country, can it build consensus around controversial projects. Positioning any initiative as an 'Us Vs Them' is a proposition that is dead before it even begins.

Fukuyama says that the many ills that haunt developing economies, from corruption to tax collection, are because we consider our obligation to the family or tribe above those to the nation. But in order to modernize, this has to change. Having a strong national identity doesn't mean suppressing any single identity. In fact, more than ever it means respecting individual identities and yet for each of them to have the faith to voluntarily suppress that identity when needed[153].

A person can be very local when it comes to culture, city roads, or sanitation. She has to think at the national level when it comes to taxes, defence, and foreign relations. More so, she must think in regional or global terms when it comes to trade, FDI, and production sharing. There is a missing link in Pakistan's national consciousness.

To industrialize, a society needs supra national symbols to meet the needs of labour mobility and commercialism. Pakistan has some work to do in this regard. This is the task for politicians to deliver. The large military footprint on the nation works in the opposite way. Parade ground rules do not work in sensitive matters.

First step is to recognize where we are:

Even as a state, Pakistan has much work to do to gain the trust of its citizens. East Asian economies, especially the early beginners were already cohesive and effective entities when they began. They too were encumbered by friction and wars. Pakistan's security problems are not much greater than East Asia's experience. So, just because we are in the wrong neighbourhood is not reason enough.

Our leaders have not done enough to build an effective state or a national identity. The state stands weakened in many ways. Below is a list of how the state is compromised. The list is long, and it will be a while before the country solves these problems. Yet, growth does not have

[152] Ibid
[153] Ibid 3388-3397

to wait. We can embark on a growth programme even as we resolve these. They are recounted merely as challenges, which the Pakistan policy makers must recognize. In fact, growth itself may take care of many of the problems.

A growth programme calls upon many players to play their role. Yet, they will do so only if they have the faith that the state can and would keep its end of the bargain.

Several issues mar the state's ability and effectiveness. They are[154]:

- Violence is not the monopoly of the state. Religious extremists, militias, and madrassahs are armed and challenge the state. In cities, and on the Western borders, there are 'no go' areas.
- As the government does not do so, people have to privately access essential services for themselves. They must have their own security, drinking water, schooling, and health services. This is expected of all economic classes, including those who do not have the means. The affluent will have their own backup electric power and other such services. To the citizen, the state seems a manifest failure.
- Pakistan has been swept away by external influences and developments. This has had vast effect on its security, society, and economy. The contest between Iran and its Gulf neighbours gets played in Pakistan, often in very violent ways. Afghan government's inability to control drugs and instability in Afghanistan spills over to Pakistan in the most egregious ways. Millions of refugees have entered Pakistan. The state seems a bystander.
- "US influence also highlights the comprador and co-opted nature of the institutions of Pakistan's state, especially the military and government. A complicit and comprador civil and military elite is unable to develop national and nationalist agendas"[155].
- Such state failures give legitimacy to any alternative ideology. For example, sharia law acts
  as a beacon of hope and a symbol of good governance for those who feel abandoned by the state[156].

Many more examples of state's dysfunction leave citizens wondering about its intent and ability. Having painted the direst picture here, let us see what the possibilities are. Despite the above, Pakistan must begin a major programme of development

"Government is an institution which prevents injustice other than such as it commits itself.", Ibn Khaldun

[154] Zaidi, Akbar Rethinking Pakistan's Political Economy, The News on Sunday, 9 February 2019
[155] Ibid
[156] IPR, Strategy not Tactics: Better Governance for Social Stability in Pakistan, Page 2 quoting Noah Feldman The Fall and the Rise of the Islamic State, A CFR Book, 2008 Princeton University Press, pp. 19-20.

Role of State

The above list is daunting, but Pakistan has faced many problems before. There is nothing that the resolve of a committed leadership and well thought out policies would not solve. This has to be done. We have no other option. Different parts of the state must agree to play their role.

Barrett (2007) finds that past experience of former colonial states shaped the later evolution of their institutions. These institutions stayed on the path of inequality and exclusion that colonial governments had forced upon them[157]. Elites of successor governments often preempt to themselves excessive power. This also decides the distribution of assets. It "limited the options of the poorer members of society"[158]. As seen before, Amartya Sen is of a similar view[159]. Recognizing this matter is the first step to improving policies. As in Malaysia, long term steady effort will correct the seeming disregard of common good that we see in Pakistan.

To embark on a growth agenda, government must make a conscious effort to change its policy priorities. In the case of Pakistan, in addition to its extortionist policies, an extra dimension affects the state. Pakistan's policy makers have been especially casual and capricious with the state, in their tolerance for internal instability. The state is a precious institution. It has been with us for a mere couple of hundred years. It must be nurtured and developed with care. We can no longer treat it as carelessly as we have done so far.

Pre-condition Policies

From a review of state's readiness, we move now to the pre-conditions for growth. If Pakistan makes hard political choices to correct policy priorities, it can begin to act on the essential starting points for a growth policy:

- Ensure macroeconomic stability
- Invest in human capital
- Improve infrastructure services

We have dealt elsewhere with the importance of macroeconomic stability. Pakistan's high fiscal and current account deficit is a choice we opt for. It does not happen on its own. In order to know, why this has been a regular pattern, one merely must see whom the deficits benefit and whom they hurt. This can be done by analyzing where the money is spent and where it comes from. In the previous section, this paper has shown where the bulk of spending goes.

Regarding revenue, sixty percent of it comes from indirect taxes. It is certainly not progressive, as it unfairly burdens the poor. Moreover, a lot of the direct taxes also have an indirect content. They are deducted at the point of transaction as withholding tax. Voluntary taxes based on annual returns is a mere 14% of FBR revenue. After adjusting for corporate taxes, individual tax is less

[157] Barrett, Christopher B, Development Economics: Critical Concepts in Development Studies, Page 38, (based on research by Douglas North et.al.) Routledge 2007 (Via ResearchGate)
[158] Ibid (based on Acemoglu).
[159] See Page 65 of this paper.

than one percent of GDP[160]. This suggests that those that have the most ability to pay get away with paying very little. Reforming revenue and expenditure are key to macro stability. Controlling the twin deficits is important or else growth on a sustained basis will not happen. This depends on policy maker's resolve.

The deficit will occur only if decision makers want it to occur.

The other factor is to increase savings rate. Partly, this is because of the high budget deficit that the government regularly runs. Partly, it is the result of structure. Much of household savings is informal. Also, real rates of returns on savings are negative in some years[161]. Most of all, only a small percent of Pakistanis have bank accounts.
Pakistan economy does not save enough to increase investment without resorting to foreign savings, nor does it manufacture enough goods to export and earn foreign exchange. Contribution of foreign savings to investment ranges between 20% to 35%[162]. This is almost all debt not equity. Within its present framework, the economy can avoid an external crisis only if it functions at a low equilibrium with modest levels of savings, investment, imports, and exports and low GDP growth.

If we do not change priorities, we will not have the means to provide public goods to the economy. Public goods along with, access to credit, and incentives in an industrial policy is the means to change the economy's comparative economy[163]. We cannot let Western experts decide for us our comparative advantage. We must make that shift in steps.

The industrial policy will not work without economic stability and capital accumulation. Stability gives confidence to investors. It suggests that they would not have to deal with frequent exchange or interest rates adjustment. Inflation too would be stable. A necessary condition of stability is debt to GDP ratio. The ideal is that government spend more funds on public goods than on creditors, especially external.

The Finance Ministry must have built in stabilizers. It is hard to understand how they allow the debt to GDP ratio, or its twin, the fiscal deficit grow to the levels that we have seen of late. Should they not have a policy to avoid a crisis. SBP has not played its role. It is mandated to ensure that government observes the borrowing ceiling placed on it. Yet, borrowing has gone on with abandon. This is nothing but dereliction of duty and negligence.

There are indictors that a crisis is looming. SBP and MoF must be alert to these[164]:

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[160] Planning Commission of Pakistan, Report of the Panel of Economists Medium-Term Development Imperatives and Strategy for Pakistan, April 2010
[161] Planning Commission of Pakistan, Final Report of The Panel of Economists Medium-Term Development Imperatives and Strategy for Pakistan, April 2010
[162] Ibid Page 28, Table 14
[163] Ito, Takatoshi, Japanese Economic Development: Idiosyncratic or Universal? Page 20
[164] IPR Research and Griffith-Jones, Stephany, Causes and Lessons of the Mexican Peso Crisis, World Institute for Development Economic Research, Working Paper No 132, May 1997

- Current account deficit is the first, which goes without saying. The current account balance worsened suddenly in FY 2017 when it rose to 4.1% of GDP from 1.7%[165]. Clearly, this was unsustainable.
- Despite this, Pakistan did not adjust Rupee value. Of course, this would have added to inflation, but that too was a necessary adjustment. To guard against inflation, government recklessly kept an overvalued Rupee. Inevitably inflation rose once the Rupee adjusted. The more adjustment is delayed the more it hurts.
- Pakistan borrowed short term commercial paper at high cost. There was no justification for this. This helped keep Forex reserves high. As their tenure was limited, they were either rolled over or we borrowed in greater amount to service the debt. Tens of billions of high cost debt were put in service of a high exchange rate.
- As the crisis shows, the reserves were on quicksand and disappeared very quickly. It is not the amount of reserves that matters, but what the reserves consist of. East Asian reserves are built on exports and FDIs.

There were several voices that warned GoP about the dangerous path it had chosen. These voices were labeled as naysayers. Policy makers basked in the uninformed glory of praise by Western newspapers and magazines[166]. In an unusual paean, Forbes said that "Pakistan has the potential to be a global turnaround story". Washington Post extolled our virtues by quoting a fund manager who called Pakistan "the best, undiscovered investment opportunity in emerging or frontier markets"[167]. Except that portfolio investment is good for savvy investors, but fleeting for an economy. There is no substitute for good fundamentals.

The crisis that followed was almost unprecedented. Economic activity has slowed, and jobs have shrunk. The effect of economic slowdown has spilled over also into the financial sector. Banks' non-performing loans have grown. risking a financial crisis as, in addition to the stock market crash.

IMF orthodoxy was necessary. But let not the cure be worse than the malady. Whether under IMF advice or voluntarily, government has taken steps that have brought the economy to a halt. Just when we needed to restore demand, we imposed conditions on transactions. An economy is nothing if not the sum total of transactions. When transactions stop, the economy halts. This is especially risky when the bulk of tax revenue comes at the stage of transactions.

In recent years, government's exchange rate policy too has been a travesty. They have faulted on both sides. First, by sticking to an artificially high rate. Then, they swung the other way to a rate that, along with the bank rate, brought an end to economic activity. Sudden currency volatility raises the expectation of further decline. This leads even more to outflow of funds. The only beneficiaries here were currency speculators. Their cause seems to have been served well.

[165] MoF, Pakistan Economic Survey, 2017-2018, Statistical Supplement, Page 116, Table 8.2
[166] Runde, Daniel, Pakistan: The Next Colombia Success Story?, 3 August 2015. See also Pakistan's Market Leaves India's And China's In The Dust, Panos Mourdoukoutas, 28 November 2016
[167] Tim Craig, In Pakistan, a prime minister and a country rebound — at least for now, Washington Post, 8 September 2015

As the economy moves towards stability, it is time to gain space from IMF to revive it. We must restore confidence in the economy and let transactions again take place. We must also revive aggregate demand. GoP should encourage banks to lend for private projects. Lastly, as the IMF permits capital controls as a last resort, we must introduce controls on portfolio flows and ration forex for the most crucial projects in public and private sectors. The first step is to reduce budget deficit. It must also make the monetary policy less restrictive. And it must rationalize the public investment programme keeping projects with the highest externalities, especially those with high foreign liability[168]. These measures will begin growth in tax collection and bring down the deficit[169].

Petersen Institute's John Williamson adds a nuance. His idea is to look at the net and not gross debt . In a recession it makes little sense to cut good expenditure. If the cause of debt is solid investment that creates assets, an economy must continue with it[170].

To exit the circle of weak macro indicators and low growth, we must target both. Macro stability is crucial for growth, which in turn feeds into stability. Malaysia's response to the 1997 crash is often cited as an example. Malaysia voluntarily followed IMF recipe of steep fall in its currency with increase in interest rates. When that slowed the economy, Malaysia changed tacked within months. It revalued its currency and decreased interest rates. It temporarily restricted convertibility. The economy picked up again. Pakistan does not have the space that Malaysia had at that time. Malaysia was never about to default on external payments[171].

Pakistan's option is to make macro stability a sacrosanct goal and proceed cautiously. In the next step it must make stability and growth sacrosanct.

What has the growth in debt financed? Why have we had such high needs for debt servicing?

Our high indebtedness has financed:

- An economy captured by the elite and special interests.
- High tax burden on the poor
- Our policy choices that necessitated a security state

Debt has not financed an increase in productive capacity in the economy. Refer Tables 7, 9 and 10. See also Figure 42. They show the exponential growth in debt. They also show where

[168] Mordokoutas Panos, To Solve Its Debt Problem, Pakistan Should Either Follow Malaysia or Turn Into The Next Sri Lanka, Forbes, October 8, 2018
[169] Khor Martin, Revisiting How Malaysia Overcame the Financial Crisis, Third World Network, 18 January 2004 and Mah-Hui Lim and Soo-Khoon Goh, How Malaysia Weathered the Financial Crisis: Policies and Possible Lessons, North South Institute, September 2012.
[170] John Williamson, Designing Economic Policymaking, Petersen Institute of International Economics, 1 November 2012
[171] Khor Martin, How Malaysia Overcame the Financial Crisis

government spending go. Figure 46 shows that on an average, between 1988 and 2014, Pakistan has spent about 70% of revenue collected each year on debt servicing and on defence. By comparison, India is at 50%, while Bangladesh and Vietnam are at 10% of revenue collected. Add subsidy paid and the figure is higher. Between 1952 to present average expense on defence is over 5% of GDP, Table 11[172].

Figures 44 and 45, show continuous growth in debt servicing. We borrow to pay interest and principal. The data behind these charts is revealing. Between 2003 and 2019, we spent Rs. 18.5 Trillion on debt servicing[173]. Annually we spent 5.63% of GDP on debt servicing. Between 2000 and 2018, we spent over USD 155 Billion on defence[174]. Figure 51 shows spending on defence as % of GDP.

Add money spent on subsidy to SOEs, including DISCOs, and we spend about 13% of GDP on three items of debt servicing, military, and subsidies. About 10% of GDP makes no contribution to capital accumulation.

Capital accumulation and human capital

In a preceding section we refer to an Ito quote that comparative advantage in an economy changes as the economy develops[175]. While industrial policy was the preferred option, it will succeed only if there is minimal capital accumulation. An industrial policy needs the right amount of physical and human assets.

Recall Figures 28 and 29 that show where we stand in physical assets compared to like economies. The inadequate funds available is spent indiscriminately on prestige projects. Rather than target physical indicators, decision makers must have service quality and its cost as goals. In the power sector, they prefer to have more generation capacity. This is in disregard of cost and reliability of supply. In roads, they target number of miles of gleaming highways. It is more important to reduce time and cost of freight and people movement.

Even more than physical assets, we are especially weak in human capital. See Table 12 below. In terms of World Bank's Human Capital Index, we are at par with Afghanistan. Within South Asia, India and Bangladesh are better. Malaysia and China are way ahead. We are worse than Afghanistan in harmonized test scores and stunting under 5 (though it is hard to dismiss estimate errors).

Pakistan's large young population is an asset if they are empowered to take part in the economic life. We are still in a youth bulge, with annual growth of 2.4% in working age population from 2004 to 2015. As total population grew by 2.1% annually for the same period, the country's dependency ratio has declined. Also, the labour market during this period was promising. Is Pakistan making full use of this opportunity? Because if we do not do so, the opportunity will soon

[172] SIPRI data
[173] MoF, Annual Fiscal Operations Data
[174] SIPRI data
[175] Ito Takatoshi, Japanese Economic Development: Idiosyncratic or Universal? Page 20

pass[176]. We must increase investment in the people to stimulate growth. Given how many people enter the workforce each year, we must grow at over 6.5% to absorb them.

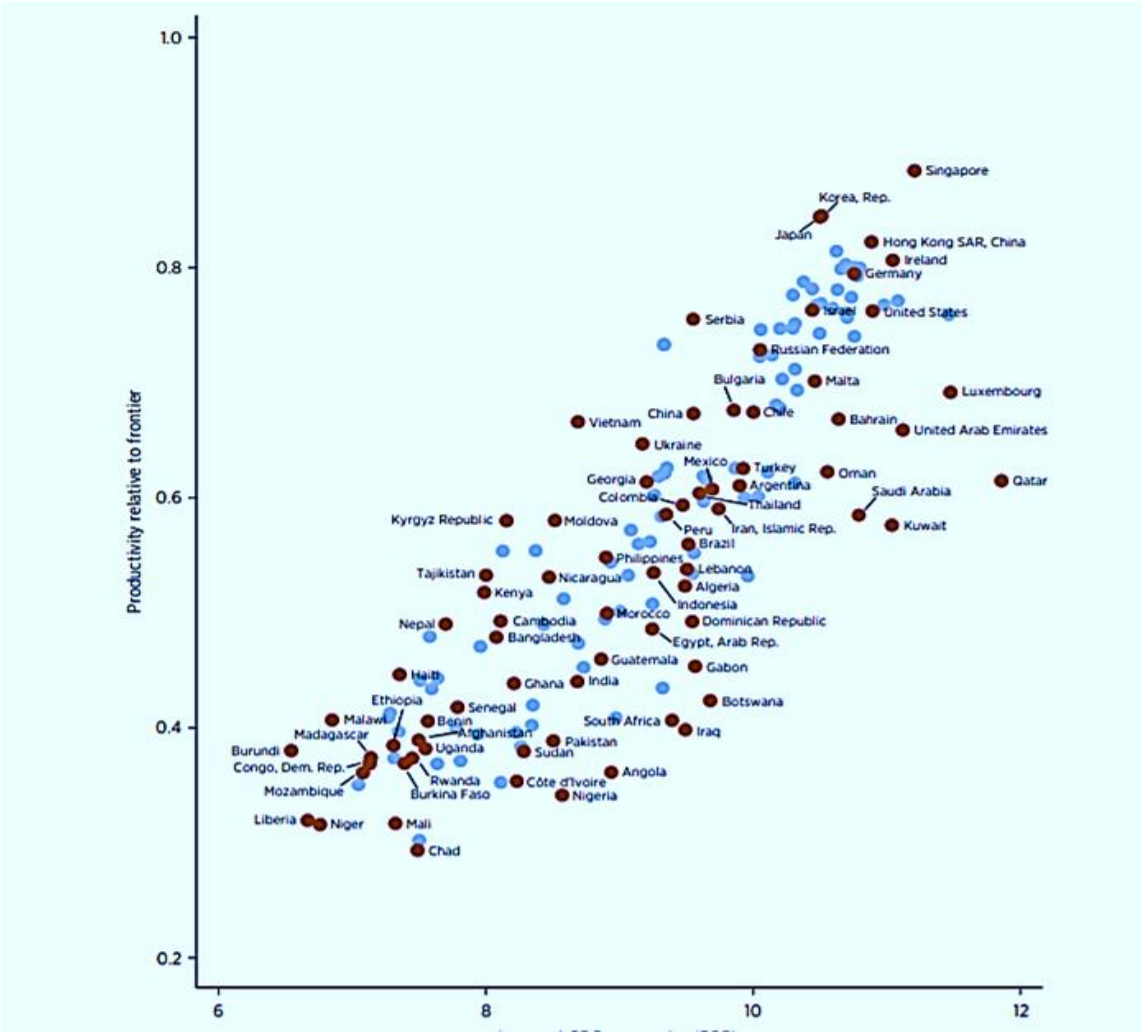
Table 12: Human Capital Indicators- Pakistan and Selected Economies

	Probability Of survival to 5	Expected years of School	Harmonized test scores	Learning adjusted years of school	Fraction of under 5 not stunted	Adult survival Rate	HCI
Pakistan	0.93	8.8	339	4.8	0.55	0.84	0.39
Afghanistan	0.93	8.6	355	4.9	0.59	0.78	0.39
India	0.96	10.2	355	5.8	0.62	0.83	0.44
B'Desh	0.97	11.0	368	6.5	0.64	0.87	0.48
Indonesia	0.97	12.3	403	7.9	0.66	0.83	0.53
Malaysia	0.99	12.2	468	9.1	0.79	0.88	0.62
China	0.99	13.2	456	9.7	0.92	0.92	0.67
Japan	1.00	13.6	563	12.3	0.93	0.94	0.84
Korea	1.00	13.6	563	12.2	0.98	0.94	0.84
Singapore	1.00	13.9	581	12.9	..	0.95	0.88
Source: World Bank Data							

Pakistan does far worse in worker productivity. Figure 54 below shows productivity against GDP per capita. At HCI of 0.39, Pakistan is doing worse than countries with lower GDP per capita. See Cambodia, Tajikistan, Nepal, and BD against Pakistan[177]. It is a clear indicator of government priorities. Recent research also suggest that in addition to years of education, improved cognitive skills are needed. While developing economies are able to increase school attainment, i.e. years in school. The next step is to improve school achievement. They must improve school quality that improve basic and advanced skills[178].

[176] World Bank, Pakistan @ 100, Page 22-23
[177] World Bank, The Human Capital Project 2018, Page 25
[178] Eric A.Hanushek, Economic growth in developing countries: The role of human capital, Stanford University April 2013, Via ScienceDirect

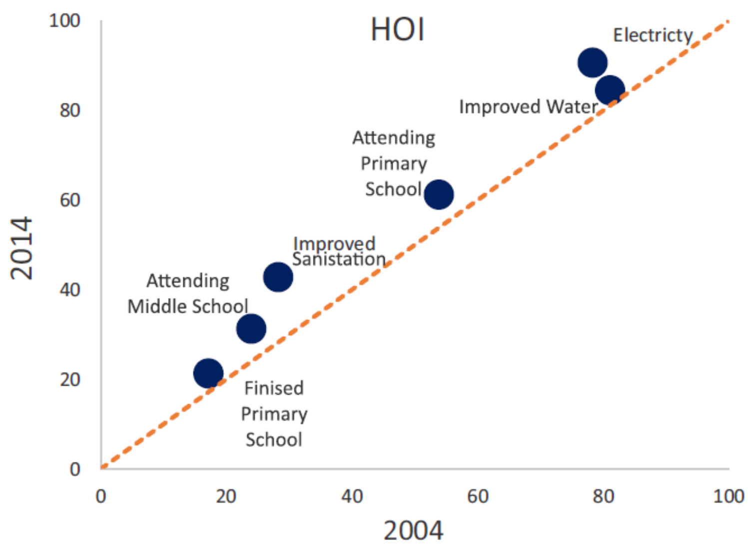
Figure 54: Human Capital Index[179]



According to World Bank, Pakistan must enhance labour productivity to improve its competitiveness. Pakistan's annual growth rate is lowest by comparators.

179 World Bank The Human Capital Project, 2018, Page 25

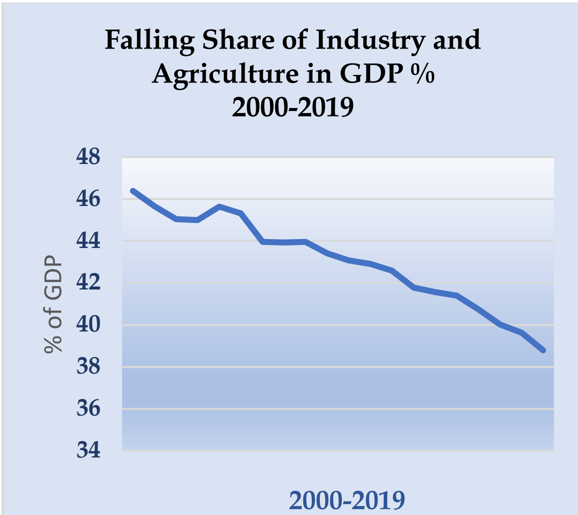
Figure 55: No change between 2004 and 2014 in level of opportunity provided to the population: Human Opportunity Index[180]



Reproduced below are graphs from Section 4 of this paper. It shows consistent fall in exports as percent of GDP, as well as of savings and investment and of production of goods. See also the falling trend line of GDP growth. Pakistan's gap in these areas with like economies have grown. This augurs poorly for the future. These indicators suggest an economy forever on life support and getting worse. This is a matter of high risk for our independence and sovereignty. Looking beyond the economy, in a tough neighbourhood, we will not be able to finance our security to the extent needed. The growing gap in defence with India will become insurmountable.

To conclude our finding about what the economy needs to do, we now analyze two other issues, competitiveness and youth bulge.

[180] WB, Pakistan@100 Page 61



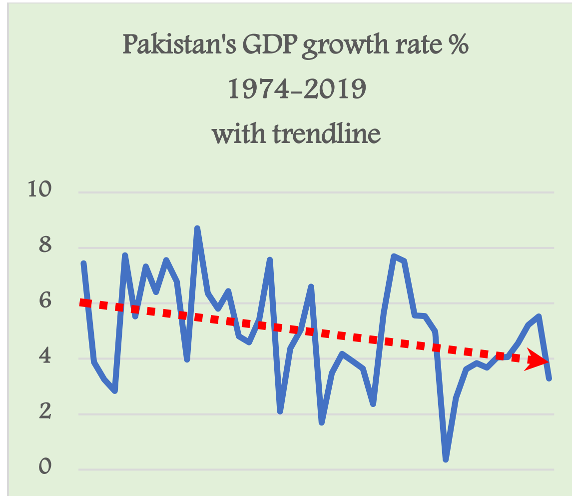
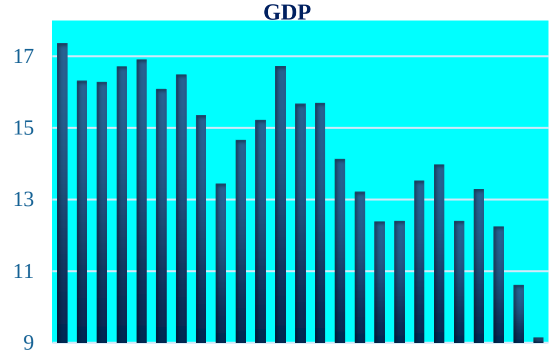


Fig 15A: Pakistan's declining exports as percent of GDP



Pakistan manufacturing as % of GDP

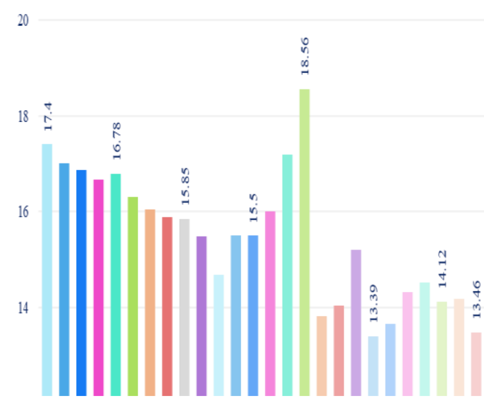
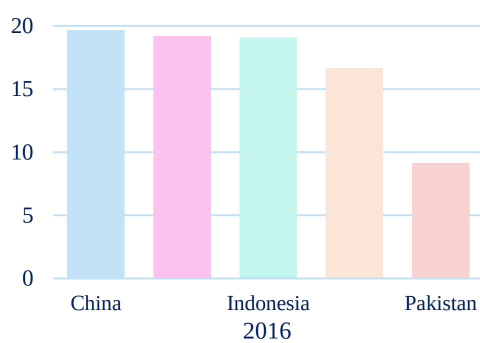
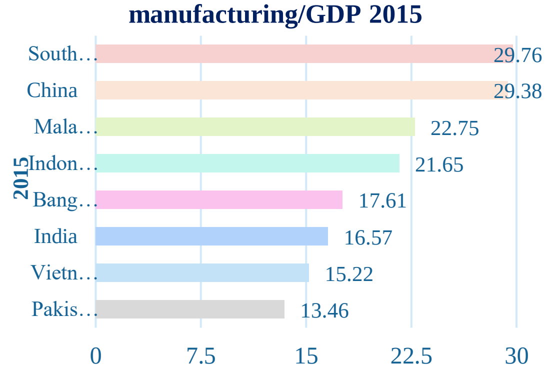
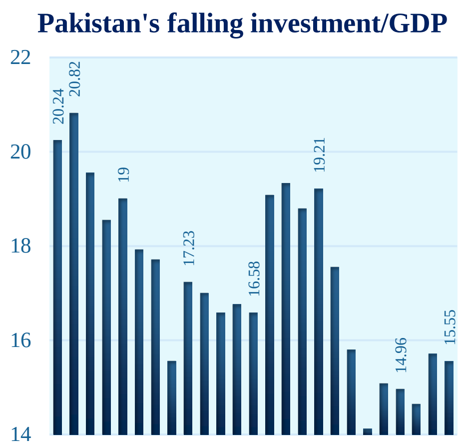


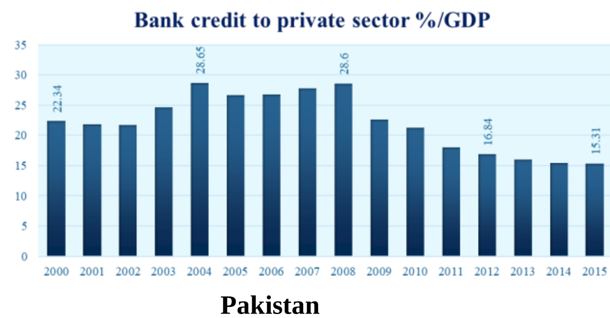
Fig --: Exports as percent of GDP is low compared to other economies



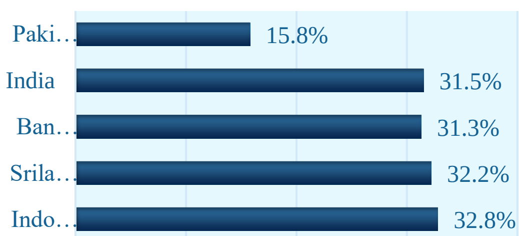
Country comparison: manufacturing/GDP 2015



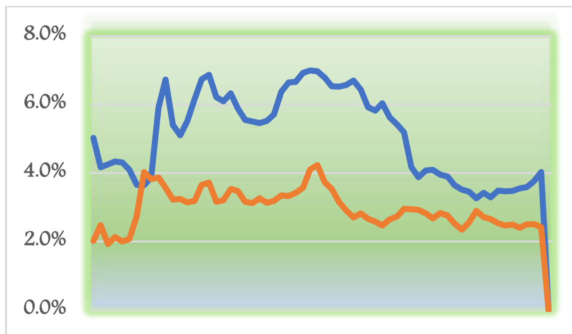




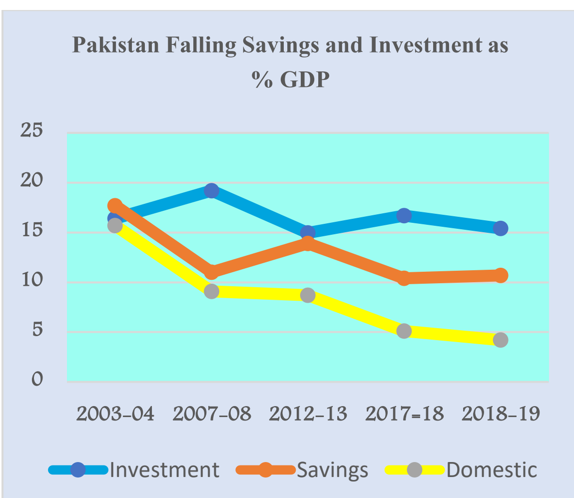
Investment % of GDP comparison

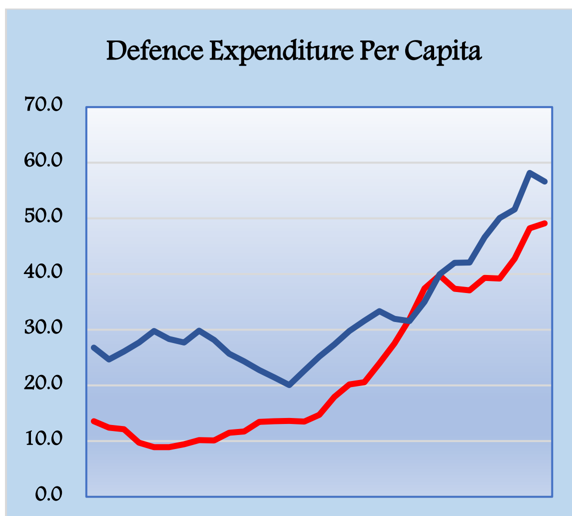


Defence Expenditure as % of GDP Pak and India

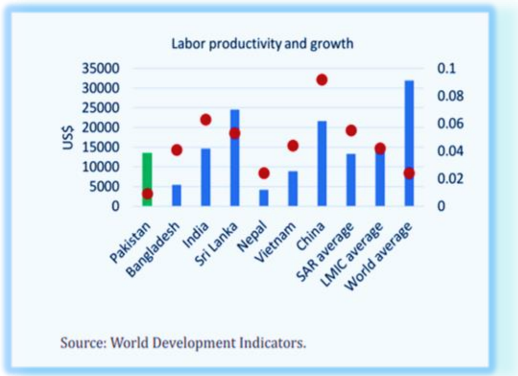


Pakistan Blue, India Red



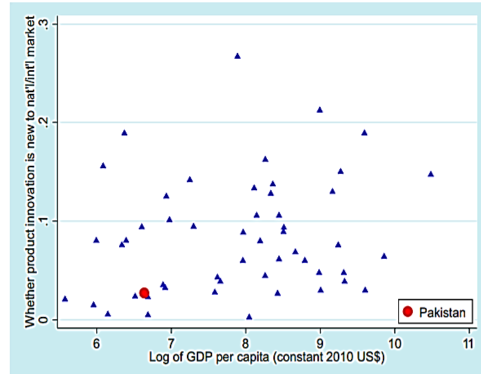


Pakistan Blue, India Red



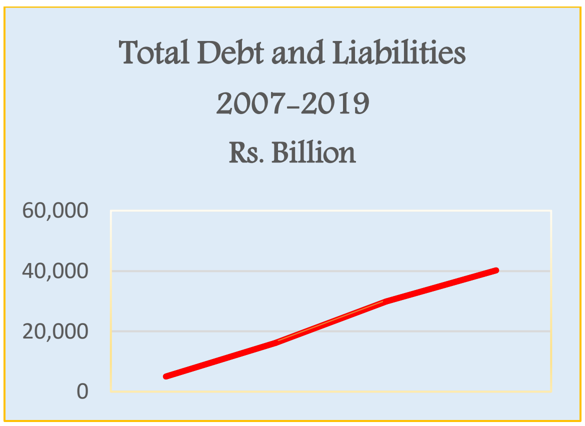
Source: World Development Indicators.

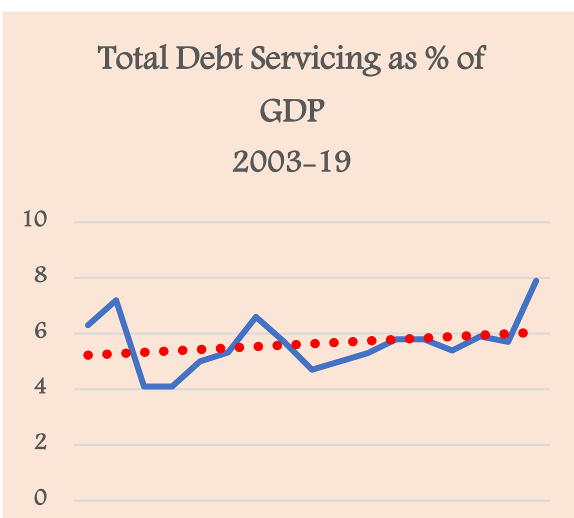
Bars US $ 2011 constant PPP, left axis, Dots, annual growth rate 2003-14, right axis

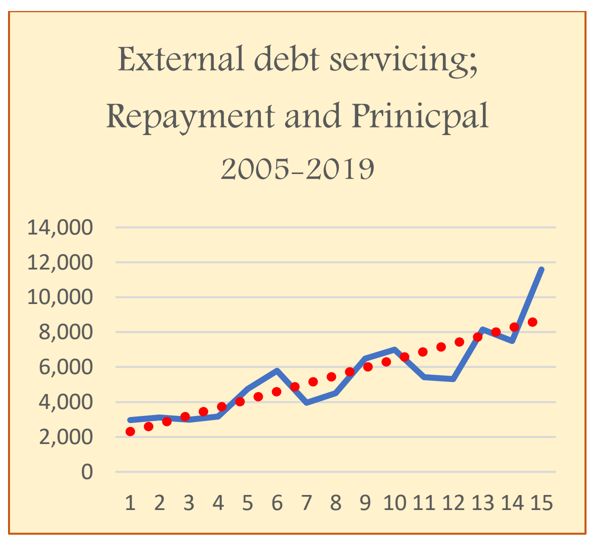


Source: World Bank Enterprise Surveys, 2013-16.

Comparison of innovation in Pakistan







Competitiveness

Nothing captures competitiveness better than exports. As seen before, exports as percent of GDP have fallen consistently. Atif Mian says that it shows deeper issues in the economy, but also in the society and the political landscape. In fact, he says, there is an overall decline in all spheres be it cricket or the number of international flights in and out of the country.

Clearly, we are not competitive in what we make as our exports to GDP has been in continual decline. That should be no surprise from the other charts that show our saving and investment have been in similar decline. Overall production of goods, both farm products and industry, has fallen over the last twenty years. All of this show up in GDP growth rates, whose 47 years linear trendline show a fall in annual growth rate. Take a look defence expenditure, at our per capita and as percent of GDP. Both are well above that if India. That suggests that we can't spend more on defence or it will drastically affect provision of public goods. And yet, as Figure 50 shows, the gap in military expenditure between two countries has become insurmountable. How does Pakistan protect itself?

We must know why all our economic indicators have worsened. We must know also why this subject is not front and centre of all discussions on the economy. Knowing the cause helps in finding how to move forward.

According to Professor Atif Mian[181], the reasons are deep and structural. Pakistan has failed to invest in the people. The quality of the people decides their quality of contribution to the firm and the economy. People bring innovation, good managerial practices and entrepreneurship. Nor has Pakistan built the physical assets that its firms need to compete globally. He marks 1992 as the year when the economies of Pakistan and India began to diverge. Since then, India has galloped away in exports and GDP growth. Likewise, since then, India has become better connected with the rest of the world. This divergence is not just with India. Our exports have fallen even when compared with Bangladesh. It has nothing to do with India's liberalization of its economy since 1990.

He says that Pakistan has fallen behind other economies because of how the society is structured. This reflects in how public policy is made. It shows up especially in lack of capacity or motivation of the private sector. Despite having a good market share in some products globally, not one Pakistani firm is world class. Nor has even one private firm become a regional or world class conglomerate.

He says that the reasons are fundamental. Pakistan has the wrong incentives, institutions and priorities. Talking about energy shortage, exchange rates, or privatization is to distract from the real issues. He ends his presentation by saying that "I suspect the deeper issue is about incentives, human capital, and protection from rapacious state and non-state actors".

Not being subjected to competitive pressures, the private sector hasn't moved up the value chain. The nature of goods being produced haven't changed in decades. When exports decline, government steps in with fiscal incentives. "Increased competition in domestic markets will unleash the private sector's creative and innovative forces".

[181] Presentation at a Conference on South Asia Growth, Lahore 2014

Youth bulge

Pakistan's large and young population is an asset, but it has not invested in it. Young people are entering the labour market at a higher rate than population growth[182]. This situation comes at crucial moments in an economy's history. Lack of investment means that Pakistan cannot leverage the youth bulge for high growth[183].

According to experts, to enhance youth productivity needs " investment in each stage of the life cycle"[184]. They recommend reduction in fertility rates and to improve nutrition and health indicators. They need also early childhood development and later education and skills interventions.

In highlighting three major trends in Section 4, this paper has already touched upon an analysis of what is happening. It bears repeating briefly. With continued decline in all economic fundamentals, how has Pakistan achieved moderately high growth rates during 2005-07 and 2012-18? They came from inflows of aid. One-time spending revived the economy. In 2005 especially, there was no visible addition to assets, nor to productive capacity. Under CPEC, physical assets grew, but not those that add to output, exports or competitiveness. It did not enable repayment of debt.

Pakistan must also make every effort to do away with frequent internal strife and ethnic differences. Indeed, the state must show more care and empathy for the weak segments of the society. We must also not be quick refer to others as less patriotic. This weakens us a society.

Though our military spending is high, but it will continue to fall short if the economy does not grow. Despite being in a challenging neighbourhood, it must do everything possible to stabilize regional security.

Putting all problems at the door of military spending is misleading. Though the economy would benefit from reduction on defence, but there are several other reasons that debases our support for the economy. Social sector spending lacks efficiency. Political leaders have shown no urgency to improve health and education quality. Urban centres are a nightmare. Structural transformation sees high shift of population to cities. Yet, cities hardly provide our firms a base to become competitive.

Selection of public projects leave much to be desired. The preference is to opt for prestigious projects and not those that reduce cost and reliability of service. This is especially seen in motorways at the expense of railways. Private investment too is done with guarantees of high returns (IPPs) and protection (auto assembly). All this has to change if Pakistan must upgrade its industrial structure and grow on a sustained basis.

[182] World Bank, Pakistan @100, Page 1
[183] ibid
[184] Ibid Page 22

Foreign Direct Investment:

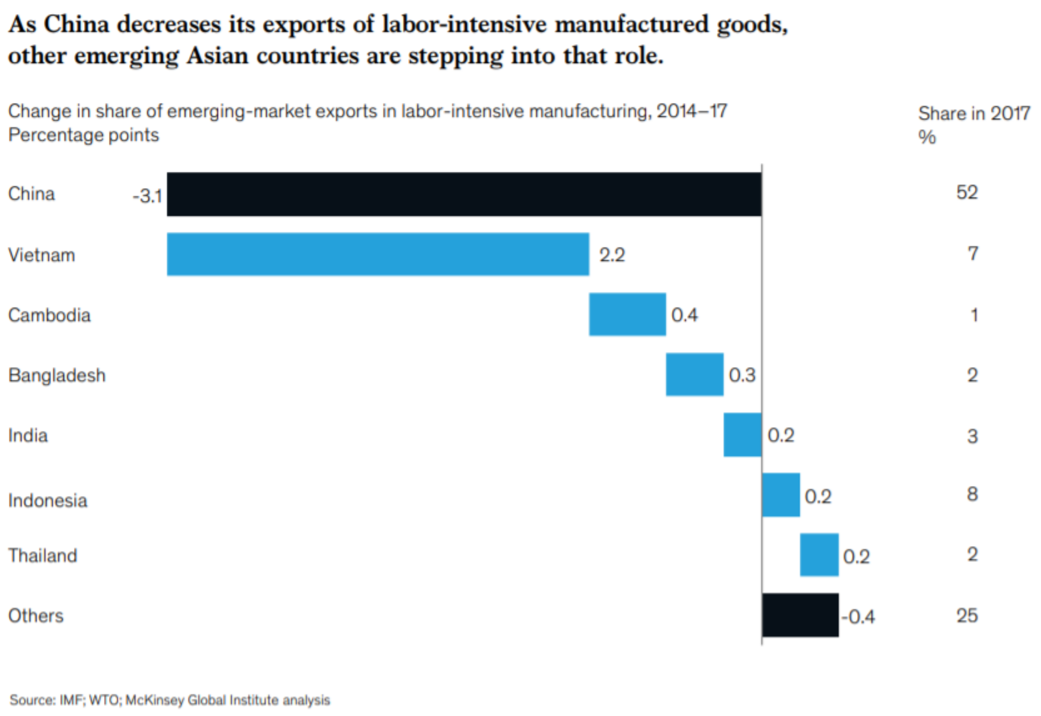
A tiresome narrative surrounds Pakistan's policy for attracting FDI. Decision makers believe that Pakistan has a liberal FDI regime. As policies go, that is indeed true. Yet, we must also pay heed to Pakistan's competitiveness level, governance performance, and HDI. We must also recognize that political influence counts for much in business success.

Also, Pakistan is one of the least open economies. Washington based Heritage Foundation ranks Pakistan at 131 of 180 countries in its economic freedom index, categorized as 'mostly unfree'. This is one step above the 'repressed' category. Pakistan performs particularly badly in rule of law. It scores low in respect for property rights, government integrity, judicial effectiveness, and in financial health. Overall, South Asia scores poorly, but all SAARC members have a modestly higher rank. FDI depends also on our security situation and on the quality of infrastructure, skills, and soft support to businesses is weak. The latter includes access to credit, trade facilitation and utility services. Our weak standing among these indicators is not about red tape alone. It is because political leadership does not give them the priority that they deserve. See previous charts about trends of savings and investment, exports, and access to credit[185].

[185] Chart in Box 2 below from McKinsey Global Institute's, Asia's Future is Now, Page 6

Box 2 Has Pakistan missed out.

When Pakistan and China agreed on a list of projects under CPEC, Pakistan called it a game changer. The projects selected under CPEC were important, yet GoP did not say what its vision of a changing game was. BRI/OBOR, of which CPEC is a component, envisaged production sharing arrangements. CPEC provided for SEZs, which could have been the springboard to doing so, by attracting FDI from China. We did not see progress on SEZs. Yet, China is graduating out of labour intensive industries and other countries have tried to fill the gap. In 2017, China still had a very large share in export of labour intensive goods. As it moves to higher technology goods, it will shed more of the labour intensive industry. Only efficient economies will attract them.



Based on the findings in this section, we move to the recommendations.

6. Conclusions and Recommendations

Recall the paper's objectives set in the initial pages:

- Make recommendations for long term high growth of the economy.
- Propose a way to exit from the endless loop of macroeconomic instability and external dependence into which the economy has locked itself.
- The end goal is to improve citizen wellbeing and increase the respect and esteem of all Pakistanis.

This section is in two parts:

- Recap of the essential findings
- Recommendations

We have covered several dimensions of the Pakistan economy and have observed, with empirical evidence, that the country's political choice is the major hindrance to development. If the leadership is serious about the country's development, it must build and express resolve, develop a plan, build consensus around it, and have an implementation plan and put in place a structure to do so.

Recap

An ambitious development plan calls for political leaders to lead societal change. It is an opportunity that comes once in a generation. Leaders can either grab it or merely talk about it. From Adam Smith to modern practitioners, every expert believes that development requires looking at the big picture. Leaders can become agents of societal change that takes the country to development. As said before, development is "a dramatic process of total transformation of a nation which can be experienced only once in its history"[186]. Leaders of East Asia were imbued with the idea of modernization, pride in their countries, and transformation.

It is no easy task. It calls for rigour and an honest and disciplined commitment to governance for economic growth. That is why it is called a miracle. The real miracle is the rigour and effectiveness with which development policies are conceived and implemented in East Asia. This allowed them to compress the growth process to a couple of decades. After that the process becomes self-sustaining. China's path to development is especially instructive. Leaders such as Deng Xiaoping, Japanese PM Yoshida, Lee Kuan Yew, and Mahathir Mohamad understood this. Their names are the stuff of legend.

Other ideas to keep in mind:

- Economic growth is key. Through economic growth, East Asia found an exit from the fragility created by the world wars.
- Led actively by committed leaders, East Asia built institutions of governance in support of growth. They created norms of behavior in the society, both formal and informal, that set up the "incentive structure of societies"[187].

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[186] Ohno, Kenichi, The Role of Government in Promoting Industrialization under Globalization: The East Asian Experience, National Graduate Institute for Policy Studies (GRIPS) Tokyo, Japan, page 15, November 28, 2003

[187] North, Douglas, Nobel Prize Lecture, 9 December 1993

- Lessons summarized from leading thinkers on development give us the following important pointers;
    - Create a sound business climate that provides preconditions for growth
    - Create a sound growth strategy with market-based policies that nudges the economy towards desired ends. Support it with industrial policy
    - Increase output and production built on higher investment backed by high savings
    - Increase effective demand in the economy, including through trade
    - Capital accumulation: i.e. more stock of capital for more production. More fixed plants by reinvesting business profits, more public goods for human capital, infrastructure
    - Implement policies for structural transformation: shift to manufacturing, which graduates to higher value added through higher productivity.
    - Invest in programmes for technology progress and higher human capital
    - Improve governance and build sound institutions

- Institute preconditions for growth:

    - Political stability: Put an end to frequent and sudden political changes. Recall how Darron Acemoglu compared the economies of South Korea and oil rich Nigeria[188].
    - Social cohesion: Be inclusive of ethnic identities (refer Fukuyama on building a nation state) and particularly of weaker economic segments
    - Build macro stability, not just during an IMF programme, in the long term that begins the process of exiting from macro crises and external dependency
    - Based on above provide public goods to firms to support their growth and competitiveness.

- Preconditions are very important part of development policy, but perhaps the most challenging. After these pre-conditions are in place, GoP may launch an industrial policy as the main vehicle for economic growth, through increase in manufacturing, competitiveness, and exports.

A Plan to Grow

- Our top goal should be economic growth. For decades, it has not been a priority. Economic growth is the path to better economic fundamentals. It will also provide resources to build human capital and infrastructure, create jobs, reduce poverty, and afford more funds for security. Nothing is possible without it. Later, we will discuss how.

[188] Acemoglu, Introduction to Modern Economic Growth. He wrote that Nigeria had civil wars, coups, and corruption with no incentives for firms to invest in technology

- The economic reforms that need to be done cannot all happen at once. Work has to go on consistently, and beyond an election cycle. We must take care that reforms should not bring the economy to a halt. Boost in economic activity must be the first priority.
- Likewise, political and security reforms must be pursued long-term. We cannot change the country's fundamental paradigm in a couple of years. Our effort should be to have internal stability and regional peace within several years, gradually moving towards these goals.
- Pakistan must take advantage of its strategic location for both security and economic interests.
- Leadership must deliver on the promise of good governance and take difficult decisions as given in many of the recommendations below.
- We must distinguish between the roles played in the economy by financial management, economic policy, and development strategy. In recent decades, financial management has prevailed over all others. Development is not in the calculus, and monetary policy has been subservient to public finance management. Despite this, the latter has been the weakest link in the overall management of the economy. In fact, we may say that financial management has been negligent and has created high indebtedness.
- The policies we follow should not be cherry picked as a collection of best practices. They should accord with endowment, governance norms, private sector capacity, institutions, and also the evolving global trade rules to work together in a well-functioning strategy.

The most important consideration is to have top leadership with statesman like approach that harmonizes a fragmented society, raises citizens' self-esteem, builds bridges with neighouring states and never allows a compromise on principles. The leader must govern for concrete results and not for abstract goals. There should be no difference between words and deeds.

Given the challenges and their nature, the plan cannot be implemented in one go. It must be implemented in phases.

In the first phase, it must address issues of state effectiveness and, especially of macro stability. The main issues that bedevil economic stability the most are a high share of interest and subsidies in total government expenditure. Second, the unsustainable level of imports, and the inability of governments in Pakistan to find substitutes within the economy. Also, the central bank has not played its role in enforcing budget deficit limits.

Addressing the macroeconomy will take us to the second phase of the plan's implementation. It will free up resources for providing the public goods needed by firms to compete and grow. This would give a segue to formulating an industrial policy that would stimulate manufacturing, exports, and industrial sequencing.

Hence, structural transformation and growth will be the second phase. Even within these two broad stages, implementation of the plan must be in steps, though some measures can be taken up in parallel.

Some recommendations below are so fundamental in character, that their treatment here may seem cursory. These are very basic matters to do with the state and often may need a separate paper in themselves. But they are important steps and need mention.

There is lots to do. Consequently, the lengthy list below will take several years to implement:

Phase One

- *State Effectiveness: Political and social stability, regional economic relations:*

    - Build a national consensus: All parties in the country must agree that Pakistan should embark on long-term development. This should cut across party lines and all parts of the state. This cannot be a general agreement. There is need to spell out clearly what this entails. It means a shift to a development state with the concomitant allocation of resources to needed public goods. It means also a commitment to rule of law and improved governance. If this sounds too good to be true, there is no need to read the steps that follow.

    - Create political stability: In East Asia, governments have lasted a long time. Their tenure is measured not in years but decades. Lee Kuan Yew was Prime Minister and Secretary General PAP for 31 years between 1959 and 1990. Following this he was a Minister for another fourteen years. Mahathir Mohamad was Prime Minister for 22 years from 1981 to 2003. Before that he was Deputy Prime Minister and Trade and Industry Minister. During its growth period, President Rhee headed the South Korean government for eleven years and President Park for fifteen years. In China and Japan where heads of governments change, the party in power has been the same. In 64 years since 1955, Japan's Liberal Democratic Party has governed for 59 years. In China, the Communist Party has led the country since 1948. The people of Pakistan have repeatedly voted in favour of democracy. Yet, the citizens also must have the opportunity for personal growth. Businesses also need support for their success. Development policy must give time to a leader, provided they are committed to improving the economy. Of course, this assumes competence and probity in the leadership.

    - Informal constraints: As a society, Pakistan must be more open to new ideas and be better connected, refer Atif Mian. We must grow out of conspiracy theories that the citizenry is so attached to. They give a free pass to those responsible for the problems. According to North, ideas, myths, and prejudices matter.

- Formal constraints: Pakistan has all required state institutions. Their performance leaves a lot to be desired. Our formal constraints lack effectiveness, North. We underperform in rule of law and some of the basic functions of governance. They affect norms of behavior in providing justice and making commercial transactions more predictable and certain.

- We must reengineer our policy towards economies in the region. From continuous adversity we must see the region as an economic unit for the benefit of our private sector and the economy. We have to make especial effort to graduate from the fragile security environment to regional stability.

- Build a competent bureaucracy that can assist in provision of rule of law, equal application of rules, and provide public goods on merit. Remove them from political influence and lobbies. We must ensure their autonomy and credibility.

- Specific Steps:

  - Raise understanding about the cost to economy and society of frequent political jolts and regional tensions. The uncertainty and loss in confidence has had profound effect on development.
  - Similarly, begin in earnest to ensure rule of law and equal treatment of all citizens.
  - Lead by example and ensure statesman like approach. Stop alienating whole groups of people.
  - Pakistan should do its bit to create regional stability and open borders. The commitment to regional peace should be strong and visible, even if its execution is in phases.

- Strong autonomy for decision making bureaucrats

  - Make bureaucrats final authority in enforcing economic policy, incentives, and laws, after political direction and targets are assigned. Take exemplary action against those who breach trust.
  - No political intervention. Bureaucrat’s decision should be final, no matter how powerful the person being judged. We cannot have two sets of laws and also expect to develop.
  - The country’s approach to governance must change, if it is to evolve into a dynamic economy and society. It is possible for a committed leader to ensure this. Otherwise, we must accept that we do not wish to transform as a society and will always be economically weak and dependent.

For those who believe that the above is not possible, they must say clearly that we will forever stay a poor country without respect in the eyes of the world.

- *State Effectiveness: Macro fundamentals*

    - With the economy always on the brink of crisis, businesses find it hard to plan long-term. Interest rates and exchange rates change very quickly. It makes project feasibilities redundant. Because the state cannot collect enough revenue for its needs, it imposes other regulatory measures. These dampen demand and put businesses in a crisis mindset.

    - Inability to reform tax policy and a penchant for coddling special interest, leaves government budget with a high deficit. At the same time, spending continues. This has made us a highly indebted economy. External debt creates dependency and vulnerability. Public finance management and tax administration has to change. Without macro stability we cannot create confidence in the economy or provide public goods. Those responsible for public finance management must be persuaded to make the needed reforms.

    - Start with external account:

        - Look at imports and substitute major exports with domestic content, without allowing for anti-export bias. This is possible in the energy sector.
        - Stop import of those other goods with reasonable substitutes in domestic market (this must be preceded by enforceable and publicized standards)
        - GOP's foreign borrowing must be for economically critical projects only. It should stop foreign borrowing for budget support and set a target to stop borrowing for BoP support.
        - Government must also end inflow of foreign portfolio investment into the country. Such inflows are not a solution. They are a problem
        - Government must not allow sovereign guarantee for private borrowing from overseas, unless they are for industries in the industrial policy.
        - GoP may ration available foreign resources with priority for those in the industrial policy (see below). Other firms may rely on suppliers credit or the like and must bear exchange and interest rates risk.

    - Reduce and gradually end budget deficit:

        - SBP must exercise its autonomy and enforce debt limit on federal government spending. Thus far, SBP has not played its role.
        - Increase tax collection from those exempted either as policy or for lack of enforcement. Withdrawal of exemptions are more effective than the present efforts by FBR to document the economy. These efforts have brought all transactions to a halt. Such unrealistic instruments have done nothing for FBR's reputation.

- GoP must put an end to the image of FBR as a dysfunctional circus. FBR must regain its respect and prestige. It needs political backing.
- It must also bring a constitutional change to make agriculture tax a federal subject or else make release of funds under NFC award contingent on realistic levels of agriculture tax collection.
- GoP must vow to impose exemplary punishment where either officers and taxable citizens or both indulge in tax evasion. Despite the many claims of tax evasion, there is not one case of an officer or a tax offender having been penalized.
- Reallocate subsidies on SOEs to increase provision of services. We must stop subsidizing poorly performing SOEs. Management must be held accountable for poor financial results, not rewarded for mismanagement.
- GoP, with buy-in of all stakeholders, must scrutinize all expenses and try to reduce spending where possible
- GoP must renegotiate IPP agreements and put an end to tariff differential subsidy. Also, it should hold DISCO management responsible for line losses and under recovery above an established threshold. NEPRA must be held accountable for ensuring that IPPs observe provisions of their tariff determination.
- As much as possible, MoF must first pay back the principal amount on high cost external borrowing. It must also stop Euro bond, Sukuk, and commercial borrowing immediately. Rather than borrow externally, GoP must limit expenditure.
- The leadership must contact major world capitals to reschedule debt servicing of multilateral and bilateral loans.

Above polices will end frequent jolts from inflation, Rupee devaluation, and changes in discount rates.

- *State Effectiveness: Institutions, formal institutions, laws, rules, policies, Informal institutions, norms, practices, standards, and excellence*

  - Enforce law equally and fairly. Be supportive of citizens and firms. When needed, hold those responsible accountable for mismanagement. This should never be done on political considerations.
  - Informal institutions: Top leadership must build faith in government and to lead by example with probity.
  - Build trust and certainty in commercial transactions, ensure contract enforcement. In giving approvals to firms, government must facilitate with prompt action rather than be a hurdle.
  - Change public rhetoric so that people redevelop faith in the spoken word. Words must have meaning. The rhetoric must also show respect for all and compassion. Make sure that

- *Remove market inefficiencies and correct market failures*

    - Government can no longer allow policy failures to fester indefinitely, such as in the areas of power supply and water management.
    - GoP must redirect incentives towards new manufacturing value added that builds exports. It must take away incentives from rent seeking industries
    - GoP must also acquire major economic power, in addition to administrative power, to enforce industrial policy. For example, it must build quasi market institutions such as DFIs and decide the target lending criteria.

- *Preconditions: public goods, even the small expenditure is not well spent*

With macro stability always fragile, provision of public goods has been inadequate. There are a couple of ways to address it:

- Political leadership must make provision of public goods a government priority.
- Regulatory environment: ensure that rules are equally enforced on all businesses without a free ride for those with influence.
- Government must begin a stringent review of federal and provincial PSDP/ADP projects. These projects should only support industrial growth, especially industries selected in industrial policy for exports.
- The above should be the sole criteria for project selection of public sector projects. All other projects must be excluded. Projects that have been executed up to 50% or more must be completed in full. All others should be shelved.
- Repeated research confirm that human resource quality is key for technology adoption, innovation, and growth. Human capital depends on spending on health and education. For one, they are below needs in our economy. However, what is available is often poorly spent. Political leadership gives no importance to enhancing human capital. Resultantly, political favourites get teaching or medical jobs. They are often not qualified, indulge in absenteeism and overall render poor quality service.
- PSDP must also fund technical and managerial skills training for industries, especially those prioritized in the industrial policy.
- Federal and provincial governments must build well-functioning industrial parks and SEZs to facilitate manufacturing investment. SEZs must target export oriented FDIs.

Phase 2

Preconditions capital accumulation: Capital accumulation is vital for the economy, i.e. introduction of new machinery, new manufacturing investment, improved human capital, and much needed infrastructure makes a dynamic and competitive economy.

- *Preconditions: Savings and investment*
  - Always low, domestic savings have been in decline for over a decade. Currently, the economy is trapped in low income, low savings, low investment and low technology:
    - Government must develop policies to increase savings and also to channel it to desired end, including to DFIs and off-budget infrastructure projects
    - During high inflation ensure that real return on savings are positive
    - Encourage increase in bank accounts from the present 14% of adult age population
    - Revive post office savings and use it for off budget projects. Postal savings must be government guaranteed
    - Support and encourage E savings platforms and monitor for increase in savings
    - Establish and revive DFIs. To have the resources to fund private sector, they must also issue government guaranteed savings certificate.
    - NIT mutual fund should invest in feasible export oriented new units
    - For selected industries, allow favourable access to capital, including through cost of capital incentives, and by credit rationing

Bring down regional trade barriers for trade and investment; Look at production sharing arrangements, provide protection from import to new industries where needed, and for limited periods.

Recall that development is a process that interacts between factors. These factors include labour, capital, government policies and working, better techniques, better skills, and institutions. Together they lead to changes in the way societies are organized.

- *Launch a well thought out industrial policy to increase share of manufacturing in GDP and to boost exports for selected export-oriented industries. Follow East Asian example of flying geese:*

  - Prepare a state led industrial policy. The aim of the policy should be structural transformation and industrial sequencing for export growth. It should be prepared with deep consultation with the private sector. Government's role should be to help the private sector achieve export targets while being profitable. Overall goal should be economic growth.

  - The policy must have clear goals, and its instruments must be well considered, so that the support is effective.
  - The eligibility criteria for availing incentives must be quantified to the extent possible with no deviation or compromise. Export targets should be the primary criteria. Incentives must have stated sunset. Also, incentives should be for the industry and not firm specific. GoP should ensure that there are sufficient number of firms in each industry, so that they compete for incentives.
  - If a firm cannot become a healthy exporter within an agreed period, it must improve or exit.
  - Selection of industries must be based on their likelihood to succeed in the country. The selected industry must have access to supply of input. It should have the next-level technology, that is one-step above the technology that exists at present. It should be a product whose export is declining in comparator economies.
  - Through withdrawal and grant of incentives as well as by offering public goods, GoP can nudge industry to newer products and higher technology.
  - GoP and industry must be in continuous consultation in a symbiotic relationship to achieve industrial policy goals. This also would work as a feedback mechanism to tweak policies and instruments.
  - GoP and industry must build a valuable channel of exchange of ideas and information. This should be for each industry. It will bring predictability and trust between government and industry, but also make clear government's seriousness to effective implementation of the industrial policy.
  - Proposed incentives include public sector R & D support, tax incentives, risk sharing for new industries, access to capital and foreign exchange, and creating knowledge hubs by linking industrial clusters.

- *Pakistan must become a link in the Regional Supply Chain:*

For Pakistan to be able to do so, requires urgent reform and improvement in a number of areas. For one, we need to improve relations in the neighbourhood. Policymakers must, more so, 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.

We must:

- Create manufacturing and supply chain hubs, clusters or SEZs
- Review policies based on continuous dialogue between policy makers, government, private service providers, and investing 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. 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.

Structure to plan and manage the Industrial Policy

1. *Rebrand the present annual Trade Policy:*

- The present trade policy of the government should be rebranded as the 'Export and Manufacturing Promotion Policy' with a tenure of three, five, and ten years. Its main aim should be to boost private investment in the country oriented to building exports. It must be owned as an inter-ministerial document involving the ministries of Commerce, Industry, Finance/Revenue Ministry (FBR), Science and Technology (and their research and standards affiliates), State Bank of Pakistan, the BOI, HEC, and TDAP. Their provincial counterparts must also be in the loop. A monitoring Board must be chaired by a Minister with all of the above along with leading export and industry trade bodies. Its decisions must have PM and Cabinet approval. It must have a dedicated secretariat.

- The Export and Manufacturing Policy must plan and announce the industrial policy. Incentivize promotion of manufacturing:

  - Select industry to be promoted
  - Access to credit, subsidized credit, and foreign exchange. Details later in this section.
  - Tariff policy:

- Curb under invoicing, which creates unfair competition for manufacturers[189].
- Use rigorous and punitive measures to stop smuggling from Afghanistan (i.e. misuse of Afghan Transit Trade), as this has almost halted industrialization in the country
- Selectively and gradually reduce import duties: ensure cascading finished goods to raw material. Withdraw these gradually to make Pakistan manufactures internationally competitive.
- Remove or reduce duty on import of capital equipment, raw material and intermediate good for select industries.

- Tax Policy
  - Simplify and reduce number of taxes
  - Tax incentive for specific industries: 50% tax rebate on all export earnings, tax holiday of three to five years for technology industry
  - Promote corporatization and buildup of firm capital base by withdrawing Super Tax and abolishing tax on less than 40% profit distribution. Remove cascading tax on inter-company dividends. Encourage risk-taking by limiting the scope of minimum tax on turnover[190].
  - Clear backlog of refunds for sales tax, duty drawbacks, and income tax
- Industrial Parks and SEZs: The federal and provincial governments must have a national plan for industrial parks/SEZs and clusters. While provincial governments, with ownership of land, will have the lead, the national effort must be coordinated. If done well, industrial parks and SEZs will stimulate growth in industry. Their progress and issues related to them must be monitored and resolved by the above-mentioned Board.
- The monitoring board referred above must hold monthly meetings for approving incentives to individual firms, for trouble shooting, and to review if the incentives are working. It must also approve other micro-level support as needed by firms:
  - Briefs with market trends prepared by the secretariat, help with accessing foreign technical partners or licenses, solve problems with specific firm level issues and with specific parts of the production and marketing chain. They may also help with reverse engineering of products.
  - Businesses may bring cases of over-regulation or official delays to the Board to resolve operational issues.
  - Where facilities are less than demand, the Board must ensure that their availability is based on the claimants' performance. There should be no other criteria.

[189] The Pakistan Business Council recommends specific action to curb under-invoicing. It advocates introduction of specific duties (by unit/ weight/ pieces/size) on sensitive items and to replace the "full and final" presumptive tax regime for commercial importers with a minimum tax and seek full tax accountability from all

[190] Pakistan Business Council proposals in their document Make in Pakistan

Access to Credit

- It is important to establish again DFIs with fixed cost of capital for private project finance in the country. Government's role should be monitor that credit is disbursed promptly and according to criteria.
- Access to subsidized credit: For select new industries in value added, knowledge intensive, and economically strategic industries.

Steps to increase credit availability to private sector:

- SBP and ministries of Commerce and Industry must adjust LTTF and Export Refinance to make them more relevant for industry needs so that they promote manufacturing and exports in a major way.
- Continue Long-term Financing Facility for exports
- Extend LTTF to selected non-exports sector: Example, manufactures of chemical and petro-chemical, pharmaceuticals, heavy industry, renewable energy, off-shore and indirect energy exploration and production.
- Remove Rs. 1.5 Billion ceiling on LTTF
- Continue with export refinancing facility and relax some stringent performance criteria to enable wide use for export growth

Two issues mar commercial banks' ability to act as effective financial intermediaries. They are a great constraint on access to credit for private firms, regardless of their size. First, because government is a major borrower, banks prefer to subscribe to government paper. They come with fixed returns and entail no risk. They also do not demand any effort on the bank's part to invest in project appraisal capacity. Second, bank credit is now offered within a small network of camaraderie. Apart from a handful of blue-chip companies, banks often extend credit to sponsors and leading shareholders of other banks. As SBP regulation restricts credit for related transactions with individuals and companies affiliated with a bank, they circumvent by lending to sponsors of other banks. A quid pro quo is part of this arrangement.

These exclusionary practices are a great barrier to private investment. SBP must strengthen Prudential Regulations so that commercial banks play their essential role in generating economic activity.

Institutional arrangement for credit availability to the private sector

Development financial institution played a vital role in promoting private investment from the 1960s to 1990s. They provided fixed cost project finance to the private sector. It is important to revive these organizations.

- Revive the Industrial Development Bank of Pakistan and establish more development institutions on the lines of the former NDFC, ICP, PICIC, and BEL.
- An Infrastructure Bank has been under discussion with International Finance Corporation. Should be made operational immediately.
- Especial access to finance arrangements may be made for SMEs:

- SBP and government may set targets for commercial banks to lend to SMEs
- Government may incentivize with lower tax on income from SME lending
- SME lending must be at lower rate than KIBOR or GoP's Market Treasury Bills

Innovative arrangements:

- Large and established companies may be allowed to issue unsecured bonds. SECP may develop modality. Investors in such bonds should be qualified institutional buyers.
- SBP may create a PKR 200 Billion fund for mortgage lending through commercial banks.
- Allow REIT securitization for development of real estate

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[191].

2. *National Commission on Science and Technology:*

If sustained growth of Pakistan economy is possible only with export of higher value-added goods, Pakistan must establish a Commission on Science and Technology on the lines of the Pakistan Atomic Energy Commission. The Commission must prepare short, medium, and long-term Science and Technology Strategy to boost value added manufacturing and export[192]:

- The S&T strategy must integrate into all aspects of the economy: industry, agriculture, services, as well as government.
- For effective implementation, it must be led at the highest government level, by the Prime Minister.
- Support through S&T is the only way for the private sector to productively acquire and the knowledge needed to manufacture, and export value added goods.
- The S&T strategy must have several components:
    - Focus on STEM education, technical training, R&D, setting up of specialized technology institutions, and effective enforcement of standards and testing.
    - Immediate declaration of a National Education Emergency, working with HEC and provincial governments. This must be dome on a war footing as education is necessary for improving quality of managerial and line level workforce.
    - Another key component of the strategy should be to set up specialized training and research institutions. Such institutions should prioritize the specialties selected in the Industrial Policy.
    - Also, the strategy must offer incentives for development of knowledge industry by using the instruments of Industrial Policy.

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[191] IPR, Re-engineering Economic Structure: A Growth Strategy for the Long Term, March 2017
[192] IPR, General Recommendations to Promote Science, Technology, and Innovation in Pakistan, Dr. Atta-ur-Rahman, FRS, N.I., H.I., S.I., T.I., May 2018

- To ensure consistent quality of goods produced in the country, GoP must strengthen standards and testing institutions, bring them under the aegis of the Commission, and hold them accountable for performing at a high level.
- Knowledge transfer from overseas is also a key instrument to upgrade industry. All FDI must include transfer of knowledge.
- Training and R&D facilities must be a part of FDI investment proposals. These will enhance the country's absorptive capacity for use of technology in production.
- In order to meet its promise, the Commission must have an effective organization, quality talent, and sufficient funds. Doing so needs political will. That is why direct engagement of the Prime Minister is crucial.

The world is now in the fourth-generation industrial revolution and beyond via the information society to a smart society. Pakistan must prepare for this new era as many manufacturing sectors evolve and take new shape. Driverless cars will populate roads and robots are staffing factory floors. So, for Pakistan the challenge is not merely to catch up in labour intensive manufacturing, but to be ready for an evolving manufacturing sector based on AI and robotics.

For this, Pakistan must radically and immediately upgrade its engineering capabilities. Successful implementation of the S&T strategy will bring a boon to industry, agriculture, and exports.

Support through skills and knowledge: The Commission's mandate should also include training and skills development:

- Vocational and skills training would enable the youth to enter the job market for employment. These training programmes must be certified by international institutions (such as City and Guild).

- A government programme for reliable internet connectivity on a mass scale at low cost will enable people to access online knowledge and skills in large numbers. Some of these courses come with certification.

- Commission may work with international MOOCs for the purpose. Pakistani youth must catch up on technology and skills. Partner with IT MOOCs will help create mass training courses in Pakistan (Udemy, Udacity, Code.org, Coursera, and Edx). Plan on training millions of young Pakistanis each year. Where possible translate/over speak instructions in Pakistani languages. This could be a transformational initiative.

A major skills and knowledge development programme will equip our young population to gainfully participate in the economy and enhance productivity of manufacturing and service businesses. This will stimulate economic growth.

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[193]:

- 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.

[193] IPR Report, Re-engineering Economic Structure: A Growth Strategy for the Long Term, Pages 47 and 48

Afterword

As far back as the fourteenth century, Ibn Khaldun highlighted the important role of the State in the social, political and economic life of nations. He said that the government and people must define the role and the nature of the State.

Governments must ensure law and order as well as rule of law. The state's goal must be to ensure that economic activity would flourish. Governments must put in place a legal framework that lends certainty and predictability to economic activity. They include "enforcement of property rights, the protection of trade routes and the security of peace" These are necessary "for any civilized society to engage in trade and production". As a result, output and as a consequence prosperity would grow if states have policies that stimulate the economy. Government must tax as little as possible but enough to give its citizens and firms necessary services and infrastructure.

While experts differ on the extent of the state's role, and Ibn Khaldun counseled a minimalist approach, these ideas were not different from what later thinkers in the West and elsewhere propagated, though they came to these findings separately. These thinkers include Adam Smith and so many more who followed until the present. Governments have given heed to these ideas. The essence of growth and development lies in these words written seven hundred years ago. Are they really impossible for us to follow?

Pakistan must shake out of the complacency in which its decision makers find themselves. That complacency teaches us that dependency for capital and ideas are fine. That poverty is a given and cannot be changed and that technology is something that the West has a monopoly of. The lesson of East Asia, but also of thinkers from Ibn Khaldun onwards, is that it is for us to change our destiny. Because if we don't we will perish.

Pakistan Total Debt and Liabilities Billion Rs.				
	June 2007	**June 2013**	**June 2018**	**June 2019**
Total Debt and Liabilities	**5,024**	**16,228**	**29,879**	**40,215**
YoY Growth			**19**	**35**
% of GDP			**86**	**104**
Domestic Debt	**2,597**	**9,833**	**17,483**	**22,123**
YoY Growth				**26.5**
% of GDP				**57**

External Debt **YoY Growth** **% of GDP**	**2,341**	**5,698**	**10,935**	**15,625** **43** **40**
Total Debt **YoY Growth** **% of GDP**	**4,935**	**15,531**	**28,437** **18** **82**	**37,748** **33** **98**
Liabilities	**89**	**697**	**1,442**	**2,467**
Domestic	--	*470*	*820*	*756*
External	*89*	*227*	*622*	*1,710*
Source: SBP Pakistan's Debt and Liabilities Profile, All domestic liabilities are commodity operations				

	FY 18			**FY 19**			+/- **Principal**	+/- **Interest**
	Principal	Interest	Total	Principal	Interest	Total		
Public Debt	4,190	1,787	5,977	7,357	2,288	9,645	76	28
Private, PSEs, Others	988	530	1,588	1,297	645	1,943	-9	-1
Total	5,178	2,317	7,495	8,654	2,933	11,588	67	27

Expenditure and Revenue[194]				
Expenditure **Billion Rs**				
	FY 18	**FY 19**	**% +/-**	**% of total FY 19**
Total Exp Federal **% GDP**	4,704 **13.7**	5,599 **14.5**	19.0	100
Current Exp. Fed **% GDP**	3,814 **11.0**	4,804 **12.5**	25.9	86
• Debt servicing	1,500	2,091	39.4	*44*
• Defence	1,030	1,147	11.4	*24*
• Pensions, grants, others	961	1,182	23	*25*
Sub-total	3,491	4,420	27	*92*
Balance for civil government Including grants, pension, and subsidies	323	384	19	*8*

194 Source MoF

PSDP	890	795	-11	14
Revenue				
				Billion Rs
	FY 18	**FY 19**	**+/- %**	**% Share**
Total Revenue **% GDP**	4,066 **11.8**	4,072 **10.5**	0	
Total FBR **% GDP**	3,842 **11.2**	3,829 **9.9**	-0.35	100
Indirect	2,306	2,384	3.38	62
Direct	1,537	1,446	-6.0	38
Non-tax revenue	630	364	-53