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GROWTH AND DEREGULATION: PAKISTAN'S ECONOMY AT THE CROSSROADS

"DEREGULATION SET THE STAGE FOR AN ENORMOUS WAVE OF CREATIVE DESTRUCTION IN THE 1980S". **ALAN GREENSPAN**

ECONOMIC PERFORMANCE

When Pakistan gained independence from the British rule and partitioned from India under the Indian Independence Act of 1947, the nascent state was faced with the daunting task of rehabilitating the migrant Muslim population while at the same time building up a viable economic base from the weak infrastructure it had inherited. Compared to the neighbouring countries and a number of countries that started on the journey to development facing roughly similar initial conditions, Pakistan's growth performance has not been remarkable (Table 0.1).

Table 0.1: Decade-wise Annual Average GDP and GDP Per Capita Growth Rates

%

	Variable	Country	1960s	1970s	1980s	1990s	2000s	2010s
1	GDP	Bangladesh	3.89	1.52	3.22	4.80	5.81	6.37
2	GDP	India	3.91	2.93	5.69	5.73	6.93	6.70
3	GDP	Nepal	2.52	2.60	4.09	4.84	4.06	4.44
4	GDP	**Pakistan**	**6.79**	**4.84**	**6.86**	**3.98**	**4.64**	**3.56**
5	GDP	Sri Lanka	4.67	4.23	4.15	5.26	5.00	7.56
6	GDP	China	3.01	7.44	9.75	9.99	10.29	9.17
7	GDP	Korea	8.25	8.29	7.68	6.25	4.39	4.02
1	GDP per capita	Bangladesh	0.85	-0.65	0.50	2.57	4.34	5.16
2	GDP per capita	India	1.75	0.59	3.39	3.79	5.35	5.35
3	GDP per capita	Nepal	0.59	0.40	1.74	2.26	2.44	3.25
4	GDP per capita	**Pakistan**	**4.03**	**1.79**	**3.37**	**1.26**	**2.67**	**1.79**
5	GDP per capita	Sri Lanka	2.21	2.50	2.59	3.96	4.25	7.77
6	GDP per capita	China	0.89	5.34	8.19	8.75	9.62	8.64
7	GDP per capita	Korea	5.64	6.32	6.38	5.24	3.83	3.44

Source: World Bank (2014)

A commonly cited case is that of South Korea, which also embarked on its journey to development in the late 1960s. A combination of factors including a strong developmental state, national cohesion and a favourable political settlement arrangement (Amsden, 1989; Rodrik, 1999) enabled it to leapfrog ahead of Pakistan. Pakistan's neighbour, India, exhibited a sluggish performance compared to Pakistan in the 1960s, but managed to surge ahead in the 1980s. Both South Korea and India invested heavily in

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human capital and infrastructure development, foregoing an immediate payoff in favour of reaping the benefits in later years from higher value added manufacturing output, thanks to a solid technological base. Pakistan underinvested in education compared to India, as is evident from the trends in Table 0.2.

%

	Share of Public Expenditure on Education						
	Decade / Years	in Government Expenditure			in GDP		
		India	Korea	Pakistan	India	Korea	Pakistan
1	1970s	-	18.73	4.88	-	2.95	1.97
2	1980s	-	24.57	6.03	-	3.94	2.29
3	1990s	12.64	17.34	7.34	3.56	3.61	2.66
4	2000s	11.14	15.34	10.51	3.43	4.37	2.45
5	2010-11	10.76	-	10.04	3.24	-	2.30

Table 0.2: Decade-wise Public Expenditure on Education in Selected Countries
Source: Bank (2014)

Historically, national defence has overshadowed the social sectors in terms of government expenditure. The shares of 31 percent for defence, 2.7 percent for Public Health and 7.3 percent for Education in Table 0.3 reflect the priorities of the state. The trend has somewhat improved in recent years, with military expenditures falling to 17.6 percent while Public Health and Education have increased to 3.6 percent and 10.1 percent respectively.

%

	Year	Military	Education	Public Health
1	1995	31.37	7.34	2.67
2	1996	28.20	7.12	2.86
3	1997	27.52	8.07	2.76
4	1998	27.19	-	2.41
5	1999	26.34	-	2.42
6	2000	23.42	-	2.40
7	2001	24.84	-	2.41
8	2002	24.95	-	2.95
9	2003	25.23	-	2.76
10	2004	28.49	6.42	3.00
11	2005	27.67	10.94	3.11
12	2006	24.69	12.18	3.47
13	2007	21.90	11.24	3.19
14	2008	18.39	11.15	3.16
15	2009	19.28	11.15	3.29
16	2010	18.53	9.93	3.42
17	2011	17.55	10.14	3.58

Table 0.3: Major Social Sector Expenditure versus Military Expenditure Shares in Pakistan (1995-2011)

Source: World Bank (2014)

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In terms of per capita income, Pakistan's performance over the years has been quite respectable, averaging an increase of 2.5 percent in annual GDP per capita income growth from USD 220 to 802, but pales in comparison to the performance of a number of other countries in the region such as China, India and Sri Lanka. However, all countries in the South Asian region have exhibited a more consistent positive trend in the decade wise growth rate of per capita income.

The sectoral contribution to GDP growth in Pakistan has been the strongest from the manufacturing sector, averaging 6.83 percent (1961-2012), even though Pakistan is primarily an agrarian economy, with agricultural sector growth of 3.71 percent over the same period.

The sectoral contribution to GDP growth in Pakistan has been the strongest from the manufacturing sector, averaging 6.83 percent (1961-2012), even though Pakistan is primarily an agrarian economy, with agricultural sector growth of 3.71 percent over the same period (Table 0.4). The economy has undergone substantial structural transformation over the years, with the share of agriculture in GDP falling from over 46 percent in 1960 to 20 percent in 2012. To put this in a regional perspective, consider the fact that the corresponding share in India has gone down from 43 percent to 17 percent, in China from 22 percent to 11 percent and in South Korea from 38 percent to only 3 percent.

The share of manufacturing sector, on the other hand, has increased from over 14 percent to almost 19 percent over the same period, a shift that suggests the economy has become more resilient in recent years - less vulnerable to the seasonality of agricultural output driving GDP growth. This shift away from the agriculture sector has also been mirrored in the structure of labour employment, though it appears that rather than moving towards the industrial and manufacturing sectors, surplus labour force from the agriculture sector is starting to find its way to the services sector instead.

This is not a detrimental shift per se for the economy; rather it is worrisome in terms of the fact that spillovers of improved performance in the services sector are unlikely to have as great an impact on the general economy as that from the manufacturing sector, or even the agriculture sector.

While the share of agriculture in Pakistan has fallen from 46 percent in 1960 to 20 percent in 2012, the corresponding share in India has gone down from 43 percent to 17 percent, in China from 22 percent to 11 percent and in South Korea from 38 percent to only 3 percent. The share of manufacturing sector, on the other hand, has increased from over 14 percent to almost 19 percent over the same period, a shift that suggests the economy has become more resilient in recent years - less vulnerable to the seasonality of agricultural output driving GDP growth.

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Table 4: Sectoral Contribution to GDP Value Added

(% of GDP)

	Sector	Country	1960s	1970s	1980s	1990s	2000s	2010s
1	Agriculture	Bangladesh	-	-	31.59	27.13	21.19	18.13
2	Agriculture	China	37.16	32.35	29.39	20.50	12.45	10.06
3	Agriculture	India	42.23	38.57	31.71	27.38	19.75	17.64
4	Agriculture	Korea	33.78	26.16	13.43	6.64	3.52	2.67
5	Agriculture	Nepal	67.88	67.44	56.02	43.49	36.31	37.01
6	Agriculture	**Pakistan**	**41.16**	**33.78**	**28.55**	**26.13**	**22.31**	**20.96**
7	Agriculture	Sri Lanka	30.32	28.97	27.23	23.64	14.09	12.45
1	Industry	Bangladesh	-	-	21.17	23.94	27.12	28.40
2	Industry	China	35.18	44.48	44.33	45.39	46.44	46.60
3	Industry	India	19.87	22.27	25.52	26.11	27.35	26.68
4	Industry	Korea	23.26	29.82	39.20	41.39	37.10	39.03
5	Industry	Nepal	10.21	10.11	14.20	20.92	17.97	15.35
6	Industry	**Pakistan**	**19.22**	**22.79**	**23.27**	**24.36**	**25.45**	**25.31**
7	Industry	Sri Lanka	20.69	26.08	27.02	26.37	28.89	29.66
1	Manufacturing	Bangladesh	-	-	13.76	14.87	16.59	17.75
2	Manufacturing	China	29.02	37.22	36.04	32.93	32.37	29.52
3	Manufacturing	India	13.82	15.24	16.03	15.80	15.31	14.26
4	Manufacturing	Korea	15.57	21.61	27.51	27.14	27.21	30.75
5	Manufacturing	Nepal	3.57	4.11	5.24	8.77	8.28	6.44
6	Manufacturing	**Pakistan**	**14.30**	**15.89**	**15.98**	**16.44**	**17.24**	**18.44**
7	Manufacturing	Sri Lanka	15.59	19.02	15.39	15.68	18.19	18.11
1	Services, etc.-	Bangladesh	-	-	47.24	48.93	51.69	53.47
2	Services, etc.-	China	27.67	23.17	26.27	34.11	41.11	43.34
3	Services, etc.-	India	37.89	39.16	42.77	46.51	52.89	55.68
4	Services, etc.-	Korea	42.96	44.02	47.37	51.98	59.38	58.30
5	Services, etc.-	Nepal	21.91	22.46	29.78	35.59	45.72	47.72
6	Services, etc.-	**Pakistan**	**39.62**	**43.43**	**48.19**	**49.50**	**52.24**	**53.73**
7	Services, etc.-	Sri Lanka	48.99	44.96	45.75	49.99	57.02	57.89

Source: Author’s calculations based on World Bank (2014)

These results suggest that even though Pakistan has made substantial strides in generating growth, sadly it has been unable to sustain a high level of self-reliant growth due to a myriad of challenges faced over the years.

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1.1.1.1. INFRASTRUCTURE

Infrastructure development plays a vital role in the development process of a country; without the road or railway links (at the very least) to get crops to the market, agriculture would collapse, and without adequate power generation and supply to today's highly mechanized manufacturing firms, the industrial sector would be hamstrung and unable to compete effectively. Poor infrastructure availability also harms quality of life and the wellbeing of the population of a country. Improved supply, quality and affordability of infrastructure is thus essential for stimulating growth and reducing poverty levels in a country.

Given the fact that the topography of the country is rugged with varied and significant mountainous regions, roads would be the preferred choice of transport. In fact by 2012-13, the road network in Pakistan was responsible for over 96 percent of inland freight traffic and 92 percent of all passenger traffic in the country. It is the veritable transport backbone of the economy. 263,415 km of roads are networked across the country, with 40 percent lying in Punjab, almost 31 percent in Sindh, a little over 16 percent in Khyber Pakhtunkhwa and 11.3 percent in Balochistan.

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The railway network which is considered essential for movement of freight has tended to be relegated to the back seat in terms of receiving funds from the state. Out of a total inventory of 515 locomotives, by June 2012 only 92 passenger locomotives and 8 freight locomotives remained in operation. The revenue of the state run Pakistan Railways has fallen by 25 percent while working expenses have increased by 33 percent, comprised for the most part of employee related costs and maintenance costs associated with operating overage infrastructure and rolling stock.

Adequate generation of power has created a bottleneck for development of the economy, which the state has attempted to alleviate in the short term by importing power from abroad, renting private power plants and making long term investments in nuclear and hydroelectric power projects.

Trends in growth of electricity generation suggest that the country lacks the capacity to generate sufficient power to meet its current needs, let alone those of the future. Losses due to transmission failures and theft have also placed a growing burden on the domestic economy while at the same time compromising the ability of the manufacturing industries to develop and grow. In fact, after the substantial investment made in installed capacity after independence, the rate of growth has been slowing down, except for a slight increase on account of the commissioning of Tarbela Dam in the 1980s.

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Inadequate generation of power has created a bottleneck for development of the economy, which the state has attempted to alleviate in the short term by importing power from abroad, renting private power plants and making long term investments in nuclear and hydroelectric power projects.

Alternative sources of power, including wind and solar, are also being pursued. However, the demand for power continues to outstrip any additions made to the installed capacity from these alternative sources, and the technology involved is relatively new and costly, which impedes its operation in the economy. The continuing power brownouts and blackouts across the economy have prompted many firms to invest in independent generators and back-up power supplies to ensure production operations remain unhindered by the lack of this infrastructure component.

Table 0.5: Growth Rate of Installed Capacity and Generation of Electricity

%

	Decade	Installed Capacity (MW)	Generation (GWH)
1	1950s	21.50	21.75
2	1960s	13.83	20.00
3	1970s	7.75	8.97
4	1980s	8.61	9.59
5	1990s	8.23	5.88
6	2000s	1.89	3.87
7	2010s	4.00	0.00

Source: Government of Pakistan (n.d.)

CHALLENGES FACING THE ECONOMY

The discussion above has highlighted the trends in Pakistan's economy as it has evolved since the time of independence for almost 65 years ago. Between 1949 and 2013, GDP growth has averaged 5.29 percent which compares quite favourably with other countries in the region. Despite a swift rise in population, per capita income has managed to more than triple since 1960, and the growth in GDP has been made possible due to substantial increases in output from the agricultural and industrial sectors. Production of wheat rose almost ten-fold from 2.4 million to 23.9 million tonnes, rice from 0.83 million to 6.9 million tonnes and cotton from 1.9 million to 12.9 million bales between 1953 and 2010. Maize witnessed a ten-fold increase from only 0.35 million to 3.5 million tonnes. Industrial production that began with only a textile mill and a cement plant, has since blossomed into a wide variety of food industries, cigarettes,

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fertilizers, engineering and automotive, electrical and mechanical engineering, metallurgy, pharmaceutical and even ship building industries.

Despite a swift rise in population, per capita income has managed to more than triple since 1960, and the growth in GDP has been made possible due to substantial increases in output from the agricultural and industrial sectors.

Despite the quantum increases in agricultural crop yields, production in the sector is subject to weather conditions, and industrial firms are finding it difficult to break into the global market for their products. Unable to export products of any meaningful value addition means that import levels invariably exceed exports and this places an almost intolerable strain on the economy's foreign exchange reserves and has led to a mounting external debt. Traditionally, debt servicing has been the major component of the federal budget, followed by funds set aside for defence, with the result that only meagre amounts are set aside for investment in other areas considered crucial for successful development; infrastructure, health and education, to name a few. It can be concluded that the development of human capital is more of an afterthought than a national imperative, and the fruits of economic growth are not in evidence in the lives of the ordinary populace of the country.

Economic growth has clearly taken place, but the distribution of gains has been uneven, as evidenced by the persistent levels of poverty across the country. With a high growth rate of population, the country is on the brink of witnessing a demographic dividend; the proportion of able bodied, young persons is increasing by the day, and the pressure is mounting on the labour market which is ill-equipped to handle the increased levels joining the market.

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Despite the bias towards promoting industrial sector development and the growing importance of the services sector, agriculture sector continues to be the mainstay of the economy to this day. This has implications for the consistency and sustainability of medium and long-term growth of the economy since it is painfully clear that agricultural output is subject to the vagaries of the weather.

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Traditionally the industrial sector is tapped as the engine of growth in developing countries; as the sector most suited to absorbing and utilizing large pools of labour for productive means and generating the spillovers that will ensure that productivity in the other sectors of the economy also increases. Even though the industrial sector has shown the potential time and again to drive growth of the domestic economy, the state has failed to put forward a meaningful strategy and vision for long term development of the sector.

The lack of investment in infrastructure development, especially power generation and affordable rail transport has meant that firms have to allocate resources towards meeting their needs from private sources, which tend to be more costly. Not only that, the industrial sector as a result is also unable to realise its full potential due to the infrastructure bottlenecks.

Despite inheriting only a meagre industrial base at the time of independence, the state had the foresight early on to make significant investments in building the infrastructure required to industrialize successfully while at the same time directing the development of the local industrial sector and deepening of production capabilities through technology acquisition efforts. Later, both the internal and external environments have not been conducive to promoting economic growth and development.

Even though the industrial sector has shown the potential time and again to drive growth of the domestic economy, the state has failed to put forward a meaningful strategy and vision for long term development of the sector.

Lastly and most importantly, the incumbent government has focused on the issue of corruption as a major challenge for the economy and appears to be focusing on this from top down. Pakistan's ranking in recent years has worsened; rising from 2.5 to 3; an anomaly in the South Asia region. That is not to say that other countries are corruption free; rather the extent of corruption compared to the size of the economy is small enough for the economy not to be overcome by it. Markets still function relatively efficiently, productivity and competitiveness levels remain high and growth continues apace. The situation in Pakistan is different; markets are underdeveloped or non-existent, competitiveness appears to be the exception rather than the rule and we have a preference for regulations and bricks and mortar.

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The focus in Pakistan is now on eradicating this menace to the economy, by catching and making an example of people believed responsible for it. However, no one appears to be focusing on the reason why corruption is taking place; why do people feel compelled to go for such an undesirable activity.

> *This excessive regulation and love for red-tape acts as a major deterrent for entrepreneurs already operating or thinking of operating in the economy.*

But individuals by and large are not inherently dishonest; there has to be something pushing them to adopt such behaviour. Our hypothesis is that the business environment in the country is hamstrung and stifled by over-regulation. This is evident in the ranking of the World Bank's Ease of Doing Business Index; Pakistan ranks at the low level of 108! This excessive regulation and love for red-tape acts as a major deterrent for entrepreneurs already operating or thinking of operating in the economy. Who wants to spend hours upon hours dealing with various government offices to get their taxes sorted out? Interviews conducted by PIDE with key stakeholders in various industries have highlighted this fact . No doubt, this connection deserves to be explored further for other industries and sectors of the economy.

[1] See: Qadir, Din and Ghani (2019) "Competitiveness in Pakistan: A Case Study of the ICT Industry" PIDE Working Paper Series, No. 168; Malik, Ghani and Din (2017) "An Assessment of Pakistan's Export Performance and the Way Forward, PIDE Working Paper Series, No.153.

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%

	Country Code	Corruption Perception Index							EODB Index (2018)
		2005	2010	2011	2012	2013	2015	2018	
1	PAK	2.5	2.5	2.5	2.5	2.5	3	3	108
2	IND	3.5	3.5	3.5	3.5	3.5	-	-	63
3	BGD	2.5	3	2.5	2.5	2.5	2.5	2.5	168
4	LKA	3.5	3	3	3	3	3	-	99

Source: World Bank

CONCLUSION

The divergence of industrial development and by extension, overall economic growth trends, between developed and developing countries, and even among various groups of developing countries is a disturbing trend. The expectation had been that when late developers would accelerate their growth efforts the growth trajectories of all countries would converge.

However, this has not turned out to be the case; a number of developing countries managed to close the gap but the majority languished behind, and this has rekindled interest in trying to identify the reason for this gap. Earlier explanations focused on openness, free markets and a minimal role of the state as the driving force of the success stories of development. Later explanations drew inspiration from the work on evolutionary theory to argue convincingly for the key role played by technological change and capabilities in driving competitiveness and growth.

We feel an underlying reason that plays a crucial role in explaining why growth is faltering rests in excessive or overburdened regulation in the economy.