

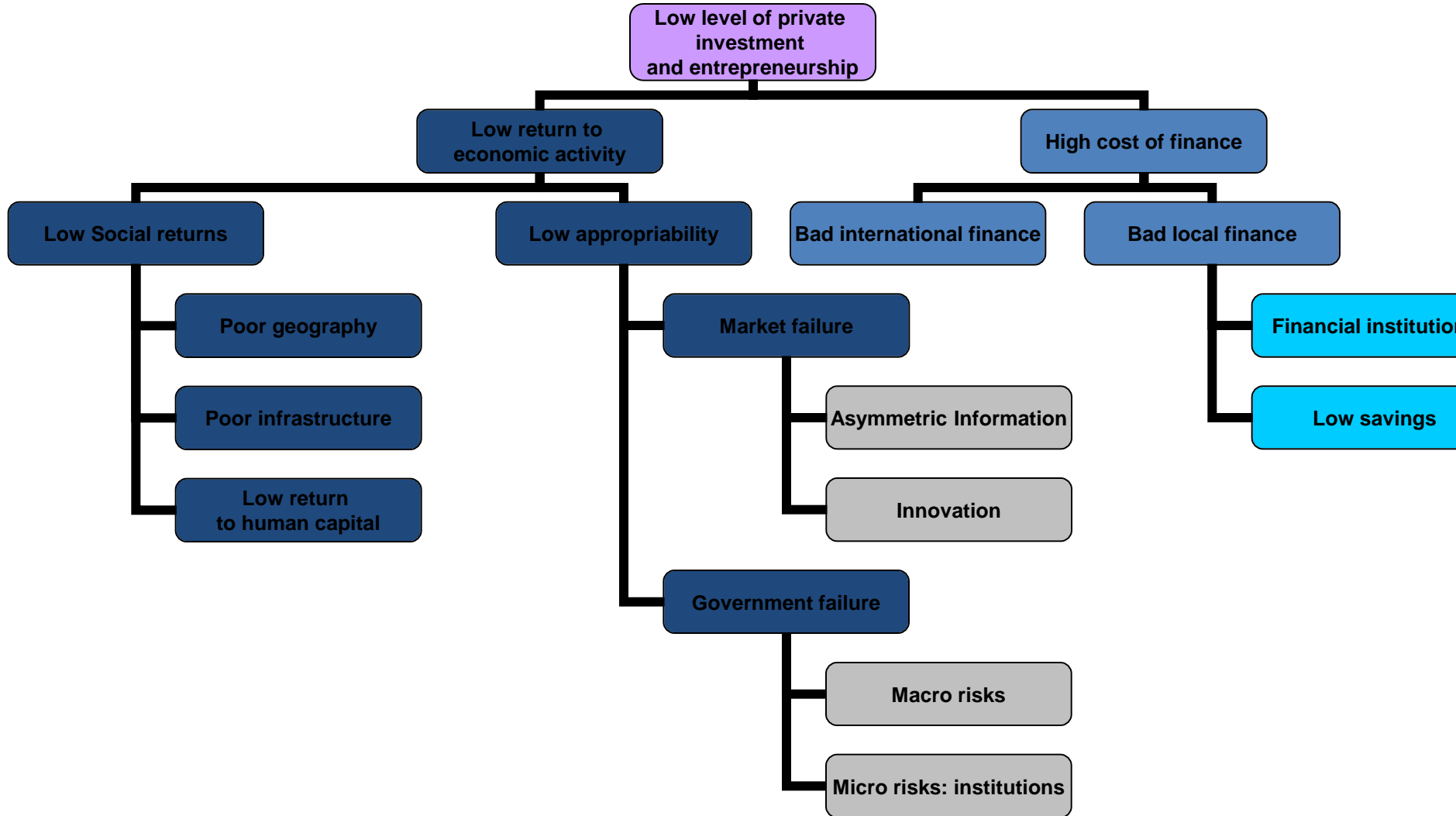
Growth Diagnostics in Pakistan

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Introduction

- Identifying critical constraints to Growth
- Methodology proposed by:
 - Hausmann and Rodrick and Valesco (2005)
- Motivation for methodology:
 - All reforms cannot be undertaken simultaneously
 - Reforms in one area may lead to distortion in another area
 - Countries need to focus upon one or two binding constraints that would have wide ranging effect

Growth Diagnostics



Cost of Finance

- International Finance or Local finance
- Local Finance
 - Low Savings
 - Bad Intermediation

Bad intermediation

- Good intermediation
 - Mobilize savings, lend across the board to private sector while keeping interest spread low.
- Lending to Public Sector...crowding out
- High interest spread
 - Floor interest rate to curb high spread
- Lending concentrated in manufacturing sector

Intermediation

- Does non-availability constrain investment
- If yes:
 - The constraint is on:
 - Demand side
 - or
 - Supply side

Evidence from small and micro retail firms

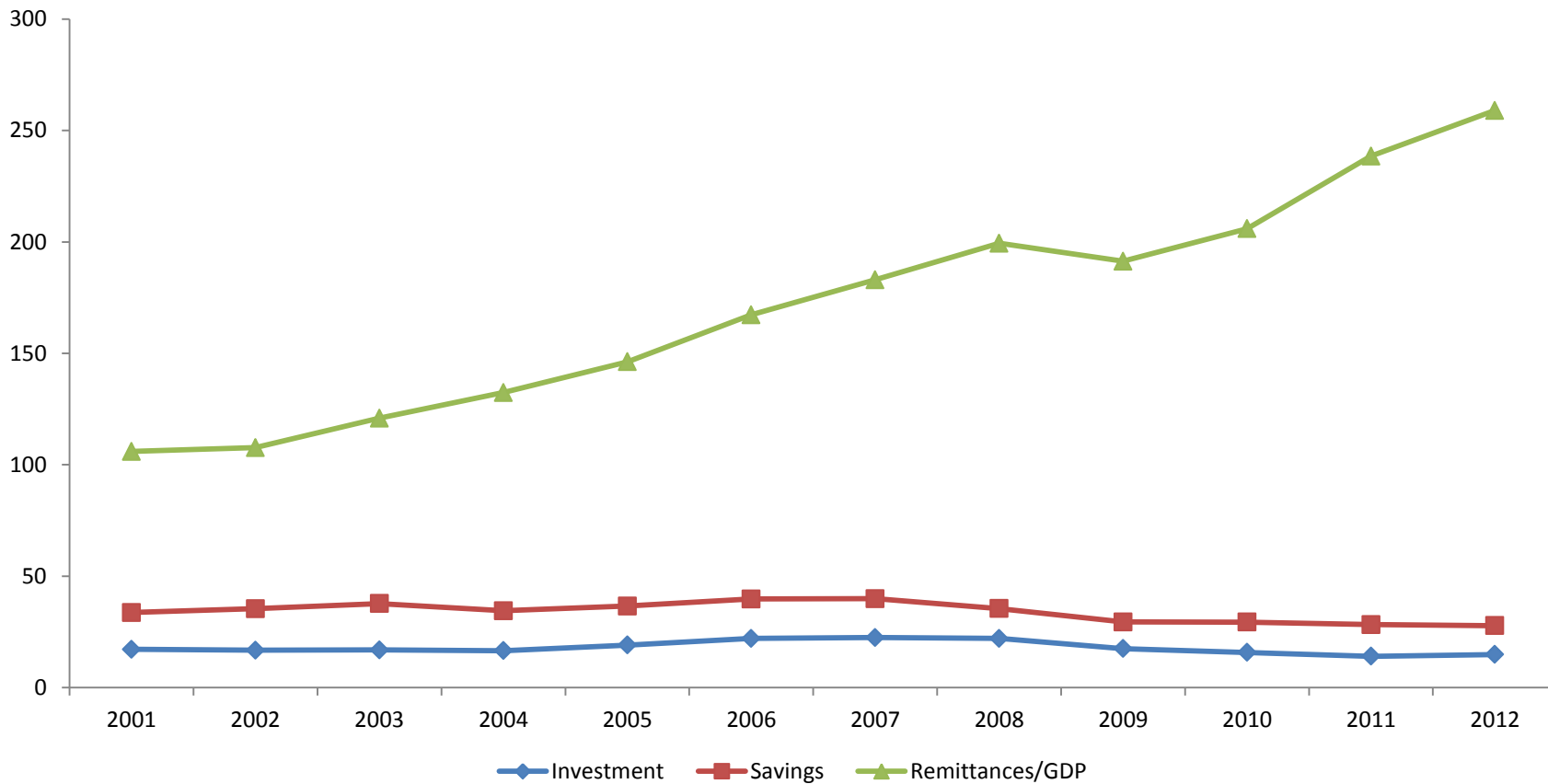
- 87 pc use retained earnings
 - 66 pc: don't need loan (demand side constraint)
but
 - 63 pc make use of committees
- 11 pc borrow from friends and family
- 2 pc borrow from banks

Constraint: Low Savings?

An economy constrained by low savings:

- has high real interest rates
- borrowers should be chasing lenders
- the current account deficit should be large
- Entrepreneurs should be full of investment ideas
- Remittances used for investment rather than consumption and investment in real estate.

Investment, Savings & Remittances



Foreign Debt, Current Account Deficit and Weighted Avg. Cost of Deposits

	Foreign Debt/GDP (%)	Weighted avg. Return on deposits	Current Account Deficit/GDP (%)	Real Interest Rate
2001-2	50.9	3.61	-0.70	2.8
2002-3	43.1	1.61	1.90	-1.4
2003-4	36.7	0.95	3.80	-2.3
2004-5	32.6	1.37	1.40	-1.4
2005-6	28.7	1.96	-3.92	0.6
2006-7	27.5	2.60	-4.81	1.1
2007-8	29.9	4.13	-8.47	-0.5
2008-9	30.4	4.44	-5.52	-5.0
2009-10	33.3	4.29	-2.23	2.0
2010-11	29.8	4.53	0.10	0.0
2011-12	28.0	4.56	-2.07	0.0
2012-13	24.3	4.38	-1.04	0.9

Low Return to Economic Activity

- Low interest rates
- High bank liquidity
- Current account is near balances
- Entrepreneurs invest abroad
- Increase in foreign aid or remittances finances consumption, housing, capital flight

Low Return to Economic Activity

- Low Appropriability of Return
 - Governance/Institutional Failure or
 - Market failure

- Low Social Return
 - Poor Infrastructure
 - Poor human capital

Governance Indicators

Variables	Pakistan	Average	Malaysia	
		South Asia	Asian Tigers	
V & A	-0.87	-0.44	0.55	-0.34
Political Stability	-2.68	-0.98	0.84	0.00
Govt Effectiveness	-0.79	-0.39	1.58	1.01
Regulatory Quality	-0.73	-0.65	1.49	0.55
Rule of Law	-0.91	-0.45	1.33	0.51
Control of Corruption	-1.06	-0.45	1.26	0.30

Governance Indicators: Pakistan

Variables	1996	2000	2006	2011	2012
Voice and Accountability	-0.67	-1.31	-0.93	-0.83	-0.9
Political Stability	-1.21	-1.14	-2.05	-2.7	-2.7
Govt Effectiveness	-0.59	-0.58	-0.36	-0.82	-0.8
Regulatory Quality	-0.45	-0.73	-0.44	-0.61	-0.7
Rule of Law	-0.66	-0.94	-0.83	-0.9	-0.9
Control of Corruption	-1.15	-0.82	-0.76	-1	-1.1

Institutional Failure

1. Plea bargain
2. Controlling theft of electricity
3. Creation of new provinces
4. NFC
5. Political Finance
6. SROs

Institutional failure

Bureaucracy

Local Government

Medium of Instruction

Financing Education

Holding Census

Social Return

- Poor Infrastructure
 - Energy: Governance failure
- Low human capital
 - Financing Education
 - People opting out of public education
 - Medium of instruction

Macroeconomic Instability: Elections 2008

- Before Elections
 - Oil prices static at Rs. 51 for 10 months
 - Exchange rate depreciation 6 months: 3.6%
- After Elections
 - In 7 months: 30% depreciation
 - Oil prices increased heavily

Macroeconomic instability

Elections 2013

- Before Elections:
 - In 6 months Exchange rate depreciation by 1.3%
- After Elections:
 - 6.7 % depreciation
- Electricity prices not changed for almost a year before elections
- Money for financing: raised used deficit financing...Independence of central bank?

Micro Evidence: Firm level

Growth in employment

Labor Quality	84.03 (35.47)**
Institutional Quality	74.15 (14.75)***
Finance	18.29 (8.46)**
Law and Order	-16.16 (18.56)
Electricity	-2.77 (4.20)
Constant	-107.59 (27.10)***

Macro Evidence

- Large Foreign capital Inflows
- Slight Impact of institutional quality

Conclusions

Cost of Finance:

- Low Savings: ?
- Low return to Economic Activity Yes
 - Infrastructure:/Energy Yes
 - Low Human Capital: Yes
- Macroeconomic stability Yes
- Access to Finance yes
- Energy Yes
- Governance: yes
- Institutions: yes