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Shaping Pakistan's Future: Insights From A Visionary Economist

In this issue, SDSB 360 is in conversation with Dr. Ishrat Husain, an influential Pakistani banker, economist, and reformer whose leadership has shaped Pakistan's financial landscape. From steering the State Bank of Pakistan (1999–2006) to driving educational excellence as Dean of IBA Karachi (2008–2016) and championing institutional reforms as Advisor to the Prime Minister (2018–2022), Dr. Husain's career is a testament to visionary leadership and a relentless pursuit of progress.

Convocation at the Institute of Business Administration, Karachi

Q. You've had a distinguished career across various countries and institutions. Could you reflect on this journey and how your diverse experiences have shaped your approach to economic reform?

I have had the good fortune of working as a civil servant at the grassroots level at the beginning of my career, grasping and understanding the day-to-day problems faced by ordinary citizens. This was followed by policy-making positions in the Finance, Planning and Development departments, which permitted me to apply this understanding in finding solutions to their problems. My pursuit of advanced degrees in economics helped me contextualise these solutions from the larger perspective of theory, history, and evolution of development issues faced by newly independent countries. Two decades spent at the World Bank exposed me to a large variety of countries as diverse as Liberia, China and Uzbekistan and sharpened my knowledge about the determinants of growth and poverty alleviation.

This cumulative reservoir of knowledge came in handy when I assisted the top leadership in reviving Pakistan's economy as the Governor of SBP. I doubt if I would have been successful in implementing the strategic plan of restructuring and modernising the Central Bank and reforming the ailing financial sector without the benefit of this cumulative knowledge.

As a development economist, policy maker and practitioner, it dawned upon me that the institutions of governance make a substantial difference between the success and failure of developing economies. Pakistan's robust and sound institutions were pivotal in the rapid growth in the first forty years after its independence. It was one the fastest growing economies, way ahead of India and Bangladesh. The subsequent decay of these institutions turned it into a laggard trailing behind the two neighbours in the next three decades, frequently knocking at the doors of the IMF and creditors for bail-out. This hypothesis was tested rigorously and found to be the main explanatory factor when I did extensive research and produced the book "Governing the Ungovernable ".

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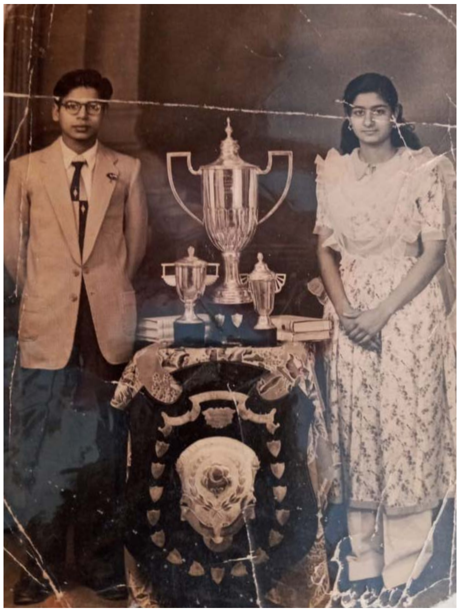
After I was invited to join the Cabinet in 2018, I tried to implement some of the findings of the book in making the institutions in Pakistan vibrant and functional, responsive to the needs of the citizens, paving the way for inclusive and sustained growth rather than being captured by the elites. We held more than 80 consultative sessions throughout the country involving 2223 stakeholders from all walks of life. After consolidating their views and incorporating their suggestions, the road map for institutional reforms (compiled in a report IRC Volume 1) was presented to the Cabinet. Unfortunately, with the subsequent political instability, these reforms were not implemented.

Q. In your recent book Development Pathways: India, Pakistan and Bangladesh 1947-2022, you examine the divergent development pathways of these countries; what lessons can Pakistan draw from these comparisons to overcome its economic challenges?

This study dwells upon a large number of topics from which a list of lessons and pain points have been extracted. This may require another interview at depth.

However, for this interview, I would like to focus on only one major finding: regional cooperation. Individual South Asian countries have made progress in raising the living standards of their population, reducing poverty, improving social indicators and integrating themselves into the world economy. However, the region has regressed since 1947 in terms of regional economic cooperation. There are many reasons for this unfortunate development, but the asymmetrical dominant power of India, which forms 80 percent of the population and 82 percent of the GDP of the region, lingering political tensions between India and Pakistan and the trust deficit among the countries are among the main contributory factors. Studies have concluded that low transportation costs, cultural similarities influencing taste and fostering profitable complementarities, and low transaction costs make the economic benefits of liberalizing trade between India and Pakistan outweigh the associated costs. Despite this, the trade between the two neighbouring countries has remained negligible. So far, regional trading arrangements have not been successful in South Asia. SAARC (South Asian Association for Regional Cooperation)



Debating competition at college

Civil Academy

and SAFTA (South Asian Free Trade Area) can stimulate trade and growth as competition is unleashed, lowering domestic prices by achieving economies of scale and acquiring new technology. Historically, India, Pakistan, and Bangladesh were unified markets until 1947, when one-quarter of trade took place within the subcontinent. It has dwindled to 6 percent as national boundaries have become barriers to trade flows and the exchange of goods and services. Dismantling tariff and non-tariff barriers has made a huge difference in North America, Europe, and East Asia, but not in this region. The advantages of proximity, low transportation costs, and cultural similarities, which influence trade and cause profitable complementarities, have remained elusive. South Asia is today the least integrated region in the world. Intra-regional trade has remained stagnant at less than 5 percent of the total trade in the last 30 years. East Asia and the Pacific's intra-regional trade has risen to 52 percent. Even Sub-Saharan Africa carries out twice as much intra-regional trade as South Asia. Cross-border investment is negligible, and while there is an overall liberal environment for foreign investment flows, there are a lot of formal and informal restrictions for flows originating from within the region. Common historical and cultural heritage would have, in other parts of the world, induced ease in the movement of the people, educational exchanges, access to each other's media and cultural resources, sharing of scientific and technological knowledge and other forms of cooperation but none of this has happened in South Asia. With rising purchasing power in the hands of an expanding middle class, South Asian countries would be in a win-win situation if they decided to open up their economies to promote regional trade, investment, and educational and scientific exchanges. Pakistan and India missed an opportunity to normalise trade between the two countries and then strengthen the South Asia Free Trade Area when India and Pakistan reached an agreement in early 2014. Pakistan had agreed to grant Most Favoured Nation status to India, while India had agreed to phase out its negative list from SAFTA in one year. India also removed some of the items of importance to Pakistan from the negative list. The Pakistani Cabinet had to ratify the agreement, but because of the impending general elections in India, it was decided to postpone the ratification until after the elections. That occasion has never arisen, although ten years have elapsed since then, no progress is visible. Had this agreement been reached, the picture of South Asian economic cooperation would have vastly differed from what we observe today. For example, Punjab in India and Punjab in Pakistan, Assam and Sylhet, Bangladesh and Northeastern states of India, Northern Sri Lanka, and Tamil Nadu would have derived substantial benefits from the operationalisation of SAFTA. These contiguous corridors can lower the cost of production by sourcing cheaper raw materials and reconfiguring the supply chain from neighbouring sub-regions across the borders. Consumers benefit from proximity as food shortages occurring in one country can be easily met by bringing in the commodities from the countries producing surplus much faster and with lower costs than anywhere else from within the country. Fluctuations in agriculture production do provide intra-regional trade as a strong buffer. When there is a shortage of onions in India, Pakistani Punjab can supply within two hours compared to the expensive shipments from the rest of the country or overseas and vice versa.

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Other complementary areas for promoting regional trade are trade facilitation and non-tariff barriers. Trade facilitation across the borders within the region has been hindered by issues of phytosanitary, health, environmental standards, quality testing, considerable delays in custom clearance, lengthened travel times and higher transaction costs. Truck crossings, where they are even allowed, take several days, and allegations of unnecessary harassment by border officials are rampant. Non-tariff barriers had, in fact, diverted normal trade flows to informal or border trade or routing through third countries such as Dubai and Singapore, raising costs to end-users.

Q. Your book Unravelling the Gordian Knot discusses the complexities of Pakistan's economic reforms. What, in your view, are the main obstacles that hinder successful reform in Pakistan today?

There is a lack of broad political consensus on the contours of these reforms, and there are no champions for reform among our politicians as they are quite complacent with the status quo, where a patronage system helps them acquire or retain power. There is no incentive for them to give up power or perks, but they should voluntarily.

Reaching consensus, messaging and carrying out the people alone can only be tackled by the elected representatives. To have a long-lasting impact, these have to be presented before the legislature for their consideration and approval on a cross-party basis. This negotiation, persuasion, give-and-take process can only move forward if there is no serious confrontation or adversarial relations between the party in power and the opposition. Take, for example, the privatisation of loss-making SOEs (State-Owned Enterprises). If it is leased out to a private operator who guarantees decent returns to the government, provided the existing staff on the payroll is given severance packages, what do you think the reaction to this move would be? The workers would come out on the streets and approach the media and the opposition parties for their support. It is now the political calculus of the leader and the party in power whether to yield to these pressure tactics, roll back or reverse the actions taken, stick to them despite this resistance or modify them. So far, they have rolled back and yielded to pressures.

Emphasis is to be given to student participation, experiential learning, apprenticeships, innovation and entrepreneurship.

The reason for the kind of political behaviour exhibited by elected representatives has to do with the incentive structure under the present voting system. MNAs and MPAs owe their election to constituency politics. They are obligated to take actions which keep their constituents pleased and their opponents subdued. That means that prices of essential commodities and tariffs charged for electricity, gas, water, and railways should remain frozen and controlled through administrative means (whatever the government has to cough up to bear the subsidies) so that people don't complain about rising prices. They would like the government to create new jobs to take care of the young men and women in their constituencies who are seeking employment even if such jobs are not needed by the organisations concerned, or the candidates nominated by them are not suitably qualified for the jobs. Postings and transfers of key officials – particularly SHOs, patwaris, irrigation SDOs, and schoolteachers in their areas – at their recommendations so that these officials can oblige the elected person. Development funds in their areas allocated at their discretion for the schemes they choose. These actions enhance their political prospects for winning the elections. The principles of good governance – a neutral, impartial, objective – administration that would benefit all and sundry without any parochial or partisan considerations and form the core of the reforms are thus in conflict with the imperatives of constituency politics. Whether the considerations that the government deficits keep on rising and the country's debt stock becomes unbearable because of subsidies, utility tariff freezes, wasteful expenditure, expansion of government payroll, and pensions are of great concern to the party leadership but of very little consequence to constituency-driven politicians. There is a lack of congruence between the collective national interests and the individual or partisan interests of elected representatives due to perverse incentives entrenched in the existing election system.

This is the most significant impediment to the implementation of reforms. There are several other compelling reasons. First is a design flaw: one of the instruments for achieving the stated purpose is how best to deliver basic public goods and

Left to Right: Mr. Naqvi, Dr. Husain, Mr. Shahid Hamid, Former Governor of Punjab, and Ms. Roshaneh Zaffar, Managing Director and Founder, Kashf Foundation

80 percent of medical college seats are won by females on merit. However, only 30 percent of the graduates go on to work in the profession.

services to the citizens in a cost-effective and efficient manner. The natural corollary from this is that the reforms should be geared at the local level as that is where the interaction between the citizen and the government functionary takes place. Whether it is security, law and order, education for the kids, healthcare for the family, drinking water and sewerage, sanitation and cleanliness of the streets and neighbourhoods, roads and pavements, public transport, streetlights, parks and amenities, *mandis* and market spaces, the pursuit of justice and adjudication of disputes – all these functions are performed at the local level, not in provincial capitals. Local governments have been disempowered and deprived of the necessary resources to perform their functions. A country of 240 million people with highly diverse and differentiated factor endowments and socio-economic milieu cannot be run from the federal or provincial headquarters. The true spirit of the 18th Amendment will be realised when the devolution to the local governments is completed. Studies from across countries and across Pakistan show that resource allocation is more efficient, responsiveness to citizens' needs is swift, and resource mobilisation efforts are successful when people see that tangible results are accruing to them and their communities.

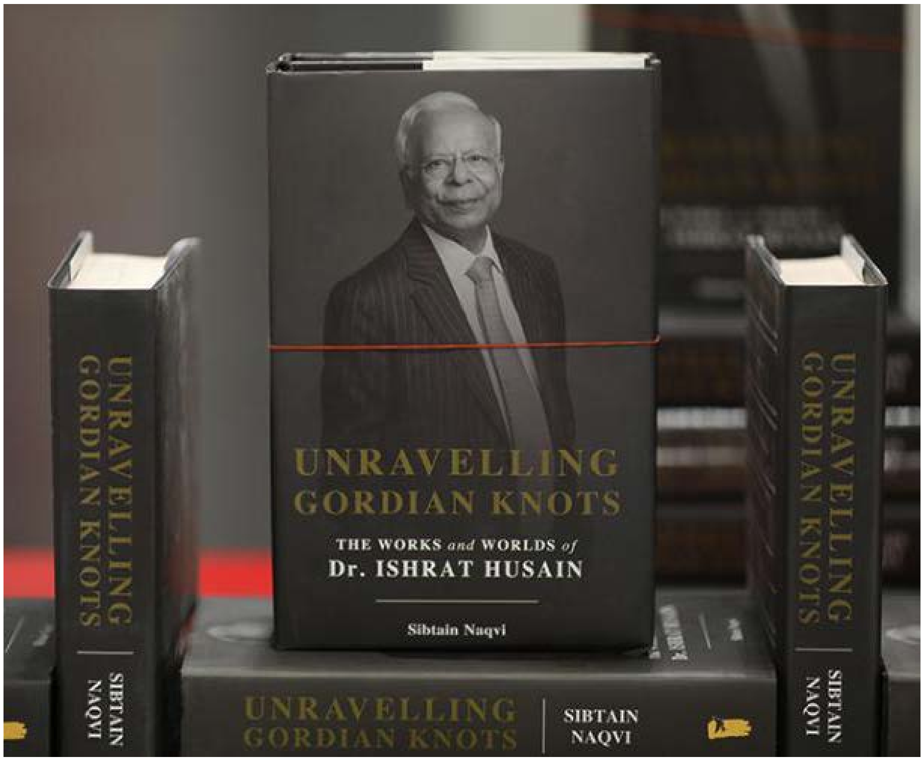
Another major impediment is time inconsistency. Every reform creates losers and winners. The losers are well organised and clearly visible, while the gains will accrue sometime in the future and diffused throughout the economy. The losers can mobilise public support in their favour, but as the winners have yet to emerge, there is nobody to champion their cause. Therefore, the political party that undertakes the reforms upfront bears the costs. Still, the gains will be captured by their opponents or some other unknown political configuration in the future. This asymmetry between the timing of losses and gains and accrual of costs and benefits has remained a major hurdle in the successful implementation of reforms along with the design flaw, political incentive structure and civil servants' attitudes.

Q. Drawing upon your experience with international organisations like the World Bank, how can Pakistan become competitive in the global economy?

The largest setback to the country has been the neglect of human development. Had the adult literacy rate been close to 100 percent, it is estimated that per capita income would have reached at least $ 3000. Pakistan ranks low in human development indicators with an adult literacy rate of 60 percent, average schooling of five years, and high infant and maternal mortality rates. Science and technology, which are the drivers of productivity and efficiency, have been neglected, and innovation is missing from the production structure. The respective roles of the state and markets have been distorted. A small class of elites has rigged markets which allocate resources efficiently to maximise their benefits. In contrast, the state that ensures benefits of growth are widely distributed among the population has also been hijacked by the same elite class. We end up with the worst of both worlds – inefficiency and inequity – that slows down our economic progress and creates a sense of deprivation.

Pakistanis consume more than they save – both the government and households. They import more than they export, have low investment rates in private and public sectors, but aspire to grow beyond their means. Unless these recurrent imbalances of fiscal, trade, financial, and savings-investment gaps are bridged, the situation will remain unchanged. Finally, Pakistan's institutions of governance – parliament, judiciary, media and civil services – which brought about spectacular results in the first 40 years, have decayed. Patronage-based politics and polarisation have weakened these institutions. Loyalty rather than competence has become the hallmark of appointments in the executive branch, resulting in waste, corruption and nepotism. Most of the private sector has also become used to rent-seeking with the help of the tax and regulatory authorities – and, with a few exceptions, lost its vibrancy and dynamism.

Domestic productive capacity to meet the aggregate demand when the country is growing fast is inadequate. It creates a balance of payments problem as the demand spills over into higher imports. We have to borrow to finance these imports as we need more than our foreign exchange earnings from exports, remittances, and foreign direct investments (FDIs) to meet



I would urge the students to stop chasing grades, degrees, and credentials and seriously focus on acquiring, assimilating, absorbing and applying knowledge to solve the real-world problems of Pakistan.

the rising import bill. The consequences of this boom-and-bust economy are that we must meet periodic crises and approach the International Monetary Fund (IMF) and other donors to meet our external financing requirements. To avoid depletion of our foreign exchange reserves, we have to allow the exchange rate to depreciate, the interest rate to rise to contain inflationary pressures, and allocate a higher amount of our budgetary revenues to meet debt-servicing costs. The rising fiscal deficits continue to reduce the space for public-sector investment. Agriculture input supply, marketing and processing have remained stuck in medieval modes. The private sector has not established warehouses, cold chains, agro-processing units, certified quality seed companies, advisory services, veterinary services, artificial dissemination units, equipment and implements rental shops to increase domestic production of cotton, wheat, sugarcane, powdered milk, pulses, vegetables and fruit, oilseeds, fodder, etc. that can save at least $7-8 billion of imports every year.

Information Technology (IT) and IT-enabled services have emerged as promising avenues for domestic digitalisation agendas and exports in recent years. Investment in innovation and technology should be undertaken by our well-established businesses rather than following the herd instinct. Petrochemicals, oil refineries and steel are the most critical industries.

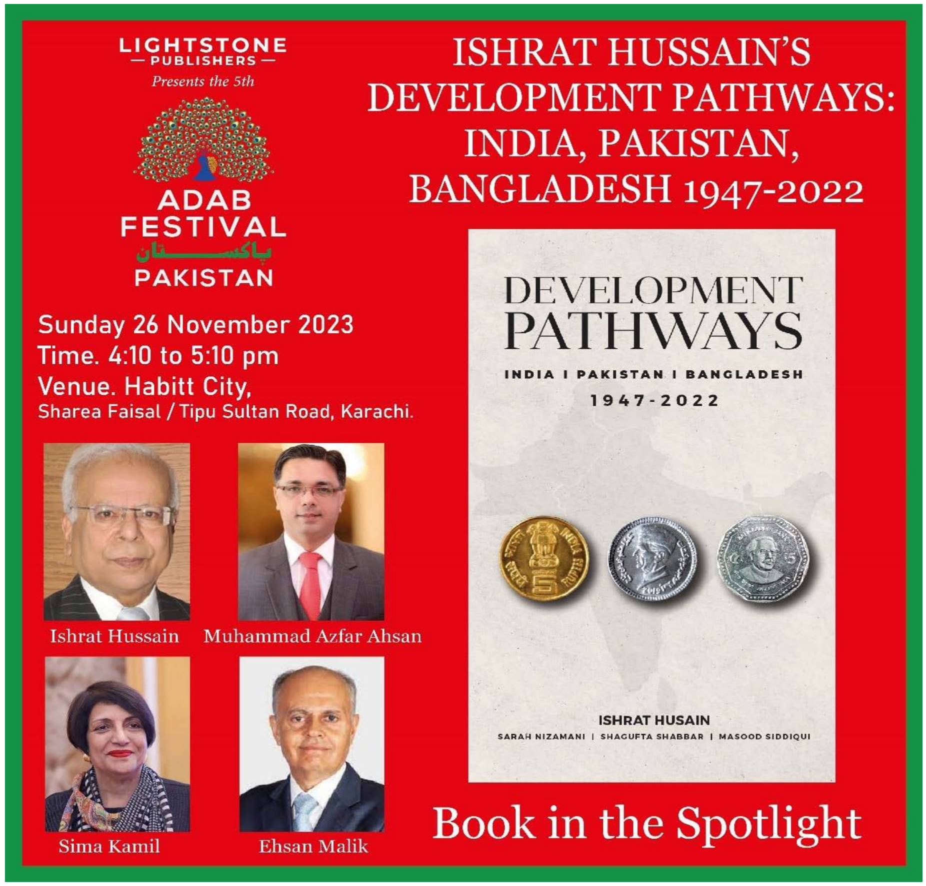
Our share in global export markets has declined from 0.2% to 0.15% in the last 30 years, and the export-GDP ratio plummeted to 10% from over 17% in 1992. At the turn of the millennium, 90-97% of merchandise exports were used to finance Pakistan's imports, but this capacity has dwindled to only 47%. Not only has export growth levelled off, but the composition of our exports has also remained unchanged for the last three decades.

Two-thirds of our exports are concentrated in a few agricultural raw materials based and unskilled and semi-skilled labour-intensive products, such as textiles, rice, leather, etc, rather than dynamic, fast-growing strategic products in the medium-tech and hi-tech sectors. The share in hi-tech exports has remained static at less than 2% while low-tech exports account for two-thirds of the total, down from one-half in the 1980s. Private businesses should tap the hidden wealth in the industry through labour productivity gains by hiring professionals, restructuring the internal organisation, revamping logistics and acquisition methods, entering into joint ventures and bringing in FDI, and mobilising capital for expansion and investment in sunrise industries through initial public offerings (IPOs). We may be a low-wage country, but adjusted for productivity, efficiency, quality (rejection rate), reliability and innovation (design), we are an expensive country.

Finally, there is tremendous political and business lobbyist pressure to protect domestic final goods industries by imposing high tariffs. In Pakistan, we have become used to open-ended and continuous extension of concessions, exemptions and high tariff rates. Therefore, the entry and exit rates of firms exporting their goods and services are low, product diversification has shrunk, the sectoral composition remains unchanged from the 1990s, and geographical concentration is elevated. It is not realised that in a world dominated by global value chains, tariffs on imports of components, ancillary supplies and intermediate inputs act as tax on exports. Studies have found that reducing import duties helps minimise input costs in downstream industries, some of whom become competitive in third-country markets. Let's start living in the 21st century.

Q. There remains a significant gender gap in Pakistan's workforce, particularly in decision-making roles. What policies do you think are needed to close the gender gap in Pakistan's workforce and leadership?

There is indeed a gender gap in Pakistan's workforce, which is proving to impede the way of inclusive, sustained development of



Persistence, perseverance and patience are the attributes that pay off dividends in the long run. So, my advice is don't give up.

the country. With a 23 percent female labour force participation rate dominated by unpaid family workers in the agriculture sector, the urban female workforce in the formal economy is relatively low. The paradox is that females excel in educational attainments at all levels. For example, 80 percent of medical college seats are won by the females on merit. However, only 30 percent of the graduates go on to work in the profession. This is a huge waste of talent and a misallocation of human resources. Social norms, family pressures, concern for safety and security, unsatisfactory transport arrangements, and workplace harassment act as deterrents for their entry and sustenance.

Policy actions where the employers provide pick-and-drop facilities, on-premises day care centres, flexibility in working from home, narrowing the wage gap, generous maternal leave, and equal opportunities for career progression would enable qualified females to rise and occupy decision-making positions. SECP's stipulation to have a female director is a step in the right direction. Similarly, reserving quotas for 33 percent of females in local government bodies and reservations in Central Superior Services examinations would accelerate the process of women occupying leadership positions. Freelancing, e-commerce, telehealth, and other technological advances will also contribute. Altering social norms is still a significant stumbling block.

Q. As a mentor to the next generation of economists and policymakers, what advice would you give to young professionals and students who aspire to drive change in Pakistan's financial and public sectors?

I would urge the students to stop chasing grades, degrees, and credentials and seriously focus on acquiring, assimilating, absorbing and applying knowledge to solve the real-world problems of Pakistan. We are at present confronted with a paradoxical situation, i.e., one-third of our university graduates are unemployed either because they got degrees in soft subjects for which there is no demand in the economy or had adopted shortcut methods, used examination guides, memorised answers to selective questions, reproduced them at the exams or cheated and indulged in unfair practices or approached the teachers for favours. This mindset and attitudinal behaviour have got them into difficulties and a country with low-quality human resources. On the other hand, employers are desperately looking for hard-working individuals who possess strong work ethics, are competent in their areas of expertise, think critically to solve problems, excel in working collaboratively as a team, and display sound communication skills. Both sides can rupture this disconnect by revising course contents, curriculum, pedagogical tools, and assessment methods. Emphasis is to be given to student participation, experiential learning, apprenticeships, innovation and entrepreneurship.

In my case, I made several changes in my career—from Chemistry to Economics, from teaching to civil service, from national to international organisations, returning to Pakistan and heading the Central Bank and then IBA. Every switch was made against strong advice from my family, friends, and well-wishers, but I had to cater to my passion and commitment for a larger purpose rather than doing a routine job.

Even though, with the grace of Almighty Allah, I successfully turned around two public sector institutions—State Bank of Pakistan (SBP) and IBA--- my larger goal of transforming the civil services and restructuring the government apparatus has not met with much success. I am no longer in the government, but I have not given up and keep urging the country's changing leadership to adopt these reforms developed after so much effort and wide consultations. Many friends advise me to give up as I waste my time, but I persist in writing, lecturing, and discussing this unfinished agenda. Persistence, perseverance and patience are the attributes that pay off dividends in the long run. So, my advice is DON'T GIVE UP.