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| How green is my valley | The News August 13, 2012 |
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|  | **By Ishrat Husain** |  |
|  | The 65 years of trials and tribulations, which Pakistan’s economy has faced, are a testament to its underlying resilience. The recent difficulties we have faced have led to memory lapses regarding the country’s historical economic performance. It is, therefore, imperative to survey the long and arduous journey of the economy since 1947.  At the time of independence, the prospects of the economic survival of a ramped Pakistan appeared quite dim. The following extract from the cover story of LIFE magazine dated January 5, 1948, is reflective of the sentiments about Pakistan’s economic future at the time.http://magazine.thenews.com.pk/upload_image/10/3227_8-13-2012_1.jpg  “When Pakistan suddenly received its freedom last August 15, proud and energetic patriots boasted that they had created a nation with more land than France and more people than Germany. Granting these comparisons, Pakistan still lacks most of the attributes of a modern nation. Today, its capital of Karachi is partly a tent city. And, as the following paragraphs and the picture indicate, it is fighting a close battle with economic bankruptcy.  Labor: Of the approximately 70 million Pakistanis, more than 80% are farmers, very few are wealthy landlords and the rest are shopkeepers and artisans. Nearly all of Pakistan’s financial and professional men were among the approximately four million Hindus who fled to India. From India, Pakistan got about six million impoverished Muslim peasants who, for the most part, left their agricultural implements behind. In return for freedom, Pakistan has huge transient camps full of landless farmers and an almost complete lack of skilled technicians or businessmen.  Industry: As a producing country, Pakistan must quickly industrialize to achieve self-sufficiency or else might establish a cordial interdependence with a processing nation. At present, in all of Pakistan there are only 26,000 workers employed in industry. She has no big iron and steel centers, only 34 railway repair shops, no match factories, no jute mills, no paper mills and only 16 cotton mills against India’s 857. Lacking the money or know-how to industrialize, Pakistan obviously requires a commercial rapprochement with Hindu India if her people are to be clothed.  Finances: Pakistan’s financial troubles are compounded by her political, trade and industrial failures. At the time of the division, the Hindu businessmen took all the gold bullion jewels and other liquid assets they could carry with them. With normal trade cut off by rioting and use of railroads for refugees, Pakistan’s income probably will not exceed 450 million rupees for the current year against almost certain expenditure of 800 million rupees. Officials talk hopefully of foreign investment or loans but in Pakistan’s present conditions, the risks are not very attractive”.  From such a shaky start, Pakistan today is the 34th largest economy in the world with a per capita income in current US dollars of about $1,200. It is one of the few developing countries that have achieved an average annual growth rate of over five percent over a period of six decades. Per capita incomes in constant terms have multiplied four- to five-fold. Consequently, the incidence of poverty has halved from 40 percent to less than 20 percent. But there are other remarkable achievements that the country can proudly boast of:  o A country with 30 million people in 1947 couldn’t feed itself and had to import all its food from abroad. In 2012, the farmers of Pakistan are not only able to fulfill the domestic needs of wheat, rice, sugar, milk for 190 million people at a much higher per capita consumption level but also export wheat and rice to the rest of the world. Pakistan has emerged as the world’s third largest exporter of rice.  o An average Pakistani earns about $ 1,200 in 2012 compared to less than $100 in 1947.  o Agriculture production has risen more than five times with cotton attaining a level of more than 14 million bales compared to 1 million bales in 1947. Pakistan has emerged as one of the leading world exporters of textiles.  o The manufacturing production index is well over 13,000 with a base of 100 in 1947. Steel, cement, automobiles, sugar, fertiliser, cloth and vegetable ghee, industrial chemicals, refined petroleum and a variety of other products that did not exist at the time are now manufactured for the domestic market and, in many cases, for the world markets too.  o Per capita electricity generation in 2012 was 10,160 kwh compared to 100 in 1947.  o Pakistan’s vast irrigation network of large storage reservoirs and dams, barrages, link canals constructed during the last six decades has enabled the country to double the area under cultivation to 22 million hectares. Tubewell irrigation provides almost one-third of additional water to supplement canal irrigation.  o The road and highway network in Pakistan spans 260,000 km – more than five times the length inherited in 1947. Modern motorways and super highways and four-lane national highways link the entire country along with secondary and tertiary roads.  o Natural gas was discovered in the country in the 1950s and supply has been augmented over time. As of now, almost 32 billion cubic feet of natural gas is generated, transmitted and distributed for industrial, commercial and domestic consumption and accounts for 40 to 50 percent of the country’s energy needs.  o Private consumption standards have kept pace with the rise in income. There are 52 road vehicles for 1,000 persons in 2012 compared with only one vehicle for the same number of people in 1947. Phone connections per 1,000 persons have risen to 683 from 0.4 over this period. TV sets, which were nonexistent then, adorn 70 out of every 1,000 houses.  These achievements in income, consumption, agriculture and industrial production are extremely impressive and have lifted millions of people out of poverty. But these do pale into insignificance when missed opportunities are looked at. The largest setback to the country has been the neglect of human development. Had adult literacy rate been close to 100 percent instead of close to 50 percent today, it is estimated that the per capita income would have reached at least $2000.  Pakistan’s manufactured exports in the 1960s were higher than those of Malaysia, Thailand, Philippines and Indonesia. Had government investment in education and the upgradation of training, skills and health of the labour force been at the levels maintained by East Asian countries and had it consistently maintained a policy of openness to world markets, Pakistan’s exports would have been at least $100 billion a year instead of the paltry $25 billion they are today. Had the population growth rate been reduced from 3 percent to 2 percent, the problems of congestion and shortages in the levels of infrastructure and social services would have been avoided; the poor would have obtained better access to education and health and the incidence of poverty would have been much lower than what it is today.  If this neglect of human development were not enough, the country began to slacken from the beginning of the 1990s. Slippages in growth, exports, revenues and development spending landed the country in a deep morass of external and domestic indebtedness. As a result, the incidence of poverty rose from 18 percent in 1988-89 to 33 percent by the end of the 1990s.  On a broad level, these problems stemmed from fundamental structural and institutional problems as well as poor governance and frequent changes in political regimes. With short life spans, succeeding governments were hesitant, if not outright unwilling, to reform the rent-seeking ruling elite consisting of a small class of politicians and bureaucrats; the political costs of pursuing structural reforms were too high.  But the starting point of the reversal was the paradigm shift in the basic model of development after the break-up of the country. Until late 1960s, Pakistan relied upon its private sector and achieved very high rates of economic growth. The nationalisation of the major manufacturing industries, banking, insurance, education etc. in 1971 caused a major disruption to economy and an erosion of private investor confidence that persisted for the next 20 years. This experiment with socialism had a negative impact on industrial development, export expansion, the quality of education and gave an overarching role to the bureaucracy in economic decision-making. The substitution of a culture of entrepreneurship, risk taking and innovation by rent-seeking and patronage suppressed the dynamism of the private sector.  The opportunity to undo most of the damage done by nationalisation was missed by the Ziaul Haq regime (1977-88). Instead of taking proactive measures to reverse the state-owned and state-dominated economy, the regime maintained the status quo. Although the process of nationalisation was abandoned, the orientation towards the public sector did not diminish in any perceptible way.  While economic performance was impressive during this period, it was not due to any fundamental policy or institutional reforms. The regime benefitted from the output that came onstream from large public sector investments made in the 1970s, the most significant among them being the Tarbela Dam that added considerably to irrigation water availability and hydel power capacity; the fertiliser and cement factories.  Meanwhile, defence spending averaged 6.5 percent of GDP in this decade and contributed to large fiscal deficits and a rapid buildup of public debt. These macroeconomic imbalances had repercussions on the economy in the subsequent period in form of increased debt burden. The neglect of development spending, for example, was one of the contributory factors to slow growth in the 1990s.  The other contributing factor was the neglect of social sectors. Pakistan underperformed other countries with similar per capita income in just about all of social indicators – a phenomenon called the ‘social gap’. The discrepancies are especially large for women i.e. a ‘gender gap’ reinforced the social gap. These twin gaps stunted the growth rate since no country can hope to make much progress in a globalised world economy without an educated and healthy work force.  Although the Nawaz Sharif government introduced major economic liberalisation reforms in 1991, both private investment and exports stagnated or declined through the 1990s. Macroeconomic sustainability was a serious problem. The financial sector was dominated by inefficient state-owned banks and access to capital was limited. The policy environment in relation to rules, taxes and import tariffs was unstable and the arbitrary use of Statutory Regulatory Orders (SROs) affected the level playing field needed for investors to compete based on business fundamentals rather than their ability to secure special deals.  Economic growth through the 1990s decelerated, showing an average trend of GDP growth of 4.4 percent per year. Political instability, frequent changes in government, weak governance, poor macroeconomic management and an unfavourable external environment were more dominant than the favourable impact of economic policies of deregulation, liberalisation and privatisation, especially since these reforms and policies were pursued sporadically.  The imposition of sanctions by western governments following the nuclear tests in 1998 exacerbated difficulties. The freezing of the foreign currency accounts of Pakistani residents and non-residents eroded investor confidence. While the turnaround in the economy post 2000 did put Pakistan on a higher growth path, it is important to understand this phenomenon with reference to earlier episodes of growth acceleration.  Since 1960, Pakistan has experienced two sustained growth accelerations with per capita real growth rates consistently exceeding 2 percent per year. The first period started in 1961 and lasted 10 years; the second began in 1977 and lasted 12 years. In both, growth resulted from an increase in capital inputs as well as an increase in productivity.  Importantly, the two growth accelerations were preceded by or coincided with a significant increase in the investment ratio. In the early 1960s, the investment ratio rose from just over 12 percent of GDP in 1960 to 22.5 percent in 1964. By 1971, when this ten-year period of strong growth ended, the investment ratio had declined again to about 14 percent of GDP. Similarly, the investment ratio rose sharply to 19 percent of GDP in the two years preceding the 1977 growth acceleration. While this second period ended in 1992, barring a dip in 1993, growth was fairly strong again between 1994 and 1996. Starting in 1993, the investment ratio started to decline, falling back again to 14 percent by 1998.  The recent growth acceleration of 2002-07 has also been accompanied by a similar increase in the investment ratio from 15.5 percent of GDP in 2001-02 to 23 percent in 2007-08. Contrary to popular belief that external official aid flows – particularly from the US in the post-September 11, 2001 period – were responsible for the economic turnaround of Pakistan, careful empirical analysis shows that the growth acceleration had come largely from an increase in Total Factor Productivity.  Exports of goods and services went up from $13.6 billion to $21.2 billion in this period, an increase of 55 percent. Workers’ remittances through official channels reached $6.5 billion annually by 2007-08 from less than $1billion and Foreign Direct Investment inflows rose five-fold in this five-year period. Meanwhile, US assistance as percent of Pakistan’s total foreign exchange receipts was a paltry 4.5 percent at its peak and, as a percentage of total budgetary expenditure, never exceeded more than seven to eight percent. These facts do not substantiate the widely-held myth that Pakistan’s sustained high growth between 2002 and 2007 was rendered possible by massive foreign assistance from the US.  Interestingly, the contribution of productivity to growth in this period is similar or even somewhat higher than that in the earlier growth periods. To some extent, this may reflect the growing contribution of the services sector to growth, which usually requires less investment compared to manufacturing. It may also reflect that following the slump of the late 1990s, there was considerable excess capacity in the economy and therefore less need for new investments to generate growth. The increase in capital utilisation translates to higher productivity per unit of capital and is reflected in the higher-than-average contribution of productivity to growth.  An IMF study of Pakistan’s economy between 1960 and 2004 confirms the importance of investment and rainfall as key determinants of growth in Pakistan. Macroeconomic stability also appears to be a precondition for growth. Periods of sustained growth appear to have been preceded by a reduction in inflation from relatively high levels. Prior to the 1977 growth spurt, inflation was at seven percent, down from a peak of almost 27 percent in 1974. Similarly, inflation in 1999 was at four percent, following a peak of about 12 percent in 1994-95. Inflation averaged 3.5 percent during the growth spurt of the 1960s; 7.5 percent during the one in 1977 and at five percent during 2003-04. By comparison, inflation averaged 15 percent during 1971-76 and 10.5 percent during 1991-98.  A World Bank study on growth determinants of Pakistan reports that economic growth increases with improvements in education, financial depth, trade openness and public infrastructure. It decreases when governments impose excessive burdens on the private sector and do not execute policies conducive to macroeconomic stability. An increase in the inflation rate, the volatility of the output gap, real exchange rate overvaluation or the probability of financial crises all lead to a significant reduction in economic growth.  The deterioration of world growth conditions between the 1970s and 1980s led to a decrease in a country’s growth rate of about 1.5 percentage points.  Going forward, there are a number of factors that will determine the growth trajectory of Pakistan. First, the global economy is not in very good shape at present. The US, Europe and Japan – the main drivers of the world economy – are stagnating and emerging countries – particularly China and India – are in slow growth phases. World commodity price spikes can affect Pakistan adversely.  Second, the speed at which Pakistan successfully integrates into the global markets will determine the extent of benefits to our external sector. In absence of diversifications of exports in composition as well as markets, chances are that other countries will overtake us. The latest country to have surpassed us in the exports is Bangladesh. The mindset, focus and efforts of exporters in Pakistan have to undergo a radical change whereby attention should be paid to labour productivity, efficiency within the firm and plant, aggressive marketing, research and development and a halt to seeking government concessions and subsidies.  Third, policy makers in Pakistan should steadfastly persevere in pursuing sound, credible and consistent economic policies and their effective implementation. Political stability and a working equilibrium between various organs of state will help provide strength to the economic environment. Fiscal deficits, inflationary financing losses to public sector corporations and untargeted subsidies have to be contained.  Fourth, the intermediation between good policies and their impact on the lives of the majority of citizens takes place through strong institutions and well-functioning governance structures. Devolution of powers to local governments has been one of the significant hallmarks of the recent times in Pakistan but the lingering reluctance on part of provincial governments to cede power; the absence of supporting infrastructure; lack of capacity building at lower levels; the clogging of systems and outdated procedures are some of the constraints that have not made this tier of government effective so far.  Further, civil services have to be strengthened and made more responsive to the people and made to carry out the basic functions of the state impartially, transparently and efficiently. Accountability for results has to be built in the system rather than extraneously enforced. Most of our key institutions have lost their way and have to be brought back to their original track.  Fifth, energy shortages are hurting the economy badly and corrective actions have not yet been put in place. Supply of critical infrastructural facilities such as power, natural gas, pipelines and storages, roads and railways, urban mass transit, water supply and sewerage, ports and civil aviation have not kept pace with the growing demands of the industry, commerce and general public. Investment and management through public-private partnerships can help increase this supply.  Ongoing public and private investment projects such as new dams and reservoirs; the rehabilitation of canals, barrages and lining of water courses; new power generation plants; the Iran-Pakistan gas pipeline; Liquefied Natural Gas projects; the oil refinery at Khalifa point; extensions to the road networks in Baluchistan; new science and engineering universities; the upgradation of the quality of technical and vocational education; mass transit systems in Karachi and Lahore and other projects – if completed on time – will give a big boost to the economy and help overcome some supply-demand gaps.  Further, the Gwadar Port should be made fully operational and linked with the transport network of Central Asia Republics and China. Once this network becomes effective and the National Transport Corridor network is completed, the economy should be able to extract benefits worth another 0.5 to one percent of GDP.  Sixth, Pakistan ranks absurdly low on the Human Development Indicators. Skills, technology and innovation are changing the competitive advantages of other nations; Pakistan, as a laggard, will have to redouble its efforts in the fields of education, skills upgradation, science and technology. The governance and incentive structures of scientific research organisations need to be revamped to bring them at par with at least China and India.  Seventh, a predictable, orderly and constitutional transition of power from one government to another will add a lot of strength to Pakistan’s economic prospects. Fortunately, the thrust of economic policies of all leading political parties in the country is much the same but this positive aspect has been lost in political bickering, venomous rivalries and unwarranted accusations against each other. The lessons of the 1990s should clearly teach us that the gains achieved can be reversed if we do not manage our political governance with tolerance, a healthy respect for dissent and differences of opinion and reliance on institutions rather than personalities.  Eighth, Pakistan is facing serious problems of internal and external security. The law and order situation has worsened in some parts of the country more than others. A reversion to normalcy in the security conditions of the country will reassure the investor community and help the mobility of factors of production. Foreign buyers and technical personnel are reluctant to visit Pakistan at present. Improved security would allow their free movement in and out of the country.  The actual realisation of Pakistan’s economic potential will depend upon a number of critical factors such as a benign global economy, successful integration of Pakistan into the global economy, sound macroeconomic policies, strong institutional and governance frameworks and investments in infrastructure, human development and political stability. Under a constellation of these favorable conditions, Pakistan can see its per capita income double to $2000 by 2020 and can reduce the incidence of poverty by half.  The writer is a former governor of the SBP. |  |
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