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Pakistan: Path to Rapid Growth and Job Creation

José Lopez-Calix

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Pakistan: Path to Rapid Growth and Job Creation

José Lopez-Calix

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Introduction

1. Pakistan's rebound from the global financial crisis has been slow and fragile, and unless it changes course swiftly, it could face the prospects of a second balance of payments crisis in less than five years. Its recovery from the 2008-09 global financial crisis has been the weakest in South Asia, featuring a unique double-dip growth pattern. Pressing short-term macroeconomic imbalances were barely improving when two floods hit the country in 2010 and 2011, the fourth and fifth natural disasters in five years. Despite some recovery of exports and strong dynamism in remittances, borderline stagflation continues—modest growth with (until recently) double-digit inflation, compounded by unsustainable macroeconomic policies and domestic and international armed conflicts. Pakistan must now climb out of this untenable situation.

2. The country's demographic transition is an opportunity to do just that. With high fertility, Pakistan will double the size of its already young population by 2025. The labor force has risen faster (3.7 percent a year) than the regional average (3.1 percent—a result of a larger working-age share of the population and a faster increasing labor force participation. The youth workforce has grown even faster, at 4.3 percent a year, well above the regional average of 2.7 percent. That growth is expected to last for at least 10 more years.

3. The only way to convert this massive demographic bulge from a political and social burden to an exceptional dividend is through rapid and inclusive growth that creates millions of new and better jobs. The labor force is expected to expand by 3.5 percent a year, as about 1.5 million young workers start seeking jobs each year. If female labor force participation rises, the pressure for new jobs will be even stronger. International migration does not seem to be a safety valve, with net migration a negligible 0.8 percent of the labor force in 2009.

4. But just creating large numbers of jobs is not enough. Creating more productive jobs—with jobs defined to include all wage work and self-employment, formal or informal—is the most reliable route for individuals and societies to move away from poverty, crime, and civil conflict. International experience shows that the key to sustainable rapid growth is shifting the labor force from less to more productive jobs. In sum, the two main challenges are improving the types of jobs available and enabling people to move into those more productive activities. East Asia's successful economies, and Pakistan's growth acceleration in the mid-2000s, are good examples of how this can happen.

5. Rapid growth and job creation are attainable, but to be sustained, they have to be pursued in tandem. When this happens, growth creates opportunities and incentives for people to specialize and get better education, to move from farm activities to more specialized and services-oriented nonfarm activities, and to rely less on government transfers and more on competition, innovation, and private initiative. Economies also grow faster as people acquire better skills and move from less productive rural work to more productive urban jobs.

6. Underlying bouts of rapid growth and resilience in the face of adversity, there are many positive features that can help Pakistan achieve its potential. One of them is the remarkable capacity to isolate key national projects from inefficiencies of the rest of the system. Another positive feature is Pakistan's capacity to absorb major shocks, as the

economy is relatively closed, and much of it is informal, featuring many small family farms and urban businesses generating massive underemployment. Steady and rising workers' remittances from Pakistanis working abroad are another important cushion. Agriculture is central to this sturdiness, as it still provides about 22 percent of the country's Gross Domestic Product (GDP), 45 percent of its jobs, and 60 percent of its exports. So while many ordinary Pakistanis suffered from rising food prices in recent years and malnutrition remains a serious problem among the poor, there is no risk of nationwide food shortages or famine. The natural endowments of Pakistan, from geography to mining, are other factors contributing to its potential, with Pakistan's only overland route between India and the energy-rich countries of Central Asia and the Persian Gulf. Last but not least is the rapid growth of women's participation in economic and political life, in tandem with progress on female literacy, and more female than male students in colleges and universities.

7. The binding constraints to Pakistan's growth are both emerging and structural. Emerging constraints include massive cuts in electricity access and macroeconomic instability, leading to high country risk and a sudden stop in external and domestic financing. Structural constraints include low access to domestic finance and government and market failures (micro risks) that impede investment, entrepreneurial activity, and competitiveness, blocking the transition from low-productivity to high-productivity jobs. The main government failures are ineffective taxation, large anti-export bias, cumbersome business regulations, and poor civil service. The contributing market failures are bad governance, excess business regulations, and an ineffective civil service. By holding down productivity, these failures limit job-enhancing growth.

8. Pakistan needs a transformational and inspiring agenda. The Pakistani economy will have to rely on new growth drivers to escape the status quo, while it is necessary to deal with both short-term macroeconomic imbalances and the microeconomic constraints that limit credit expansion, business productivity and competitiveness. It also faces important head-wings with the continuing weak external environment that are affecting its manufacturing and agricultural export dynamism. In response to identified constraints and gaps, the agenda proposed is based on six main growth-oriented reforms fostering productivity:

- *Macroeconomic stability*. The primary concern should be to maintain stability until the prospect of a sudden stop of external financing inflows recedes.
- *Increasing power supply and infrastructure*. The immediate priority should focus on improving sector governance. Once professional management takes over, reducing untargeted subsidies and exploring prospects for private investment in important energy (small and big dams) and gas projects should proceed.
- *Improving business environment*. Initially, measures aimed at fiscal consolidation and monetary tightening would help keep inflation in single digits and favor positive but low real interest rates, while reducing government borrowing would reduce the banks' incentives to crowd out private credit. At the microeconomic level, the focus should be on adopting measures that facilitate credit to Small and Medium Enterprises (SMEs) and women entrepreneurs. And regarding the business environment, the federal government could set up a One-Stop Shop for business registration, while provincial governments computerize land registration and ease procedures for construction permits. At least two loss making State Owned

Enterprises (SOEs) can be privatized or restructured in a short time frame, while setting norms for implementing the new Corporate Governance Code.

- *Export diversification and tapping the potential of regional trade partners*. Removing all trade-related Statutory Regulatory Orders (SROs) and bringing tariff slabs to three (0, 10 and 25 percent) would help liberalize trade, eliminate privileges and adopt a much simpler and corruption-prone system. Granting Most Favored Nation (MFN) status to India would have a worldwide demonstration effect.
- *Dynamic Cities and urban jobs*. Careful urban planning requires the revamping of zoning laws, and the establishment of a national database for housing titles and prices. Similarly, expanded Technical Vocational Education and Training (TVET) programs target urban youth and female unemployed and unskilled workers, as well as demobilized army members. Expanding microfinance jobs would target formation of youth entrepreneurs.
- *Agricultural development and rural jobs*. Pakistan's potential for an upward shift in agricultural productivity should come from a combination of technology innovation and extension, improved water use management (irrigation) and removal of trade distorted policies that create adverse agricultural incentives. Institutional reform of the agricultural extension and water management systems would provide funds and capacity building to authorities so as to fulfill their mandate.

9. Pakistan is at a turning point. It could stick to a status quo of piecemeal reforms leading to partial and unsatisfactory outcomes, which at best would lead it to recover its modest historic growth rate of 4-4.5 percent, or it could aim for a bold reform agenda supporting rapid growth (on or above 7 percent) and job creation. Both options are possible, but the former would make it very difficult for Pakistan to meet the aspirations of its people, and especially of its youth.

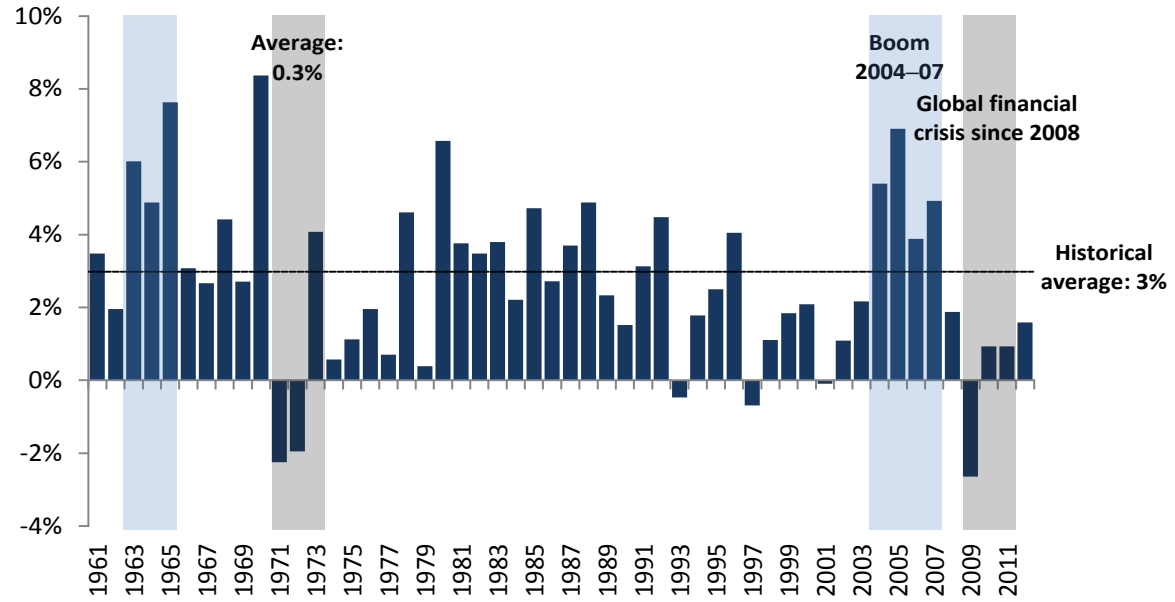
A Country at the Turning Point

10. Pakistan must climb out of its modest economic growth. The country's rebound from the global financial crisis has been slow and remains fragile, and unless it changes course in a swift manner, it could face the prospects of a second balance of payments crisis in less than five years. Economic recovery from the 2008–09 global financial crisis has been the weakest in South Asia, featuring a unique double-dip growth pattern. Pressing short-term macroeconomic imbalances were barely improving when two floods hit the country in 2010 and 2011, the fourth and fifth natural disasters in five years. Despite some recovery of exports and strong dynamism in remittances, borderline stagflation continues—modest growth with (until recently) double-digit inflation, compounded by unsustainable macroeconomic policies and domestic and international armed conflicts.

Lagging Behind on Growth

11. Pakistan's episodes of high growth tend to be short-lived, with multiple short cycles of rapid growth followed by stagnation. Though longer than low-growth episodes, few of the high-growth episodes can be characterized as 'growth accelerations'. Since 1961 GDP growth has remained on or above 3 percent for 29 years, but it consistently remained above 5 percent a year for at least five years in only three periods: 1963-66, 1980-83, and 2004-2007. And its current economic slump is the deepest in half a century (Figure 1). One has to go back to 1963–73 to find a boom-bust episode comparable to that of 2004-12.

Figure 1 **Pakistan: Booms and Busts in Growth, 1961-2012** (GDP per capita growth, %)



Source: Calvo and Ottonello forthcoming. All dates refer to fiscal years.

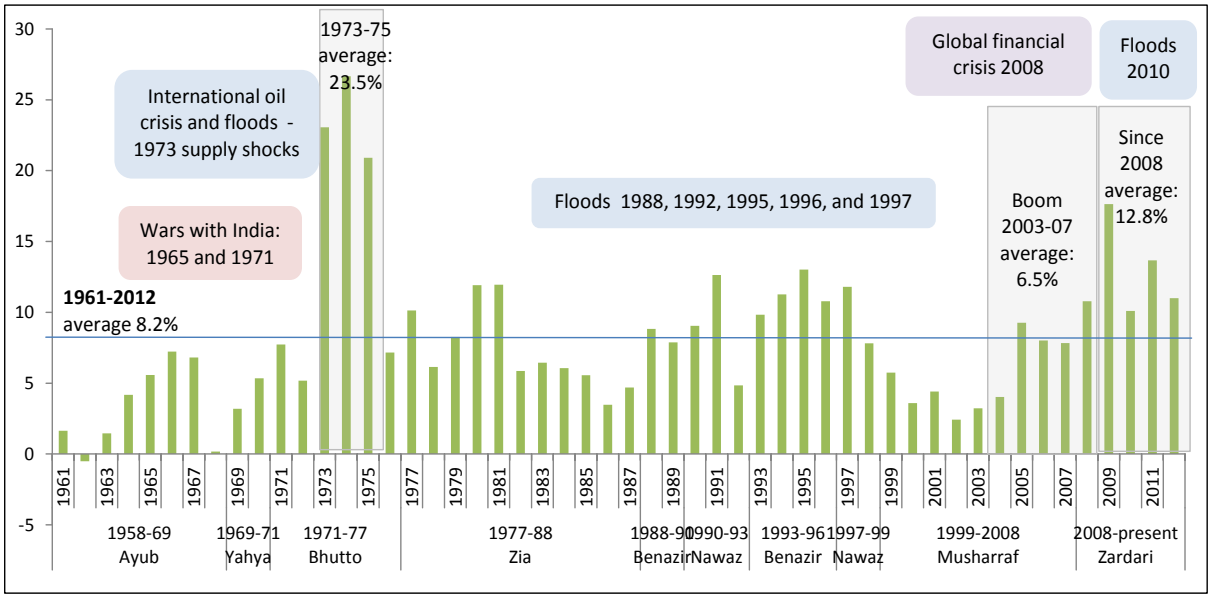
From Boom to Bust to Crisis

12. The most recent boom ran from 2004 to the 2008-09 global financial crisis. Since 2009, GDP growth has averaged a modest 3 percent per year, and severe fiscal and external imbalances have built up. During the boom, fiscal accounts were strongly pro-cyclical. But they began to deteriorate well before the crisis, and the countercyclical fiscal stance that

followed has led them to deteriorate even faster. Fiscal deficits of 6 percent or more have prevailed for four years in a row; the deficit of 8.5 percent of GDP for fiscal 2012 is the fourth-highest in Pakistan's history and the highest in more than two decades.

13. Expansionary monetary policies before the crisis led to double-digit inflation, peaking at 18 percent in 2008 (Figure 2). Monetary tightening has lowered inflation slowly, but rates have dropped to single digits only since July 2012. During fiscal 2013 the current account deficit, declining financial inflows, sizable repayments to the International Monetary Fund, and Central Bank intervention in the foreign exchange market to avoid a rapid depreciation of the currency, have shrunken international reserves. With less than two months of import coverage, and another year of fiscal disarray, Pakistan's next administration is confronted with the prospect of another currency crisis.

Figure 2 **Pakistan: Inflation Rates, 1961–2012** (CPI, year over year, %)

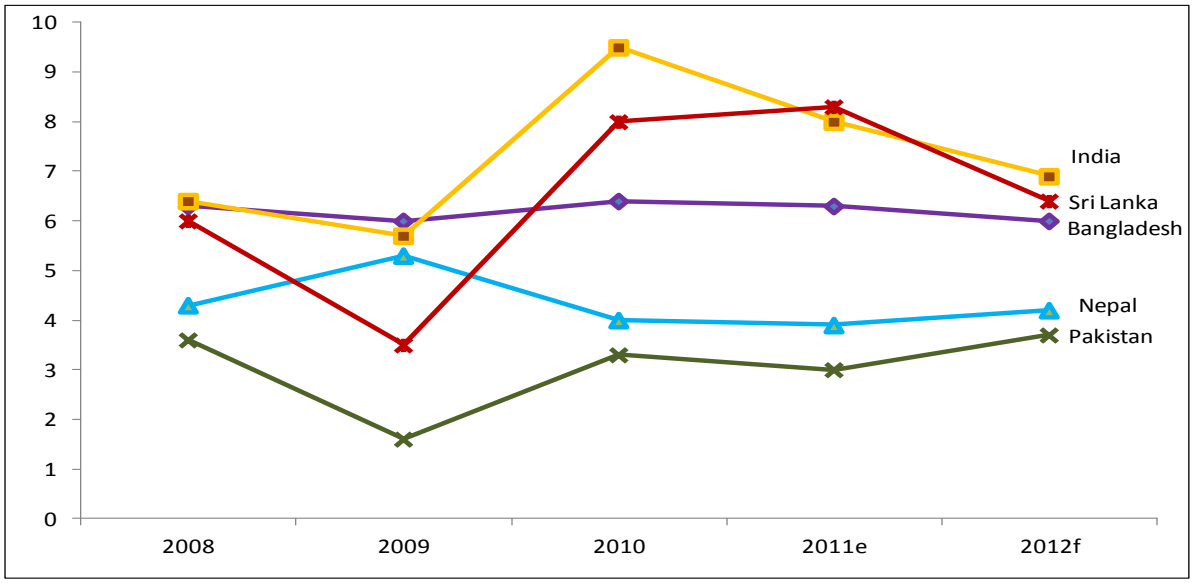


Source: Calvo and Ottonello forthcoming. World Bank Staff estimates

Distanced by Neighbors

14. Pakistan's growth is diverging from China and India, two of its most important competitors. Its performance had been robust for over half a century, at 2.5 percent per capita a year, but it lost momentum in the mid-1990s and by now lags behind that of its neighbors (Figure 3). Since 2009, average real GDP growth per capita has been only 0.2 percent. India, with similar institutional (and to some extent resource) endowments at its founding, surpassed Pakistan's GDP per capita in the early 2000s (Box 1). The Republic of Korea and other East Asian countries had a lower GDP per capita than Pakistan in the 1960s but have rapidly overtaken it. Thirty years ago China's income per capita was half that of Pakistan, and only today it is two and a half times Pakistan's (Figure 4).

Figure 3 GDP Growth in Pakistan & South Asian countries, 2008-12



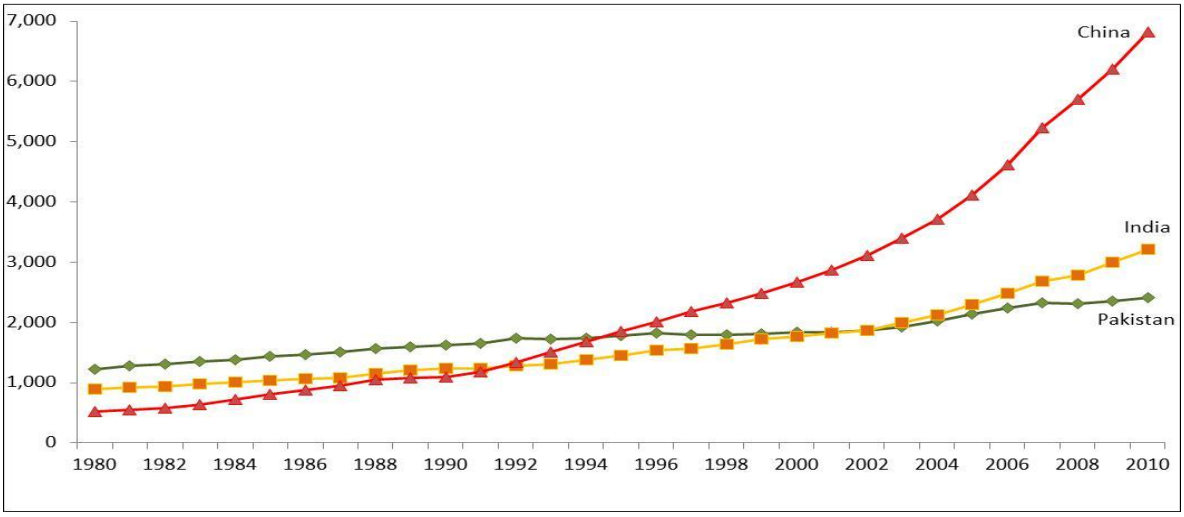
Note: e is estimate, f is forecast. GDP Growth is in percent, based on GDP at 2005 $
Source: World Bank Staff estimates

Box 1 What Explains the Long-term Growth Divergence Between Pakistan & India?

Due to their common historical roots, there is no question that India's performance remains a reference for Pakistan. What factors contributed to this reversal of fortunes, and what lessons can Pakistan extract from it? There are three main reasons:

- The bigger scale of India's inter- and intra-sectoral labor reallocation. India decreased its reliance on a volatile agriculture sector and increased its dependence on services. The share of agriculture in India's GDP dropped from 32 percent in fiscal 1991 to 20 percent in fiscal 2012, while the share of services rose from 50 percent to 56 percent. Something similar occurred in Pakistan, but on a milder scale. Furthermore, in India important agricultural reforms supported a strong movement of labor from farm to non-farm activities. Reforms focused on irrigation, credit, markets, research and extension services, and the supply of inputs. These reforms reduced farmers' dependence on weather conditions and improved agricultural productivity.
- The faster pace of India's physical capital accumulation and productivity growth. Analyzing the sources of growth over the past 50 years shows that capital accumulation and productivity have played important but unequal roles in the two economies. In India, the contributions to growth of physical capital and productivity rose over 1980–2012 compared with 1960–80. In contrast, physical capital's contribution declined in Pakistan in the same period while productivity rose by a meagre 0.5 to 1.4 percent on average (and was on a declining trend in the 2000s). Pakistan's economy is experiencing a long-term decline in productivity, and capital accumulation, the main driver of growth in the 1960s, has dwindled in importance.
- India's stronger emphasis on trade liberalization and export-led growth, which has supported a steady diversification of industrial and services sectors. The systemic structural reforms undertaken in the 1990s led to large increases in India's share of exports while Pakistan's exports, less diversified, experienced a downward shift. The four main components of India's global integration drive were export incentives, liberalization of capital and intermediate goods imports, prudent macroeconomic policies and a flexible exchange rate. None of this makes India a very open economy, and opaque nontariff barriers remain. But the direction of change has been in opposite directions in the two countries

Figure 4 **Diverging GDP per capita between Pakistan and its neighbors (PPP 2005$)**

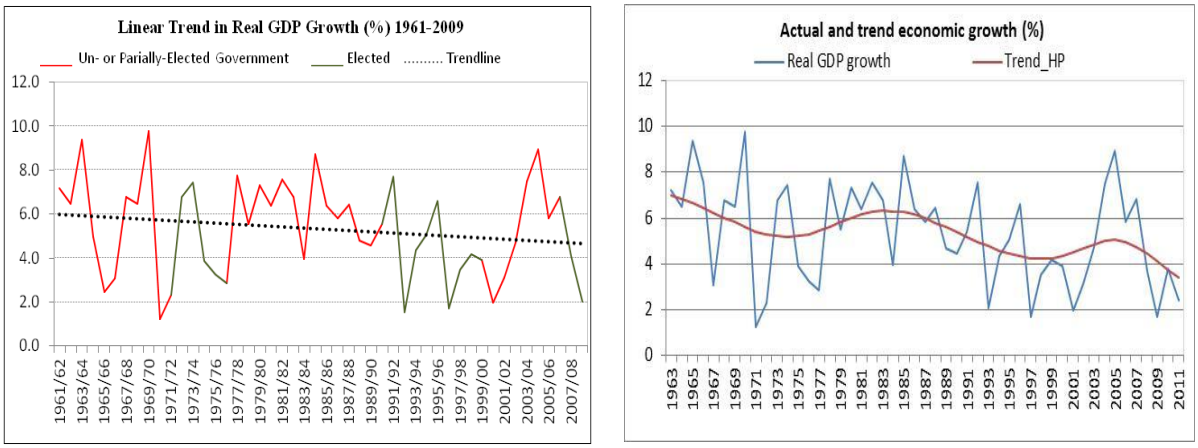


Note: PPP: Purchasing Power Parity
Source: World Bank 2013 forthcoming

Declining Trend, Growing Volatility

15. Most disturbing is the steady fall in the economy's potential over the past 50 years, from 6-7 percent to 3.5-4 percent (figure 5). The loss of growth potential results mainly from agriculture's slowing dynamism over the past two decades, compared with manufacturing and services. This decline is particularly evident in Punjab, which accounts for 63 percent of agricultural output. Recent floods, emerging constraints in power (rising load-shedding), less availability of irrigation water, and meager public investments in the sector explain Punjab's agricultural slump.

Figure 5 **Pakistan's Declining Long-term Growth Trend, 1961–2009**



Source: José Lopez-Calix, Srinivasan, and Waheed 2012.

16. Meanwhile, the volatility of Pakistan's GDP growth has increased. At around 1.8 percent during the past four decades, the standard error around trend growth is average by international standards, but it has risen since the 2000s and is higher in per capita terms. The recent rise partly reflects the global financial crisis and recent floods. Volatility in GDP

growth has been higher in manufacturing than in agriculture and services; it has been lower in Punjab than in the rest of Pakistan (Table 1).

Table 1 GDP Growth Volatility in Pakistan and Punjab Province, 1973–2011 (% Points)

	Punjab	Rest of Pakistan	Pakistan
Agriculture	3.2	3.5	2.9
Industry	4.2	4.3	3.3
Services	2.2	2.2	1.9
GDP	1.9	2.2	1.8
National GDP (1980s)	n.a.	n.a.	1.4
National GDP (2000s)	n.a.	n.a.	2.5

Note: n.a. is not applicable. Volatility: Standard error around trend growth rate.
Source: Institute of Public Policy 2012; World Bank staff calculations

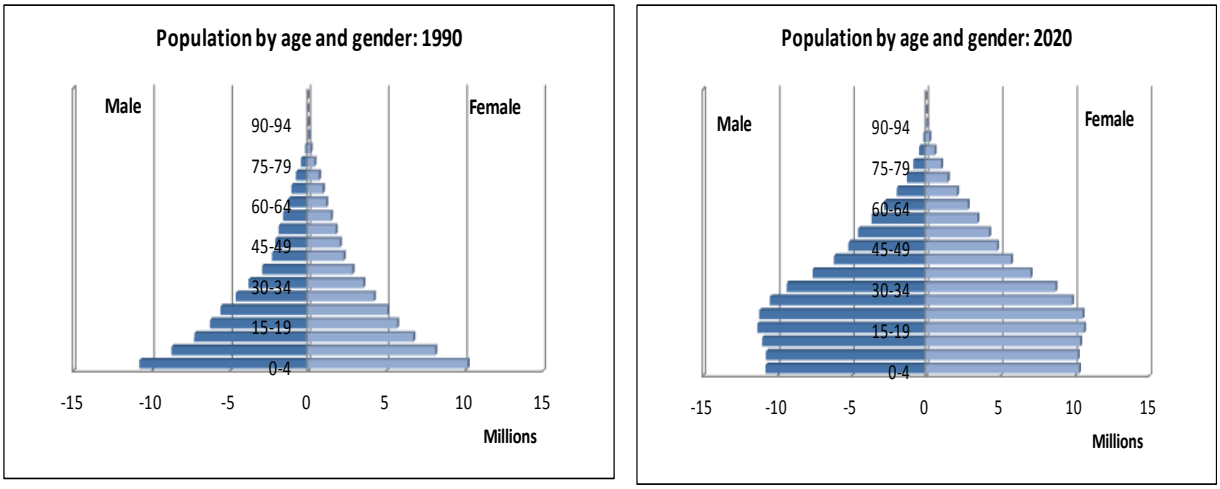
A Mixed Performance on Jobs

17. With the world's sixth-highest fertility, Pakistan will see the size of its already young population double on or before 2025. The labor force has risen faster (3.7 percent a year) than the regional average (3.1 percent), a result of its larger working-age population share and its faster-growing labor force participation rate.

A Massive Youth Bulge

18. The youth workforce has grown even faster, at 4.3 percent a year, well above the regional average of 2.7 percent. That growth is expected to last for at least 10 more years. With no changes in participation, the labor force is expected to grow 2.7 percent a year as about 1.5 million young workers start seeking jobs each year (Figure 6). If female labor force participation rises, the pressure for new jobs will be even stronger. International migration does not seem to be an important safety valve, as net migration was a negligible 0.8 percent of the labor force in 2009.

Figure 6 Change in Pakistan's Demographic Structure: 1990 and 2020 (millions)



Source: World Bank 2013, forthcoming

19. The only way to convert this demographic bulge from a political and social burden to an exceptional dividend is through rapid and inclusive job-enhancing growth that creates millions of new and better jobs. But just creating jobs in large numbers is not enough. Creating more productive jobs—with jobs defined to include all wage work and self-employment, formal or informal—is the most reliable route that enables individuals and societies to move away from poverty, crime, and civil conflict. International experience shows that the key to sustainable rapid growth is shifting the labor force from less to more productive jobs. In sum, the two main challenges are improving the types of jobs available and enabling people to move into those more productive activities (Box 2).

Box 2 Should Pakistan's Strategy focus on Growth alone or on Growth & Jobs together?

Pakistan's policymakers often seem to believe that growth acceleration will be enough to address the country's job needs. But this is far from guaranteed. True, over the medium-term, employment is determined by the labor force's size; and that only in the short term fluctuations around this trend can be significant. From this perspective, it is possible that a number of jobs sizeable enough to match the growth in the size of the labor force will be created. However, it is not only the number of jobs that matters, but also their quality. And Pakistan needs better jobs of the type that can be transformational.

Three dimensions make some jobs transformational from a development point of view.

- First is the living standard. Depending on where job opportunities are, growth can be associated with faster or slower poverty reduction. Typically, productivity gains in smallholder farming and the expansion of off-farm employment are associated with rapid declines in poverty. Conversely, jobs in enclave sectors such as mining can be very productive but do not do much to spread the wealth. Vulnerability is associated with jobs with volatile earnings. But even low-paying jobs in the informal sector can be transformational. This is often the case with paid employment for women, which tends to empower them and lead to greater investments in children.
- Second is productivity. Even when employment levels are relatively stable, there is simultaneously quite a lot of job creation and destruction. As far as more productive jobs appear and less productive ones disappear, efficiency rises. In industrial countries, young firms have been the main creators of productive jobs, regardless of their size. But in many developing countries there is simply churning at play: productivity on the job does not grow, and employment transitions are between jobs of similarly low productivity.
- Third is social cohesion. Jobs are not only what people do, or what people earn: they also shape the way they interact with each other. Jobs influence the identity of those who hold them, provide social networks, and may give a sense of fairness and opportunity. Having a job, and especially a motivating job, is associated with greater trust in others and with more active civic engagement. Jobs can thus help defuse conflict, especially when they bring together people from different ethnic and social backgrounds.

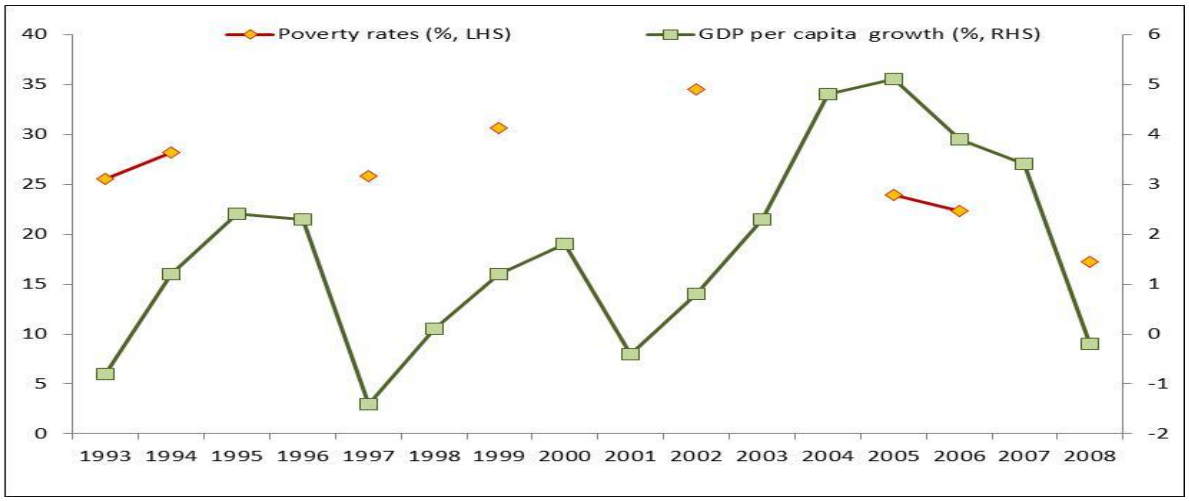
Policies should support the creation of more of these transformational jobs, beyond what growth alone can accomplish. But this should not be confused with creating public sector employment, or with making jobs artificially good. Jobs of that sort may look attractive from an individual perspective, but they are seldom good jobs for development. They may carry high pay and benefit, but those often come on the back of barriers to competition and government transfers, undermining the earnings or job opportunities of others. This is the case of jobs created by loss-making state-owned enterprises, or by ailing industries benefiting from trade restrictive measures.

Jobs Have Reduced Poverty

20. So far Pakistan has been doing well on the living standards dimension of jobs, as shown by its high elasticity of poverty reduction to economic growth. Despite falling and increasingly volatile growth in per capita GDP, poverty declined over the last decade. The poverty rate broadly followed the growth trend (Figure 7). But it declined very rapidly: the share of the population below the national poverty line fell from 34.7 percent in 2001-02 to

21.9 percent in 2005-06 and 17.2 percent in 2007-08. Other poverty indicators improved as well. The depth of poverty (the average income needed to lift a poor person out of poverty) dropped from 7.0 percent of the poverty line (PKR 79.9 per poor person in 2007-08 prices) in fiscal 2002 to 2.7 percent of the poverty line (PKR 30.8) in fiscal 2008.

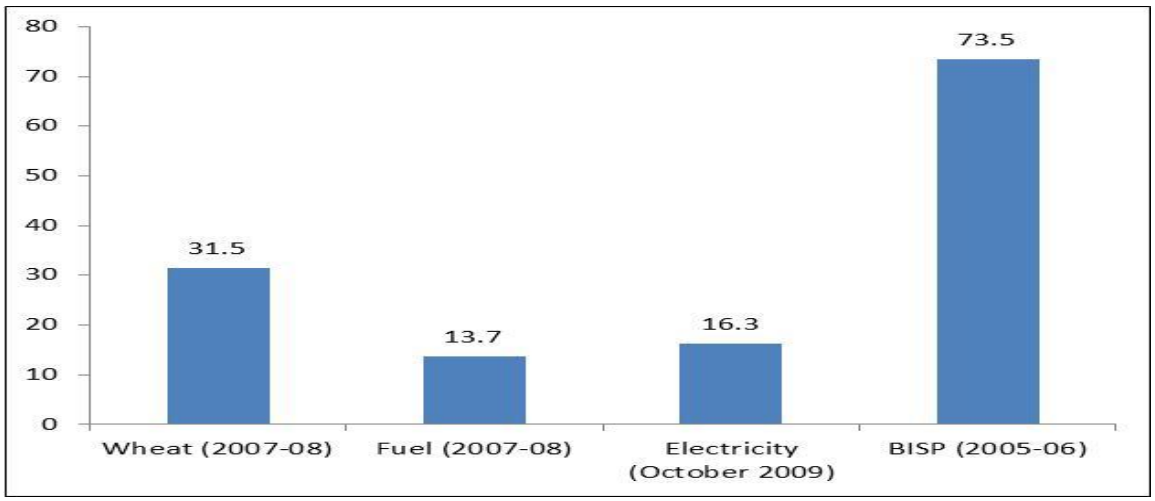
Figure 7 Growth in GDP per capita & Declines in Poverty (%)



Note: Dots indicate discontinuous data
Source: World Bank 2013, forthcoming

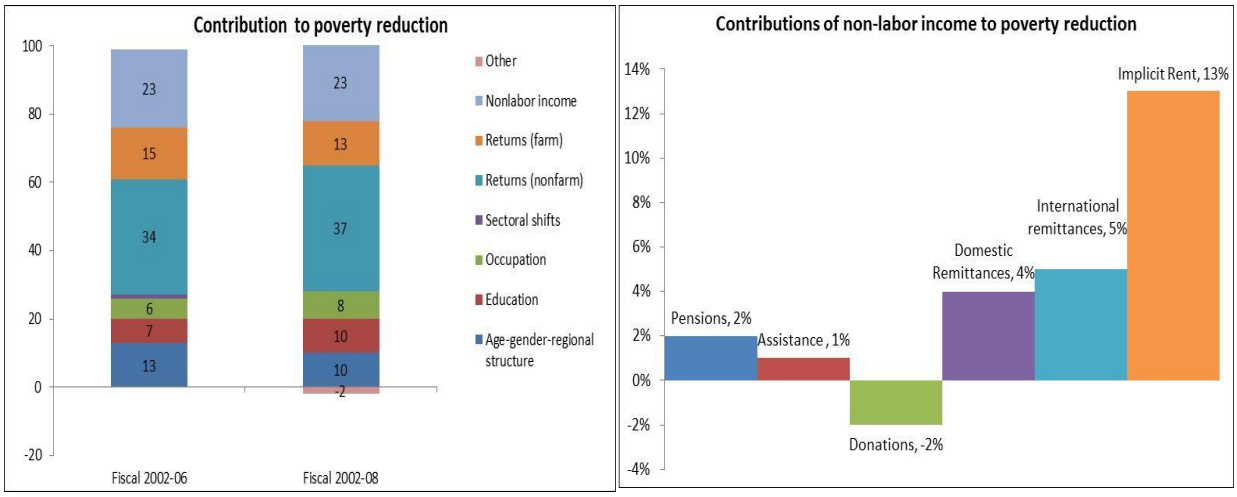
21. Admittedly, not all the gains in poverty can be attributed to jobs. Social safety nets have a unique redistributive impact on the poor and vulnerable and, because of higher growth volatility, are especially important. Not all social transfers in Pakistan are well targeted to the poor, and the volume of resources they mobilize is generally small. Subsidies on wheat, fuel and electricity show poor targeting performance, at 31.5 percent, 13.7 percent, and 16.3 percent respectively. Paradoxically, the biggest subsidies (on fuel and electricity) are the most regressive. But the Benazir Income Support Program (BISP) achieves high efficiency, with 73.5 percent of the program budget estimated to reach the poor (figure 8). Overall, however, non-labor income only accounts for a fifth of poverty reduction in Pakistan, confirming that poverty reduction has more to do with jobs than with social transfers, especially during boom episodes (Figure 9).

Figure 8 Benefit Incidence of Four Transfer Programs in Pakistan (%)



Note: BISP – Benazir Income Support Program, Source: World Bank 2013, forthcoming

Figure 9 The Contributors to Poverty Reduction in Pakistan, FY02–08 (%)



Note: Share of total reduction in poverty headcount rate in % Source: World Bank 2013, forthcoming

But Jobs Have Not Supported Productivity Gains

22. Although it is expected that rural areas would be more prone to agricultural activities and there is a disproportionate share of employment (around 60 percent) generated by agriculture, there is also considerable diversification of employment into non-farm activities in rural areas. Rural to urban migration has also been an important determinant of cities' growth, and the increasing role of services as employer in cities.

23. The performance of Pakistan is less stellar on the productivity dimension of jobs. On the positive side, the labor earnings premium on skills has increased in recent years. In fact, between 2001 and 2008 the largest contributor to poverty reduction was the growth in returns to labor endowments. Among them, returns on non-farm income were almost three times higher than returns on farm income (Figure 9). Consistent with this finding, labor earnings out of agriculture increased relative to earnings in agriculture, which provides an incentive for the reallocation of labor towards more productive activities. Similarly, the shift in occupation from unpaid family worker toward wage employment accounted for about 8 percent of poverty reduction in Pakistan between 2001 and 2008 (Inchauste and Winkler, 2012). This, again, suggests some reallocation towards more productive activities. Data on educational attainment and returns to education also bring more insights on why many youth are trapped into low-paid jobs. Despite returns to education are higher for women—rural and urban—than for men workers, their level in both cases is close and respectable: between 6-9 percent increase for an additional year of schooling. However, earnings do not appear as the only variable in determining educational attainment. Youth appear rather facing two extreme options: (a) working immediately in low-skilled and low-paid jobs, with the worrisome implication that those with less than a class 6 education will remain uneducated their entire lives; and (b) preparing themselves for a high-skilled and high-paid job in the future, i.e. a long term commitment, while assuming the risk of spending some time unemployed while searching for a job, either after completing secondary or university education. This makes both male and female youth concentrate at the two ends of the distribution of educational attainment (no formal education versus class 9 or higher education).

24. Unfortunately, all these gains seem to be happening close to the poverty line. The slow growth of total factor productivity in recent years suggests that job transitions from farming to off-farm employment or from unpaid family work to wage employment have only led to marginal increases in aggregate productivity. They are suggestive of people migrating from low-productivity jobs in agriculture to slightly more productive jobs in the construction and informal sectors, not of a massive migration to wage employment in factories operating in vibrant cities connected to world markets, as was the case in China. There is also evidence of migrant workers that moved from urban areas to rural areas, even if these were minority. For their part, migrant workers (about 15 percent of total employment), worked less in the agricultural sector but more in the manufacturing/construction sectors. Migrants were also more likely to work as wage employees than non-migrants workers.

25. Job creation may also be failing on the social cohesion front. Pakistan's level of violence (measured by deaths per capita) is much higher than could be expected for its income level. Pakistan ranks second (after Iraq) of 158 countries on the 2012 Global Terrorism Index. Violence affects poverty as well as growth: provinces with the highest conflict intensity (Khyber Pakhtunkhwa and Sindh, in particular) have the highest poverty rates.

And Yet an Enormous Potential

26. Pakistan's demographic challenge is essentially an opportunity to accelerate growth. The only way to convert its demographic bulge from a political and social burden to a dividend is through rapid growth and the creation of millions of new, more productive jobs. Pakistan already has many of the conditions needed to meet both challenges. It has experienced three previous episodes of sustained, rapid GDP per-capita growth above 3 percent a year (fiscal 1963–66, 1980-83 and 2004–07). At that rate, the economy doubles in size every six to seven years. Pakistan has also demonstrated an extraordinary resilience to maintain moderate growth despite civil conflict, natural disasters, and complex political transitions.

At the National Level

27. Underlying bouts of rapid growth and resilience in the face of adversity are many positive features that can help Pakistan achieve its potential.

28. One of them is the remarkable capacity to isolate key national projects from the inefficiencies of the rest of the system. The state is good at preventing famine, establishing elite educational institutions, building infrastructure in some sectors, recruiting and sustaining a disciplined and efficient military, and maintaining a certain level of order despite rebellion and ethnic and religious clashes. The state made real progress when it focused on particular development projects, appointed good officials with adequate resources, and left them in place long enough. Examples include the crackdown on domestic heroin production in the 1990s and the creation of the National Database and Registration Authority (NADRA), a computerized registration system to provide a computerized ID card for every citizen. NADRA has contributed to the success of the Benazir Income Support Program for the poor.

29. Another positive feature is Pakistan's capacity to absorb major shocks, without ever collapsing. Several factors cushion the economy against international shocks. The Pakistani economy is relatively closed, and much of it is informal, featuring many small family farms. Though this contributes to massive underemployment, it also protects large parts of the population. Because of the informal economy's size, the economic situation is rarely as bad as official statistics indicate. Consumer spending has held up well in recent years, despite a severely troubled economic climate. Remittances from Pakistanis working abroad are another important cushion. Since the 1970s remittances have not only supported the balance of payments but also improved the incomes of many poor households. Remittances totaled more than USD 13 billion in fiscal 2012, an amount equivalent to about half of Pakistan's exports.

30. Agriculture is central to this sturdiness, as it still provides about 22 percent of the country's GDP, 45 percent of its jobs, and 60 percent of its exports. So while many ordinary Pakistanis suffered from rising food prices in recent years and malnutrition remains a serious problem among the poor, there is no risk of nationwide food shortages or famine. The surprisingly rapid recovery of Pakistani agriculture from the floods of 2010 and 2011—especially cotton, sugarcane, and rice—showed its strength. The key to these successes is the extensive irrigation system, based on the Indus River and its tributaries. Thanks to it, Pakistan has great potential as a food exporter, especially in light of the rising demand for food from rapidly growing China, India and South East Asia.

31. The natural endowments of Pakistan, from geography to mining, are other factors contributing to its potential. The province of Baluchistan alone has an estimated USD 3 trillion in mineral resources. Unexploited hydrocarbon reserves are estimated at 27 billion barrels and 280 trillion cubic feet of natural gas. Unexploited hydroelectric potential is estimated at more than 100,000 megawatts, enough to make Pakistan a regional power supplier. As for geography, Pakistan's location has created serious problems over its history, but if regional stability can be achieved, location would become an advantage. Pakistan is the only overland route between India and the energy-rich countries of Central Asia and the Persian Gulf. It is also China's most direct overland route to the Arabian Sea and the Persian Gulf. Dedicated rail freight corridors from Karachi to Lahore and from Lahore to Islamabad have immense potential to reduce logistic costs. Gwadar's underutilized port opens connections to Afghanistan, China, and the rest of Central Asia and is a logical channel for exports of Baluchistan's mineral wealth.

32. Pakistan's international alliances have hedged against economic difficulties but are underused, especially with China and India. Aid from the United States has sometimes been vital. Saudi Arabia has at critical times provided Pakistan with essential supplies of oil at delayed or reduced payment. China's immense financial reserves and status as the world's second-largest economy offer tremendous potential for Pakistan. And Pakistan's stands much to gain when its most favored nation status with India becomes effective in early 2013.

33. Last but not least is the rapid growth of women's participation in economic and political life. Women have made extraordinary progress in Pakistan over the last decade. Female literacy has improved, albeit from a low base. There are now more female than male students in colleges and universities. By 2015 a million well-educated and trained women will join the workforce. Many will take jobs in the modern sector of the economy, or add to family income through part time work. Even without assistance from the state, within five

years women will contribute more than one additional percentage point per year to economic growth. Moreover, women have a strong presence in the national and provincial legislatures. Pakistan is one of few countries to have a woman as the speaker of the National Assembly.

At the Provincial Level

34. Pakistan's potential is also marked by an unusually wide regional diversity. Punjab and Sindh share a long international border with India on the east, and Sindh has sea connections with the Middle East and elsewhere. Khyber Pakhtunkhwa and Balochistan share international borders with Afghanistan and the Islamic Republic of Iran, and Khyber Pakhtunkhwa provides a direct land route to China and the north.

35. The provinces also have varying factors of production and physical and human resource endowments. Balochistan is the largest province (covering 43.6 percent of the land area), but it contains only 5 percent of the national population, owing mainly to the difficult terrain. Punjab is the second largest province, with a 55 percent share in national population, followed by Sindh (24 percent) and Khyber Pakhtunkhwa (16 percent). Punjab has a large agricultural and industrial base (mostly small industries) and better connectivity with other provinces, especially with Bin Qasim, the country's main seaport, located in Sindh. Balochistan has abundant natural resources, including natural gas and mineral reserves, and the newly developed seaport of Gwadar is located there. Sindh also has mineral reserves—including gas, oil, limestone, and coal—a sound agricultural base, and a strong industrial base. Home to Pakistan's main seaport, Sindh provides opportunities for international trade and trade links for the country's landlocked provinces and neighboring countries. Khyber Pakhtunkhwa's abundant natural resources (water, forests, minerals and gemstones, and oil and gas) and its geographic diversity (from high mountains in the north to the Indus plains in the south) offer great potential in mining, hydropower, and tourism. But the province relies mostly on services because of geographic constraints, including its distance from the country's main port.

36. Some challenges of rapid urbanization, environmental deterioration, and neglect of tourism are specific to certain provinces. For example, in Punjab and Sindh greater rural-to-urban migration is placing pressure on urban infrastructure and employment needs. Sindh suffers from air and water pollution, affecting forests, biodiversity, and coastal and marine ecosystems. Sindh has also neglected the tourism potential of cultural heritage sites because of inadequate funding and conservation regulation. Khyber Pakhtunkhwa faces natural disasters and security concerns, which also affect its tourism potential. The federal strategy includes urbanization under its main pillar of building creative cities, but it does not mention issues related to tourism and the environment, both important for growth and employment in Khyber Pakhtunkhwa and Sindh.

What is Holding Back Pakistan?

37. The binding constraints to Pakistan's rapid growth and job creation are numerous. Some of them are structural in nature, as they have a long history; others have emerged in recent years. Structural constraints include low access to finance and government and market failures that impede investment, entrepreneurial activity, and competitiveness, blocking the transition from low-productivity to high-productivity activities. Inadequate taxation, a large anti-export bias, a weak civil service, and cumbersome business regulations

slow the transition to a more diversified production and affect the competitiveness of Pakistani businesses. The emerging constraints include massive cuts in electricity access and macroeconomic instability, creating the risk of a sudden stop in external and domestic financing. While a detailed explanation of these constraints could be provided, five main groups of issues followed by a selective list of key policy recommendations stand out.

- *Poor macroeconomic management*. There is no way for an economy to sustain rapid growth when the investment rate trails at a meager average of 14 percent of GDP, as was the case in Pakistan in last 4 years, and with investment collapsing to 12.5 percent of GDP in the most recent fiscal year. The decline in investment is the result of a confidence crisis, reflecting the widespread perception that the decline in international reserves since June 2011 risks becoming a full-fledged balance of payments crisis if left untreated. It must be noted that the current account deficit is actually very modest. The forecast for fiscal 2013 is just about 1 percent of GDP. Similarly, central bank financing of fiscal deficits only explains a minor fraction of the contraction in international reserves. More than three-quarters of the rise in bank credit to the government is rather linked to problems in rolling over or repaying external debt, i.e. high country risk. And the problem is the scarcity of capital inflows of any sort. Pakistan actually has the lowest ratio of FDI (Foreign Direct Investment) to GDP of all emerging countries, and it has to make a stiff amount of repayments to the International Monetary Fund (IMF) in the next fiscal year. The sudden stop and virtual lack of access to international credit markets and official external financing makes current policy unsustainable in the medium term. A fiscal adjustment is, therefore, unavoidable, but the parallel major challenge is identifying growth-oriented reforms which are feasible from a political economy perspective.
- *Power shortages and insufficient infrastructure*. Pakistan ranks 166 of 183 economies on the ease of getting electricity, lower than the average for South Asia. The situation in the provinces varies, as it takes longest to get a connection in Balochistan, followed by Sindh and Khyber Pakhtunkhwa. Load shedding is massive and spread out nationwide. The effect of electricity shortage on productivity is most acute in Punjab. For their part, public and private investments in infrastructure are also too low to achieve rapid growth. At below 1 percentage point of GDP, public investment in infrastructure has declined over the last 20 years due to fiscal constraints. For its part, at around 2 percentage points of GDP private investment has not offset the fall in public investment and filled the gap in most sectors, as it happened in many comparator countries. If Pakistan were to bring its public investments in electricity, transport, and telecommunications sectors up to those in Malaysia, for example, growth in GDP per capita would rise 3.7 percentage points, with varying contributions from each sector (1.9 percent electricity, 0.6 percent transport, and 1.2 percent telecommunications). And as the fiscal space for financing infrastructure is small, and to a great extent transferred to provinces, reinvigorated private (and provincial) financing of infrastructure has become critical.
- *Distortive regulations*. Identifying 'software' business regulations as binding constraints to growth means that governance weaknesses and inadequate public sector management affect service delivery and public and private investment. Private access to finance remains restricted, particularly for small and medium-size enterprises and for female entrepreneurs. Access to finance is a greater problem in Punjab and Khyber Pakhtunkhwa than in other two provinces, because of the rapid growth in the nonagricultural informal sector over the last decade. Pakistan ranks 158 of 183 economies on the ease of paying taxes, and 154 of 183 on enforcing contracts. Among the provinces, paying taxes is a greater obstacle to doing business in Sindh and Khyber Pakhtunkhwa, whereas enforcing contracts takes longer in Khyber Pakhtunkhwa (six years on average) and costs more in Punjab (43 percent of the claim's value). Pakistan also ranks 126 of 183 countries on registering property and

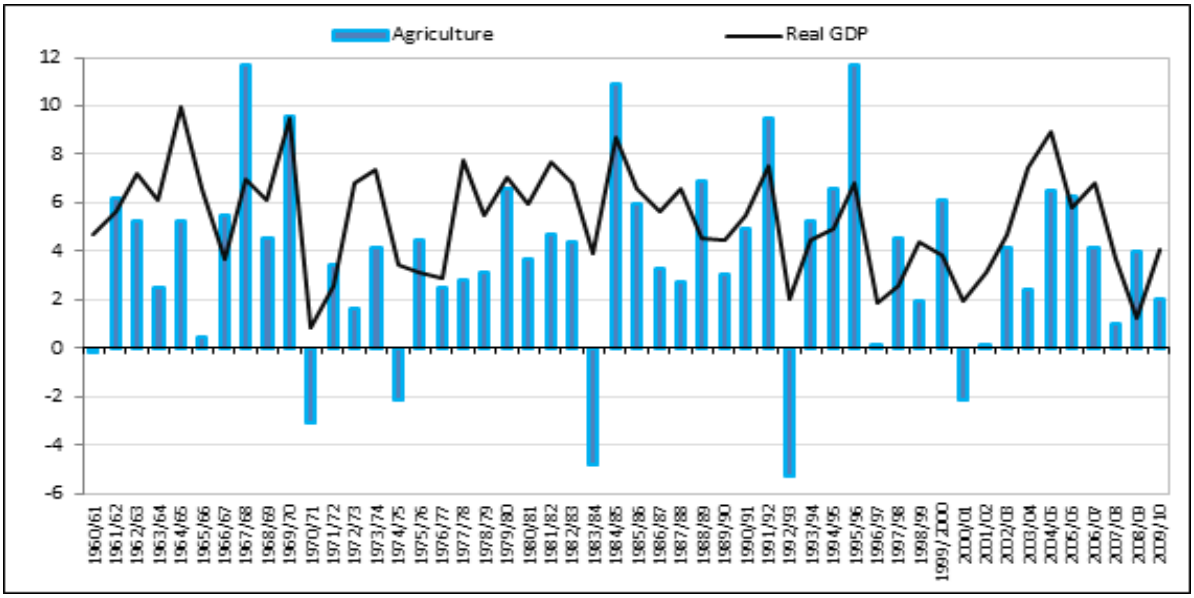
104 of 183 economies on the ease of getting construction permits. The time and cost vary at the sub-national level, with building permits, utility connections, and licenses for site development governed at the local level. Obtaining approvals and utility connections is easier in Khyber Pakhtunkhwa and Punjab than in Sindh and Balochistan. It takes much longer in Sindh to get electricity and water connections. And there are different building permit fees and charges for processing and validating building plans. To start a business, registration times differ due to varying levels of efficiency, despite the same regulatory framework and a similar number of procedures. Among different procedures, the registration for tax and labor (social security, employees' old age benefits, and labor department) takes longer. Except in the provincial capitals, most work is done manually, and documents must be submitted in person, despite the fact that many areas lack proper offices. So the entrepreneurs must travel to the main cities to complete registration, adding time and cost. As a result, registration costs are very high in Balochistan and in some cities of Punjab (Sialkot and Sheikhupura) and Sindh (Hyderabad).

- *Business-unfriendly cities and slow productive diversification*. Pakistan's potential for fast growth relies on rising productivity of services and manufacturing in an economy that is already associated with urbanization and growing in sophistication through high productivity jobs and connectedness. In a virtuous circle, it is possible to link urbanization, agglomerations, high productivity jobs, and green manufacturing growth to infrastructure services. Face-to-face exchange of information allows labor and production to learn from each other and apply technological advances. By reducing 'transport' costs—moving goods, people, and ideas—urbanization facilitates agglomerations, which enable highly productive jobs and economic growth. Agglomeration economies also help create international cities, concentrating production and further facilitating services growth. And as cities catalyze agglomerations, and agglomerations attract migrants, cities are also important engines of employment and income gains. Cities' development is crucial to Pakistan's growth, jobs and future prospects. Pakistan's urbanization has been the fastest in South Asia. By 2030 cities are likely to house about 50 percent of Pakistan's population. More than half of Pakistan's urban population is already living in eight urban agglomerations—Karachi, Lahore, Faisalabad, Rawalpindi, Multan, Hyderabad, Gujranwala, and Peshawar. These large cities have grown at around 3 percent a year over 2000-05. The number of Pakistani cities with more than 1 million people is projected to increase from 9 today to 17 in 2020. The macroeconomic effect of Pakistan's cities might be well above those of other developing countries. In 2011 nonagricultural activities in Pakistan might have generated up to 78 percent of GDP. Karachi handles almost 95 percent of Pakistan's foreign trade and contributes about 20 percent of Pakistan's GDP and 30 percent to Pakistan's manufacturing sector. While Pakistan is the most urban country in South Asia, its urbanization process pales compared with East Asian and Latin American countries. Cities like Karachi suffer from the bad externalities associated with urbanization, such as congestion, pollution and crime. Hence, for Pakistani's cities to improve economic performance, they would need to not only raise economic growth but also address the quality of their jobs, environment and life; conditions for attracting and retaining higher skilled higher-income earners.

- *Anti-export bias and agriculture*. To a large extent, agriculture still drives Pakistan's overall growth. Although agriculture's share of GDP fell from 42 percent in 1960 to 21 percent in 2009, a high correlation still exists between real GDP and real agricultural GDP (Figure 10). That correlation has weakened, however, since the 2000s, as the service sector came to dominate the economy (Figure 11). Overall the shares of agriculture, industry, and services in total output have changed from an average of 39 percent, 23 percent, and 38 percent in the 1970s to 21 percent, 26 percent, and 54 percent in the 2000s respectively, representing a structural shift in the economy. An

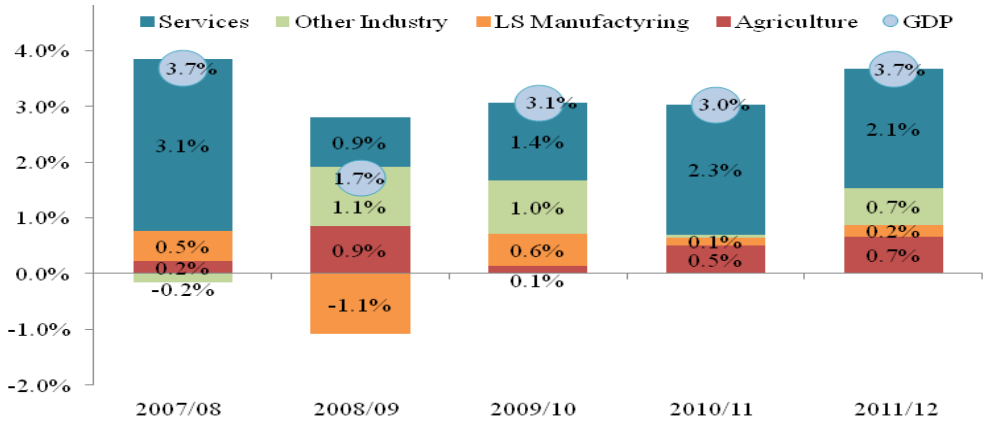
anti-export bias is created with Pakistan's highly discretionary and deliberately complicated trade policy, with its many tariffs and para-tariffs including agriculture. The policy invites lobbying for preferential treatment and risks corruption. The current formal tariffs, with SRO exemptions and regulatory duties, have become a de facto mechanism of concessional rates and import licensing, contravening the Uruguay Round international trade agreement. Most SROs are aimed at specific firms rather than all importers and primarily target inputs. These exemptions make the trade regime highly discretionary and ever-changing, and prevent openness and competitiveness. The trade regime's complexity deleteriously affects incentives in agriculture. Major crops like wheat, rice, sugar, and cotton are also implicitly taxed by the various price distortions that the policies introduced. Government procurement policies also affect agricultural incentives. Since government partly controls domestic wheat prices and substantial procurement volumes, as well as Pakistan's international wheat trade, there is very little price transmission from world markets to domestic markets. The effect of these procurement policies on consumer welfare is ambiguous, but they can become fiscally unsustainable and lead to perverse outcomes, such as subsidized exports.

Figure 10 **Correlation between Agriculture and Real GDP Growth, 1960–2010, %**



Source: José Lopez-Calix, Srinivasan, and Waheed 2012

Figure 11 **Sectoral Contributions to Pakistan's Growth**



Source: Debowicz and others 2012b; World Bank staff calculations.

An Agenda for Rapid Growth and Job Creation

38. Pakistan needs a vision for a transformational job-enhancing growth agenda. The country faces now a rare opportunity to embark on a renewed economic trajectory. Just sticking to the status quo is not an option anymore, because growth will not accelerate under current trends and the economy will not create the kind of jobs needed to meet a massive youth bulge. Recent developments show the high risks associated with this 'wait and see' approach. Preliminary growth estimates for fiscal 2013 are feeble at around 3.5, while inflation is expected to rise next fiscal year and could attain double digits again. And the country also faces several external shocks, including steep decline in domestic and FDI, a severe drain on international reserves, and an uncertain international environment.

39. The Pakistani economy will have to rely on new growth drivers to escape the status quo, while it is necessary to deal with both short-term macroeconomic imbalances and the microeconomic constraints that limit credit expansion, business productivity and competitiveness. It also faces important head-wings with the continuing weak external environment that are affecting its manufacturing and agricultural export dynamism. Growth drivers will therefore have to come from a mix of more modern and competitive cities and more productive farm and off-farm agricultural activities. Dynamic cities are important for trade, commerce and construction. They are also a platform for networking, learning, and social mobility. Together with agricultural development, they hold the key to accelerating the diversification of Pakistan's export basket and to improving its global competitiveness.

Macroeconomic Stability

40. The primary concern should be to maintain stability until the prospect of a sudden stop of external financing inflows recedes. Therefore, Pakistan may have to face high inflation and a large current account deficit in the short run. But credit lines from international financial institutions could help it address the debt rollover problem in the near term, and this support could be accompanied by strong commitments on fiscal and monetary policy, ensuring a sustainable policy stance and bringing back much-needed credibility. If some degree of fiscal consolidation to ensure debt sustainability is achieved in the medium term, strong initial liquidity support from international finance institutions is likely to generate a positive response from the private sector and lower Pakistan's future needs to draw from multilaterals.

41. Strengthening the fiscal balance is likely to help Pakistan's growth prospects in at least two ways. It would help reduce the still extraordinarily large country risk spread, thus bringing credibility to the rest of the Government's program; and its additional and costlier external financing of the budget would help relieve the private sector's crowding out of credit, which constitutes a major roadblock for prompt growth recovery. However, a radical fiscal adjustment based on important tax hikes and severe cuts in government spending to cover for debt amortizations could generate political disarray and actually worsen country risk.

42. In the medium term, the objective should be to achieve a sustainable fiscal deficit of 4 percentage points of GDP, to attain a tax revenue ratio of 14-15 percent of GDP by 2018 (up from about 10 percent today), to rebuild the international reserve position to at least three months of imports (possibly leading to an upgrade of risk-agency ratings for Pakistan

sovereign bonds), and to bring the ratio of public debt to GDP to below 50 percent. Fiscal consolidation is the key element to strengthen the external position and improve public debt sustainability. It could be started up with an emergency fiscal package covering revenues, expenditure and subsidies. This would facilitate recovering access to fast-disbursing international lines of credit. In the medium term a comprehensive fiscal reform program should also be accompanied by tight monetary policy to keep inflation low.

43. From a development perspective, however, tax reform is the most important foundation of macroeconomic stability. Relying on spending cuts or international assistance is not sustainable in the medium term. Raising tax revenue would be the main instrument to expand public savings and ensure fiscal space for investments in infrastructure and spending in social sectors.

44. A key measure in the short term is to issue an emergency tax package, consistent with the fiscal one, and under the framework of a new Federal Board of Revenue (FBR) tax reform strategy, and establish a joint National Tax Policy Committee—staffed by FBR and Ministry of Finance solid professionals, with capacity to outsource specific studies. In the medium term, the priority would be to agree on a plan to gradually eliminate tax exemptions and zero rates in three years supported by modern and integrated IT-systems and adopt performance agreements in all major functional areas of FBR (e-registration, e-filing, risk-audit and reporting). Converting the FBR into a fully autonomous institution, reliant on its own generated revenues, staffed with high-quality professionals and accountable also to parliament, would follow best international practices in revamped tax administrations worldwide.

45. From an implementation perspective, the federal government could make three-quarters of this effort and the provincial government one-quarter. Tax reform at the provincial level could be stimulated by explicit arrangements linking provincial transfers to additional local revenues. These additional revenues could be generated through services sales tax expansion, a hike in agricultural tax, or other agreed measures under the incoming 8th National Finance Commission award.

Power Supply

46. To raise low investment in infrastructure, public and private investment combined should increase to no less than 4-5 percentage points of GDP. Fiscal consolidation should open fiscal space for public infrastructure, and this concerns not only the federal but provincial governments whose resources have been increased significantly. On the public investment side, priority should be given to projects on power generation, roads and water irrigation. On the private investment side, exploring further private and public partnerships would also encourage private sector investment.

47. To deal with power crisis, the ultimate outcome would be to cut average load-shedding at least to half its present eight hours a day (i.e. below 4 hours a day, its 2007 level). In the short term, an emergency plan should focus on improving governance. A single-point lead authority would manage power sector reform and managerial autonomy and professional appointments of competent Chief Executive Officers (CEOs) in Discos and Gencos (distribution and generation companies) should take place. The tariff differential subsidy could be adjusted in there years starting by adjusting the notified tariff to less than

85 percent of the average determined tariff (an increase of around 25% over its actual level). Line losses and theft would be cut with the support of a new electricity bill. Medium-term reforms would aim at wholesale energy sector reform. Besides completing the phase out of the tariff differential subsidy, important energy (small and big dams) and gas projects should be put on a fast track. More domestic gas would be supplied to power generation and Discos would be made financially independent, privatized or reorganized as a corporation (following the best example of the Karachi Electric Supply Company). Finally, while the circular debt is a symptom and can be unwound over time once the system is put on better footing, consideration can be given for taking it off the books of energy companies and parking it for now.

An Improved Business Environment

48. To tackle low domestic access to finance, thus ending the credit crunch to the private sector, private sector credit should be raised to 25 percent of GDP, its average in the mid-2000s and 50 percent above its present level. At the macroeconomic level, fiscal consolidation and monetary tightening would help keep inflation in single digits. Favoring positive but low real interest rates and reducing government borrowing would reduce the banks' incentives to crowd out private credit. At the microeconomic level, the focus would be on actions strengthening transparency in private credit and expanding programs that provide credit to small and medium enterprises and women entrepreneurs. In the medium term, approving the bill creating the Microfinance Fund and reforming the collateral system would be critical.

49. To overcome the 'soft' regulatory barriers to the business environment, the ultimate outcome could be to improve Pakistan's position in the Doing Business Indicator to 75th place (up from its present 105th place among 183 economies). This improvement requires a customized agenda of actions by the federal and provincial governments. In the short term, the federal government could set up a One-Stop Shop for business registration. In the medium term, creating new courts to solve commercial disputes, computerizing land registration and easing procedures for construction permits by provincial governments would help streamline processes to facilitate construction, enable contracts, and prevent corruption.

50. Reinvigorating the business environment also requires addressing the drag imposed on the private sector by an under-performing public sector and losses-generating SOEs. To deal with an inefficient civil service, a first goal could be to achieve a transparent public payroll system that minimizes perks. In the short term, completing the inventory of all non-wage allowances granted to civil servants would be a pre-requirement to redesign job categories and their remuneration. In the medium term, design and implementation of a plan to rationalize public perks would be needed. To create a level playing field and improved services, the Government should prepare a roadmap on which loss making SOE's can be privatized or restructured in a short time frame. The ultimate goal is to reduce their overall financial losses by half and, besides completing their imminent restructuring, privatize at least 2 major SOEs. In the medium term, the recent approval of the new Corporate Governance Code is a step in the right direction, but the real test is its implementation; for which norms should be issued. The Government should also fairly quickly prepare the ground for a One-Stop Shop for new investors to reduce red tape. Streamlining construction permits and property registration by provinces would also be important. For increasing

access to finance, lowering reserve requirements on credit to SMEs, improving the registration base for land and housing, and allowing movable collateral, would also allow more firms and individuals to count on more collateral to borrow funds.

Export Diversification and the Regional Potential

51. To promote export diversification, including urban manufacturing, and reduce the anti-export bias, the ultimate outcome would be to raise the export to GDP ratio to about 15 percent. In the short term, approval of a plan to remove all trade-related SROs would help liberalizing trade (while adopting regulations to prevent new ones in the future). In the medium term, a roadmap to simplify tariff slabs to 3 (0, 10 and 25 percent) would be fundamental to eliminate privileges and adopt a simple system. Other measures could include completing the trade normalization with India, starting with the full granting of the most favored nation status; making progress on eliminating nontariff barriers; tangibly improving customs procedures at the Wagah border, which would have a substantially visible demonstration effect; and actively developing supply chains, especially with entrepreneurs from China and India. And to foster innovation, a minimum level of investment (0.5 percentage points of GDP) in technology and innovation could also be agreed, following the example of emerging and developed economies (2 percent of GDP for European countries).

Dynamic Cities

52. Cities should become growth-friendly clusters with appended green industrial parks in their periphery and large and dense markets for goods and services, which would foster firms' competition and job's learning. Careful urban planning would imply strong coordination between the federal, provincial and local governments. Three key measures that could be achieved during the next administration are the revamping of zoning laws, the streamlining of construction permit procedures and the establishment of a national database for housing titles and prices. To foster cities' potential for jobs (and growth), a possible goal could be to move Pakistan's rank to 75th position in property registration and construction permits at Doing Business.

53. Similarly, to deal with youth (and female) unemployment, the technical and vocational education and training (TVET) systems should be mainstreamed with a view to enroll at least 3 percent of the youth working-age population, about twice today's enrollment. Targeting youth and female unemployed and unskilled workers, as well as demobilized army members, should provide either a combination of counseling, training, job-search assistance, intermediation, and subsidized internships, or microfinance skills to foster entrepreneurship. This would imply expanding budgetary resources to existing TVET programs: The Punjab Technical and Vocational Education and Training, the Sindh Benazir Bhutto Shaheed Youth Development Program, and the Skills Development Program being the most important ones. Providing incentives for greater involvement of the private sector in program design, on-the-job training, and temporary initial placements would be critical for achieving the required job expansion rates.

54. This would also imply expanding microfinance jobs by targeting formation of youth entrepreneurs. Self-employment and entrepreneurship programs have received little attention in Pakistan. The National Rural Support Program reaches out to unskilled,

uneducated, rural youth living in poverty, and participants and provides initial training in microfinance to those willing to become entrepreneurs. The Small and Medium Enterprise Development Authority could be singled out to promote the growth of micro and small enterprises. And particular priority should be given to creating or expanding programs encouraging female-managed small and medium enterprises.

Agricultural Development

55. Pakistan cannot afford to ignore agriculture while trying to diversify manufacturing and expand services. Pakistan's potential for an upward shift in agricultural productivity should come from a combination of technology innovation and extension, improved water use management (irrigation) and removal of trade distorted policies that create adverse agricultural incentives. For growth to be not only high, but inclusive and job enhancing, a dynamic agricultural sector also must play an important role. Agriculture's importance extends beyond its direct contributions to GDP through multiple channels: Initially through its foreign exchange earnings and its role in supplying savings and labor to other sectors; and then through its substantial links with other nonfarm activities (often services and inter-industry links), calling for an 'expanded' agricultural sector. Broad estimates of Pakistan's agriculture's GDP share that account for an 'expanded' sector are positive, varying between 3 and 5 percent of GDP over its actual share of national GDP.

56. Besides its direct impact on growth, agriculture contributes more to poverty reduction and reduction of inequalities than other sectors do—poverty remains more entrenched in rural areas, and a major share of the (poor) population still depends on farm and nonfarm rural activities. Despite a drop in national poverty, rural poverty reduction has tended to lag urban poverty reduction, with poverty in rural areas twice that in urban areas. About half of the rural poor tend to be in nonfarm activities, and there is a close relationship between land ownership, rural poverty and inequality. Many rural poor are landless or own only small amounts of land. When landless households are accounted for in the Gini coefficient estimation, the value rises to 0.86, higher than that of other South Asian countries. Since the landless do not have access to credit—with land being the most commonly accepted collateral for formal loans—they are unable to generate financing to acquire land in the first place or to create their own small businesses.

57. Simulation analysis also suggests that agriculture-led growth can be more poverty reducing than non-agriculture-led (cities-led) growth by comparing the economic impacts (shocks) of a 10 percent increase in Total Factor Productivity (TFP) among four sectors: crops, livestock, industry, and services. The main results reveal, first, that productivity shocks in services produce higher growth than a similar shock in the two agricultural subsectors—crops and livestock; but the opposite occurs with poverty reduction, so GDP growth originating in crop and livestock subsectors tends to be more pro-poor, though it does not generate faster growth, relative to an approach that targets services. Second, productivity shocks in crops results in larger gains in the incomes of urban poor, rural nonfarm households—poor or non-poor—and rural wage laborers (derived from the decline in food prices), than growth led by similar productivity improvements in services. This suggests that growth strategies that strictly focus on non-agriculture (urban) services, while ignoring the positive spillover effects from agricultural major crops production are less pro-poor. Last, but not least, gains in GDP growth (and poverty reduction) from TFP improvements in manufacturing are lower than those in services and agriculture.

58. To diversify and raise agricultural productivity, the ultimate outcome could be a 1 percent increase per year in crops productivity (or alternatively a 15 percent increase in irrigated land). On the one hand, the agricultural research and extension system—a critical supporter of the Green Revolution in past decades—needs an overhaul. About 111 public agencies are involved in agricultural research and extension, thus fragmenting scarce resources. And even though devolution under the 18th Amendment has contributed to institutional duplications and overlapping functions between national and provincial agricultural research councils, it also represents an opportunity to redesign an institutional reform plan, followed by proper reallocation of human and financial resources. On the other hand, a critical factor in improving crop yields is water availability. Under the current water management system, the present irrigation system is financially unsustainable. Institutional reform of the water management system is also needed to complete the devolution of authority to the relevant scale, and provide sufficient resources and capacity building to each authority so as to fulfill its mandate.

Implementation and Prospects

59. Pakistan has a unique opportunity to bring leadership in making bold reforms and there are reasons for being optimistic. On the one hand, the leading party in the government–Pakistan Muslim League (N)'s manifesto's focus on 'Strong Economy-Strong Pakistan'– establishes the overarching goal of breaking out of the trajectory of low growth to reach a GDP growth rate of over 6%. To get there it calls for (i) increasing investment—with particular attention to energy, agriculture, transport and cities, (ii) placing the energy sector on a solid footing through reducing losses, corporatizing and privatizing energy companies, and rationalizing power tariffs, and (iii) opening up markets and encouraging regional trade. It seeks to place Pakistan on a sound fiscal path with increased tax revenues, reducing subsidies and losses in state owned enterprises, and limiting government borrowing. And it seeks to substantially increase investments in human capital–health, education and social protection. These are admirable goals and measures that provide the Government with options to meet its objectives.

60. On the other hand, it is obvious that consensus around building together a national vision would much facilitate bringing the agenda forward. The overarching goal could be high growth and more and better jobs. Overall, the proposed consensus could commit participants to reaching 7 percent economic growth and creating 1.5 million more and better jobs a year. Simulations show that a 7 percent annual growth—well above its historic average of 4.3 percent—can produce more (and implicitly better given productivity improvements) jobs in Pakistan. Poverty would decline and other Millennium Development Goals (MDG) indicators would improve even faster. A change this large assumes broad structural reforms that would improve the investment climate, economic governance, and private savings and investment in physical and human capital; and a balanced strategy that conveniently addresses the main—emerging and structural—binding constraints limiting growth. The consensus around these measures could be explicitly or implicitly endorsed by all (or the main) political parties' members (or not yet members) of Parliament in the next administration (and could possibly be ratified by the Council of Common Interests regarding policies to be adopted by provincial governments).