Pakistan: Charting a New Course to Development[1]

Akmal Hussain

Introduction: An Alternative Approach to Development

Over the last seven decades of Pakistan's history, an economic structure has emerged that is characterised by three features. First, an inability to maintain high growth in national income per person over the long run. Second, endemic mass poverty accompanied by growing inequality between social groups and regions of the country. Third, persistent dependence on aid. These features manifest underdevelopment, which can be defined as a condition whereby the actualisation of the human potential of a society is systematically constrained. Pakistan's underdevelopment is fundamentally rooted in a socio-economic environment that restricts access over high quality education, constrains competition and where hiring is often not based on merit. This precludes equality of opportunity for individuals to develop their capabilities. Consequently, the human potential of society remains untapped.

In this essay we will briefly examine the question of why Pakistan has been unable, so far, to achieve sustained high rates of national income growth. We will then explore the approach to development followed by policymakers in Pakistan to indicate that public policy has so far failed to address the fundamental constraints to growth sustainability and overcome underdevelopment. Finally, we will outline an approach that conceives of development as economic transformation. This is based on actualising Pakistan's human potential for creativity, innovation, sustained productivity increase and thereby sustained long term economic growth.

I. The Failure to Sustain Economic Growth

An important feature that distinguishes developed from underdeveloped countries is that while the former are able to sustain per capita income growth over long periods of time, the latter fail to do so.[2] This is not to say that underdeveloped countries are unable to grow; they do grow, but their economic growth takes place in spurts.[3] Periods of relatively high growth are followed by close to zero or even negative per capita income growth, so that the gains

---

[1] This paper is published as a chapter in Bilal Zahoor and Raza Rumi (eds.), *Rethinking Pakistan: A 21st Century Perspective,* Folio Books, 2019.

[2] North, Douglass C., John Joseph Wallis, and Barry R. Weingast. *Violence and social orders: A conceptual framework for interpreting recorded human history*. Cambridge University Press, 2009.

[3] Rodrik, Dani. "Where did all the growth go? External shocks, social conflict, and growth collapses." *Journal of economic growth* 4, no. 4 (1999): 385-412.

made during the high growth periods are largely lost during periods of stagnation. Consequently, over the long run, the increase in per capita income is rather modest. It is certainly inadequate to transform the material conditions of life of most of the people. In this sense, Pakistan's pattern of stop-go growth is typical of underdeveloped countries.

The evidence shows that while during the Ayub-Yahya period (1960-73), there was high economic growth (6.3 per cent annually), during the subsequent Z.A. Bhutto period (1973-77), the growth rate declined to 4.9 per cent annually. Again, in the Zia ul Haq period that followed, there was an acceleration in economic growth to 6.6 per cent annually, but was followed once again by the low growth period of the 1990s (about 4 per cent annually). There was another pendulum swing to relatively high economic growth during the Musharraf period (6.3 per cent annually) followed by a decade of slow growth and virtual stagnation of per capita incomes. Over the long run, despite the spurts, economic growth in Pakistan is on a declining trend. This is in sharp contrast to the growth performance of China and India, who have not only achieved sustained high growth but are on a rising trend.

The proximate factors that explain Pakistan's stop-go pattern of economic growth are: (i) Low domestic savings which are inadequate to finance the investment required for high growth. For example, during the period 2001-07, the domestic savings rate was 16.5 per cent of GDP while the investment rate required for the GDP growth rate of 7 per cent was 28 per cent of GDP.[4] This investment-savings gap is an enduring feature of Pakistan's economy and has created a structural dependence on foreign aid grants and loans. (ii) Low export growth that is insufficient to finance the import requirements of high GDP growth.

These factors have resulted in the observed growth pattern where, near the end of every high growth period, Balance of Payments pressures have built up, forcing a slowdown in growth. The slowdown in growth usually occurs when the Balance of Payments deficit becomes so high that it cannot be financed by Pakistan's foreign exchange reserves, and the recurrent knee jerk reaction has been to seek an IMF bailout package. The standard prescription of the IMF, which is based on questionable theoretical and empirical foundations[5], is to address the Balance of Payments crisis by contracting import demand through a slowdown in GDP growth.

The policy instruments that have been used for achieving this objective are: first, an increase in the interest rate which would tend to reduce private sector investment and the associated import expenditures and, second, sharp reduction in the budget deficit. Given Pakistan's power structure, it is often politically difficult to drastically reduce unproductive

---

[4] With an incremental capital output ratio (ICOR) of 4, a 7 percent annual GDP growth requires 28 percent of GDP to be saved if the country's investment is to be domestically financed.

[5] See for example Stiglitz, Joseph E. *Globalization and its Discontents*. Vol. 500. Norton: New York, 2002. See also Dreher, Axel. "IMF and economic growth: The effects of programs, loans, and compliance with conditionality." *World Development* 34, no. 5 (2006): 769-788.

expenditure and so the axe of budget deficit reduction in the past has fallen on development expenditures. Historically, development expenditure has been a key stimulant to economic growth and an important redistributive mechanism since such expenditures are aimed at benefitting the poorer sections of the society. Consequently, a sharp reduction in development expenditure not only slows down economic growth but also increases economic inequality.

The Balance of Payments crisis in Pakistan on each occasion has been quelled in the short run, through an IMF programme. However, the associated policy instruments used under the programme, by reducing GDP growth, have consequently also reduced the growth of government revenues. In subsequent periods, the very budget deficit, which IMF policy aims to reduce, reappears due to low revenues. At this stage, there is little room left for manoeuvre through further expenditure cuts, hence a high budget deficit. More importantly, IMF programmes, by focusing on the short run and failing to address the structural factors underlying the Balance of Payments crisis, have served to reproduce the crisis itself.

We have indicated in the above discussion the two proximate factors underlying recurrent Balance of Payments crises, the resultant aid dependence and the stop-go pattern of economic growth: low domestic savings rate and slow growth in exports. At a more fundamental level, the failure to sustain long term economic growth is rooted in the institutional structure of Pakistan's economy. This structure systematically generates rents (unearned income) for the elite coalition that has been in power since the mid-1950s. The rents are generated through the rules and norms that restrict competition, discourage hiring based on merit, dis-incentivise hard work, induce inefficiency, constrain innovation and hence prevent growth sustainability.

It is this rent-based institutional structure that has nurtured an entrepreneurial elite, which is largely dependent on such rents with a proclivity for ostentatious consumption rather than savings. At the same time, the incentive-disincentive system embodied in the institutional structure is also the deeper underlying cause for the failure to achieve high export growth. This could only be done through diversification of exports towards high value-added, knowledge-intensive goods and services which constitute an increasing proportion of global export demand. In Pakistan, relatively low value-added and low knowledge-intensive exports (such as rice, leather, cotton, yarn and textiles) constituted about 82 per cent of total exports in 2017-18. By contrast, high tech exports as a percentage of total manufactured exports constituted less than 2 per cent. Even in the case of textiles, which occupies a decreasing proportion of global export demand, Pakistan's entrepreneurs have lost some of their share of total textile exports to neighbouring countries, such as India and Bangladesh, due to lack of efficiency, quality and marketing acumen. Thus, Pakistan's entrepreneurs within the institutional environment of rent seeking have largely failed to diversify exports towards innovation-intensive, high value-added products; they have failed even to shift into the higher value-added end of the textile range, barring a few exceptions.[6]

II. Pakistan's Past Development Perspective and its Consequences:

Growth, Inequality and Underdevelopment

The development perspective of policymakers, through most of Pakistan's history, has been focused on growth on the basis of investment by the elite. In the 1960s, when the basic economic strategy was fashioned, the idea in line with development thinking of the time was to nurture an industrial elite through government-instituted protection from imports, direct and indirect financial incentives and subsidies.

The inequality that was the logical consequence of this approach was considered to be a transient phenomenon. This idea emerged from the influential 1955 paper by Nobel Prize winning economist Simon Kuznets in the American Economic Review.[7] He had argued that inequality would rise initially, and as growth proceeded at a later stage, inequality would decline through the operation of the market mechanism. The Kuznets view has now been rejected on the basis of the seminal empirical work by Thomas Piketty (2014)[8] who has shown that over the last two centuries, inequality, far from falling, has in fact been increasing. He has shown that the increase in inequality has occurred precisely due to market forces which Kuznets thought would reduce it.[9]

Pakistan's policymakers assiduously followed the Kuznets' view. The economic policies of the 1960s were derived from the doctrine of "functional inequality" which was well articulated by Dr. Mahbub-ul-Haq, Pakistan's most influential economist of the time: "There exists therefore, a functional justification for inequality of income if this raises production for all and not consumption for a few. The road to eventual equalities may inevitably lie through initial inequities".[10]

---

[6] For a more detailed discussion, see Hussain, Akmal. "Institutions, Economic Growth and Participatory Development." *Pakistan: Moving the Economy Forward. Lahore: Lahore School of Economics* (2013): 514-520.

[7] Kuznets, Simon. "Economic growth and income inequality." *The American economic review* 45, no. 1 (1955): 1-28.

[8] Goldhammer, Thomas Piketty Arthur. *Capital in the Twenty-First Century*. Penguan UK, 2014.

[9] The rate of return on capital in the Piketty data is higher than the average GDP growth over the period, so the share of capital in the national income tends to rise, unless there is government intervention into the market mechanism.

[10] Mahbub-ul-Haq. *The strategy of economic planning: a case study of Pakistan*. Oxford University Press, 1963. Note: To his credit, Dr. Mahbub-ul-Haq had the intellectual integrity to blow the whistle when near the end of the decade interpersonal economic inequality had become extremely high, and revealed the famous figure of 22 families controlling 66 percent of industrial assets. Dr. Haq combined intellectual integrity with dynamic

During the 1960s, while the average annual GDP growth at 6.9 per cent was impressive, yet inter-personal and inter-regional inequality increased precipitously. The richest 22 families were reported to be controlling 66 per cent of industrial assets. By contrast, for the majority of Pakistan's population, there was an absolute decline in the per capita food grain consumption. The poorest 60 per cent of the rural population over the period 1964-70 suffered a decline from an index of 100 in 1964 to 91 by 1970. In the case of the urban population, there was a decline in per capita food grain consumption from an index of 100 to 96 over the same period. At the same time, there was a sharp increase in inter-regional disparity between East and West Pakistan, so that by 1970, the per capita income of West Pakistan was 42 per cent higher than that of East Pakistan. This was because the GDP growth per capita in East Pakistan was only 1.5 per cent per annum compared to 3.6 per cent in West Pakistan.

The sharp increase in the inequality between a small elite and the majority of the population led to a mass movement against the Ayub government resulting in the overthrow of the very political system within which high economic growth had been achieved. The rapid increase in regional economic disparity between East and West Pakistan became a key factor that fuelled the popular movement in East Pakistan which culminated in the emergence of independent Bangladesh.

The strategy of inequality-based growth thus ruptured not only the political fabric but the integrity of the state itself. At the same time, the expectation that as the rich grew richer, there would be an increase in the domestic savings rate was not fulfilled. There was a growing gap between domestic savings and the level of investment required (28 per cent) to sustain a growth rate of 7 per cent. At the same time the policy of subsidising and protecting the rich-induced lack of competitiveness and hence slow export growth. This shaped an economic structure with an endemic dependence on aid as well as the incapacity to sustain growth.

In the two decades after 1990, a new corpus of research had emerged that challenged the view held by economists since the 1960s that income inequality enables higher economic growth. The work of Berg et. al.[11] showed that inequality in poor countries is a key factor in their inability to sustain economic growth over the long run. Earlier econometric analysis of

---

scholarship when he later changed his view. In his Seven Sins of Economic Planners, he emphasized that what is important is not only the level of investment, but the extent to which it helps develop human resources. Mahbub-ul-Haq then went on to be one of the architects, along with Professor Amartya Sen, of the Human Development Index. Dr. Haq pioneered the UNDP Human Development Reports which had a major impact on changing worldwide, the focus of policy towards human beings rather than GDP growth alone.

[11] Berg, Andrew, Jonathan D. Ostry, and Jeromin Zettelmeyer. "What makes growth sustained?." *Journal of Development Economics* 98, no. 2 (2012): 149-166.

cross country data by Galor and Ziera[12] established that a high inequality of income and wealth, by narrowing the base of investment in human and physical capital, has a negative effect on long term growth.

Pakistan's policymakers failed to learn from the country's own history of the grave political and economic consequences of inequality-based growth. They also appeared to be unaware of the new research and change in economic thinking that occurred over the last two decades. No serious attempt has been made to change the institutional structure that engenders both inequality and growth unsustainability. Consequently, inter-personal as well as inter-regional inequalities continue to grow. According to our estimate in 2016, the per capita monthly income of the richest 0.1 per cent of the population, adjusted for tax evasion, is more than Rs. 1 million.[13] By contrast, the per capita monthly income of the bottom 60 per cent of the population is Rs. 6,000.[14] The growing inequality is accompanied by persistent mass poverty. According to the 2015 UNDP estimate of the incidence of multidimensional poverty in Pakistan, 38.8 per cent of population is below the poverty line. There are also acute inequalities at the regional level. For example, the multi-dimensional poverty in Lahore (Punjab) is 4.3 per cent, while it is 96.9 per cent in Killa Abdullah (Balochistan).

The income inequality is exacerbated by the taxation policy of the government. Over 60 per cent of total tax revenues are currently being generated by indirect taxes which are regressive in nature. In Pakistan, an estimate by the late Dr A.R. Kemal showed that during the late 1980s and early 1990s, the tax burden as a percentage of income was highest at 6.8 per cent for the lowest income group and lowest at -4.3 per cent for the highest income group. To make matters worse, there is inequality in the access over basic services such as quality healthcare and education. Inadequately funded government health and education facilities have led to a rapid increase in private medical facilities as well as private schools and colleges. These facilities in some cases have good quality, but are much more expensive than government facilities, and are therefore beyond the reach of the poorest sections of society. Thus, public expenditure (which is supposed to be a redistributive mechanism providing a cushion to the poor) and tax policy (which is supposed to be progressive by placing a relatively lesser burden on lower income groups) are both regressive in Pakistan, serving to accentuate inequality instead of reducing it.

---

[12] Galor, Oded, and Joseph Zeira. "Income distribution and macroeconomics." *The review of economic studies* 60, no. 1 (1993): 35-52.

[13] According to the World Bank data, 25.62% of Pakistan's National Income goes to top 10 percent of its population. The figure above is estimated on the basis of the assumption that the same distribution holds within the richest 10 percent of the population as in the case of the population as a whole.

[14] *Pakistan Economic Survey 2013-14*. Ministry of Finance, Government of Pakistan. 2014.

III. Transforming Pakistan: Developing the Human Potential in a Growth Process by and for the People

Transforming Pakistan will involve changing the institutional structure as well as configuring key organizations of the state to move towards what we can call a *human economy* i.e. an economy that works to actualise the untapped human potential of the hitherto deprived sections of society: the middle classes and the poor. This transformative development requires four key policy initiatives:

1. Providing to every citizen of Pakistan basic services of quality healthcare, quality education including skill training and social protection (including old age pensions and unemployment benefits). The universal provision of these services, as a key feature of the development process, will lay the basis of a dynamic *human economy*. They will also enable sustained economic growth because of the following:
    i. These services for all citizens will move the economy and society towards equity, which is essential to social justice and central to the idea of an Islamic society as well as a democratic state.
    ii. A healthy and productive labour force with quality education will have the capacity for original thinking and innovation. As empirical research on endogenous growth by Aghion[15] has shown, innovation is a determinant of long term productivity increase and thereby sustained long-term growth.
    iii. The universal provision of health, education and social protection facilitate social cohesion and give a stake in the state to every citizen. This, as research by Easterly (2006)[16] has shown, is a key factor in long-term economic growth.

    In proposing the universal provision of health, education and social security, some assert that Pakistan cannot afford it. Recent evidence shows that this assertion is not true. In the case of a number of countries in Europe, Asia and Latin America that achieved long-term economic growth on the basis of a commitment to the universal provision of these services, their per capita incomes were lower than that of Pakistan today. For example in Germany under Bismarck in the year 1880, the GDP per capita (in terms of 2011 US dollars) was 2792; in Norway in year 1848 the GDP per capita was 1475 (in 2011 USD); in Sweden in year 1891, the GDP per capita was 2676 (in 2011 US$). Similarly, in Meiji Japan in the year 1900, the GDP per capita (in 2011 US$) was 1575, and in China in the year 1950, the GDP per capita (in 2011 US$) was 757. Thus the per capita GDP of each of these countries at the time when they had made

[15] Aghion, Philippe, Peter Howitt, Peter W. Howitt, Maxine Brant-Collett, and Cecilia García-Peñalosa. *Endogenous growth theory*. MIT press, 1998.

[16] Easterly, William, Jozef Ritzen, and Michael Woolcock. "Social cohesion, institutions, and growth." *Economics & Politics* 18, no. 2 (2006): 103-120.

the commitment for universal provision of basic services, was far lower than the GDP per capita of Pakistan in 2016, where in this year the GDP per capita was $5250 in terms of 2011 US dollars.[17]

2. Accelerating the growth of small and medium-sized enterprises (SMEs) that have an export potential. Increasing the share of this sector in GDP can lead to a higher GDP growth for given levels of investment, faster export growth, higher growth in employment and a more equitable distribution of national income. This is because medium and small scale enterprises require a smaller investment per unit of output compared to the large scale sector, and have considerable export potential and higher employment generation per unit of output growth. To achieve this objective, institutional measures will have to be undertaken to provide access for SMEs to a package of services including the following: (i) institutional link-up with the large scale manufacturing industries for outsourcing; (ii) provision of credit; (iii) raw material banks to enable the small units to buy in small lots; (iv) skill training and management systems for quality control to meet export standards; (v) access to facilities for forging and heat treatment for dimensional control of product manufacture.[18]

3. Shifting from an elite, farmer-based agriculture growth of the last six decades to a new agriculture growth strategy based on small and medium farmers. Reducing inequality in the agriculture sector and accelerating the overall agriculture growth rate requires a shift of focus to small and medium farms where there is considerable potential for increasing yields per acre as well as off-farm production of milk and meat. It is noteworthy that about 94 per cent of total number of farms and over 60 per cent of total farm area in Pakistan is being operated by farms below 25 acres in size.

   Two key initiatives could be undertaken for the development of the Small and Medium Farm sector, and thereby accelerate overall agriculture growth as well as the export of dairy products:

   i. An estimate shows that at least 2.6 million acres of agricultural land is state-owned. It is proposed that this state land may be distributed in five acre packages to landless tenants. This would provide land to the tiller in the case

[17] Maddison Project Database, version 2018. Bolt, Jutta, Robert Inklaar, Herman de Jong and Jan Luiten van Zanden (2018), “Rebasing ‘Maddison’: New Income Comparisons and the Shape of Long-Run Economic Development” Maddison Project Working Paper, nr. 10, available for download at www.ggdc.net/maddison.
[18] Hussain, “Strengthening Democracy through Inclusive Growth. Chapter in, Akmal Hussain and Muchkund Dubey (ed.) Democracy, Sustainable Development and Peace: New Perspectives on South Asia." (2014).

of 58 per cent of tenant farmers operating farms below 25 acres. Providing ownership rights to these tenants would create both the incentive and the ability to increase yields per acre on small farms.[19]

ii. To equip and enable small and medium farmers to sharply increase their output and income, it is proposed that a Small Farmer Development Corporation (SFDC) be established through a loan by the government. The SFDC would be owned by the small and medium farmers, whereby their equity is financed by the government loan which can be returned from the dividend income of the shareholders. The SFDC, while being owned by small and medium farmers, would be managed by high quality professionals. The SFDC would provide the following support services to small and medium farmers: (a) provision of technology for laser levelling to enable better on-farm water management; drip irrigation to increase higher water use efficiency; soil testing to enable farmers to use the specific chemical fertilizers that are consistent with the nutrient requirements of the local soil; technology for tunnel farming to produce high value off-season vegetables. (b) Provision of high quality seeds and appropriate pesticides. (c) Provision of credit as well as equitable access over markets. (d) Linking up small-medium farms producing fruits and vegetables with a supply chain for export marketing on the basis of compliance to international standards of quality in production, processing, packaging and transportation.[20]

4. Reducing regional economic disparities both between provinces and within provinces. This requires the development of infrastructure in selected growth nodes in the backward districts and provinces.[21] These growth nodes for both small and medium scale manufacturing facilities, as well as the production of dairy products, could be linked up with national as well as international markets. The CPEC has created the possibility of developing backward areas and linking them up with both global and national markets. However, actualising this possibility requires maximising the multiplier effects of investment in CPEC-related projects. Careful planning is required for developing the credit, technological and skilled labour requirements of the new growth nodes in backward areas. Ancillary roads going deep into the backward areas for linking them up with the main CPEC network will also be

---

[19] Ibid., 181.

[20] For a more detailed discussion, see Hussain, "A Framework for Inclusive Development: Growth through Equity" in Inclusive *and Sustainable Development*. UNDP Pakistan. June 2017. http://www.pk.undp.org/content/dam/pakistan/docs/DevelopmentPolicy/Inclusive and Sustainable Development.pdf

[21] For a more detailed discussion, see Akmal Hussain, Ibid., 19-20.

required to enable processed fruit and automobile parts to be produced by small scale entrepreneurs in the backward areas.

Conclusion

The time has come to change development thinking and development policy of unsustainable growth by and for the elite. A new perspective of transformative development for unleashing the human potential of the middle classes and the poor has been proposed in this chapter. We have in Section I discussed how the policies of past decades have led to the emergence of an economic structure that is characterised by inequality, unsustainable growth and aid dependence. We have then indicated, in Section II, the explosive political consequences of such economic policies and demonstrated how the resultant economic structure perpetuated underdevelopment. We have argued that the intellectual basis of the policy of growth-with-inequality, which has been followed over the last seven decades, has been shown to be flawed by new research. We have proposed that a higher and more sustained growth can be achieved *through* equity. This requires opening up the economy to the middle classes and the poor and developing their human capabilities. As this hitherto excluded majority of people begins to invest and contribute to productivity increase and innovation, they can power a new economic dynamism. In section III, we have suggested concrete policy initiatives through which Pakistan can chart a new course towards a *human economy*. This would be an economy that enables the people to actualise their human potential, and thus economic dynamism would be drawn from the creativity and enterprise of its people.

Bibliography

Aghion, Philippe, Peter Howitt, Peter W. Howitt, Maxine Brant-Collett, and Cecilia García-Peñalosa. *Endogenous growth theory*. MIT press, 1998.

Berg, Andrew, Jonathan D. Ostry, and Jeromin Zettelmeyer. "What makes growth sustained*?." Journal of Development Economics* 98, no. 2 (2012): 149-166.

Dreher, Axel. "IMF and economic growth: The effects of programs, loans, and compliance with conditionality." *World Development* 34, no. 5 (2006): 769-788.

Easterly, William, Jozef Ritzen, and Michael Woolcock. "Social cohesion, institutions, and growth." *Economics & Politics* 18, no. 2 (2006): 103-120.

Galor, Oded, and Joseph Zeira. "Income distribution and macroeconomics." *The review of economic studies* 60, no. 1 (1993): 35-52.

Goldhammer, Thomas Piketty Arthur. *Capital in the Twenty-First Century*. Penguan UK, 2014.

Hussain, Akmal. "Institutions, Economic Growth and Participatory Development." *Pakistan: Moving the Economy Forward. Lahore: Lahore School of Economics* (2013): 514-520.

—"Strengthening Democracy through Inclusive Growth. Chapter in, Akmal Hussain and Muchkund Dubey (ed.) Democracy, Sustainable Development and Peace: New Perspectives on South Asia." (2014).

—"A Framework for Inclusive Development: Growth through Equity" in Inclusive *and Sustainable Development*. UNDP Pakistan. June 2017. http://www.pk.undp.org/content/dam/pakistan/docs/DevelopmentPolicy/Inclusive and Sustainable Development.pdf

Kuznets, Simon. "Economic growth and income inequality." *The American economic review* 45, no. 1 (1955): 1-28.

Mahbub-ul-Haq. *The strategy of economic planning: a case study of Pakistan*. Oxford University Press, 1963.

North, Douglass C., John Joseph Wallis, and Barry R. Weingast. *Violence and social orders: A conceptual framework for interpreting recorded human history*. Cambridge University Press, 2009.

Pakistan Economic Survey 2013-14. Ministry of Finance, Government of Pakistan. 2014.

Rodrik, Dani. "Where did all the growth go? External shocks, social conflict, and growth collapses." *Journal of economic growth* 4, no. 4 (1999): 385-412.

Stiglitz, Joseph E. *Globalization and its Discontents*. Vol. 500. Norton: New York, 2002.