

## **SOME SUGGESTIONS FOR CRITICAL POLICY STUDIES**

This is my first meeting with this group. Therefore, I ask for your indulgence if I occasionally go over some ground that you have already covered or appear to be ignorant of discussions that you might already have had.

I have been asked to suggest some areas of work that we might undertake in order to support policymakers. My perspective on what we should try to do is inevitably conditioned by my experience of working in Pakistan during the last six years. Since 2003 I have worked with the World Bank, the Asian Development Bank, DFID, J. E. Austin Associates, the four provincial governments, and the federal Ministry of Finance on several major tasks. Four of these were economic reports on each of the provinces—the first in 60 years—while the fifth was the Poverty Reduction Strategy Paper 2. I have also prepared a medium-term economic strategy for the Punjab (which was issued with the current provincial budget), and at present am engaged in a strategy for private sector development for that province.

I will try to isolate from my recent experience some key areas in which government policies would be significantly strengthened by being underpinned by serious research. Of course, my aim is not to be comprehensive, but only to indicate some threads that I found policymakers to be interested in, but for which they lacked analytical and empirical support.

My remarks fall broadly under three headings:

- The importance of government departments obtaining support from research institutions;
- Pakistan's overall economic strategy;
- the view from the provinces.

### ***Federal and provincial economic ministries have inadequate capacity and policymakers lack analytical support***

In the course of my work I was surprised that in terms of knowledge and technique matters had not progressed from the time that I worked in the Planning Commission (1962–75); in many ways they seemed to have regressed. Several things that were done routinely—such as using input-output tables to forecast import requirements; regularly measuring the changes in cropped area in response to announcements of support prices; assessing time lags between a decision to invest and the full capacity utilization of that investment; and so on—appear to have fallen by the wayside. We seem not to have learnt from the experience of the economically most successful countries that decision-makers must be fed a continuous diet of information and analysis if they are to construct rational and effective policies.

This is unlike the situation in many of the fast-growing countries. Shahid Javed Burki can tell you authoritatively about the situation in China and in Latin America. In my own experience of East Asia, I was struck by the practice in Korea where virtually every ministry had a research body attached to it. The very impressive Korean Development Institute worked on economic

problems for the Ministry of Planning; in fact, the *chef du cabinet* of the Deputy Prime Minister for economic matters (who was also the Minister of Planning) was frequently a senior economist seconded from the Korean Development Institute and acted as a liaison between the two institutions.

In Pakistan, economic ministries at both the federal and provincial levels lack such support. The government may well not have the necessary resources to set up structures along the lines of the East Asian countries. However, there is no need to exactly duplicate such structures. Fortunately we have a number of outstanding research institutions; the problem is that the research bodies and the government appear to be working in different silos. In view of this weakness, and the fact that the economy is progressively becoming more complex and dealing with an international environment that threatens to become ever more uncertain, it is essential to bring together the research institutions with the appropriate departments in the provincial and federal governments.

***The international economic environment for the next 5 to 10 years and Pakistan's security situation will require a more nuanced economic strategy***

Let me now offer a few comments on Pakistan's economic strategy, and indicate how this group could help make it more nuanced. This group has already spent some time discussing the sort of economic model that Pakistan should follow. I do not know if the group has reached any definitive conclusions on this point; however, the reports of previous meetings that I have read show a considerable amount of interest in pursuing some sort of export-heavy strategy.

It is absolutely essential that Pakistan pay much, much greater attention to promoting exports. This is obviously necessary to avoid greater pressure on the already fragile external accounts of this country, and also to enable us to better resist the whims of donors both on our economy and on our polity.

One of the first orders of business, therefore, must be to examine the efficiency of our major industries in relation to our main competitors, and to assess what kinds and levels of incentives our competitors are being offered by their governments. I understand that a unit in the federal Ministry of Commerce will be conducting such a study. It would be useful if one or more institutions represented here were to join in this study in order to provide it with greater rigor.

Second, the participation of an independent research think-tank is essential to ensure that the study is conducted free of pressure by the industries concerned. During my work on private sector development, I have had occasion to discuss Pakistan's deteriorating export performance with several representative businessmen. Their insights were frequently valuable but, to be frank, many of the measures that they wanted from the government seemed to be more of the rent-creating variety than of the efficiency-enhancing. The argument generally took the form of an assertion that India, or Bangladesh, or China, or whatever provided a subsidy of X percent (with X being a large number) to the exporters of the commodity in question, while Pakistan either did not provide a subsidy at all or provided a much smaller amount; therefore, would the government kindly cough up the difference and correct this inequity. Of course, we would not like to see our

exporters disadvantaged in any way; however, assertions such as the one that I have described—and they were very common—smack of self-service and need to be studied by a neutral body.

On the question of an export-led growth strategy, I would like to inject a note of caution on two grounds. First, following the success of the "East Asian Tigers"—such as Korea, Taiwan, Malaysia, Singapore, Hong Kong, with Vietnam coming up fast—and of course the spectacular performance of China in using the export sector to pull their economies out of poverty, it has become a fashion, if not a fetish, on the part of international development agencies to prescribe export-led growth to virtually every country under the sun.

However, this overlooks an important point. The aggregate of exports from developing to developed countries cannot be larger than the total external deficits that the latter are prepared to sustain. Trade between developing countries is no doubt growing, but is still small compared with their trade with the developed economies. Most of the discussion, analyses, and forecasts of the recovery from the present international recession suggest that this will be slow and shallow. In particular, it is most improbable that the United States will continue to run external deficits of the magnitude that it has done for the last four or five decades.

It is difficult to see any other country, or even group of countries, that would be prepared to sustain deficits comparable to those of the United States during the last 50 years. Most analysts suggest that deficits in the coming decade or two are likely to be significantly smaller than in the past. This means that developing country exporters will have to compete much more vigorously with each other (and with developed country exporters) in order to secure a piece of a smaller pie. Moreover, the most likely stimulus to trade is expected to come from China, with perhaps India and Brazil also helping.

These trends will make life difficult for Pakistan's exporters, especially in the immediate term. We have not invested sufficiently in upgrading our technology, infrastructure, and human resources to meet the sort of ferocious competition that is likely to ensue. Moreover, India, Brazil, and China have not been major export destinations for Pakistan; consequently our share of their markets is very small. We must continue to push our exports, but we must be realistic about how far a small tail can wag a rather large dog.

The slow international recovery will affect all exporters. However, another factor impacting on Pakistan's exporters is the present security situation. The terrorist attacks that have taken place and the strong perception that further attacks will occur in the future has created an atmosphere of uncertainty even among Pakistan's regular customers. In my discussions with some major foreign importing groups, I have been told that they are hesitant to commit major orders to Pakistan because they are afraid that terrorist activities could disrupt production and make it difficult for Pakistani businesses to meet delivery schedules. Consequently, many of these importers are looking elsewhere to meet their requirements. This loss of market share might be difficult to recapture; certainly it will be so in the short term. Thus, while I would urge the authorities to do everything in their power to boost exports, I would also urge all of us to absorb a dose of realism as to how much must be done to make them grow rapidly on a sustained basis.

The consequence of these events is that for the next five years at least, Pakistan will have to follow a more nuanced strategy. The strategy will have to try to boost exports as much as possible, but at the same time pay a great deal of attention to developing the domestic economy. In developing and implementing such a balance strategy, the institutions represented here have the opportunity of playing a key role.

Let me first consider the export side.

In view of the importance of exports, it is essential that the government develop a coherent and economically rational strategy, in order to focus our efforts and to attain the goals in the economically most efficient manner. I stress "economically efficient," because Pakistan does not have the resources to squander in scattering them in the encouragement of all export possibilities.

The export strategy will first have to begin with what might be termed a philosophical change. The overwhelming view among Pakistan's exporters and policymakers appears to be that the country can be competitive only in the export of items that are based on raw materials indigenous to Pakistan. Hence we have the continued emphasis on cotton and its derivatives.

This is contrary to the practice and the experience of the East Asian countries. If there is one thing that the East Asian tigers share, it is an almost complete absence of natural resources. The East Asian "miracle," in a nutshell, was based on importing raw materials and semi-finished goods, adding value by a trained labor force, and exporting at a competitive exchange rate. In the modern world, exports are commonly based on imports—the average import component of Korea's and Taiwan's exports is over 30 percent. This is a lesson that Pakistan must take to heart.

Thus, perhaps the first useful thing that our research institutions could do would be to show the government what successful exporting countries actually did. Such a study should also describe the international environment in which it was possible to implement many of the policies of the Koreans, Taiwanese, etc and how that environment differs from the present—for example, the conditions of the WTO—which sets tighter limits Pakistan's ability to replicate that policy set.

Second, the economic policy must be supplemented by an overarching industrial strategy. It is quite striking how quickly any discussion of export policy in Korea, Taiwan, Japan (and now Vietnam) merges into a discussion of industrial policy. Dr Ijaz Nabi made a commendable start on this in a study for the Ministry of Industries and the World Bank, and we must build on that.

Third, in addition to the studies that I have mentioned earlier about the competitiveness of particular industries, think tanks might also usefully consider other studies that examine in which areas Pakistan can earn a dollar with the smallest expenditure of real domestic resources. Such studies could take the form of estimating effective rates of protection for particular industries or estimating the domestic resource costs (appropriately shadow-priced) of earning a dollar by our main export lines. Such studies used to be conducted almost routinely as far back as the mid-1960s and early 1970s by the Planning Commission and the Pakistan Institute of Development Economics; in fact, a number of papers in this area were published in the *Pakistan*

*Development Review* of the period and Pakistan was often cited in the literature as one of the pioneers in applying such techniques.

The implication of this line of the foregoing thinking is that a strategy for rapid growth must also include as a major element the development of the domestic market. Pakistan, after all, has a population of 175 million, which is nearly twice the population of Germany. Properly developed, the domestic market could sustain the necessary demand for industry while the war against terrorism is being won and while the country undertakes the necessary investment in upgrading its plant and equipment, its infrastructure, and its stock of human skills.

Developing effective policies for the domestic economy will require the authorities to increase their knowledge and improve their policy tools in a substantial number of areas. I will not try to give a detailed rationale for each of the studies; I will content myself with mentioning several serious areas of weakness that emerged during my discussions with federal and provincial governments.

***Pakistan's history suggests that we neglect provincial economic differences at our peril***

A fourth major area for study—and a key one in the analysis of the domestic economy—is the disparity in the development of the different provinces. One of the unfortunate aspects of Pakistan's approach to development planning is that it looks largely at the behavior of macroeconomic indicators for the country as a whole, and refers only in a general manner to the trajectories of each province and even more cursorily to the policy issues, constraints, and opportunities that confront the different provinces. This approach—that it is the federation as a whole rather than the federating units that matter—is so ingrained that even after 60 years of Pakistan's existence the authorities do not produce official statistics of provincial GDP's, investment, and saving.

I do not need to remind this audience about the crucial need to study interprovincial disparities. One of the main reasons for the breakup of Pakistan in 1971 was the feeling in East Pakistan that it had been systematically disadvantaged economically and little was being done to seriously address this issue. Evidence of similar strains surfaced during the work on the four provincial reports. The country cannot afford an encore.

It hardly needs to be said that the absence of reliable statistics on GDP, investment, savings, and other provincial economic activities makes it very difficult for the provinces to plan reliably or to execute economic policies with some assurance as to their impact. An important contribution could be made by one of the institutions represented at this table taking up this task and generating a reliable time series for the key economic indicators of each of the provinces.

A start has been made in preparing a series of the Gross Provincial Products for the four provinces, notably by Dr Kaiser Bengali and his associates, and built on that by the World Bank. These were pioneering efforts, with the shortcomings that can be expected of such efforts, and it would be an important contribution to policymaking if a more reliable series were established.

Moreover, for purposes of economic management, it is also important to develop a well-founded time series of provincial investment, especially of private sector investment.

It is also important not to regard the provinces as monoliths. After all, the population of the Punjab equals that of Germany, and there are wide divergences in development between different parts of the province. The work of Dr Ali Cheema and his associates has shown that the southern and western districts of the province are systematically the poorest. Similarly, the overall per capita income figures for Sindh hide wide divergences between Karachi and the rural districts. The study of intra-provincial disparities could constitute an important work program for research institutions and would be of inestimable benefit to policymakers.

A fifth important area for investigation, and one that should be very important for policymakers, is the informal or "gray" economy. We do not have reasonable estimates of how large it is, what its structure is, and whether it moves pro- or counter-cyclically with the formal economy. Knowledge of the informal economy is important because many policymakers appear to believe, on the basis of virtually no information, that if things go wrong in the formal economy, the informal one will pick up the slack. We need to know if this is indeed the case. In fact, studies from Latin America and India suggest that many of the factors that caused the formal economy to expand or contract affected the informal economy in the same manner, thereby making it move in the same direction as the formal one. Most probably, therefore, we cannot expect the informal economy to act as a reliable cushion if things go bad for the formal economy.

A sixth area that is ripe for study—and is fundamental to any investigation of employment and poverty—is that of small and medium enterprises (SMEs). These account for about 90 percent of all enterprises in Pakistan and generate the bulk of employment in the country. Some of the problems that they confront—in particular the difficulties of accessing finance—are well known. The answers are much less clear. The main reason why SMEs have difficulty in obtaining finance, especially bank finance, is of course the well-known difficulty of "asymmetric information." The borrower knows much more about the true state of affairs of his business than does the lender, and the latter may have to spend substantial amounts of money to get the information. Since most loans to SMEs are likely to be of relatively small amounts, the expenditure on obtaining the information might well wipe out the profit on the loan. Hence, most commercial banks are reluctant to consider lending to SMEs.

It would be useful if some of the institutions around this table were to study the problems affecting SMEs, particularly the key question of accessing finance. They could begin by simply examining what other countries that have been successful in supporting the SMEs have done to tackle this problem. They might then be able to recommend if some of the actions undertaken by other countries would be useful in the Pakistan situation, or they may be able to make original recommendations themselves, based on the results of their study. Given the importance of employment as a factor in moving people out of poverty, and the huge role played by SMEs in this area, a well-designed study should yield very important results for policy.

Another area that appears to have been neglected is the construction of input-output tables. Again, this neglect is surprising. The first input-output table (45x 45) for Pakistan was

constructed as far back as 1964 in the Planning Commission. In the next six years, two more such tables were constructed, the largest being 60x 60. This table was used for estimating effective rates of protection, and for forecasting the import requirements of the economy. The results of the latter exercise were made available to the Chief Controller of Imports and Exports for the formulation of the twice-yearly announcement of the import policy, and were also used in developing Pakistan's estimate of aid requirements that were presented to donors at the Pakistan Consortium.

Apart from the uses that I have just described, an up to date input-output table would also be very useful in showing backward and forward linkages among different economic sectors and thereby suggesting to policymakers where selective intervention would be most effective. A number of countries, notably Korea, have quite often used such tables in thinking about policy interventions.

So far I have been dealing largely with issues that might more or less be called macroeconomic in that they dealt with studies that could be useful to policymakers at an all-Pakistan or an all-provincial level. But there is plenty of scope for very useful policy-oriented studies at the sectoral level. Let me just give a couple of examples of issues that kept recurring in my work on the provinces.

A question that the private sector repeatedly brought up was the efficacy, or rather the lack of it, of the technical education system. It appeared that the private sector saw several shortcomings in the training imparted to would-be engineers and technicians. The constant complaint was that the graduates of our technical institutions lacked practical skills and that engineering companies had to devote significant time and resources to bringing them up to speed.

I asked the head of one of the major engineering companies to identify more clearly what was responsible for this shortcoming. His investigation revealed that the theoretical knowledge of the engineering students was generally satisfactory and they also had access to some very good equipment for training. However, the recurring budget was severely constrained, especially the portion that was devoted to purchasing the materials used on the machines for practical work. He estimated, on the basis of the budgets for the previous two or three years, the costs of the materials, and the number of students, that on average a student would be able to work on a machine for only 27 minutes in the academic year. Such a state of affairs would obviously not produce very practical or skilled engineers and technicians.

The study that I am referring to was done for the NWFP; it would be interesting to see if a similar situation obtains in other provinces. I am focusing on technical education, because this is one of the key drivers of productivity, which is necessary if Pakistan is to become competitive in the world economy.

One could go on listing studies that should be done in order to inform major policies. I propose to mention only one more, which is important because it deals with the key sector of education.

A study of 112 schools in three districts was done a year or so ago on Learning and Educational Attainment in Punjab Schools (LEAPS) that produced some very critical results. The principal findings were that compared to our neighboring countries, both public and private primary schools in the Punjab produced inferior educational outcomes. However, the outcomes in public schools were much worse than those in private—the study estimated that a public school student in the third grade would require another 1.5–2.5 years to catch up with a third-grade private school student. These outcomes resulted in spite of public school teachers being paid four to six times the salaries of private school teachers; thus lack of pay did not appear to be the issue. The study also administered standardized tests in language and arithmetic to both public and private school students and estimated that it cost society (taking all expenditures into account) more than twice as much to obtain one mark on the test in public schools than in private.

However, these findings do not indicate that public schools should be eliminated. Private schools tend to congregate in the better-off villages and in the more prosperous parts of such villages; public schools are widespread throughout the province. Thus public schools do offer some sort of education in areas that are not served by private schools. The challenge is to make public schools perform better.

The analysis of the reasons for the difference in performance was largely inconclusive. The only variable that the study found statistically significant was the authority of private school headmasters to terminate the services of teachers who did not produce the desired educational outcomes; public school headmasters had very limited authority in this area.

It would be very desirable to carry out more studies along these lines in all the provinces, using larger samples to perhaps get greater clarity as to the variables that really made the difference. The shortcomings of our education sector are undoubtedly responsible for many of the most serious ills that presently infect our society. Any light that the institutions represented here are able to cast on this problem and to help find efficient solutions should be welcomed by policymakers.