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National Policy Platform for

Competitiveness and Economic Growth

Sectoral Interventions: Drilling Down to the Specifics

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1. Introduction

This note develops the paper presented at the first meeting of the Platform. It begins with a brief discussion of the appropriateness of the development model in a country in Pakistan's situation. We will then focus on the development of the Pakistani firm as a catalyst of economic change in the country. The chapter concludes with the identification of a dozen areas for analytical work and policy advice, each with enormous bearing on improving the competitiveness of the Pakistani economy and improving the prospects of growth.

2. A different model of economic growth

There is some debate in the country on what is the most appropriate model of growth for Pakistan and also about what kind of strategy should be pursued by the country in order to sustain high rates of uninterrupted growth as has been done successfully in a number of Asian countries. Should Pakistan be guided by the experience of countries such as South Korea and now India that have relied on industrialization by focusing on the development of large industries? Should industrial growth be left to medium-sized enterprises as was done by Taiwan? Should industrialization be left to foreign companies who will bring in capital and associated technologies in order to supply external markets? This is essentially the route taken by China. Or should Pakistan adopt an entirely different route and opt for agriculture, agro-processing and the various modern service sectors as the engines of growth? Should the country encourage the development and modernization of the enterprises operating in these sectors of the economy? In order to find answers to these questions we should examine both Pakistan's endowments on which the country can build its economic future as well as develop a good understanding of the changes that have occurred and are occurring in the country's external economic environment.

The process of globalization has changed the structure of production and trade in the world economy. With the extraordinary development of information and communication technologies, economists have given up classifying the "products" of the service sector as non-tradable. There are a number of new opportunities that have opened up for countries such as Pakistan that have large and young populations and are physically close to some of the more rapidly growing and dynamic countries in the global economy. The country inherited a well developed sector of agriculture that could have become the engine of growth and also a significant earner of foreign exchange had the attention of the first generation of policymakers not been turned towards industrialization. This happened largely as a result of a number of actions taken by India in 1947-49 to economically cripple Pakistan. These included the refusal to release funds that were due to Pakistan from the compensation provided by Britain for British India's war effort; the attempt to divert water from the rivers that flowed into Pakistan from India; and, finally, a trade embargo imposed on Pakistan by New Delhi when Karachi (then the capital of Pakistan) refused to devalue its currency with respect to the US dollar as was done by all countries of the

British Commonwealth. These Indian actions were to have profound consequences for Pakistan's economic development. Of these two were particularly important.

The first was the neglect of agriculture which, at the time of independence, was by far the most important part of the Pakistani economy. The second was to make the economy less trade-oriented. At the time of independence trade accounted for more than 50 per cent of the country's economy. India was the most important trading partner accounting for nearly two-thirds of the new country's exports and imports. All this changed as a result of the initial Indian hostility towards its neighbor. Had India not forced Pakistan to opt for industrialization as a way out of the problems the country faced right after gaining independence, the structure of the economy as well as trade would have been very different from what is today. In both, agriculture would have played a more important role.

Pakistan's other economic inheritance was the small-scale industrial and commercial sectors. The first was based on the presence of skills that were developed over centuries; the second was connected with the need to supply agricultural surpluses to several distant parts of British India. Several small towns in the Punjab and the North-West Frontier Province had metal working and basic engineering skills that could have become the basis for both industrialization and exports. The Punjab also had wood-working skills; there were skilled workers in Sindh producing ceramic tiles, stone works, and furniture; the people of the NWFP had built up small businesses in processing the area's abundant food crops; the Kashmirs, some of whom were to become the citizens of Pakistan, were known for their weaving and wood-working skills. However, for several decades Pakistan's policymakers made no effort to develop this sector as a major contributor to economic growth and poverty alleviation. It was only in the late 1990s, that the government turned its attention to this part of the economy.

The same kind of neglect was visited upon small-scale commerce and retail trade. It remained burdened with regulations that had lost their meaning after the partition of India. *To this, as we well discuss later in this chapter, import into the urban areas of agricultural commodities and livestock products remained controlled by the institutions of local government that created all manner of rent-seeking opportunities for the functionaries of the state while inhibiting the modernization of this important part of the economy.

Building Pakistan's economic future on the development of these sectors offers a viable opportunity for the country. Had this been done in the past, Pakistan would have chartered a different economic course for itself, different from those pursued by other more successful Asian countries. According to one Pakistani economist, the main components of an appropriate economic strategy for Pakistan are the "knowledge economy, biotechnology driven agriculture growth and strong support for development of a modern retailing sector. There are obvious linkages between these three, but more important are the linkages between them and other growth areas in the economy". *What kind of public sector interventions are needed to develop these essentially neglected parts of the economy is the subject of the last section of this chapter. However, before we get to that point, we will discuss the state of the Pakistani firm in all parts of the economy.

3. The state of the Pakistani firm

Economists working in the area of development reached the conclusion a couple of decades ago that the sustained growth of backward economies required an environment that provided the right set of incentives for the various economic players. “Set the policies right” became their mantra. What were the right sets of policies to be pursued? This was defined at some length within a framework that was given the name of *The Washington Consensus*. It was so called for the reason that those who developed it worked at the Washington based institutions such as the World Bank, the Inter-American Development Bank, the IMF and several think tanks operating in the American capital.

The most important part of the advice given the developing world was to open the economies by allowing relatively - if not totally free - flow of goods and capital across their borders. This meant reduction in tariffs and other barriers to trade. It also meant easing controls on the movement of capital. The governments were also advised to reduce fiscal and balance of trade deficits - to bring their economies in balance. It was recognized that opening the country to trade would initially increase imports to the point where serious balance of payments deficits would occur. To deal with this problem, the policymakers were advised to adopt export promoting policies, to move away from import substitution and move towards export promotion. Also, under this consensus, the state’s role had to be reduced and the private sector given the role of the leader in the economy.

Later, when some of the economies to which this prescription was applied did not grow as rapidly as the authors of the *Consensus* had hoped, another set of policies came to be advocated. These were aimed at the development of the private sector. To achieve this objective, the governments were advised to create a business-friendly environment. This required the governments to reduce the regulatory burden on the enterprises operating in the economy, to ease the entry of new enterprises and to make it easier for them to exit if they failed, to make it easier for enterprises to obtain finance, to facilitate the hiring of new workers by them and let the workers go if they had to reduce their operations, to improve the legal and judicial systems so that the contracts into which enterprises entered could be readily and cheaply enforced.

To give substance to this advice, the World Bank started a program to evaluate how various countries were doing with respect to these indicators. The purpose of this exercise was to alert the policymakers where their country stood compared to other countries in the region and in the developing world. These results are reported every year in a document titled *Doing Business,* most recently in a report published in late 2008. Along with this work, the World Bank is in the process of completing its second *Investment Climate Assessment* for Pakistan. Most of the data used below on the economic enterprises in Pakistan are drawn from the latter document.

Pakistan has 3.3 million economic establishments, 90 per cent of which are sole proprietorships and another 2 per cent are partnerships. The distribution of the enterprise sector, in other words, is heavily skewed towards informality. Punjab, with 67 per cent of the total, has the

largest share of these enterprises followed by Sindh with 17 per cent, the NWFP 14 per cent and Balochistan 2 per cent. A significant number of those in Punjab are small while a much larger share of the large enterprises is in Sindh. In fact Sindh, having had an earlier start in the process of industrialization, has much older enterprises compared to those in the Punjab. Pakistan is different from other developing countries in the sense that the older enterprises are more efficient and productive than those that are relatively new. This is one indication of the important fact that newer enterprises were not technologically more advanced, as would be expected, compared to those that were established earlier. For the country to move forward economically it is the small enterprises in the informal sector that must become the focus of public policy.

For a country of its size and the stage of development, Pakistan's economy is dominated by small and medium-size establishments. Almost 90 per cent of the enterprises are SMEs which employ 78 per cent of the non-agricultural workforce and contribute 30 per cent of the GDP. Ninety five per cent of the 3.3 million economic establishments employ less than 5 workers, another 4 per cent employ between 6 and 50 workers. Only 1,617 enterprises employ more than 50 workers. A handful of the enterprises can be considered to be big, employing more than 1,000 workers. More than one half of the large enterprises are in the textile sector. Most of the smaller enterprises are in retail trade and simple manufacturing, the two sectors we have identified as holding potential for quickening the pace of economic change in Pakistan.

These facts about the structure of the enterprise sector raise an important issue with respect to public policy. If Pakistan is to opt for the adoption of an industrial policy - something we believe it should do - should its emphasis be on the development of the SME sector, should it aim to encourage the establishment of large enterprises, or should it follow a strategy that aims to develop both types of enterprises? This is an important question. If an SME- oriented approach were to be adopted, there would be the need to develop linkages with the large corporations operating in the global field. One consequence of this approach would be to focus on the development of the vendor industry which would supply parts and components not only to the domestic industry but, more importantly, to the large transnational corporations. Since the most rapidly growing part of international commerce is the growth of "parts and components" in trade, such an approach may yield high dividends.

The sectoral distribution of Pakistan's establishment provides one more piece of evidence of the relatively underdeveloped structure of the country's economy. A little over half of the enterprises operating in the country are in wholesale and retail trade. This is the semi-formal part of the enterprise economy which needs to be developed to gain size and efficiency. That would not only contribute to increasing the rate of growth in GDP but also help to reduce poverty and narrow income distribution in the country.

About one fifth of the enterprises are in the manufacturing sector. That some 660,000 establishments are engaged in manufacturing is one more indication of the relative backwardness of the economy. The activities in which they are engaged in are relatively low cost, low technology, and low-skill. An important part of the strategy aimed at increasing the efficiency of the economy would be to improve the scale and technological base of at least the top 20 per cent of these enterprises. The state should get actively involved in improving the working of 125,000 enterprises in the manufacturing sector. In order to do this would not mean providing them with financial support. It would mean a number of interventions by the state of the type discussed in the financial section of this chapter.

If an industrial policy were to be developed and followed by the government to promote growth, to increase the amount of incremental resources flowing to the poorer segments of the population, to obtain a larger share in the global economy, Pakistan will need to look carefully at the structure of establishments operating in the economy. In other words, an important part of the industrial policy will have to be a policy aimed at developing enterprises.

Should Pakistan's policymakers, worried as they must be about security, also be concerned about the cost of doing business in the country? It is well known that this is an important determinant of the decision to invest. For foreign investors stories about kidnapping, demands for ransom, and the killing of some hostages pose serious issues in their decisions to bring capital to Pakistan. Security concerns must also weigh heavily with the domestic investors particularly in the troubled areas in Balochistan and the North-West Frontier Province. While these are weighty concerns, the government should be mindful of the fact that the cost of business is an important factor in investors' calculus. This is one reason why the World Bank is spending a significant amount of its resources on estimating the cost of business in the developing world and publishing it findings in annual reports titled *Doing Business*. The report for 2009 has recently been released and has some interesting findings for Pakistan.

The first *Doing Business Report* was published in 2003. It covered five indicator sets in 133 countries. The more recent report has a wider country coverage. It has data on 181 countries. It has also expanded the issues of likely concern for the investors. The Bank has looked at ten indicator sets. These include the ease of starting a business, the cost of obtaining construction permits, the cost of employing workers, the ease (or conversely difficulties faced) in registering property, availability of credit and the cost of obtaining it, what kind of protection is available to the investors, how difficult (or easy) is it pay taxes, what are the problems encountered in cross-border trade, can contracts be enforced and what are the costs of closing businesses. The Bank's work is focused on small and medium-size industries since it is this type of entrepreneurship that ultimately determines the pace and scope of economic growth in the developing world.

How does Pakistan fare in this exercise and how does it compare with other countries in the region and with the countries that are its competitors in the global market place? There are some surprising conclusions concerning Pakistan, especially when we compare the various elements in the perceived cost of doing business with those in India and Bangladesh. Pakistan ranks 77th compared to Bangladesh's rank of 110th and India's 122nd out of the 181 countries studied by the Bank. India's relative low rank is particularly surprising considering the strong interest in the country shown in recent years by the community of international investors.

There are two other areas in which Pakistan does relatively well. These are ease of closing businesses and obtaining credit for business. The country's ranks in these areas are respectively 53 and 59 out of 181 countries. Once again the question of the cost of closing business is relevant for the formal sector of the economy. For the informal sector which accounts for the vast majority of the enterprises in the country, shutting down a business is not problematic. The burden falls on the family and is not too difficult to bear. Most often, the entrepreneurs set up industries producing another line of products or providing another kind of business. Access to credit, however, is important for businesses of all sizes. In most developing countries the formal financial sector - banking as well as non-banking - is open to large businesses. Small enterprises have to make do with informal parts of the financial sector. The cost of obtaining capital from these sources may be high but the time and cost of enforcing informal contracts can be quite low. This is one reason why small and medium-size industries may not be keen to graduate in size in the search for capital generally available to the formal part of the financial sector.

For Pakistan the best ranking among the ten indicator sets is for "protecting investors". This set has four indicators, all concerning the way publicly listed companies are managed. This is an important indicator. A recent study suggests that the presence of legal and regulatory protections for investors explain up to 73 per cent of the decision to invest. In contrast, company characteristics explain only between 4 per cent and 23 per cent. Thus both government and businesses have an interest in reforms strengthening investor protections. However, much of the small and medium-size sector in Pakistan is outside the formal capital markets in Pakistan. Consequently a relatively high ranking in terms of investor protection is of limited consequence for the country.

What is of great consequence is the relative ranking on another score - enforcement of contracts. For this indicator, Pakistan has the worse score among the ten used by the Bank for the purpose of evaluation. Contract enforcement has three elements - number of procedures that have to be followed, the time it takes to enforce a contract, and the cost of enforcement. The three are assigned the same weight in the rating for this indicator. In Pakistan's case 47 procedures have to be followed for the enforcement of contracts compared to 21 in the case of Singapore that has the top ranking in terms of ease of doing business. In Pakistan it takes an average of 976 days to reach a settlement on a contract dispute compared to 150 in Singapore. The cost of settlement of a contract in Pakistan is 23.8 per cent of the total value, a bit lower than Singapore's 25.8 per cent. Justice may be rapid in Singapore but it is costly. India does considerably worse than Pakistan in two of the three elements of contract enforcement. It has 46 procedures that need to be followed, it takes 1420 days for the courts to enforce contested contracts and the cost of enforcement is 39.6 per cent of the value of the contract.

It is obvious that this is one of the areas where Pakistan has to put in real effort in order to reduce the cost of doing business. As the World Bank report puts it: "In many countries only the rich can afford to go to court. For the rest, justice is out of reach. In the absence of efficient courts, firms undertake fewer investments and business transactions. And they prefer to involve only a small group of people who know each other from previous dealings." Problems associated with contract enforcement not only inhibit investments they also work as disincentives against scaling up. Firms prefer to remain small, fearing that by growing in size they will invite more legal problems.

Employing workers for businesses is another area where Pakistan does poorly. This indicator has five elements - difficulty in hiring, rigidity in the number of hours worked, difficulties in firing, the cost of firing, and the rigidity in employment. A lot of the problems the country faces in this area can be traced to the 1970s when fairly stringent labor laws and regulations were adopted by the first Pakistan People's Party government headed by Prime Minister Zulfiqar Ali Bhutto.

Some obvious conclusions flow from this analysis. The most important is that while Pakistan may be placed relatively high in terms of its rank in the group of 181 countries studied by the World Bank in its latest *Doing Business* report, not much comfort should be drawn by the policymakers from this conclusion. The high ranking scored by Pakistan is on account of the factors that are less relevant for the success of the businesses that dominate the real sectors of the country's economy. In the case of those that really matter, the country does relatively poorly. That is where the policymakers have to concentrate their attention.

As we will suggest below there are a number of areas in which action by the government will increase the productivity of the establishments operating in various parts of the economy. We list and briefly discuss a dozen of these. It is by improving the performance of the enterprises that the country will be able to improve the functioning of its economy and to set the economy on the path of a high rate of economic growth that could be sustained over time.

4. Areas for specific attention

There is one common element in the areas proposed below for public policy focus. It is only with attention given to increasing the productivity and competitiveness of the economy that Pakistan will succeed in dealing with the current crisis and securing a better future for its growing population. In focusing our attention on these areas we have kept in view some of the main characteristics of the Pakistani economy and society. These include a large and very young population; a society with a very weak institutional base; an economy that is technologically even move backward than is the case for the countries at its level of development; a number of significant endowments that have been largely ignored by successive generations of policymakers and a poorly developed enterprise sector.

4.1 Demographic asymmetry and demographic window of opportunity:

Pakistan has one of the youngest populations among the world's more populous countries. The population's median age is 17 years which means that some 80-85 million people are less than 17 years old, assuming that the country's population is between 160 and 170 million at this time (i.e. the middle of 2009). This young population could become a burden for the economy. It could also be turned into an asset. With the population in several developing countries declining there is at this moment a demographic asymmetry - declining population in some rich countries and rapidly increasing population in many of those that are less developed. This provides Pakistan a window of opportunity to use its population as an asset for the domestic economy. It could, properly husbanded, also become a major source of foreign exchange earnings. That this can happen has been demonstrated by countries such as India and the Philippines. Both countries earn sizeable amounts of foreign exchange through the export of IT services and through the remittances sent by their citizens working abroad. Pakistan also earns foreign exchange from both sources but the amounts are relatively small. Could these be increased? What are the possible areas of public policy which are pertinent for turning Pakistan's young population into an economic and social asset? What kind of public-private partnership helps in this respect? Some ways this could be accomplished are discussed below.

4.2 Human resource development:

Related to the above is the question of human resource development. The fact that the public sector has done poorly in terms of educating the citizenry is well known. What is also well known is the positive role played by both for-profit and non-profit private organizations successfully operating in the education sector. The private sector is involved at all levels - primary, secondary and tertiary. It is also present in the rural areas. However, skill development is a neglected area by both public and private sectors. There are serious shortages of skilled workers in almost all sectors of the economy. The normal recourse to meet this gap is to rely on "learning by doing" which is a costly way of bringing efficiency and productivity to the economy. Most enterprises that need skilled work force can't go to the labor market. Instead, they have to develop their own system for imparting skills to the employees. This is an expensive - both for the enterprises as well as the economy - way for doing business. How could this situation be remedied and what are the respective roles for the public and private sectors in this context?

4.3 Construction industry:

There are a number of sectors that could play an important role in providing employment to a rapidly growing work force. One of these is the construction industry. The fledgling construction industry could absorb significant numbers of workers, particularly in the urban areas. But the industry remains backward made up mostly of artisans-turned-contractors, particularly for the housing sector. The small modern component of the sector developed in several phases. Opportunities were created by the massive Indus Water Replacement works in the 1960s and the construction of the motorways in the 1990s. While some entrepreneurs successfully took advantage of these opportunities, the industry did not develop for a variety of reasons. The development of some firms that have acquired scale has occurred without a supporting policy framework. The question for policymakers is how to improve the competitiveness of the firms that are already operating in the field; how to facilitate the entry of new players into the sector; what kind of public policy support is needed to help the construction firms to enter the international market place; what kind of standardization is needed to develop industries to support the construction industry, particularly in the housing sector; how can the supply of finance be improved to develop the modern construction industry?

An important factor hindering the growth of housing is the high cost of registering property transfers. All related instruments are either wielded by or within the control of the provincial and local governments. In Punjab and Sindh the costs in urban areas include a 1% registration fees, a 3% provincial stamp duty and transfer fees on the value of the property (plus a 2% Capital Value Tax levied by the Federal Government), compared with a nominal transfer fee of Rs.150 per sq. yard (and no stamp duty) payable to the Capital Development Authority in Islamabad. In the case of a loan, there is a 0.25% charge for registering mortgage documents.

The building by-laws are outdated and do not reflect realties or the needs of major urban centers and leave discretion in the hands of officials. For instance, residential zones only cover single family homes and not greater urban density through say apartment blocks. For constructing apartments blocks developers are liable for commercialization charges. Moreover, there are multiple agencies, Development Authorities, Cantonment Boards, Tehsil Municipal Administrations, each administering its own, non-uniform, zoning and building by-laws (including those relating to height restrictions) with little coordination between them on these matters.

Some local government taxes and fees overly load the cost of investment for the construction sector. For instance, the Lahore Development Authority (LDA) levies a commercialization fees equivalent to 20% of the value of the plot in case of change of use of property, even in areas declared as commercial zones. In Karachi, the flat rate commercialization fee of Rs.8,000 per sq. yd. is approximately equivalent to 10% of the value of the plot in case of change of use of property in prime commercial areas of the city. As a result, commercially zoned property is inadequate, explaining the lack of hotels and shopping malls in major urban centres.

Moreover, commercialization is generally restricted in the form of strip development. In Karachi it is along 17 roads of the city (where commercialization had already taken deep roots) instead of promoting the development of commercial and business districts in the city, resulting in the uneconomical utilization of scarce developed land.

A major issue is the slow colonization of the housing schemes, even when all associated infrastructure has been provided. The levies/charges on leaving plots vacant do not serve as effective instruments for deterring speculation in land and ensuring better utilization of installed infrastructure and more efficient land markets. Also, private developers of housing and related schemes require a host of separate approvals from a variety of agencies, rather than have access to a one-stop processing facility. Developers also complain: (a) of the high charges or rates of penalties for modifying building plans, even when the variations do not result in any increase in the covered area of the building; and (b) the demands of the Employees Old Age Benefit Institution (EOBI) and the Provincial Employees Social Security Institutions for contributions at 5% and 7% of wages respectively even for casual workers, which make up most of the labor force in the construction industry. The latter is a particularly contentious issue in NWFP where the bulk of the labor force in the sector comprises Afghan refugees.

A key factor constraining the expansion of the housing sector is the rent control legislation that is biased in favor of the tenant, creating a disincentive for construction of property for rental purposes. The most important provisions of the legislation relate to conditions governing the eviction of tenants. For getting the tenant to vacate his property not only is the landlord required to establish his bonafides of the stated need, he also has to demonstrate that the premises are more suitable for his needs than the one he is currently occupying. The process of eviction is slowed down appreciably (and may even take several years) over disputed questions of fact that require submission of evidence and accounts of witnesses before they can be resolved. Moreover, the law makes the tenancy relationship even more complicated by allowing tenancy rights to automatically pass onto the legal heirs of the dead tenant.

Other major factors that serve as disincentives for renting out properties are:

a) the high rate of stamp duty (e.g. in Sindh 3% of value of contract) and registration fee (1% of contract value) on the compulsory registration of lease documents covering a period of 1 year and above; and
b) the structure of property tax in Punjab under which rented-out properties pay ten times the tax paid by similar owner-occupied properties, even though they have similar access to facilities like roads and street lights and to services like solid waste disposal. This differential is much higher than in Karachi where the ratio is 1:2 and in Islamabad where both categories pay the same rate of property tax. The NWFP government on the other hand has put in place a better policy for taxing commercial properties. Both owner-occupied and rented commercial properties pay the same rate of property tax.

As the forgoing discussion suggests, a thorough review of the regulatory regime that is place is needed in order to commercialize the housing sector and encourage the development of the construction industry to meet the enormous shortage of housing in the country. However, increased domestic demand is not the only way for encouraging the development of the construction industry. Enormous opportunities exist in the geographical area in which Pakistan is located for its expansion. There were two construction booms in the Middle East in the last 30 years which could have provided opportunities for the Pakistani construction industry. These opportunities were missed by the Pakistani industry. There has been significant amount of reconstruction activity in Afghanistan which is likely to gain momentum as a result of the increased American investment in the country. There are also opportunities within Pakistan - in the early 2000s, capital from the Middle East flowed into the housing and trading sectors. This activity may be renewed once the global economy stabilizes.

4.4 Trade facilitation:

The realization that Pakistan has not benefited from the enormous expansion of international trade was slow in coming. It was only after the current balance of payments crisis that policy makers have turned their attention to export promotion as an important element of economic strategy aimed at putting the country on a growth trajectory that parallels those followed by the more successful countries of Asia. Export promotion is a vast subject. Among some of the specifics that need to be addressed is the development of the logistics side of export promotion. Taking cognizance of the fact that the private sector has turned its attention towards the development of a multipronged approach towards the movement of goods and material should be the starting point of this exercise.

The demand on logistics created by the need to supply the NATO and US troops in Afghanistan has created a new industry that has been built on the Karachi-based forwarding agencies and the Peshawar-based long-haul trucking companies. The old and new firms are significant employers; the number of employees could increase significantly if this industry were to be developed along modern lines. There are a number of questions the policymakers should ask. Among them: How could this be done; what role could the public sector play in this endeavor; what are the other aspects of service sector that could be developed to support the growth and modernization of this relatively new industry?

4.5 Retail trade:

Also neglected by public policy is the important sector of domestic commerce, one of the largest providers of employment to the large work force. By and large the sector is inefficient and the low level of worker productivity results in limiting the incomes the enterprises provide to the workforce. The sector is underdeveloped in part because of the lack of attention from public policy makers. Its development has also been inhibited by the presence on the books of such antiquated laws as the Agricultural Marketing Acts in various provinces that continue to involve the government in price fixing and control over markets down to the small town level. These laws date back to the 1930s and were promulgated largely for political reasons in order not to allow the non-Muslim traders from extending their economic hold over the Muslim peasantry. This is no longer a concern for today's policymakers. The sector has also not been helped by land use policies in the urban areas. There is an urgent need, therefore, for the provincial governments to review the existing legislations and rationalize their content given the requirements of a modernizing economy.

The retail sector may have begun the process of radical change as a result of the arrival of large multinationals into the country. In countries that have allowed the entry of the multinational retail companies, a significant proportion of trade in agro-processed products is now accounted for by them. The firms demand quality products, quality packing, quality ware-housing, and quality transport. There are, in other words, considerable externalities associated with the operations of these companies. Metro (a German retail company now operating in Pakistan), for instance, has contracted out warehousing to smaller operators. It is also contracting the supply of meat to livestock producers. Since multinational retail companies buy and sell goods across borders, successful operations by them in the domestic market could increase exports of non-traditional products Also retail goods produced by women such as fashion garments will find markets through these multi-national firms. Their operations could, therefore, help female entrepreneurs and female workers. What kind of public policy framework needs to be put in place in order to develop and modernize the sector of retail trade? What changes need to be made in the existing legal framework - some of which is based on societal needs that no longer apply - for this sector to develop? What are the technological needs of a modernize retail sector?

4.6 Agricultural marketing:

Relating to the item discussed above is the important question of agriculture marketing. In addition to the inhibiting impact of antiquated rules and regulations on the development of this aspect of marketing discussed above, this sector suffers from the absence of relatively large sized firms. The most negative impact of this was on the development of livestock sector which accounts for significant female employment. One example of the distortions that have crept into this part of the economy is that animals arrive in the major cities on hoof, thus losing a lot of body weight. Lahore has primitive and unhygienic slaughter facilities to serve a city of perhaps more than 10 million people. The same is the case with other major cities. Slaughter houses should be located in the areas which have large concentrations of animal population and meat and meat products should be transported via a cold chain to major centers of consumption.

Another example of poor marketing of agricultural commodities is the way Pakistan exports basmati rice, a commodity that fetches premium prices in many foreign markets. A significant quantity of rice is sold to Dubai which is then packaged by Indian firms for exports to the places where there are large ethnic markets. Indian traders therefore, capture a good part of the value addition that should normally go to the Pakistani producers. In what way should agricultural marketing be improved and what are the technological needs of this activity that the state could help provide?

For maximizing the returns of farmers for their agricultural produce easing constraints that impede the marketing of these products need to be removed. The government has significant control over markets for fruits and vegetables and livestock. Farmers can only sell their produce in markets established and approved by provincial or local governments. This is detrimental to the interests of growers which results in the intermediaries, who have captured these government regulated markets, pocketing 2/3rds to 3/4ths of the price paid by the final consumer.

There is no reason why trade in fruits and vegetables and livestock cannot be deregulated by allowing private parties to set up and operate bulk/wholesale markets and manage product-grading and standardization processes. There is, therefore, a need for creating more competitive, non-monopolistic, structures that will ensure better returns to farmers, including permissions to retailers to buy directly from the farmer by-passing the markets and the intermediaries.

Such an arrangement will enable organized retailing (e.g Metro/Macro type organized retailers/wholesalers) directly sourcing from the farmer-eliminating at least two intermediaries from among the arthi, commission agent and the wholesaler, with the need for central storage and reliance on wholesalers also being eliminated in the process. The resulting overall economies from the shortening of the supply chain would be 20%-25% of the consumer price. Farmers will get higher prices and if warehouses and cold storages are constructed spoilage of farm produce would be reduced significantly and provide an incentive to increase farm productivity through improved technology.

The reforms in the area of agriculture marketing should also aim to strengthen market related information systems. To this end there is a need to improve the information providing network comprising websites and electronic boards in markets to make data real time.

4.7 Urbanization, urban employment, and urban services:

Not unlike other developing countries, Pakistan tends to underestimate the size of its urban population, the size of its large and medium cities and the proportion of the population that should normally be classified as urban. Other than the usual reasons for this underestimation, there are also political reasons for giving a smaller weight to the urban population. Pakistan was a rural place and a largely rural economy at the time of its birth. Since then, starting with the movement of the population that accompanied the partition of British India into the independent states of Pakistan and India, the size of the urban population has increased at rates between two and half times to three times the rate of increase in population. Pakistan has had one of the highest rates of the urbanization in the developing world. This should have resulted in the flow of greater political power from the countryside to towns and cities. That did not happen as the powerful landed interests succeeded in preventing the urban areas for gaining a larger space in the political system. This is one reason why population censuses have not been held on a regular basis as provided by the Constitution of 1973.

By underestimating the size of the urban population and the size of the major urban areas the country has not properly provided the needed urban services. Pakistan urgently needs an urban economic and social development strategy that can provide employment and economic security to its young and growing population.

For designing an urban strategy it may be appropriate to reflect on the economic and social dynamism that shapes urban areas. Policymakers may distinguish among four different types of urban communities: the large cities; the peripheries of large cities; the medium-sized cities and small towns. Each of these urban centers has their own dynamic. There are also differences among the large cities. The strategy that might well serve the city of Karachi, Pakistan's largest, may not exactly be the same as the one that would be relevant for Lahore, the country's second largest city. Nonetheless, both cities need better supply of water and sanitation, better transport, better education and health care, more focused attention to providing employment to the people who are constantly moving into the cities from the areas outside, more technological advance to increase the incomes of the employed and better integration with the global economy.

While the city centers of Karachi and Lahore and other large cities may need the same kind of public sector attention, their peripheries are very different from one another. Karachi has expanded into its hinter land by extending itself into the essentially empty and desert areas to its south and east. Those who have arrived in the city in search of jobs, have found or developed slum-like housing in the numerous "katchi abadis" that are located in the city's periphery. Hundreds of thousands of Pathans are living in these cities making Karachi the world's largest city for this particular ethnic group, larger than Peshawar and Kabul. There are "katchi abadis" in Lahore as well but its expansion has occurred largely by the assimilation of long-settled towns that were all around its ever-expanding periphery. Public policy designed to address the problems faced by the peripheral areas of the two cities, therefore, will have considerable differences in their content and objectives.

The medium-sized cities are the product of economic and social dynamics that are altogether different from those that are operating in large cities. Most medium-sized cities have grown in size for three different reasons. They were either important links in the system of transport and communication; they were centered on some local small enterprises; they were supplying important services to the sector of agriculture as it developed in the surrounding countryside. Two medium size cities, both in the Punjab, illustrate very well how different approaches towards industrialization can influence the shape and growth of urban areas. Rahim Yar Khan in the province's south drew a number of large transnational corporations that, taking advantage of the import substitution bias in the first forty years after independence established their operations in and around the city. The city's choice as a location was influenced by the impressive agricultural potential in the surrounding countryside. Lever Brothers, a prominent multinational that specialized in the manufacture of basic consumer goods, chose to locate its plant in the city. Engro established a fertilizer plant. But the city failed to develop as an industrial hub especially after the economy was opened to trade and import-substitution lost some of its luster.

On the other hand Sialkot in the province's center was able to become a vibrant urban center by opting for what economists now call "cluster development". By this is meant the location of relatively small enterprises in one area producing same types of goods and services. Being clustered together makes it possible for them to obtain the inputs, services, physical infrastructure they need clustering also allows access to the markets that, working individually would be expensive and, therefore, uneconomical for the small enterprises. Sialkot is an example of the success of this type of cluster development. The medium-sized cities located in the city built a strong export business based on traditional skills that were abundantly available in the area. The city's entrepreneurs also decided not to rely on the government for serving their area with the needed infrastructure. Instead they taxed themselves and raised sufficient resources in a highly innovative way to improve roads and even build an airport. A single urban development approach, therefore, would not work for all medium-sized cities.

Until the mid 1990s, the private sector had neglected the skill gap, because production technology tended to be rather simple, industry being heavily protected from both internal and external competition. However, with the opening up of the economy, more complicated technology has been introduced in the production process. The induction of modern technology is rapidly altering the nature of the skills requirement. There is therefore a need to provide skills required by the emerging industrial and services sectors.

To improve the productivity of the young labour force, we recommend skill development initiatives through public private partnerships, instead of expanding the operations of the technical and vocational training institutes and skill development centres with training courses that the market considers inadequate. To this end, we propose a two pronged approach to improve the employment capability of the potential target age group that comprises both those with limited educational qualifications and those having completed at least secondary level mainstream education.

Two possible instruments could be used to assess their individual efficiencies and efficacies in achieving the objectives of the intervention before opting for either or a combination of these skill enhancement channels. The first could be a supply side intervention in the shape of technical training grants to institutions (managed by either the public or the private sectors) that meet eligibility criteria for such support while the second could be a demand side intervention in the form of training vouchers to those seeking technical training in disciplines of their choice.

An average laborer is generally poorly educated with limited or no skills to get gainful employment. The unskilled landless, casual workers can be assisted by teaching them decent quality basic skills. Therefore, for those with up to elementary level education received in the schooling system providing education of at best indifferent quality we propose vocational training to develop skills say related to masonry, carpentry, catering and, perhaps, animal husbandry, etc. For the lower level simpler, practical skills like driving, masonry, carpentry, repairs of agricultural implements, animal husbandry and related extension work, Traditional Birth Attendant and Lady Health Worker training for women, etc. we propose partnerships with private sector associations like the Association of Builders, the Farmers Associations, the associations of Doctors, etc., as well the departments of Agriculture, Livestock and Health for approving the training course content, joint designing of the curriculum and the setting of standards, and for directly certifying the quality of the training or for mandating any other authority/agency they deem as credible for the purposes of certification.

For the skill development of those with secondary level schooling and above, a wider variety of well-structured and effective technical and vocational training could be on offer. However, to ensure demand driven training, the skills communicated under the programme should have market relevance-to match market opportunities and needs. So that the training is of the level and quality demanded by the private sector (especially those engaged in the exports of services and manufactured goods) we strongly recommend the adoption of a system for international certification of these skills. In a globalized world only those skills will have market value, and are likely to be sought by the private sector, that have been certified by an internationally recognized organization.. Such an approach will provide employability to graduates in line with emerging market needs, and strengthen their capability to earn a higher and steady stream of earnings in markets in Pakistan or abroad.

To facilitate the growth of SMEs and SME clusters there is a need for a carefully designed programme for the development of secondary/intermediate cities/towns (the design will have to ensure that these towns/cities will have the revenues/resources to maintain this newly installed or rehabilitated infrastructure) by adopting a cluster based approach (with the cities/towns to be connected, if necessary, through expressways) on the basis of economic potential (in terms of available markets and commercial centres), returns to the economy and pay back period, rather than select individual cities in different parts of a province. Initially, for instance in Punjab, this may result in the selection of clusters in the central districts of the province with basic infrastructure (supplemented/upgraded by infrastructure to be provided under this project/programme), with markets having strong forward and backward linkages, because of readily available supply chains, skills, population concentrations with purchasing power and entrepreneurial talent.

Such an approach will keep the additional investment costs low for both the government and the private sector. For foreign investors in particular the costs of investment or doing business and locating assets will become lower for each new venture as more clusters are developed in other geographical areas of the province. These investments could attract large foreign retailers like Metro, Makro, Carrefour, etc. to locate in these areas creating opportunities for the development of high quality supply chains and related skills. The experience and expertise gained by those supplying to such franchises and by those trained by such branded outlets in managing the entire range of services linked to retailing would enable them to market their products and services internationally, especially in similar wholesale and retail outlets operating in the Middle East.

Finally, small towns have their own social and economic characteristics. They are much more integrated with the economic and social situations of the surrounding countryside than the other these types of urban communities. They will be affected much more by the policies aimed at the development of agriculture and by promoting trade in agricultural commodities.

Pakistan's urban future will depend to some considerable extent on how the country builds its economy and how it makes it more productive and competitive. For instance, by encouraging the development of retail trade and by facilitating the entry and expansion of multilateral retail chains, the country may be able to develop a number of centers of agricultural processing. This will create new urban poles of economic activity which, in turn, will reduce the pressure on the large cities by holding back some of the surplus workers from the countryside that would have inevitably migrated to the large cities, further crowding them and further putting pressure on already weak urban services. Given this way of disaggregating the urban economy, in what way should public policy respond to the separate needs of each of these four urban areas?

4.8 Fiscal decentralization and the use of fiscal policy for influencing inter-personal and inter-regional income distributions:

Over the years, Pakistan has become a more centrally managed economic and political system than provisioned by the Constitution of 1973. Not only does the constitution require greater functional autonomy for the provinces (now as well for the system of local government established in 2001), it is also an important part of the strategy for improving fiscal management. Reshaping of fiscal policies could help to spread economic development more evenly among different regions of the country. It will also arrest the worsening inter-personal income distribution. Of the several elements in fiscal policy that would help in the realization of these objectives, two are particularly important: distribution of the tax and other revenues of the central government and allowing more fiscal space to the governments at lower levels.

The 1973 constitution mandated the constitution of the National Finance Commission every five years for apportioning central revenues, both tax and non-tax, to the provinces. This provision was not followed. The last time an NFC award was given by the government was in 1997, a dozen years ago, and that too was written by an interim administration put into office to conduct elections after the dismissal by the president of an elected government. In other words, the political process has not been able to resolve some of the fundamental differences among the several provinces on the question of how best to distribute federal resources.

The question of allowing greater fiscal space to the provinces and perhaps to the large cities also needs to be addressed. Allowing greater fiscal role and responsibility to sub-national governments could simultaneously serve several important objectives. It would increase consolidated tax to GDP ratio (it has fallen below 10 percent in recent years, reaching one of the lowest levels in the developing world), allow more development resources at the local level, and move some responsibility for economic and social development to the governments physically closer to the people.

4.9 Private health insurance:

Health services are being poorly delivered to the populations in both urban and rural areas. It might be appropriate to increase the flow of public funds to the countryside while encouraging the establishment of private health insurance to cover towns and cities. In the cities, the provincial governments should continue to provide basic health care to the poor while encouraging the relatively well-to-do to obtain insurance for themselves from private operators. The state could subsidize the poor to obtain insurance coverage. The development of a health insurance system should also help the growth of urban services as the cost of coverage is spread over a wider circle of potential users and also over time. Given the rapid growth in medical education in the country in recent years when a number of private entrepreneurs entered the field, Pakistan may be in a position to move into the area of export of health services following the successes already achieved in such countries as Thailand and India. Given the significance of the health sector in improving human development and also the possibility of using the young population to become providers of health services to foreign customers, this would be an appropriate area for public sector intervention. What form should it take?

4.10 Pension funds:

There is a very limited pension funds activity in the country. The public sector has funds that resemble pension funds; there is very little presence of such instruments in the private sector. Encouraging the establishment of pension funds would help as it has been done in several Latin American countries to increase the rate of domestic savings. Again, as the experience of many developing countries indicates, such funds have a positive demographic impact on rapidly growing populations. Those who seek protection for old age by relying on large families will be less inclined to take that route if a viable pension fund industry was developed. However, as was done in Latin America, the development of pension funds will have to be carefully regulated by the state. Without appropriate regulation a lot of people can lose a lot of money if pension fund owners and managers become adventurous at the cost of policyholders. The challenge before the policymakers, therefore, is to design a system of regulation that encourages the development of this industry while protecting the consumers. What shape should government regulations take is an important issue for policymakers?

4.11 Developing a supporting legal framework:

Based on a considerable amount of analytical work done at the development institutions such as the World Bank and the Asian Development Bank, economists have begun to focus their attention on the need for legal and judicial systems that support efficient economic activity and not distort it. For the last two years - from March 9, 2007 when then President Pervez Musharraf attempted to dismiss Chief justice Iftikhar Chaudhry to March 16, 2009 when Prime Minister Raza Shah Gillani agreed to restore the judge to his position on the Supreme Court - the civil society in the country conducted an extraordinary public campaign aimed at improving the functioning of the judiciary. The movement was led by the community of lawyers. The legal community became increasingly concerned with the politicization of the judiciary; with the increasing propensity of the executive branch of the government to browbeat the judiciary to serve its purpose.

While the lawyers were campaigning to have the government bring back the judges who were removed from their benches as a result of the emergency rule briefly imposed by President Musharraf on November 3, 2007, an entirely different campaign gathered momentum in the Swat district in the North-West Frontier Province. There a group loosely associated with the Taliban movement sought to force government to bring *shariah* to the area. While the Swat campaign was couched in the new idiom of the Taliban movement in Pakistan, its purpose was to restore the legal and judicial systems that had existed before 1969. In that year the semi-autonomous states of Chitral, Dir and Swat were merged to form the administrative unit of Malakand. With this merger also come the legal and judicial systems that were prevalent in the “settled districts” of the NWFP. However, the new system had all the characteristics that had come to dominate the rest of Pakistan. It was a slow and cumbersome process and those who administered it were often corrupt. The people were generally very unhappy, something that was successfully exploited by the forces of extremist Islam. In early 2009, Islamabad reached an agreement with the religious leaders of Swat to restore the old system under the guise of Islamization.

These two episodes - the campaign to restore Chief Justice Chaudhry and the campaign to bring sharia to Swat - illustrate the growing sentiment in the country that the legal and judicial systems need to be reformed and modernized. The same conclusion was reached by development economists. How should this be done and who should be entrusted are important issues in this context?

4.12 Technological backwardness:

As discussed in the previous section, firms (enterprises, establishments) form the bedrock of all the economies. This is also the case for Pakistan. There are more than 3 million of them in Pakistan, most of them are very small and most of them are technologically very backward. The economist Paul Romer developed a new (endogenous) model of growth in which acquisition of knowledge and its applications was one of the factors of production. How does a developing country such as Pakistan acquire and apply knowledge? This can be done in several ways of which four are particularly important. There are: process innovation, new equipment, foreign direct investment and "research and development" or R & D. On all these scores, Pakistan's performance is poor. Smaller firms that dominate the Pakistani landscape are less innovative than large and medium size firms. Only 6 percent of the Pakistani manufacturing firms had introduced new or significantly improved products in the last three years. Majority of the firms (78 percent) finance new technology with internal funds and 21 percent of them use bank loans for this purpose. Among the various ways of acquiring new technology, the most important is the purchase of new technology and equipment from abroad. This emphasizes the role of foreign trade and foreign direct investment in improving the technological base of the Pakistani economy. Research suggests that there is a high correlation between those countries that have shown significant economic improvement and countries that have made substantial investment in R & D. Pakistan's record in this area is poor. R & D investment increased from 0.13 percent of GDP in 2006 to 0.44 percent in 2005 but is still lower than in most comparable countries. It is 0.7 percent in India and 0.8 percent in Brazil and Turkey. Until 2003, 100 percent R & D expenditure was by the government. In 2005, the government's share declined to 87 percent, most of it the consequence of the work done in higher education institutions. There are currently no business expenditures on R & D in Pakistan.

5. Closing Remarks

This brief analysis poses some obvious public policy issues pertaining to the role of the government, association between public and private sectors, and what kind of encouragement can be provided to the smaller firms to improve the technological base.

The dozen areas of public policy listed and briefly discussed above are some of those that are particularly important for addressing the many economic and social problems Pakistan currently faces. This is one sample of issues; there are several others. The main point for highlighting them was to identify some areas for public policy interventions where the returns to the economy - in terms of GDP growth and its better distribution - and to the society - in terms of institutional development and lowering of transactional costs for various kinds of interactions among the citizens - are high.