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Raising and Sustaining the Growth Rate

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Pakistan needs to ramp up its growth rate because the country faces a population bulge for almost the next 35 years; 40 million additional are projected to be in the labour force by the end of that period. This huge number of young men and women will have to be provided productive jobs to avoid social unrest and reduce the recruitment queues for Taliban like forces. To absorb this youth the growth rate will have to be boosted from its present lack luster levels.

How fast must the economy grow to accommodate these annual entrants to the labour force? All estimates suggest a 7% rate per annum. However, to reduce both, the previously unemployed and underemployed, a rate of 8% per year may be necessary, as against the average rate of 5% that we have achieved since the mid-seventies-reflecting the existing potential of the economy, ignoring one-off events like an exceptional harvest, a spike in export prices, etc.

How can this shift to a higher growth path on a sustainable basis be achieved? I would preface the discussion to follow by arguing that, for reasons of efficiency, the bulk of this growth must come from the private sector. And achieving such growth rates will:

a) Require a much higher rate of investment than our average historic rate of less than 19% of GDP. It is not possible to generate a growth rate of around 8% per annum over a 30 year period without an investment ratio of 30% plus - the East Asian Tigers averaged 30% - 35% while India is now averaging just under 40% and China 46%;
b) Necessarily require a sharp increase in domestic savings (less than 15% of GDP for most of our history compared with India's 35%) to finance the investments needed to attain and then maintain such rates of growth. And this can only be achieved gradually over time and provided adequate incentives and reforms are in place (see discussion below); and
c) Need continued improvement in the productivity of the resources - capital and labour - employed. Higher growth rates will not only require more capital but, more importantly, higher productivity from all factors of production - necessitating a combination of greater technological progress and more efficient use of these inputs. Between 1970 and 2005 increases in productivity contributed only 20% of the growth in our GDP, while between 1998 and 2008 its contribution fell to a mere 11%, well below that of India, Sri Lanka and Bangladesh. The impediments to productivity increases include availability of reliable energy at reasonable rates, an educated, skilled and healthy labour force and entrepreneurial and managerial skills. In our case entrepreneurial skills have not developed partly because of our history of the State providing different industries

protection against competition through policy crutches. The deficiency in managerial skills is a product of our weak educational systems, poor work ethic and the incentive structures that do not create a demand for professional skills - an entrenched culture of SROs to protect different sub-sectors of industry renders irrelevant the need for quality skills to improve industrial competitiveness.

Going forward we will have to look at domestic sources to meet our growing investment requirement, since international capital flows are destined to become more volatile, while the poor country image will only make it more difficult to access such funds at affordable rates. This will require more savings both ‘public’ and private. How will these be raised?

Private savings can be stimulated through incentives and the right mix of economic policy and financial, regulatory, goods and labour market reforms, institutional reforms (the last in the form of better and more accountable civil service structures), availability of skilled labour, technological readiness, etc. - the “software of growth” that the Planning Commission argues for. These are expected to boost investment rates by reducing the cost of doing business. We presently rank lower than other South Asian countries on ease of doing business, and most of these reforms will not require sizeable volumes of expenditures to implement. This will make businesses profitable, thereby providing an incentive to save and invest - a virtuous circle.

As for ways to support the growth in household savings I would propose a) improvement in financial intermediation by ensuring real and increased returns on financial savings, say on instruments of National Savings Schemes. This will incentivize the acquisition of financial assets and a reduction in currency in circulation, today Rs. 1.7 trillion (close to 35% of deposits!) and also force banks to compete to mobilize deposits; and b) introduce new institutions and instruments, like portable and mandatory savings/pension schemes.

The above referred reforms to facilitate private investment and savings will need to be supported by complementary government investments in physical and social infrastructure. However, the financing of infrastructure, education, health, etc. related investments to improve both quantity and quality, will require significantly large resources. Unfortunately, our track record in terms of generating adequate resources (the public savings referred to above) to fund such spending has been abysmal. On the one hand we have one of the lowest tax-to-GDP ratios and, even considering developing countries we are amongst the bottom ranked nations in terms of the proportion of the population registered as taxpayers-less than 5% of household population. On the other hand, these limited resources are deployed on the basis of skewed priorities (for example on roads whereas the major constraint to growth is availability of energy at affordable prices). And the issue here is not just creation of more assets - schools, hospitals, etc. but ensuring that there are adequate budgetary allocations for doctors, nurses, teachers and medicines, etc. to keep these facilities functional, and providing decent quality services for which they were established. The enhancement in these public savings can only come through a credible time path for bringing the fiscal deficit under control - more tax revenues and less unproductive expenditures as a percentage of GDP - through a combination of policy, procedural and administrative reforms (Tax and expenditure reforms will be subjects of forthcoming articles). The increased fiscal space will enable the financing of social sector expenditures and physical infrastructure, an outcome that will require more than just higher rates of economic growth.

Future economic growth will also face a slowing down of demand in our traditional export markets of Europe and the US, who are struggling with their own recession like conditions. To overcome this demand insufficiency for our products, we will have to look towards the East, especially our neighbours, with young consumers and growing markets, as opposed to aging populations and contracting western markets. Growth in exports has become critical for financing our rising import bill, especially with doubts about the continuing robustness of remittances from sluggish Europe and US.

However, to support export enhancement and the competitiveness of the economy, apart from a competitive exchange rate, one would not recommend any generic support to a sector (to avoid creating distortions) but to factors of production and cross-cutting activities (like skill development, investment in key infrastructure or incentives for exports as a way of incentivizing performance) that are likely to have an impact upon a broad range of sectors and can draw in other complementary investments or technology or knowledge spillovers.

What other sectors of the economy would one support to absorb the large annual increments to the labour force and enable them to earn a respectable livelihood? The relevance of this question stems from the fact that that our success in achieving better ‘inclusiveness’ in the “economic growth” that we registered in the first 6-7 years of this century has not been noteworthy. Much of this growth was concentrated in the relatively capital and skill intensive sectors of finance, telecommunications, IT, oil and gas and motor vehicle assembly which favoured those at the upper end of the income scale while the bulk of the population with limited education and skills was unable to participate meaningfully in the growth witnessed in these sectors.

Sectors like housing and construction, information technology (especially in the form of BPO services) and communications, wholesale and retail, our range of merchandise exports and SMEs are essentially labor intensive, with relatively higher employment elasticities. Even sub-sectors of industries like consumer appliances, auto assemblers, engineering, and communications which are relatively capital intensive, generate large employment opportunities through their backward and forward linkages - especially through the development of the vendor industry and related service sector for the sale and after sale maintenance of these products. Their growth will be stimulated by both the software and hardware referred to earlier above and through appropriate amendments in banking regulations and credit schemes, e.g. by restricting Export Refinance to SME exporters.

Furthermore, to facilitate the growth of labour intensive SMEs there is a need for a programme to develop secondary/intermediate cities/towns 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 centers), returns to the economy and payback period, instead of selecting individual cities in different parts of a province.

Such an approach will lower additional investment costs 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 multinational retail chains like Metro, Makro, Carrefour, etc. to locate in these areas creating opportunities for the development of high quality supply chains and related skills, especially for agro-processed products. There would be a huge multiplier effect associated with the operations of such retailers. The experience and expertise gained by those supplying goods to such franchises, those providing services of warehousing and transportation and by those trained by such branded outlets in managing the entire range of services linked to retailing and timely delivery of goods and services would enable them to improve the standards of their products so that they can market their products and services internationally throughout the global networks of such companies, especially their stores operating in the Middle East.

One sector that will require special attention at the national level, despite being a subject in the provincial domain under the Constitution, is agriculture. Inclusive, robust and sustainable pro-poor growth has to be anchored in agriculture and livestock, from which 44% of the workforce (72% in the case of females) directly earns its livelihood. The sector requires support not only for poverty reduction and more equitable development of regions but also to bring more stability in growth in a manner that ensures that gains accruing from this process are safeguarded. The sharp rise in international prices for food crops and the opportunities arising for Pakistani farmers to trade in other cash crops and enhance their earnings (especially with the gradual removal of subsidies in OECD countries and the resulting increases in prices of such crops) can contribute significantly to the rapid enlargement of the middle class in rural areas.

The yields per acre can be doubled through modern agronomic practices using available technology, without aimless subsidization of outputs like wheat and inputs like fertilizer and irrigation services (see also discussion later below). Furthermore, for achieving higher growth in agriculture earnings we will need to shift effort away from food crops to horticulture, dairy farming and crop varieties that are less dependent on water. Since horticulture produce is perishable, logistics of its transportation, storage, etc. (the value chain) will acquire importance, which will in turn require changes in the legislation relating to Market Committees which restricts the sale of such produce directly to the private sector.

Admittedly, however, to achieve such increases in productivity requires a package of several initiatives, the most important of which will be better management (both quantities and timing) of a key input - water. For the efficient use of water, greater focus will have to be placed on land leveling, zero till cultivation, drip irrigation, greenhouse and tunnel technology (for horticulture, fruits and vegetables) and policies to facilitate development of private cold storage chains etc.

Moreover, since there is a lot of underemployment in agriculture, the challenge would be to increase the productivity of this labour from its movement out of the sector, but not as forced migration out of misery but as a shift to more remunerative non-agricultural employment. Ideally, so as not to aggravate the pressure of rural-urban migration, this would require its absorption in non-agricultural activities in the rural sector.

In view of the impending crisis in the availability of water, the importance of the efficient use of this scarce resource cannot be overemphasized. However, it will not be easy to conserve water use and improve use efficiency through the pricing mechanism. It is difficult to get public understanding, let alone acceptance, for the need to appropriately price the consumption of water by treating it as a scarce resource - the general perception being that it is a natural resource given to man by Allah. The demand for heavily subsidizing electricity or diesel for running tubewells, the under-recovery of cost of canal irrigation services and the subsidy in providing water for drinking, washing and sanitation are examples of what efforts to curb its consumption are up against.

To address both transient and permanent poverty of different groups in society there will be a need to initiate employment guarantee schemes for unemployed able-bodied youth and administer a transparent safety nets system for the disadvantaged, vulnerable and indigent. In this context it is important to note that although the more labour and less skill intensive agricultural sector, from where a greater part of the population derives its earnings, also benefitted from good weather, higher support prices for wheat maintained by the government and higher commodity prices internationally which kept domestic prices high as well, etc. it was mainly the province of Punjab, with a relatively less skewed ownership of land holdings, which saw a wider distribution of this prosperity. Punjab also profited from the growth in the sectors referred to earlier above (a) because of a sounder educational and skills base (admittedly Karachi also benefitted from this factor), a more competent bureaucracy, greater ethnic and lingual homogeneity, better access to the bureaucracy in Islamabad, stable single party governments, etc.

This writer fears that as Islamabad's role is reduced in financing/providing services or infrastructure because of resource constraints, the disparity between Balochistan and say Punjab and Sindh will widen even more sharply unless the residents of this province are given total control over their oil, gas and mineral resources - their resource base on which their development can be founded.

Finally, 'poverty' or deficiency when measured in terms of the controversial and much debated access to basic social and economic services (since we lag behind most developing countries similarly placed economically or faring even worse than us) has over time become more severe than the poverty estimate on the basis of nutritional intake. In this context the foremost issue requiring attention is not just poor enrollment and retention levels in schools, but the quality of the schooling available to the poor, the biggest hurdle in the way of their social mobility. Such improvements in schooling will need to be supported through skill development initiatives anchored in public-private partnerships with international certification of those graduating from this system to enable them to achieve mobility, domestically and overseas, thereby enhancing their earning capabilities.