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Which Way is Pakistan Heading? - 3¹ Scanning the Horizon for Signs of Hope

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‘The past is not dead. In fact it is not even past’: William Faulkner

Abstract

In this concluding part of the three Working Papers on the grim Pakistani situation as of mid-August 2012, “the positives” on the economic front are examined. These include the decision to decentralise a significant part of economic decision-making from the centre to the provinces. This was done by amending the Constitution. The recent thaw in the economic relationship with India is also viewed as a highly positive development. If this results in a relatively free flow of trade between the two countries, that alone could add as much as 2.4 percentage points to the rate of growth in Pakistan’s GDP. The large Pakistani diaspora in three continents and the remittances they send back to the homeland is another positive. In 2011-12 the capital flow from this particular source was equivalent to seven per cent of the national income. The fourth positive

¹ This paper by Mr Shahid Javed Burki is the last in a series of three Working Papers by him on the situation in Pakistan as of mid-August 2012.

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discussed in the paper is the extent to which women are acquiring education and skills. This has enabled many of them to play important roles in some of the modern sectors of the economy. Women have also begun to perform important entrepreneurial roles, particularly in the sectors of education, communication, and microfinance. The paper also discusses some of the strategies the country could adopt to put an end to the uncertainties that affect the performance of the economy.

The Negatives and the Positives

While the overall tone of this paper is sombre, it should not convey the impression that Pakistan, standing at the edge of an abyss as the democratically elected government approaches the end of its term, faces an inevitable economic collapse. The question was whether the country could be pulled back from the abyss. A panel discussion organised by the World Bank in April 2012 to coincide with the institution's spring meetings challenged the participants to focus on what they would regard as the positives. Isabel Gurrero, the World Bank's Vice President in charge of South Asia, posed two questions to the panellists: 'What inspires you about Pakistan and what is the one shift you believe is needed to change the country for the better?'

The first response came from Abdul Hafeez Shiekh, the country's Finance Minister. 'The grace of the people of Pakistan amidst adversity inspires me', he said and went on to suggest that the remarkable resilience of the people in the face of multiple crises is something that could be built upon. Robin Raphel, senior advisor for Pakistan at the United States (US) State Department, cited the people's response to a number of natural disasters such as the earthquake of 2005 and the floods of 2010 as signs of remarkable resilience. This theme was picked up by other participants. Nancy Birdsall, the President of the Center of Global Development, was impressed by the way the people of Pakistani origin living in the United States had reacted to the crises in their homeland³. She said 'a culture of philanthropy has helped Pakistanis embrace displaced people and respond to these challenges'. Pakistan is resilient economically as well, said Mohsin Khan who, before retiring from the International Monetary Fund (IMF) as Director of the Middle East, the department that included Pakistan, was a Senior Fellow at the Petersen Institute. He cited the growth in middle class – now, according to him, some 70-million strong – could help to modernise the country's political system as well as its economy⁴.

³ This is the subject of a well-researched book by Adil Najam who, in 2011, returned to Pakistan to become the Vice Chancellor of the Lahore University of Management Sciences. See Adil Najam, *Portrait of a Giving Community: Philanthropy by the Pakistani-American Diaspora*, Harvard University, Global Equity Initiative, 2007.

⁴ The World Bank, "Pakistan: The Untold Story", worldbank.org/WBSITE/EXTERNAL/5106~piPK:2865128~theSitePK:2234547,00.html

Resilience, however, is an abstract notion, not easily translated into the making of public policy. Some impression can be gained by studying how the incorporation of a few ‘positives’ can help the country to regain some of the lost economic growth momentum. In this context, a brief description and analysis of four developments would be useful: The adoption of the 18th Amendment to the Constitution that allowed much greater autonomy to the provinces; easing of the tensions between India and Pakistan and the promise of facilitating trade between the two countries; letting the private sector participate actively in developing higher education that created a large and increasing pool of well-educated and trained women; and large and increasing flow of remittances from the workers living in a number of countries in Europe, the Middle East and North America.

The discussion of the positives should perhaps begin with that of the negatives since the latter will have to be dealt with before the full potential of the former is realised. For the negatives, a good place to start would be the work done by the Growth Commission of the World Bank. Set up in 2008, the Commission published its report in 2010 and reached the important conclusion that some of the World Bank’s earlier work on growth misidentified the factors that contributed to it⁵. For instance, its work on the economies of East Asia that registered unprecedented rates of economic expansion before they ran into the ‘Asian financial crisis of 1996-97 popularised the term “miracles”, meaning these were unique episodes unlikely to be repeated’⁶. In the Commission’s view, it was not a miracle that transformed so many East Asian economies. These changes could have happened in other parts of the world, had the state taken the right decisions.

The Commission identified five ingredients of growth that could be made to work almost anywhere. The first of these was the full exploitation of the opportunities available in the world economy. None of the 13 countries studied by the Commission followed inward-looking growth; all benefitted from what the global economy had to offer. Two of these were particularly important. Growth in knowledge and information. This usually came in the form of foreign direct investment or through exchanges among educational and research institutions. The second was the immense restructuring of the industrial production system that relied on the supply chains leading from various points of production of parts and components to the points of final assembly. Pakistan had missed out on both and needed to catch up in order to climb on to a higher and sustainable growth trajectory.

The second ingredient of growth was the large role played by markets to allocate resources, with the state only prodding, guiding and encouraging but not getting directly involved in making or

⁵ The Growth Commission, *The Growth Report: Strategies for Sustained Growth and Inclusive Development*, The World Bank, Washington DC, 2008.

⁶ The World Bank, *The East Asian Miracle: Economic Growth and Public Policy*, New York, Oxford University Press, 1993.

forcing investment decisions. It was in the period of Zulfikar Ali Bhutto at the helm (1971-77) and the first part of General Zia's rule when Ghulam Ishaq Khan, with strong and distinctive tendencies was in charge, that the Pakistani state became intrusive in several different ways. And when the state pulled back and remained in the background, it fashioned a structure of governance essentially through a pervasive regulatory regime. This had, wittingly or unwittingly, created enormous rent-seeking opportunities for people in senior positions. This increased corruption and hence the transaction costs for private entrepreneurs and, consequently, discouraged private sector investment.

The third ingredient necessary for growth was an environment of macroeconomic stability. As discussed by Stanley Fischer in a 1993 paper, persistent inflation worked as a deterrent of growth. In many cases, including the case of Pakistan, persistent inflation that had been around for more than a decade was the outcome of the monetising of fiscal deficits⁷. The only way out of this conundrum was to increase domestic resource mobilisation and with it the tax-to-GDP ratio. Pakistan had done poorly in both respects for political reasons as well as the 'bail-out' possibilities during periods of extreme financial stress. The many changes in the political order – Pakistan's roller-coaster political history – meant that those in the policy-making positions did not settle down long enough to create for themselves the political constituency that would have encouraged the state to claim a larger share of national income for the purpose of economic growth. And the willingness of external players to provide help to the country when the times became really difficult created a 'moral hazard' thinking on the part of the policy-makers in Islamabad. There was comfort in the belief that there will always be someone around – a country or a multilateral institution – to provide the finance necessary when the moment arrived.

For the countries that succeeded, domestic savings rates were on average 25 per cent of GDP or higher. In Pakistan's case the savings rate was well below that level – below 18 per cent since the 1980s and decreasing – and tax-to-GDP ratio at between nine and 10 per cent was among the lowest in the world. A low tax-to-GDP ratio meant that the state was not able to invest in the sectors and in the projects that needed its attention. There was a long list of these: Physical infrastructure, development of hydro-power, human resource development and maintenance of the railways and irrigation systems.

The final ingredient in the growth strategy was a committed, credible and capable government. This, as shown by the work of Daron Acemoglu and James Robinson in *Why Nations Fail*, happened more readily when the political culture was supportive. They underscored the strong links between the culture of politics and the quality of governance. In extractive systems – their term – the political culture was focused on taking away the few social and economic assets from

⁷ Stanley Fischer, 'The role of macroeconomic factors in growth', *The Journal of Monetary Economics*, 32, 485-512, 1993, pp, 485-512.

those that didn't have much of either in the first place. According to their thinking, extractive political systems produced similar structures in the economic sphere⁸. There was a powerful feedback from the economic to the political sphere and that was Pakistan's story for many decades. These negatives posed an enormous challenge for the country. To address them will need strong, selfless, and dedicated leadership that may emerge but was not populating the political landscape as the country began to get ready for another general election.

Turning now to some of the positives. The legacy of the Asif Ali Zardari regime, even if it were not able to realise another lease of political life, will not be all negatives as suggested by the enormous unfavourable rating he had received in the spring of 2012 when the Pew Research Center conducted its already-cited survey of public opinion. The government took two brave decisions – brave since they went against the interests of some of the powerful groups in the political and economic systems. They were the decisions to grant greater provincial autonomy and the move towards normalising economic relations with India. Both will have enormously beneficial consequences for the country's economy; over time in the case of the former and almost immediately in the case of the latter.

The discussion of the positives in Pakistan's otherwise precarious situation should, therefore, begin with a development that will fundamentally change the structure of the government in the country. This will happen as a consequence of the 18th Amendment signed into law by President Zardari in 2010. This change in the Constitution will, once it becomes fully operational, transform the structure of government. The Amendment transferred from the federal government to the provinces a number of economic powers that were promised to them when the 1973 Constitution was written. That did not happen mostly for political reasons. Even Zulfikar Ali Bhutto, the author of the Constitution, was not willing to let go of the power that had been accumulated at the centre by his military predecessors who governed for a total of 13 years – nearly 11 in the case of General Ayub Khan and almost three years in the case of General Yahya Khan. The general-presidents brought into governance the military preference for centralised command and control. This further weakened the provinces and strengthened the federal government. This trend continued under Generals Zia ul Haq and Pervez Musharraf. It went to the credit of President Zardari to have his party men write the 18th Amendment which radically changed the way the governments will function at the federal and provincial levels. Since the Amendment's passage was preceded by the announcement of the seventh award of the National Finance Commission which gave the provinces a larger share in the 'divisible pool' – the resources collected by the federal tax administration with the purpose of transferring an agreed

⁸ Daron Acemoglu and James Robinson in *Why Nations Fail: The Origins of Power, Prosperity and Poverty*, New York: Crown Business, 2012.

proportion to the provinces – the provinces had, as a consequence, additional responsibility with added resources⁹.

There was some hope that the reshaping of the structure of government following the passage of the 18th Amendment will improve the quality of governance by bringing the state closer to the people. But there was also anxiety that the devolution of so much authority to the provinces could cause disruption in a number of areas. There was a particular concern that unless the process of devolution was managed carefully it could result in the deterioration of public services to the poorer segments of the population¹⁰.

The second positive development during Zardari's rule, as of now, was the decision to place on the back-burner a number of disputes that had kept India and Pakistan apart ever since the two countries gained independence. His government chose to focus instead on improving economic relations between Pakistan and India. After a series of meetings involving senior political leaders and bureaucrats from both sides in 2010-12, there was, in the words of Salman Bashir, the new Pakistan High Commissioner in India, a 'sea change' in the way the two sides looked at one another. Bashir told an Indian TV anchor that it was 'Prime Minister Manmohan Singh who said that we should invest in building trust by having frequent visits and exchanges at various levels'¹¹. A formal invitation was sent in late July by President Zardari to Prime Minister Singh to visit Pakistan and participate in the observance of Baba Guru Nanak Sahib's birth anniversary. There was an indication that such a visit might take place around 28 November, the birthday of the founder of Sikh religion. 'Such a visit would reinforce our mutual desire to promote inter-faith and inter-religious harmony', wrote President Zardari in his invitation letter. 'It is important to sustain this process and make it more productive and result-oriented. The intensity and the range of these engagements will help promote our ties in the right direction and will also help reshape our shared dream of a peaceful and prosperous South Asia'¹².

This was not the first time Singh was invited to visit Pakistan, the country of his birth. In fact, President Musharraf asked the author to raise the issue of the Indian Prime Minister's visit to Pakistan when he met him in New Delhi in December 2005. The Indian leader's response was interesting. 'It is easy for President Musharraf to visit us in India', he said. 'He doesn't need to bring on board a large of people that the head of the government in a democracy such as India must do'. There were many people with great political influence who felt that the moment was right for such a visit, he explained.

⁹ For a detailed discussion of the likely impact of the 18th amendment on the structure of the government and on the country's economy see, Shahid Javed Burki, 'The 18th Amendment: Pakistan's Constitution Redesigned', Institute of South Asian Studies, National University of Singapore, Working Paper No. 112, 3 September 2010.

¹⁰ Institute of Public Policy, State of the Economy: Devolution in Pakistan, April 2011.

¹¹ Dawn, 'Sea change in atmosphere with India: Pak envoy', 16 July, 2012, p. 3.

¹² Quoted in Baqir Sajjad Syed, 'Indian PM invited on Guru Nanak's anniversary', Dawn, 28 July, 2012, p. 1.

These moves by India and Pakistan were also seen favourably by President Barack Obama and should help Islamabad improve its damaged relations with Washington. In an interview with Lalit K. Jha, a Washington-based Indian journalist, President Obama, while emphasising that 'it was not the place of any nation, including the United States, to try to impose relations from the outside, nations must meet their responsibilities and all of us have a profound interest in a Pakistan that is stable, prosperous and democratic'. He said that lessening of tensions between India and Pakistan would not only be good for South Asia but also for the rest of world. 'Mr Zardari's visit to India was encouraging. Increased trade and people-to-people contacts between Indians and Pakistanis can lead to greater prosperity and understanding on both sides', Obama told the Indian journalist¹³. Various analysts working in the area of India-Pakistan trade had shown that enormous benefits will flow to Pakistan as a result of the free flow of goods and commodities as envisioned by the South Asia Free Trade Agreement. In an earlier work, the author estimated that Pakistan could add a 2.4 per cent increase in its GDP as a result of this development¹⁴.

The future, although likely to be less rocky than the past, will not be totally free of tensions. Even if trade between the two countries increased significantly and there was greater economic cooperation, there were several issues on which Islamabad and New Delhi will have conflicting interests. One of them was Afghanistan. It was not certain if either capital would have much influence over the direction in which that country was likely to go. As the Americans quickened the pace of their withdrawal, the situation in Kabul would become more precarious. An interesting perspective on what the American involvement in Afghanistan and other parts of the Muslim world had accomplished was offered in a newspaper interview by the departing Ambassador Ryan C. Crocker. A fluent Arabic speaker, Crocker had served the United States in a number of Muslim countries, including Pakistan. He said that American policy-makers needed to learn the lessons of the recent past. They must 'remember the law of unintended consequences, recognise the limits of the United States' actual capabilities, and understand that getting out of a conflict once you are in can often be dangerous and destructive for the country as the original effort'¹⁵. America, in other words, was pulling out not having won but having been chastened by its experience. It was also leaving Pakistan with a difficult problem to deal with.

The third positive did not normally figure in the discussions or analyses about Pakistan's economic future. This was the role women could play in the country's economic development. There was a widespread belief that women in Pakistan were doing poorly in receiving education. That impression to some extent was correct. The overall rate of literacy for women was low;

¹³ Quoted in Anwar Iqbal, 'Obama welcomes Pak-India efforts to lessen tension', Dawn, 16 July, pp. 1 and 3.

¹⁴ Shahid Javed Burki, *South Asia in the New World Order: The Role of Regional Cooperation*, London, Routledge, 2011, pp. 177-182.

¹⁵ Alissa J. Rubin, 'Retiring envoy to Afghanistan exhorts U.S. to heed the past', *The New York Times*, 29 July, 2012, p, A23.

much less than that for men which was also not very high. That said, over the 17-year period from 1993 to 2010, the number of girls enrolled in primary education increased from 3.7 million to 8.3 million. This implied a rate of growth of 6.7 per cent a year, about two and half times the rate of increase in the number of girls entering the primary school-going age cohort. However, even with this impressive rate of increase, girls still accounted for less than one half of the total number of enrolled students. The proportion was 44.3 per cent in 2010.

It was in higher education that girls had made the most spectacular advance. The number of girls attending what are described as ‘professional colleges’ increased in the same 17-year period at a rate of eight per cent a year. In 1993, there were only 100,400 girls attending these institutions. Their number grew to more than 261,000 in 2010. By 2010, there were more girls in these institutions than boys. Their proportion in total attendance of these colleges increased from 36 per cent to 57 per cent in this period. It was the attendance in the universities where the real revolution had occurred. There were less than 15,000 girls in 1993; their number increased to 436,000 in 2010. The proportion of girls in these institutions was approaching the 50 per cent mark with the rate of growth in their numbers an impressive 28 per cent a year. While a very large number of girls dropped out between the primary stage and the stage of professional and university education, the numbers completing higher education was large. Three quarters of a million girls were leaving the institutions of higher learning every year.

In education it was the numbers that make a revolution. Given the rate of increase in the number of girls attending these institutions by 2015, a million girls will be ready every year by that time to enter the modern sectors of the economy. That had begun to happen but the statistics on participation in the workforce didn’t tell the complete story. There were a number of sectors in the modern parts of the economy where women made up a significant part of the workforce. These included the traditional areas where educated women had been active for decades. These included teaching and medicine. However, as the number of women with high levels of skills increased, they became players in sectors such as banking, communications, law and politics. They made up a significant proportion of the workforce in the companies doing IT work. Some IT experts estimated that there were tens of thousands women engaged in doing work in what they called ‘cottage businesses’ in their sector. These women with good computer skills were working from their homes undertaking small contractual work for the members of their families or their friends who were living and working abroad. Some estimates suggested that more than a billion dollars worth of work was being done in these informal establishments. These were by and large one-person shops that receive payments through informal transactions. Women were increasingly entering the entrepreneurial field, an area that benefitted from the enormous increase in the number of well-educated women that are entering the workforce. Private sector education was one area where educated women as entrepreneurs had the most important impact on modernising some aspects of the Pakistani economy.

One example of this was the remarkable performance of the Beaconhouse School System launched on a modest scale in the early 1970s by Mona Kasuri, its founder. As happened so often in the case of family-owned businesses, while one generation may have set the ball rolling, the generations that followed make the ball go faster. While Mona Kasuri was the driving spirit behind the Beaconhouse venture, Pakistan's largest privately owned and managed educational system, it was developed further and moved along by her sons and daughters-in-law. One daughter-in-law, Sophia Kasuri, added childcare to the system. She started with an institution called The Early Years to take care of her own children, repeating her mother-in-law's story. 'The Early Years philosophy – which was based on learning through play and teaching life skills – was based entirely on Sophia's observations of her children and their needs and desires. While it started off small with just a few friends' kids, within a month, Early Years had surpassed its initial targets. Today it is a staple for many working parents in Lahore, hitting a largely ignored and potentially very lucrative niche market. Sophia is now looking to introduce Gymboree, the world leader in early childhood development, to Pakistani parents'¹⁶.

But women's entry into the workforce will not go unchallenged, particularly in the country's more conservative areas such as the tribal belt on the border with Afghanistan. A grim reminder of this came in the case of women activists such as Farida Afridi, who with her sister co-founded an NGO to work for improving women's situation in the socially backward areas. Women working at SAWERA (the acronym means the Urdu word 'morning'), or Society for Appraisal and Women Empowerment in the Rural Areas, were "accused of not observing cultural norms – not wearing veils, encouraging other women to work outside the home and working alongside male colleagues"¹⁷. Farida Afridi, 25, was killed in July 2012 as she was walking from her parents' home to her office.

Another positive for Pakistan was its diaspora. These large communities of people of Pakistani origin were formed over several decades in many parts of the world. By 2012, they had six to eight million people, perhaps earning as much as US\$ 200 billion a year, an amount equal to Pakistan's gross domestic product. They probably saved a quarter of their annual income or US\$ 50 billion a year. This was much higher than Pakistan's domestic savings rate. Some of these savings found their way back to Pakistan in the form of charitable-giving but also investment in various economic activities. A significant amount of investment by the diaspora went into real estate during the time of President Musharraf when there was political and economic stability. Not unlike other diaspora, the Pakistanis living abroad were interested in maintaining ties with the homeland. The more affluent among them bought second homes in the country. Some large investments were made in banking and industry. Bestway, a Pakistani business group in the

¹⁶ Onar Jamil, 'I kid you not', The Express Tribune, 12 September, 2010.

¹⁷ Michelle Langevine Leiby, 'Activist's killing reverberates in Pakistan', The Washington Post, 18 July, 2012, p. 11A.

United Kingdom headed by Sir Anwar Pervez, bought a large stake in the United Bank and also established a cement plant in north Punjab. The Ghauri brothers, who were dispersed in three different continents, reassembled in Pakistan to establish Netsol, Pakistan's largest IT firm and the only one listed on Nasdaq in the United States. Several doctors practising in Britain and the United States set up clinics and hospitals in the country. One example of this investment was the Doctors' Hospital in Lahore, one of the finest in the city. Another was the pharmaceutical firm Getz which from a small start was turned into an international firm by a group that came back to Pakistan, having worked abroad in this particular industry.

However, the investments originating with the diaspora declined as the country became politically and economically less stable. Notwithstanding that, the amount remitted by overseas Pakistanis continued to increase at double-digit rates. Remittances in 2012 touched US\$ 12 billion and were expected to increase to more than US\$ 13 billion in 2013. This amounted to seven per cent of the gross domestic product and significant proportion of the balance of payments deficit. In other words, remittances made it possible for Pakistan to pay for vital imports even when its exports did not earn the needed amounts. Also overseas Pakistanis, in particular those resident in the United States and Britain, were an important source of access to new technologies and management practices. As already indicated, they played important roles in modernising the sectors of health and IT.

Conclusion

Pakistan's future has never seemed more uncertain than it appeared in 2012. The country faced difficulties on many fronts. The economy was weakening; it appeared highly unlikely that the governing coalition in Islamabad would be able to take the steps to bring growth back to the level needed to absorb two million additional workers that join the workforce every year. The IMF, in its Article IV consultations with Islamabad, estimated that the economy needed to expand by seven per cent a year to keep unemployment from increasing. It expected a rate of growth at 3.4 per cent in 2012-13¹⁸. The country's external situation was weakening as it prepared to service the large amount of accumulated debt, in particular the amount owed to the IMF.

The 3 July 2012 statement by US Secretary of State Hillary Clinton saying that her government was sorry for the unintended attack by the American forces on a Pakistani post near the Afghan border on 26 November that killed 24 Pakistan soldiers cleared the air a bit, but only a bit. It was

¹⁸ International Monetary Fund, 'IMF Executive Board Concludes 2011 Article IV Consultation and Proposal for Post-Program Monitoring with Pakistan', Public Information Notice No. 12/10, 6 February, 2012, Washington DC.

followed by the signing of a Memorandum of Understanding in Rawalpindi by the two governments three weeks later. The MOU, which included an agreement with the United States for reopening the supply route to Afghanistan, was expected to bring some financial rewards. The Obama administration indicated that it would send Congress a request to appropriate US\$ 1.1 billion for Pakistan. This money was owed to Islamabad for the services that had already been provided. Pakistan, however, estimated the amount at more the US\$ 3 billion. There was, however, no mention of the flow of funds from the Kerry-Lugar-Berman bill which was supposed to put Pakistan-American relations on a firmer ground. Even if the US Congress acted with dispatch – not certain that it would, given Pakistan's very low reputation in that body – it might ease the financial situation for a while only. This happened in the week of 20 July, when the United States deposited US\$ 1.1 billion with the State Bank of Pakistan, the country's central bank. But the basic arithmetic will not change. Pakistan spent much more than it collected in taxes; its imports cost more than it was able to earn from exports. The State Bank of Pakistan had begun to lose reserves and the rupee, the domestic currency, came under pressure. The Pakistani rupee's value declined by more than five per cent in the first half of 2012.

In fact, exports were doing poorly and the trade deficit widened. While Raja Pervez Ashraf, the Prime Minister elected in June 2012, cited solving the deepening energy crisis as his first priority, prospects didn't look promising. Electricity shortage had resulted in 'load-shedding' of more than half of the day in many areas, in particular in the Punjab. There were also shortages of natural gas. The people were becoming restive and many took to demonstrating in the streets. Some Pakistan-watchers suggested 'that the power crisis is more of a threat to Pakistan's stability than terrorism – more proof that after years of mismanagement and neglect, the national energy sector is in extremis'¹⁹.

There were no signs of any easing of the tension between the government led by President Zardari and the senior members of the judiciary. The Supreme Court was relentless in pursuing cases of alleged corruption by the senior members of the administration including the president. It forced Gilani out of premiership and began to move against his successor. Other courts also jumped into the fray. The Lahore High Court told President Zardari that he had to choose between the two jobs he concurrently held: the presidency and the co-chairmanship of the Pakistan People's Party. The courts also continued to pursue several cases of alleged corruption against senior office-holders and their families.

There were many difficulties on the external side. The United States' decision to pull out of Afghanistan and complete the process by the end of 2014 left Pakistan guessing about its consequences. 'Washington seems to be settling for a degree of managed instability in

¹⁹ Richard Leiby, 'Pakistan's power crisis may eclipse terrorist threat', The Washington Post, 27 May, 2012, p. A9.

Afghanistan dealt with by the Afghan National Army and American special forces’, wrote Tanvir Ahmad Khan, who was once the top diplomat in Pakistan and knowledgeable about the Afghan situation. ‘Such a scenario will hurt the interests of most regional powers. For Pakistan, it will be a nightmare. The situation in Afghanistan is, to say the least, dynamic and may gravitate towards greater crisis, including civil war or many mini-civil wars...Washington is redefining its objectives in Afghanistan within the larger context of the strategic reconfiguration of Asia that it seeks. Much also would depend on the modalities of disbursing the assistance of US\$ 16 billion pledged at the Tokyo conference held in July’²⁰.

In these difficult circumstances, the question most often asked by those who watched the country from within as well as outside was: Where was Pakistan headed and could it avoid failure?

‘The point is that the prospect of disaster, no matter how obvious, is no guarantee that nations will do what it takes to avoid that disaster’, wrote Paul Krugman, the Nobel Laureate, in a column published in July 2012 in *The New York Times*²¹. His reference was not to Pakistan but to Europe, where a dithering leadership was letting the continent slip towards an economic abyss. But the possibility of disasters on several fronts did not seem to focus the minds of the policy-makers in Pakistan either. Nation-failure – the opposite of nation-building – became a popular topic in policy and academic discourse in 2012 as a number of countries in the Muslim world were convulsed by social upheaval. While the Arab Spring was watched, studied and analysed with great interest, there were even greater concerns about the nearly-dysfunctional states of Afghanistan and Pakistan. Their future was also of equal interest for the security establishments in the West, in particular in the United States.

Engineers have known for as long as they have been engineering that it was the fear of failure that drove the field forward. Could the same be said about nation-building, a field that has had practitioners as well as students but in which there were more failures than successes? Engineers always hoped that their designs will succeed but as Henry Petroski, an engineer who taught engineering failure at Duke University, wrote in his new book, ‘no matter what the technology is, our best estimates of its success tend to be overly optimistic’²². Statesmen who have delved into nation-building – their own or that of other countries whose development they could and would like to influence – also knew failure. President Barack Obama’s experience with nation-building in the Muslim world provided a good example of failures, perceived or otherwise, leading to policy adjustments. According to David Sanger, who wrote a book on the American President’s on-the-job education in the area of nation-building, described how an almost total about-turn

²⁰ Tanvir Ahmad Khan, ‘Our Afghan policy’, *Dawn*, 17 July, 2012, p. 7.

²¹ Paul Krugman, ‘Europe’s great illusion’, *The New York Times*, 1 July, 2012, p. 21.

²² Henry Petroski, an engineer who now teaches engineering failure at Duke University, writes in his new book²², *To Forgive Design: Understanding Failure*, Cambridge, Mass.: The Belknap Press of Harvard University.

occurred in his thinking. In October 2009, a few months after assuming the presidency, Obama announced a plan for Afghanistan that would not only advance American security but also provide ‘opportunity and justice –and not just in Kabul, but from the bottom up in the provinces’. He thought in terms of a ‘civilian surge’ made up of agricultural specialists and educators, engineers and lawyers to fashion a new Afghan economy – in fact a new Afghan society. As Robert W. Merry, a historian who has studied America’s Presidents²³ wrote in his reaction to the Sanger account, Obama’s ‘goal was level of societal coherence, and governmental functionality never before seen in that mountain redoubt of a country’²⁴. That goal, of course was not reached and within two years, Obama had reversed his course. At the end of 2011, the president convened a committee and put it in charge of narrowing his Afghan mission to its bare essence. Its task was to find a quick way to reach the exit. But reaching the exit without incurring too heavy a cost meant working with Pakistan and re-establishing a relationship that was not rocked by suspicions and ill-feelings on both sides. That was not on the cards.

Academics have also begun to devote time to studying nation-building failures. This was the subject of the often-cited book in this work by Acemoglu and Robinson that appeared in 2012 with the telling title of *Why Nations Fail*²⁵. According to them, nations fail when their institutional structures were designed to give the elite the capacity to extract resources from those who did not have access to political power. Extractive political institutions led to the creation of similar institutions on the economic side, with each reinforcing the other.

The situation in Pakistan was precarious. There was a consensus both inside and outside Pakistan that most systems in the country were now dysfunctional. The most worrying development of recent years was the emergence of extremism, a movement joined in by those who were working towards a radical change in the system of governance. For them, liberal democracy, which the rest of the world had decided was the best way to govern, was an anathema. These groups and people had to be reintegrated into the society. By their anti-state activities, they had cost the economy dearly and ruined the country’s reputation in the international community.

It would take a multi-pronged approach to bring Pakistan out of the deep crisis it faced as the democratic government entered the fifth year in office. In the area of economics, public policy will have to address the issue of poor governance. It will need to deal with the failure of the state to raise sufficient resources for delivering public goods to an increasingly frustrated and

²³ Robert W. Merry, *Where They Stand: The American Presidents in the Eyes of the Voters and Historians*, New York, Simon& Schuster, 2012.

²⁴ Robert W. Merry, ‘The Obama Doctrine’, *The New York Times Book Reviews*, 15 July, 2012, p. 19.

²⁵ Daron Acemoglu, and James A. Robinson. *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*. New York. Crown Business, 2012.

disgruntled citizenry. There was the need to overcome serious shortages of goods and services critical for industrial output as well as household consumption. There was work to be done to reduce inter-personal and inter-regional income inequalities. Physical infrastructure needed to be improved and what had already been built needed to be maintained. It had not fully dawned on the policy-makers that global warming was likely to prove disastrous for Pakistan, making the already stressed water situation even more problematic. The list of 'dos' was a long one. Pakistan had dealt with many crises in past. What was different this time around was that a number of problems surfaced at the same time. Their coming together produced a perfect storm which required a great deal of thinking on economic policies that would be appropriate for Pakistan at this time.

There were, however, many things wrong with official thinking about the state of the Pakistani economy. Much of this was being done at the Planning Commission, some at the Ministry of Finance, some more in the Ministry of Commerce and some was also coming out of the provincial capitals. There were some useful materials produced particularly at the Planning Commission. What the Planning Commission called the Framework for Economic Growth paper, or FEG, had some innovative material. It was right to focus on what it labelled as the 'soft side' of the development equation. The Commission claimed that for Pakistan to increase the rate of economic growth, it needed to invest in the softer aspects of development and not continue to commit large sums of money on brick and mortar development schemes that have dominated the Public Sector Development Plan.

The 'soft side' advocated by the Planning Commission included institution-building, human resource development, increasing the capacity of the private sector to innovate, reducing the regulatory burden carried by private enterprise, and changing and modernising urban regulation so that cities became the most dynamic part of the economy. What really irked the Planning Commission were the zoning regulations in many cities that prevent vertical development. This inhibited the economic role of the city centre. The Commission was also concerned about the declining efficiency and effectiveness of the various civil services. It called for a fundamental restructuring and reform of the civil administration. All these were worthwhile goals and they needed to be included in an approach aimed at the long-term. However, they didn't constitute a strategy that could pull Pakistan out of the deep economic hole it had by then dug for itself.

The FEG was an approach that will deliver rewards over the long-term. It will do very little to solve Pakistan's current economic problems. There were several of these but unfortunately not many among them found their way into official thinking. Following are some of the many problems crying out for policy-making attention.

I list them in no particular order: Pakistan's longest lasting recession with no end in sight; continuing violence, some of it directed at the state; increasing isolation from the world; continued dependence on external capital flows for financing the currently low levels of public sector investments; the loss of confidence on the part of the investment community, both inside and outside the country, in Pakistan's economic future; low rates of domestic savings and low tax-to-GDP ratio; very little public sector investment in improving the quality of the large human resource; declining share in international trade; poor relations between the federal government and provincial administrations; and increasing incidence of public sector corruption.

The list is even longer than this but there is no systematic official response to most of these problems. A soft-power-focused strategy of growth would work well in realising the economy's large but neglected potential. However, the impact of this focus will be felt after a long time. Pakistan is now regarded as a fragile state by development institutions such as the World Bank. In one of its recent World Development Reports, the World Bank also picked up some of the soft factors in the growth function²⁶. These, it suggested, are essential ingredients of long-term sustainable development. But it emphasised – correctly I believe – that it will take a generation or two before fragile economies such as Pakistan can begin to use these factors effectively in the development equation. In the meantime, they need to pull their economies out of the low growth traps into which they have fallen. To get to the long-term they need to focus on the short-term.

What should be the development agenda for the policy-makers at this delicate moment in the country's economic history? There were at least five areas that needed the policy-makers' urgent attention: Revival of growth; increasing domestic resource mobilisation; reconnecting the country with the world; reducing income disparities; and investing in the development of the large human resource. Each of these areas required a series of government actions. There were no indications that any of these are planned. What needs to be done in one area will impact on the remaining four. In other words, a comprehensive approach that dealt with the short-term is the need of this precarious hour. Long-term thinking could wait while the short-term was being fixed.

As already indicated, the IMF in its 'Article Four' consultations with Islamabad had correctly underscored the need for the revival of growth. It believed that a rate of growth of seven per cent a year was needed in order to accommodate two million new entrants in the workforce. If these people could not be given reasonably productive jobs in the economy, many of them will opt out and start looking for other ways of meeting their needs. When the state is weak there is great temptation to work outside its space. This was a well-known reaction by the deprived, much analysed by social scientists. There was no doubt that many recruits to the organisation that

²⁶ The World Bank, World Development Report, 2011: Conflict, Security, and Development, New York, Oxford University Press, 2011.

pursue extremism as a way of achieving their objectives were attracted to them for economic reasons. Extremism in the country was not increasing only for ideological reasons; it became a good business for those who organise it and those that become its foot soldiers²⁷. The Benazir Income Support Fund was one way of dealing with this situation and what was known about it seemed to suggest that it was working reasonably well. On top of this, the government – in particular the provincial administrations – should give serious thought to the launching of public works programmes in both rural and urban areas. There was a great deal that could be done by such programmes to improve the quality of life for those who were seeing its deterioration with every passing day. But the real economic issue at this moment was the revival of confidence in the economy. For that to happen, the quality of governance needed to improve. This was where the policy-makers needed to focus.

Experiences from other parts of the world show that appropriate sets of economic policies and good quality leadership can quickly turn the situation around. This happened in Latin America in the decade of the 1990s²⁸. It was happening now in some parts of the African continent. But these changes always occurred when those who led were committed to improving general welfare and not their own economic situation and that of their families and close associates. And it required political will to take difficult decisions especially when they were not favoured by some powerful segments of the society. Most of these conditions did not exist in Pakistan as the country moved towards another election. But they may appear as a consequence of the cleaning of the political house that may result from the next poll. One can only hope that the wait will not be a long one. Anatole Lieven, the author of an acclaimed book on Pakistan, observed, there are plenty of signs that the country is a troubled rather than a failed state²⁹.

(Concluded)

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²⁷ For what motivated people – in particular the young people – to sacrifice their lives in pursuit of various causes is examined in Riaz Hasan, *Life as a Weapon: The global rise of suicide bombings*, London, Routledge, 2011. The book has a chapter – Chapter Five, pp. 101-21 – that examines the situation in Pakistan.

²⁸ The author, as Vice President of Latin America and the Caribbean at the World Bank, had personal experience of the fast and positive response of a number of countries in the region that changed both the leaders as well as public sector policies in order to handle difficult situations. Under his direction, the World Bank was deeply engaged in helping the countries in the region out of the deep economic and social crises they faced in the second half of the 1990s.

²⁹ Quoted in Rahul Jacob, ‘Zardari court battles masks Pakistan gains’, *Financial Times*, 28 July, 2012, p. 13.