Slowdown in growth

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AFTER a decade of stabilization and gradual liberalization there is a sense of gloom in a significant chunk of Pakistan's industrial sector, in sharp contrast to the belief that drove the deregulation reforms.

Why has growth not picked up in all sub-sectors of industry, despite no important policy reversals? Are the sub-sectors with subdued or continued slack production facing demand constraints or other structural problems in transformation, were the reforms too little too late or is the poor outcome the result of poor implementation of a well-conceived policy framework owing to political and bureaucratic inertia or simply the societal and official reluctance to change?

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In the opinion of this writer, the much argued claim regarding the nexus between reforms and growth is overstated. There is little conclusive evidence of a clear and positive correlation/linkage between the scope of reforms and economic outcomes. Stabilization and liberalization may be necessary but are certainly not sufficient conditions for economic growth and prosperity. The market cannot automatically resolve problems of lack of coordination and poor linkage.

For instance, while interest rates have declined, commercial banks continue to be reluctant to lend to the productive sectors of the economy and have instead chosen to invest in risk-free government paper/securities or in the stock market where close to Rs.45 billion has been invested by the commercial banks. Admittedly, this is partly because the entrenched legal environment having a bearing on foreclosure has only partially changed the incentive to lend to enterprises.

And with the president himself reminding us and the world repeatedly that he will not give up his uniform because of internal instability, it is not too surprising that foreign investors are not queuing up to exploit investment opportunities within Pakistan. Combine this with the state machinery itself not believing in the rule of law and protecting, if not actually sponsoring, a host of mafias, a judicial system not perceived to be fair, just and predictable in its decisions and you begin to see why the climate for investment continues to be poor.

There is also little doubt that what also stifles growth and efficiency are excessive bureaucratic controls over production and trade — an elaborate and highly regulated system put in place at all levels of government (federal, provincial and local) and an oversized and inefficient public sector mandated to provide key services like energy and communications. The remaining regulatory framework and control systems not only function inefficiently but also promote a perverse set of incentives. Although most of the pernicious aspects of the features mentioned above were diluted during the 1990s, the performance of the manufacturing sector has continued to be lacklustre, since much still remains to be done.

Moreover, partly in response to large public sector expenditure on development and other related schemes in the decade up to the mid 1990s, there was investment in manufacturing without a concomitant increase in production, resulting in fairly large excess capacity.

A significant proportion of the industrial sector is now up against lack of demand which is constrained by the policy framework, poor, or at best indifferent, increase in production of major crops in recent years and the slashing of public sector development expenditure since the latter half of the 1990s. In a developing and iniquitous agrarian economy investment in public infrastructure makes a key contribution to equity, growth and economic efficiency. Public investment acts as spur for private investment. International evidence also supports the argument that public involvement in infrastructure does not displace private investment but crowds it in. With interest rates on government borrowings below the rate of inflation, fiscal space exists to augment current levels of public sector spending on physical infrastructure.

The essential fact is that Pakistan continues to be a large and poor agricultural economy with almost half the working population still dependent on agriculture for livelihood, but productivity of the land is less than one-third that of China, as is the case with value addition in per capita terms in manufacturing, which is less than one-fourth that of China.

In aggregate terms there has been no slowing down of the growth in agriculture. However, there is evidence, based mainly on physical output growth at the disaggregated level, which seems to suggest a different tendency. A comparison of the yields per acre of all major crops between the 1980s and 1990s reflects the lowering in the growth rate in the 1990s, except in the case of wheat. In view of a low level of exports and lack of natural resources and inadequately developed productive human capital, industrial growth becomes a function of the size and growth of the domestic market, whose size, in turn, depends on the performance of the agriculture sector, unless, as argued above, the government steps in and increases its spending on projects with high rates of return and short payback periods. In other words, it is the lack of demand that is acting as a constraint on industrial growth.

The fact that a large proportion of the labour force is still employed in agriculture, even though the share of agriculture in GDP has fallen to 25 per cent, is a telling indicator of the failure of our developing strategy in enabling workers to move from agriculture to more productive employment elsewhere in the economy. The small average size of land holdings is also a symptom of this failure since these would have been consolidated if fewer people had been engaged in agriculture.

The writer is former finance minister of Punjab.