CSF
COMPETITIVENESS SUPPORT FUND

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Linking Finance to Innovation and Competitiveness

The State of Pakistan's Competitiveness 2007

THE STATE OF PAKISTAN'S COMPETITIVENESS 2007

About the Competitveness Support Fund (CSF)

The Competitiveness Support Fund (CSF) is a joint initiative of the Ministry of Finance (MoF), Government of Pakistan and the United States Agency for International Development (USAID). The concept of the CSF is based on similar funds established in other economies (i.e. India, Thailand, Turkey, Ireland and Finland) and CSF is benchmarked against these funds, structured according to the international best practices and tailored to the current Pakistani economic environment.

The CSF has been established to support Pakistan's goal of shaping a more competitive economy by providing input into policy decisions, working to improve regulatory and administrative frameworks and working to enhance public-private partnerships within the country. The CSF will also provide technical assistance and co-financing for initiatives related to innovation and competitiveness that bring the private sector together with research institutes, universities and business incubators that contribute to creating a knowledge-driven economy.

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This report has been prepared by J.E Austin Associates for the Competitiveness Support Fund.

Table of Contents

Acronyms

BCI	Business Competitiveness Index
CSF	Competitiveness Support Fund
ERU	Economic Reform Unit
FDI	Foreign Direct Investment
GCI	Global Competitiveness Index
GCR	Global Competitiveness Report
GDP	Gross Domestic Product
GOP	Government of Pakistan
KPT	Karachi Port Trust
MOF	Ministry of Finance
NFC	National Finance Commission
NTCIP	National Trade Corridor Improvement Program
NWFP	North-West Frontier Province
PISDAC	Pakistan Initiative for Strategic Development and Competitiveness
PR	Pakistan Railways
RE	Renewable Energy
SIAL	Sialkot International Airport Limited
SME	Small and Medium-sized Enterprises
SMEDA	Small and Medium Enterprise Development Authority
SPC 2007	State of Pakistan's Competitiveness Report 2007
USAID	United States Agency for International Development
WEF	World Economic Forum

Tables and Figures

Tables

Figures

Statement by Prime Minister Shaukat Aziz

We, the people of Pakistan, are seeking to provide our children with good health, education and a life of dignified work. We share the hope that our children and grandchildren will have a better life. The secret to achieving this is quite simple. It is a strong economy that produces more and better jobs each day. We now know how more and better jobs are created. Those countries which have been most successful in creating jobs are those which have achieved what is today referred to as "competitiveness". As the first annual report on the State of Pakistan's Competitiveness reveals, this means not only improving the productivity of our business enterprises but also of our people through improving health and education services — a goal that is central to the desires of most people in Pakistan.

Many of the most competitive countries conduct annual competitiveness reports. Competitiveness reports are now being prepared by the most prosperous economies, including the European Union and the United States. Ireland, which is now the second most prosperous country of Europe, annually publishes a competitiveness report and Singapore has also done so. In Islamic countries, there has been increased focus on competitiveness as the key to prosperity. The Arab world now has a competitiveness report. Egypt has been publishing its national competitiveness report for the past three years and it is used as a centerpiece for discussions between public and private sector leadership. Jordan has recently created a "competitiveness observatory." Pakistan's large neighboring countries are achieving high growth rates and so it is vital to Pakistan's economic security to achieve high levels of competitiveness as well.

The first annual report on the State of Pakistan's Competitiveness makes a historic contribution to the country and announces to the international business community that Pakistan intends to become one of the most competitive and high-growth countries in the world. The Government of Pakistan has reversed the economic decline of the 1990s. The percentage of people living in poverty has declined. We are stronger today because of the growth and stability of the economy. The statistics speak for themselves. There has been an average growth of 6% annually since 2001. Government debt has been reduced from nearly 100% to 55% of GDP in the last five years. The fiscal deficit has been reduced by half. Pakistan's competitiveness has improved notably as well.

There is now a way to measure Pakistan's competitiveness, thanks to the Global Competitiveness Report, the Doing Business Report and other studies. Although we have taken notice of these rankings in the past, this is the first year in which we have made a comprehensive effort to analyze them in detail and capture the insights for Pakistan. We intend to stimulate a public discussion around these findings. A team of Pakistani and international experts was assembled to analyze the data and help make sense of this information. The result is the first annual report on Pakistan's competitiveness, revealing strengths, weaknesses and priorities that leaders can discuss.

This report on the State of Pakistan's Competitiveness will have many uses and can be important to people in all walks of life. It is hoped that the report will stimulate debate among government, business, education, civil society and regional leaders. It will help us benchmark our progress from year to year. The report should go a long way in fostering greater understanding and support for the important initiatives that are underway to help our economy grow and prosper. It will help us all remember that we must never again let our country's economy falter and fall behind. Building a strong and prosperous economy is vital to our country's national security and at the same time will allow us to pass on to our children the kind of life that we all wish for them to have.

Message from Dr. Salman Shah, Advisor to the Prime Minister on Finance, Economic Affairs, Revenue and Statistics

Pakistan's economy is growing rapidly, driven by its large product markets and favorable demographics. To leverage this potential, Pakistan faces the economic challenge of achieving outward competitive advantage to enter global markets or to maintain and expand its markets that are becoming every day more competitive. Many countries are struggling to be competitive in world markets and to adapt themselves to increasing standards of quality and efficiency. There is competition from China and other countries. However one may feel about the effects of globalization, it has become a reality. Globalization is now driving the world economy. Globalization is now an inescapable fact of life in the world economy. Technological changes in transportation and communications have connected the world as never before and have created both new opportunities and new threats.

No country can shelter itself from these impacts. Countries and industry clusters that successfully adapt to these conditions will become beneficiaries. Others will become victims. The key determining factor for Pakistan on whether it will benefit or suffer from the globalization will be competitiveness. Competitiveness is the key to the future of Pakistan and its ability to thrive in the new economic conditions. Competitiveness has become the economic imperative for both business leaders and government leaders alike. Pakistan's future competitiveness in the world economy will require active responses from business leaders, government leaders, educational leaders and civic leaders. Competitiveness will require action at the federal, provincial and district levels. Competitiveness will also require a change in mindsets. Industry will need to focus more on its customers and less on the government for the basis of its competitiveness. Government will need to listen to the private sector and remove impediments that raise the cost of doing business. The most widely followed indices of competitiveness are found in the annual World Economic Forum Global Competitiveness Report (GCR). This year, the Ministry of Finance through the Competitiveness Support Fund has decided to supplement this by undertaking the first ever State of Pakistan's Competitiveness report. It is hoped that this effort will help focus efforts on those priorities that can improve Pakistan's competitiveness in the future.

Improving the competitiveness of Pakistan's economy will in turn help achieve the ambitious rates of economic growth that have been set as goals and targets. This, in turn, will ensure continued gains in poverty reduction and help ensure that those who have recently emerged from poverty do not slip back into its grip. This is a moral imperative in addition to an economic challenge. Therefore, we call upon leaders throughout Pakistan to reflect on the conclusions and recommendations contained in this report.

Message from CSF Chairman, Omar Ayub Khan

As the Prime Minister has indicated, the Government of Pakistan has achieved important economic results and is committed to making Pakistan one of the world's truly competitive economies. The Ministry of Finance proposed this first annual State of Pakistan's Competitiveness Report to further this objective. The objective is to review objective data and then formulate a plan to increase Pakistan's competitiveness and to catalyze future economic growth and extensive poverty reduction.

The economy of Pakistan has shown great resilience. Despite the devastating earthquake and the significant increase in international oil prices, Pakistan continues to maintain high levels of economic growth and lift more and more people out of poverty. The Ministry of Finance has successfully navigated a very difficult impasse in the growth of the economy through responsible fiscal management and disciplined implementation of structural reforms.

What is required to sustain high growth and build a strong, competitive Pakistan? As this report highlights, the answer is clear, but not necessarily easy: increased investment, an improved business environment, smarter management, stronger infrastructure, and a more educated, sophisticated workforce. The Ministry of Finance has focused primarily on providing a stable macroeconomic environment that has created the necessary conditions for growth, through a focus on investments that promote such growth. It has encouraged other government ministries to improve the business environment. It has also sponsored the Competitiveness Support Fund.

The Competitiveness Support Fund, an initiative of the Government of Pakistan that has received valuable financial and moral support from the

United States Agency for International Development, seeks to finance practical initiatives to reposition Pakistan's economy regionally and globally and set it on a more competitive footing. The result will be higher productivity, increased innovation, and an economy that is integrated into global value chains and can compete internationally. We expect the new initiatives will also help to raise Pakistan's overall global competitiveness ranking from 91st in 2006 to among the top 70 by 2010, with the creation of a more productive, knowledge-based, investment and innovation-driven economy.

This report on the State of Pakistan's Competitiveness will have many uses and can be important to people in all parts of Pakistan. It is hoped that the report will foster broader understanding of Pakistan's competitiveness challenges and stimulate debate among government, business, education, civil society and regional leaders on the priority actions for overcoming those challenges. As the Minister of State for Finance and the Chairman of the Competitiveness Support Fund, it is my hope that this report will be an annual publication that over time becomes both an objective, transparent process for raising the most pressing issues in our economic development as well as provide evidence of our success in transforming our economy for future generations.

Executive Summary

Pakistan ranked 67th on the Business Competitiveness Index (BCI) and 91st on the Global Competitiveness Index (GCI) in the 2006-2007 Global Competitiveness Report. The wide gap between Pakistan's performance in these two rankings is partly explained by the country's low scores in health and education, which are included in the GCI but not the BCI.

Pakistan's competitiveness rankings and impressive growth reflect increased macroeconomic stability. Improved macroeconomic management and first-generation economic reforms have delivered increased economic stability and spurred higher rates of economic growth. Increased macroeconomic stability is allowing the economic leadership to turn its attention to second-generation microeconomic reforms despite the economic stresses of oil price increases and unanticipated budget spending associated with relief to earthquake victims.

Improving competitiveness will require microeconomic reforms and continued improvements in access to health and education. Addressing these issues will require active leadership and a coordinated effort by both public and private sector leaders at the federal, provincial and municipal levels.

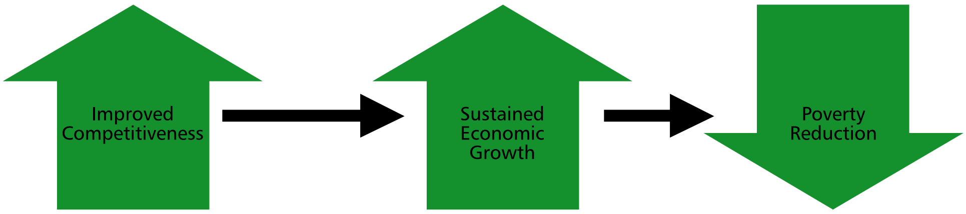
The Government of Pakistan (GoP) has proposed an ambitious program for addressing microeconomic issues that directly impact competitiveness. The government is focusing on macroeconomic stability, improving the business environment and implementing practical initiatives through the Competitiveness Support Fund (CSF). However, many of the microeconomic constraints can only be solved at the provincial level. Provincial and local leaders must therefore be part of the competitiveness dialogue.

Provincial, district, and municipal governments must play a lead role in improving the business climates within their regions and improving the provision of health and education services. Many competitiveness initiatives are regional in nature. Industries tend to "cluster" around specific areas. It is the government's role to help ensure that the business environment is conducive to creating sustainable jobs for Pakistan. In addition, provincial and district governments are primarily responsible for education and health care, which means that regional leadership must be brought into the competitiveness dialogue.

Strengthening inter-regional trade relationships will provide promising prospects for continued growth. There are now unique opportunities for Pakistan to develop prosperous trade relationships with China, South Asia and Central Asia. Ensuring trade access for Pakistan's exporters and continued trade facilitation will help Pakistan improve its export performance.

Introduction

The purpose of this State of Pakistan's Competitiveness Report is to provide an overall look at the Pakistan economy and prospects for growth using the annual Global Competitiveness Report as the framework for evaluation. Competitiveness is critical to the Government of Pakistan's objective of achieving high levels of economic growth and rapid poverty reduction.



The most widely followed indicators for competitiveness are published each year by the World Economic Forum (WEF) in the Global Competitiveness Report (GCR). Pakistan is one of the countries ranked on the Global Competitiveness Index (GCI) and the Business Competitiveness Index (BCI) that are contained in the report. Although Pakistan has been included in the Global Competitiveness Report for a number of years, until this year there has never been an in-depth analysis of Pakistan's competitiveness.

The Ministry of Finance seeks to monitor the state of Pakistan's competitiveness. This is a more difficult task than it might seem. While the macroeconomy has clear indicators such as GDP growth, inflation rates and budget deficits, the microeconomy, which is in large measure the focus of competitiveness reports, is more complex and highly nuanced. Another difficulty revolves around whether the data used accurately captures the present situation. Pakistan's rankings are based on the data available to the World Economic Forum as of April 2006. They have relied on sources that compile such data for most countries of the world. There is often a considerable time lag and the actual data and scores for Pakistan may not reflect current circumstances. Policy reforms implemented in the last two years may not be fully reflected in the current scores and rankings.

For example, the report indicates a relatively low level for cell phone penetration in Pakistan. However this indicator has seen a tremendous increase in recent years. Timely reporting of data to the appropriate international authorities and databases will help ensure that appropriate scores are given to Pakistan in various indicator areas.

The State of Pakistan's Competitiveness Report is important for mobilizing broad popular understanding and support within the country for important second-generation economic reforms. The report is designed to help the GoP benchmark current performance of the country and measure future progress. The GoP is committed to the process of dialogue with leaders of the private and social sectors in order to build consensus around initiatives to spur growth and employment. This report establishes a common platform for public-private dialogue and informs and catalyzes clear decision making among economic leadership. The State of Pakistan's Competitiveness announces to the outside world the intention to become one of the world's highest growth and most competitive economies and create a competitive environment for increased levels of domestic and foreign investment.

The Report will be used by the Government in workshops with chambers of commerce, industry associations, and regional and municipal leadership groups. It will also be provided to university rectors, economic faculties, think-tanks, trade unions and SME representatives as a way to encourage dialogue on how to improve Pakistan's competitiveness.

Definition of Competitiveness

Competitiveness can be defined as sustainable growth in productivity that benefits the average person.[1] Competitiveness is driven not only by the macroeconomic environment but also by the quality of the microeconomic business environment and by the quality and sophistication of business strategy and operations.[2]

Competitiveness is not to be confused with natural resource abundance, cheap labor or continued devaluation of the currency. Competitiveness

1. This is the definition most often utilized by competitiveness expert Michael Porter.
2. Ibid.

based on cheap labor is not a formula for boosting prosperity in the long run, especially when productivity is considered relative to neighboring countries, some of which also have relatively cheap labor on a productivity-adjusted basis. Similarly, natural resources and devaluation of the currency may create perceived shortrun advantages, but can actually distract an economy from making the necessary investments to build a dynamic economy that continually invests in itself and innovates to create more and better jobs.

Competitiveness is not simply measured by export growth rates or foreign exchange generation. While these are important generators of government revenues, they do not automatically create large amounts of investment and innovation-driven jobs. Unless the revenues generated from these activities are invested in human capital and in facilitating (but not subsidizing) the emergence of competitive industry clusters, the benefits may not reach the average person.

Professor Porter's model illustrates how a country's potential for competitiveness, and long run economic growth, is created by a sound macroeconomic, political, legal and social context, and a continuous drive to improve the microeconomic environment, foster the sophistication of local companies and increase local competition.

The model also illustrates how Pakistan's future economic growth path will be determined by its ability to support improvements in the business environment and to eliminate cross-cutting, binding constraints to growth.This in turn will enable private sector growth driven by local companies that are successful in raising the sophistication of their operations and strategies and increasing their competitiveness.

The requirements for Pakistan's economic security and growth thus need to be considered in terms of the global competitiveness of the country's businesses, the ability of the enabling environment to support competitive business strategies and operations, and the attractiveness of the country's business environment to domestic and foreign investors.

Figure 1. Determinants of Competitiveness – Selected Examples

Macroeconomic, Political, Legal, and Social Context

Controlled inflation	Primary health and education
Modest budget deficits	Trade policy
Modest debt as % of GDP	National security
Market exchange rates	Judicial independence

Microeconomic Capacity

Sophistication of Company Operations and Strategy	↔	Quality of the Microeconomic Business Environment
Corporate governance		Efficient goverment processes
Customer orientation		Access to skilled labour
Management and staff training		Efficient financial sector
Enterpreneurship training		Enforcement of contracts
Production process sophistication		Local business environment
Supply chain efficiency		Efficient infrastructure
Delegation and authority		Market efficiency
Family firm transitions		Access to technology
Breadth of international markets		Advanced research institutions

Source: Micheal Porter, 2006; Examples selected by JAA

Globalization is an economic reality. Whether Pakistan benefits or is a victim of globalization will depend on its competitiveness. Competitiveness will be key to economic growth which in turn will be key to poverty reduction. The Global Competitiveness Report, with its Business Competitiveness Index and its Global Competitiveness Index are the most widely followed measures of competitiveness in the world today. Therefore, it is important to understand these ingredients of competitiveness, to build on its existing strengths and improve areas that are weak.

1. Explaining Pakistan's Rankings

The objectives of this report are to present the global competitiveness rankings for Pakistan, to explain these results and to focus attention on potential areas of priority for improving competitiveness over the short to medium term. The State of Pakistan's Competitiveness Report can be of use to government policy makers in setting priorities to achieve economic growth and to reduce poverty. The results presented here will interest students, academia, domestic and foreign inventors, economists, lawyers, business professionals and those who live and work within this fascinating and multifaceted economy in transition.

For benchmarking purposes, a total of five comparator countries have been selected. These are: Bangladesh, China, Indonesia, Malaysia, and Sri Lanka. These countries were selected because they all form part of the Asia-Pacific region and have important ties in terms of trade, investment, and regional growth opportunities. Where appropriate, this report also refers to other countries for comparison.

Pakistan ranked 67th on the Business Competitiveness Index and 91st on the Global Competitiveness Index. Pakistan's rank on the GCI improved from 94th to 91st in 2006. This increase is more notable when taking into account the fact that the rankings were based on 117 countries in 2005 and 125 countries in 2006. This means that Pakistan ranked in the 27th percentile in 2006, an improvement on its rank in the 20th percentile in 2005. When taking into consideration its GDP per capita, Pakistan performed quite well on the Business Competitiveness Index (BCI), an index created and managed by Dr. Michael Porter at the Institute for Strategy and Competitiveness of Harvard Business School.

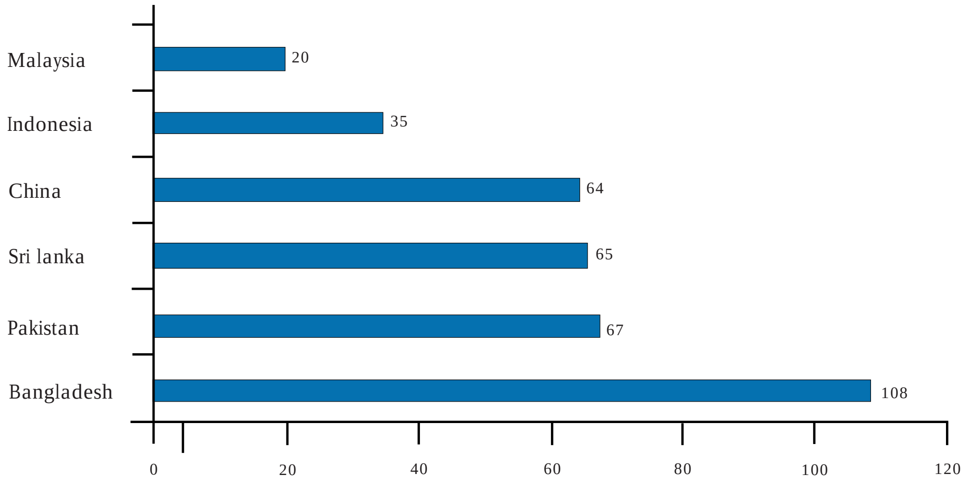
1.1 The Business Competitiveness Index (BCI)

> "Pakistan's improvements so far are concentrated in business environment upgrading, perhaps a reflection of the country's ambitious national competitiveness program"
>
> -- Michael Porter [1]

Pakistan ranks relatively well on the BCI at 67th place out of 121 total countries in the 2006 report just released, the same as its 2005 ranking. Despite many challenges faced by Pakistan, there were 54 countries that ranked lower. This is all the more impressive when one realizes that nearly all highly developed economies are included in the index. Pakistan ranks just barely behind China (64th place) and Sri Lanka (65th place), and above Kazakhstan (70th place) and Russia (79th place). As Pakistan ranks 97th among these countries in GDP per capita, it can be said that Pakistan's businesses outperform expectations based on the country's overall level of development.

Pakistan has improved its BCI ranking over the years from 77th place to 67th place. In 2003 and 2004, Pakistan ranked 75th and 77th respectively, but improved to 67th in the last two years. This improvement is even stronger than it might appear as each year the WEF includes an

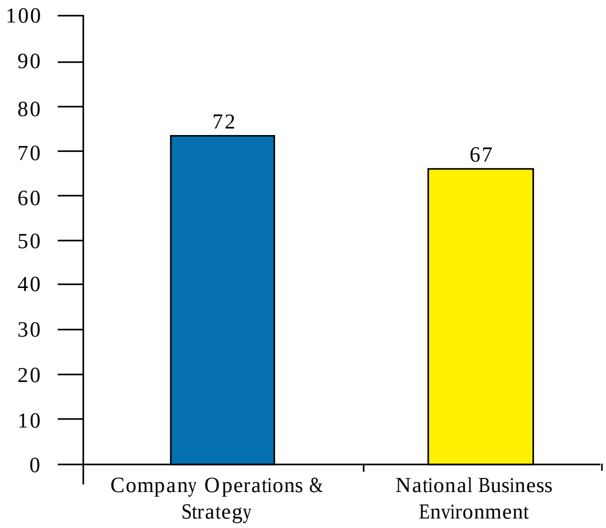
Figure 2. BCI Summary and Comparators for 2006



increasing number of countries in the index. For example, in 2003 Pakistan ranked 75th out of 101 countries, with only 26 countries ranking lower, while in 2006, Pakistan ranked 67th out of 121 countries, meaning it ranked above 54 countries.

There are two components of the BCI: Company operations and strategy and National Business Environment; Pakistan does relatively well on both. There is but little difference between the rankings for the quality of the national business environment (also 67th place) and the rankings for "company operations and strategy" (72nd place). This indicates

Figure 3. BCI Component Ranks for Pakistan



a certain balance in the level of development but it also shows that there is plenty of room for upward progress in both the business environment, where the government can play a key role, and the company and industry level, where business and industry leaders must play the key role. However, according to Dr. Porter's methodology, which included application of sophisticated regression analyses, 83.4% of the weight in the BCI is assigned to the national business environment and the remaining 16.6% comes from the quality of business operations and strategy. This illustrates how critical the business environment is to a country's competitiveness. Of the main comparators countries, Pakistan's scores are very close to the scores of China and Sri Lanka however, they lag behind those received by Malaysia.

Among the 19 low-income countries included in the index, Pakistan ranked 2nd. Pakistan also ranked above 10 middle income countries. In both business environment and business sophistication, Pakistan's performance is at the top of the class among low-income countries.

The country received high marks for "dynamism" and was singled out by Dr. Michael Porter in the 2006 report for its strong recent performance. Country "dynamism" is based on time-series data of 5 factors related to business sophistication and 10 factors for the national business environment that have the greatest impact on GDP per capita. The improvements in key scores have been concentrated in business environment improvements. In singling out Pakistan from the many countries in the data set, Dr. Porter noted that Pakistan's performance is "perhaps a reflection of the country's national competitiveness program."[4]

Pakistan ranks quite well in various areas related to government promotion of innovation and infrastructure. For example, the highest ranking received on the BCI sub-indices were for procurement of advanced technology products (33rd place), railroad infrastructure (37th place), port infrastructure (44th place) and air transport infrastructure (52nd place). Although Pakistan performs well compared to other countries in the region, it falls behind China and Malaysia in these categories.

Table 1. Pakistan's Strengths and Weaknesses in the BCI Index

Strengths	Pakistan	Bangladesh	China	Malysia	Sri Lanka
Business Environment Quality					
Government Procurement of Advanced Technology Products	33	102	22	3	3
Railroad Infrastructure Development	37	67	31	13	13
Port Infrastructure Quality	44	97	57	12	12
Company Sophistication					
Value Chain Presence	38	77	54	21	21
Capacity of Innovation	41	107	44	19	19

Weaknesses	Pakistan	Bangladesh	China	Malysia	Sri Lanka
Business Environment Quality					
Efficacy of Corporate Boards	122	103	117	13	13
Company Sophistication					
Extent of Staff Training	104	113	77	12	12
Willingness to Delegate Authority	107	121	72	15	15
Reliance on Professional Management	91	84	73	14	14
Extent of Incentive Compensation	89	113	64	18	18

4. World Economic Forum, Global Competitiveness Report 2006-2007, page 70-71.

However, the Government could do better in some areas. The low rankings for IT density (106th place) and cell phone density (104th place) indicate a need for attention. The efficiency of the legal framework ranked low, at 91st place, as did judicial independence at 82nd place. The quality of the electrical supply ranked low at 84th place.

Pakistan's private sector ranked well in some areas of strategy and operations. For example, Pakistan's firms ranked highly in "value chain presence" at 38th place. Firms also ranked well in "control of international distribution" at 51st place and spending on R&D (59th place).

However, Pakistan's private sector needs to improve its use of human resources. The country received relatively low marks on the efficacy of corporate boards, where it was last at 122nd, while Malaysia was 13th and India 25th. The survey also demonstrated low ranks for willingness to delegate authority (107th place), while Malaysia placed 15th and India 26th. The extent of staff training is low (104th place) as is the relatively low reliance on professional management (91st place). Once again, Malaysia ranked higher on the extent of staff training (12th place) and reliance on professional management (14th place), as did India (26th and 22nd places, respectively).

There is also relatively low use of incentive compensation, where Pakistan ranked in 89th place, in contrast to Malaysia's high ranking of 18th followed by India in 19th place. While there has been much emphasis on government reforms in Pakistan in recent years, it appears that the private sector also needs some reforming as well, especially in the area of corporate governance and modern approaches to the workforce.

Conclusions from the Business Competitiveness Index

Pakistan ranks relatively high, especially among low-income countries, with relatively high marks given to both the GoP for the national business environment and to Pakistan's relatively competitive private sector for the quality of its operations and strategy. The weak points in the private sector are related to corporate governance and modern management and motivation of the workforce. If these can be improved, productivity will be enhanced. However, improvements in corporate strategy and operations will have limited impact on the BCI ranking since only 16.6% of the total score is related to performance in these areas.

To improve Pakistan's ranking on the BCI in the future, it will be necessary to maintain Pakistan's strengths while improving key areas in which there are weaknesses. Some steps are relatively easy and straightforward, such as improving IT density and cell phone density. These improvements can be made relatively quickly. It will take more time to address perceived weaknesses in the judicial system and the legal framework. Antitrust policy also ranked low and needs to be addressed. By improving regulatory standards and their enforcement, the government can also drive improvements in the business environment.

1.2 The Global Competitiveness Index (GCI)

Pakistan received a GCI ordinal ranking of 91st place in 2006, improving from 94th place in 2005. This result understates the overall ranking among countries as the number of countries included in the rankings increased to 125 from 117. This is still a relatively low score and will focus the attention of Pakistan's government, business, educational and civic leaders on how to address the underlying weaknesses identified in this report. Pakistan's ranking placed it ahead of Bangladesh (99th), but behind Malaysia (26th), India (43rd), Indonesia (50th), China (54th), and Sri Lanka (79th). However, Pakistan's ranking is better than it first appears when the addition of new countries is taken into account.

The GCI has nine sub-components, or pillars, falling into three major groupings. These nine "pillars" are institutions, infrastructure, macroeconomy, health and primary education, higher education and training, market efficiency, technological readiness, business sophistication and innovation. The first four pillars are grouped under the Basic Requirments Category. The fifth, sixth, and seventh pillars fall under the Efficiency Enhancers category, while the last two pillars are grouped under Innovation Factors. Pakistan's ranks for each are found in Figure 4.

Figure 4. Pakistan's Performance on the Nine Pillars of the Global Competitiveness Index, 2006 and 2007

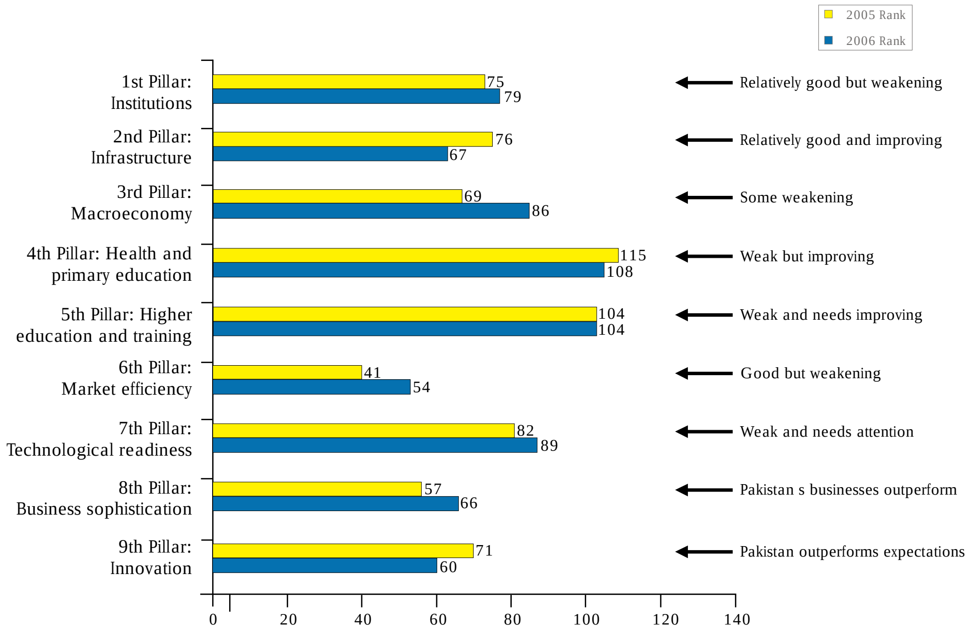
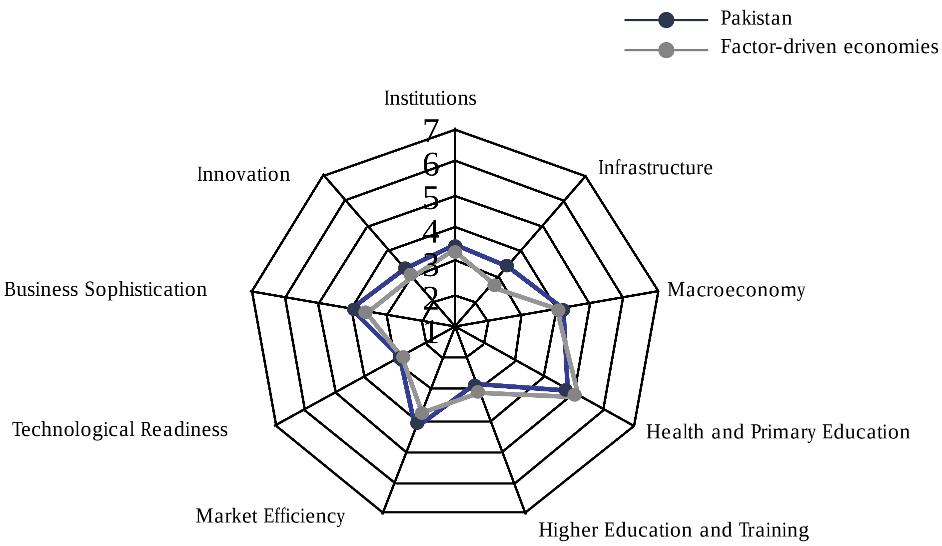


Figure 5. Pakistan's Performance on the Nice Pillars Compared to Other Factor-Driven Economies

(Source out of 7:7 = Best)



The GCI takes into account the concept that countries at different stages of development have different drivers of competitiveness. The stages of development are factor-driven, efficiency-driven, and innovation-driven. Factor-driven economies such as Pakistan are characterized by competition based on factor endowments, such as unskilled labor and natural resources. At this stage, the GCR states that competitiveness is contingent upon a well-managed macroeconomic framework, strong institutions, adequate infrastructure, and a capable workforce. In the above graph, Pakistan is compared to the average of factor-driven economies, which illustrates that Pakistan ranks above or equal to the average for factor-driven economies on all nine pillars.

Table 2. GCI Pillars and Comparators

	Pakistan	Bangladesh	China	India	Malysia	Sri Lanka
Institutions	79	121	80	34	18	82
Infrastructure	67	117	60	62	23	76
Macroeconomy	86	47	50	88	31	110
Health and Primary Education	108	90	55	93	42	36
Higher Education and Training	104	108	77	49	32	81
Market Efficiency	54	83	56	21	9	71
Technological Readiness	89	114	75	55	28	83
Business Sophistication	66	96	65	25	20	71
Innovation	60	109	46	26	21	53

In Table 2, Pakistan's performance on the nine pillars is benchmarked to all comparator countries.

Government, business, education and civic leaders need to focus attention on improving Pakistan's competitiveness. While one can debate specific aspects of the methodology, the overall conclusion from the study remains quite valid – much can and should be done to improve Pakistan's competitiveness and the GCR helps reveal areas of strength, weaknesses and priority for leaders seeking to improve the long-term economic prospects of the country. The GCR is a rich source of data on the Pakistan, perhaps the richest source from which Pakistan can compare its performance with many other countries. It is therefore important to explore the GCR in more detail to gain insight into particular areas of country performance.

Table 3. Pakistan's Strengths and Weaknesses in the GCI Index

Strengths	Pakistan	Bangladesh	China	Indonesia	Malysia	Sri Lanka
Infrastructure						
Railroad Inftrastructure Development	39	68	33	64	17	61
Macroeconomy						
Interest Rate Spead	37	63	25	66	20	55
Real Effective Exchange Rate	45	14	29	83	30	60
Market Efficiency						
Hiring and Firing Practices	26	25	50	77	59	99
Time Required to Start a Business	30	54	81	113	40	86
Extent and Effect of Taxation	33	48	46	11	12	73
Ease of access to loans	42	102	99	6	23	54
Business Sophistication						
Value Chain Presence	47	80	56	82	23	57
Innovation						
Capacity for Innovation	38	118	43	59	23	46
Government Procurement of Advanced Tehcnology Products	47	105	21	23	2	66

Weaknesses	Pakistan	Bangladesh	China	Indonesia	Malysia	Sri Lanka
Institutions						
Efficacy of Corporate Boards	123	107	119	24	19	82
Property Rights	98	87	82	90	24	63
Health and Primary Education						
Primary Encrollment	112	55	48	49	44	31
Infant Mortality	109	96	75	81	43	48
Tuberculosis Prevalence	101	105	92	96	78	69
Higher Education and Training						
Teritiary Enrollment	106	100	77	83	61	106
Extent of Staff Training	91	113	77	40	12	79
Technological Readiness						
Cellular Telephones(Subcriber per 100 inhabitants), 2004	115	119	76	92	48	95
Personal Computers (personal computers per 100 inhabitants), 2004	113	101	80	89	35	87
Internet Users (Internet users per 10,000 inhabitants), 2004	107	122	76	80	32	104
Market Efficiency						
Efficiency of Legal Framework	95	91	79	26	20	61
Extent of Incentive Compensation	94	113	62	17	18	71

Pakistan ranked in the 27^{th} percentile of countries listed in 2006, up from the 20^{th} percentile in 2005. To be able to truly compare Pakistan's performance from year to year when the number of countries changes, it is necessary to create a percentile scale that takes into account the variable number of countries included in the GCI in any given year. For example, if 125 countries are included, the 12^{th} lowest country would rank in the bottom 10^{th} percentile. By assembling the rankings into percentiles, one finds that Pakistan ranked just below the 20^{th} percentile in 2005 but was able to increase its rank among nations to score in the 27^{th} percentile of nations included in 2006. Among the family of nations included in the GCR, Pakistan has risen from its position from the bottom fifth of countries to the top three-fourths of countries in part because the class is now larger.

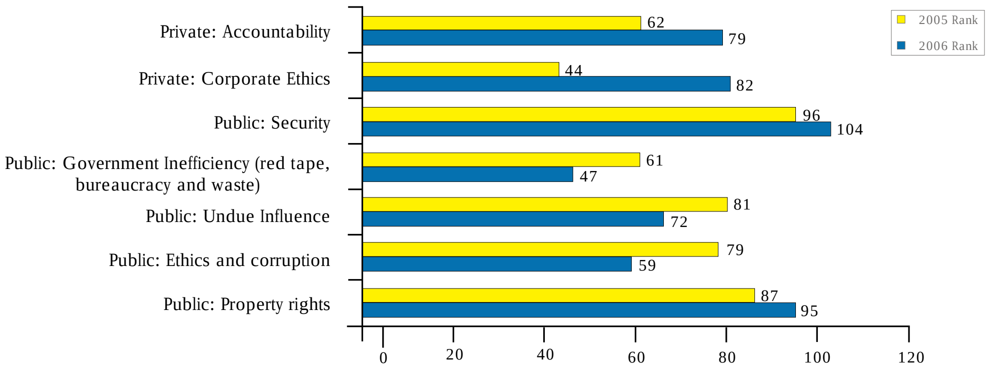
Changes in methodology in part explain Pakistan's continued low GCI ranking. The Global Competitiveness Index replaced the former "Growth Competitiveness Index" used by the World Economic Forum in prior years. Scores for this earlier index were again reported in the current GCR. Pakistan ranked consistently higher in the Growth Competitiveness Index, scoring in 84^{th} place or among the top 67.5% of countries ranked. This ranking was fairly consistent with the 83^{rd} place ranking of last year. Therefore, Pakistan's low ranking on the GCI is partly explained by the methodology used and especially by the weights assigned to different variables. In the new index, Pakistan's ranking slips seven places, from 84 to 91. The new index, however, is more comprehensive than the index it replaced.

The new index is more multi-faceted and takes into account the drivers of competitiveness at different stages of economic development. New factors that have been incorporated into the GCI include dynamism in upgrading competitiveness, weighting of scores on pillars depending on the stage of development in which the country is operating, and new indicators for measuring capacity building and workforce development.

Pakistan's strongest rankings relate to market efficiency (54th place), innovation (60th place) and business sophistication (66th place). Pakistan ranked well in railroad infrastructure development (39th), not far behind China (33rd). Pakistan's macroeconomy ranking is also strong in interest rate spread (37th) and real effective exchange rate (45th); both rankings are behind China, but ahead of Sri Lanka. In market efficiency, Pakistan was stronger then comparators in the time required to start a business (30th), and extent and effect of taxation (33rd). Pakistan also ranked higher than its comparators in value chain presence (47th) and capacity for innovation (38th). The weakest rankings were registered in health and primary education (108th) and in higher education and training (104th).

The biggest improvement was in the ranking for innovation. Pakistan improved from 71st to 60th place. While some areas saw Pakistan slipping, such as in the macroeconomy, the overall changes cancelled each other out or were slightly positive. As is evident from the summary table, Pakistan needs to focus on the health and primary education pillar and the higher education and training pillar if it is to dramatically improve its overall ranking while also improving its technological readiness ranking and addressing recent slides on macroeconomic scores.

Figure 6. Change in GCI Rank on Institutions 2005–2006



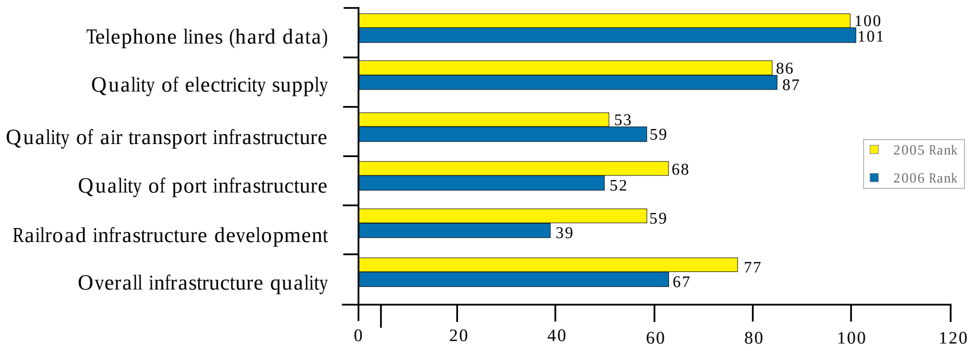
Pillar 1: Institutions

There has been a marked increase in confidence in Government and public institutions and a decreasing confidence in private institutions. Perhaps the most dramatic shift in the survey in 2006 was the score for increased efficiency of government (removal of red tape), decreases in the level of undue influence of government on company operations, and improvement in ethical and corruption standards. On the other hand, there has been a decline in confidence in private institutions related to corporate ethics and accountability. Pakistan's ranking of 79th is ahead of China (80th), Sri Lanka (82nd), and Bangladesh (121st), but behind Malaysia (18th), India (34th), and Indonesia (52nd).

Pillar 2: Infrastructure

Pakistan scored very well on rail, port and transport infrastructure. These were among the highest scores received in the GCR. However, the number of fixed telephone lines was ranked at 101st place and the quality of the electrical supply was also well below average, at 87th place. China ranked higher in the number of fixed telephone lines (52rd), while Bangladesh registered the lowest ranking of 115th. The quality of electrical supply was highest in Malaysia (33rd), and lowest in Bangladesh (121st). Pakistan's overall ranking in Infrastructure was 67th, placing it ahead of Bangladesh (117th), Sri Lanka (76th), and Indonesia (89th), but behind the rest of the comparators. Malaysia led all comparators with a ranking of 23.

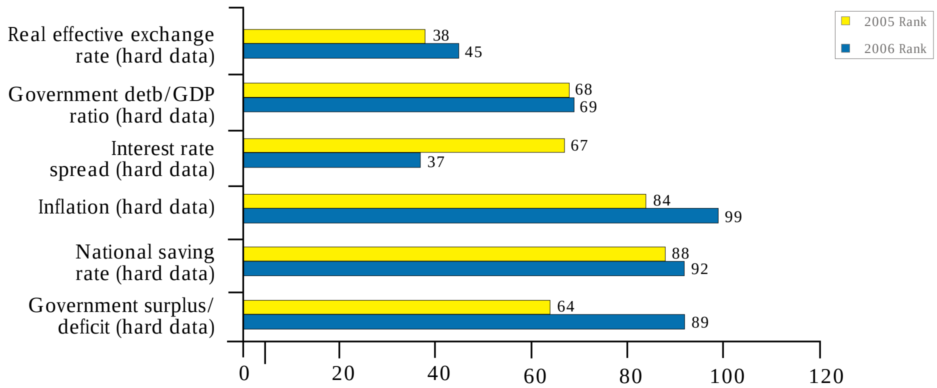
Figure 7. Change in GCI Rank on Infrastructure 2005–2006



Pillar 3: Macroeconomy

Despite relatively good overall macroeconomic performance in terms of GDP growth and poverty alleviation, Pakistan's ranking for the macroeconomy pillar declined somewhat in 2006. Pakistan's macroeconomy ranking was 86th, placing it ahead of Sri Lanka (110th) and India (88th), but behind the other comparators. Malaysia had the highest ranking among them at 31. One of the main factors that explains Pakistan's lower score was an increase in inflation rates (99th place), well below China's high ranking of 16. The relatively low national savings rate and an increase in the government budget deficit also contributed to decline in the 2006 ranking. However, there was good progress in narrowing the interest rate spread and high scores continued for a realistic real effective exchange rate.

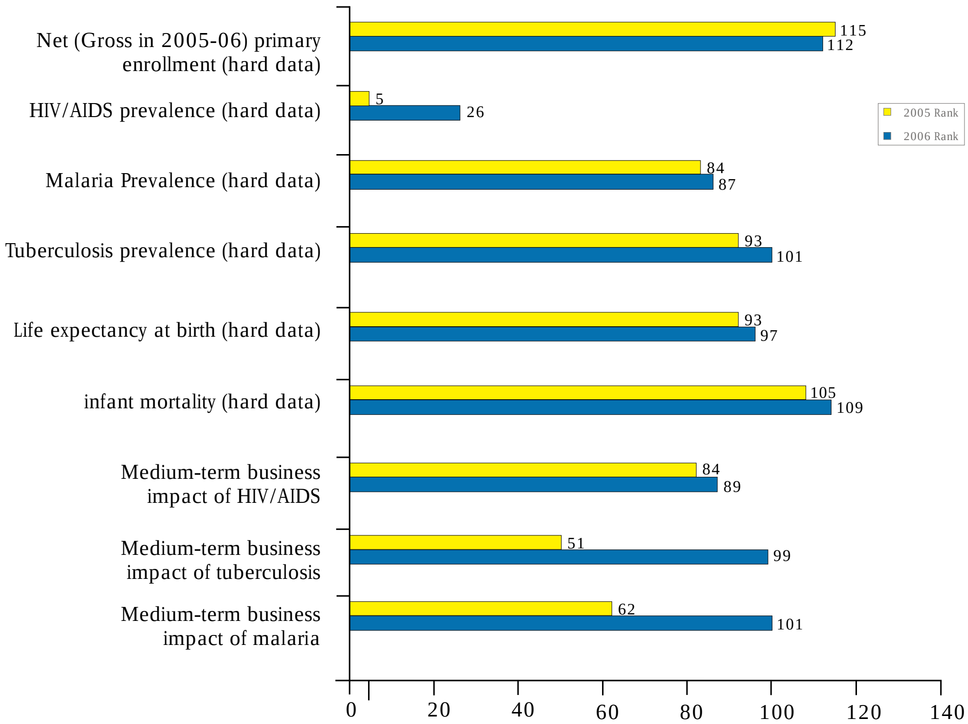
Figure 8. Change in GCI Rank on Macroeconomy 2005–2006



Pillar 4: Health & Primary Education

Pakistan shows great weakness in health and primary education. Pakistan's overall ranking of 108 placed it last among its comparators, while Sri Lanka registered the highest ranking (36th). The worst ranking in this pillar was in primary school enrollment, a score based on hard data. However, there was a slight improvement from 115th to 112th place, reflecting GoP efforts to improve primary education coverage. This ranking was well behind all other comparators, including Sri Lanka's high ranking of 31. Infant mortality scores in many countries are being reduced and Pakistan will need to make even greater effort to improve its scores relative to other countries. Prevalence of reported HIV cases increased enough to cause Pakistan to move from 5th place to 26th place and rankings for malaria and tuberculosis also showed some backward movement. The assessment of the medium term impact of tuberculosis also showed a major change in ranking from 51st place to 99th place, showing that those surveyed had become more acutely aware of increases in tuberculosis. The concern regarding the medium term impact of HIV would seem out of proportion to the current statistical prevalence.

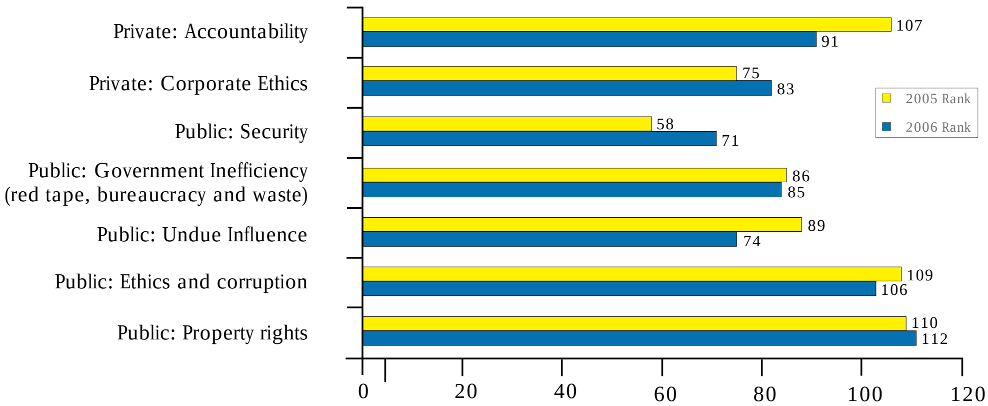
Figure 9. Change in GCI Rank in Health and Primary Education 2005–2006



Pillar 5: Higher Education and Training

Low gross enrollment figures for secondary and tertiary education bring down Pakistan's rankings for Pillar 5. Pakistan also registers a low ranking in this pillar (104th), trailed only by Bangladesh in 108th place. Malaysia ranked highest at 32nd. These rankings, based on hard data, place Pakistan far behind the majority of countries. While quantity of enrollment was Pakistan's weak spot, the perceived quality of the educational system improved to 74th place, trailed by China (87th) and Bangladesh (102nd). One area of marked improvement is staff training. A bright spot is the quality of management schools, at 71st place.

Figure 10. Change in GCI Rank on Higher Education and Training 2005–2006

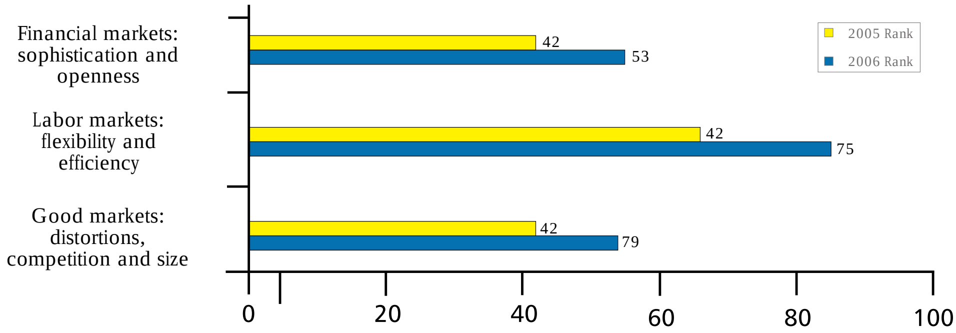


Pillar 6: Market Efficiency

Pakistan highest ranking pillar was in market efficiency. The perceived financial market sophistication and openness ranked well at 55th place, ahead of all comparators except Malaysia in 31st place and India in 32nd place. Pakistan also ranked well in the efficiency of the goods markets in terms of lack of distortions, competition and size (54th place), placing it ahead of Sri Lanka (67th), and Bangladesh (65th). This year, the perception of labor market flexibility worsened from 65th place to 85th place, with

Malaysia (22nd), Bangladesh (36th), and Indonesia (42nd) scoring higher. Pakistan's overall ranking for market efficiency was 54, ahead of China (56th), Sri Lanka (71st) and Bangladesh (83rd), but behind Malaysia (9th), India (21st), and Indonesia (27th).

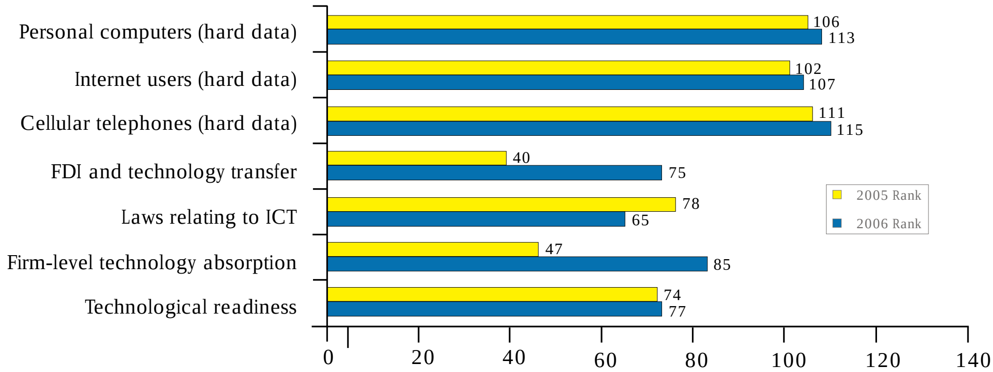
Figure 11. Change in GCI Rank on Market Efficiency 2005–2006



Pillar 7: Technological Readiness

Pakistan's ranking on technological readiness is brought down by low scores on the penetration of computers, the Internet and cell phones — all based on hard data. Rankings for these three areas ranged from 107th to 115th and showed slight deterioration relative to other countries which are advancing more rapidly in the dissemination and utilization of these technologies. Although Pakistan has more cell phones this year than last, other countries are achieving higher density of utilization more quickly. Studies have indicated that cell phone utilization can improve the productivity and incomes of even low-income farmers in rural areas.Improvements in cell phone distribution can be achieved relatively quickly with very simple changes in government policy. Initiatives such as "one child – one computer" pioneered by the Media Lab of the Massachusetts Institute of Technology also indicate the possibility of improving computer utilization. There were marked changes in perceptions regarding firm-level technology absorption and technology transfer via foreign direct investment, with rankings deteriorating sharply from 2005. Pakistan's overall ranking is 89th. Malaysia scores the highest in 28th place, while Bangladesh ranked the lowest in 114th.

Figure 12. Change in GCI Rank on Technology Readiness 2005–2006

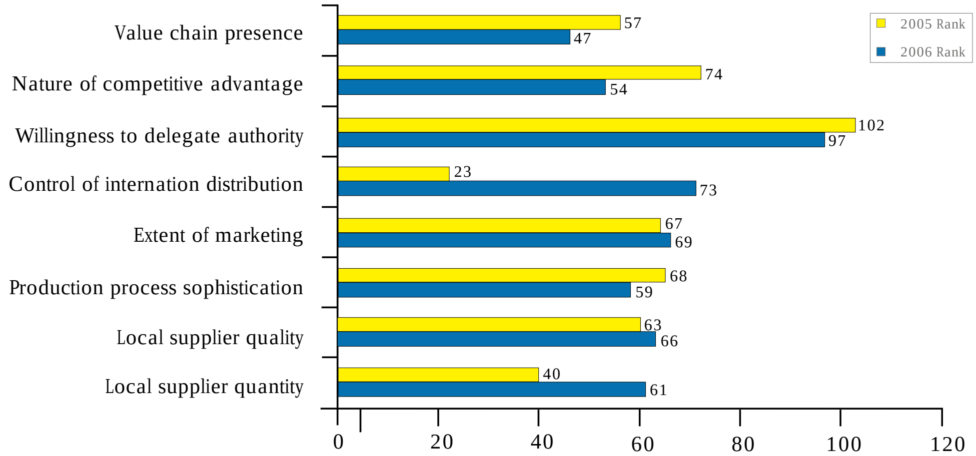


Pillar 8: Business Sophistication

Pakistan ranked relatively well on business sophistication, improving its ranking from 57th to 47th place. Pakistan did particularly well with regard to value chain presence and the nature of competitive advantage. However, Pakistani firms ranked much worse, at 97th place, on willingness to delegate authority [5], as compared to the high ranking of 21 achieved by Indonesia. There was a negative change in the perception regarding the control of internal distribution by companies and local supplier quantity. Pakistan's overall ranking on the Business Sophistication pillar is 66, just behind China (65th). The highest ranking was achieved by Malaysia (20th), while the lowest ranking was Bangladesh in 96th place.

5. In the GCR 2006-2007, willingness to delegate authority to subordinates is ranked from a lowest score of 1 (top management controls all important decisions) to a top score of 7 (authority is mostly delegated to business unit heads and other lower-level managers).

Figure 13. Change in GCI Rank on Business Sophistication 2005–2006



Pakistan's Most Problematic Factors for Doing Business: As shown in Table 4, Pakistan registers weak scores in most of the categories related to ease of doing business. On a scale of 1 to 7 with 7 being the best score, Pakistan scores a 4 in business costs of corruption, while Indonesia shows a high of 5.3 and Sri Lanka registers a low of 2.8, based on a compilation of survey responses from business people. With respect to credit ratings, Pakistan is on the low side with a score of 34.7. China has the highest credit rating of 93.5 among the comparators, while Bangladesh has the lowest at 28.5. At 9.1%, Pakistan is among the countries with the highest levels of inflation, along with Indonesia (10.5%), and Sri Lanka (10.6%). China has the lowest inflation rate of 1.8%.

Pakistan scores mid-range among its comparators in terms of the number of procedures required to start a business, with 11 (compared to Bangladesh and Sri Lanka which at 8 have the least, and China which has the most at 13). However, it beats its comparator countries in terms of the number of days needed to start a business. It takes 24 days in Pakistan to start a business, with the other countries ranging from 34 to 151. In the efficiency of its legal frame-work, Pakistan scores quite low (3 on a scale of 1 to 7, with the best score being 7) compared to Malaysia which had the best score at 5.4. In terms of technological readiness, Pakistan (3.4 on a scale of 1 to 7 with 7 being the best) is more or less at the same level as China (3.6) and Sri Lanka (3.3), but it lags behind Malaysia (5.5).

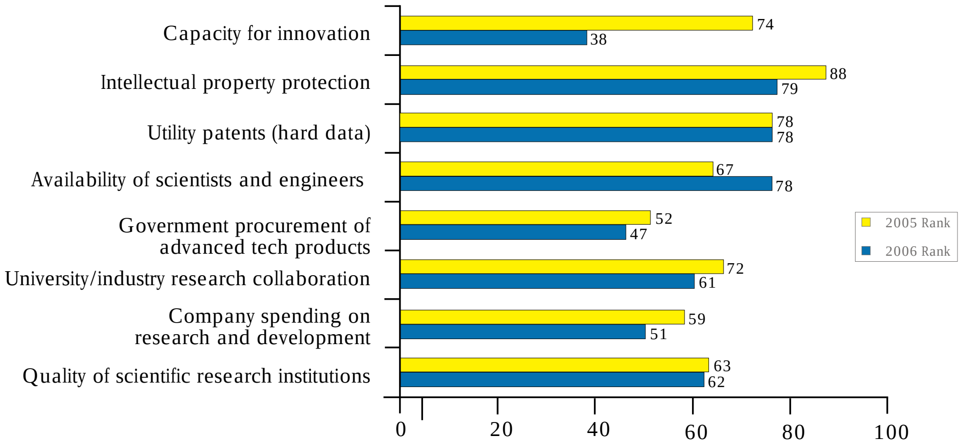
Table 4. Most Problematic Factors for Doing Business in Pakistan

	Pakistan	Bangladesh	China	Indonesia	Malaysia	Sri Lanka
Business Costs Corruption (1 = significant negative impact, 7 = no impact)	4	2.8	3.8	5.3	5.2	3.6
Country Credit Rating	34.7	28.5	69.8	41.8	69.7	35
Inflation	9.1	7	1.8	10.5	3	10.6
Number of Procedures to Start a Business	11	8	13	12	9	8
Time to Start a Business (in days)	24	35	48	151	30	50
Efficiency of Legal Framework (1 = inefficient, 7 = efficient and neutral)	3	2.8	3.4	3.4	5.4	3.6
Technological Readiness (1 = lags behind, 7 = among world leaders)	3.4	2.5	3.6	4.3	5.5	3.3

Pillar 9: Innovation

Pakistan ranked well in most innovation-related categories. The highest ranking in this group was for the capacity for innovation (38th place), which measures whether companies mostly produce through licensing or imitation or whether they are undertaking formal research and developing new products. Pakistan also ranks well on government spending on R&D (47th place) and company spending on R&D (51st place), which boosts its score on capacity to innovate. Indonesia, India, Malaysia, and China rank higher in government and company spending on R&D, while only India and Malaysia rank higher in capacity for innovation. All other ranks in this category for Pakistan were in the 60s and 70s, significantly above Pakistan's overall country ranking. The overall rank for Pakistan was 60th, placing it ahead of Bangladesh (109th), but behind the rest of the comparators. The highest ranking among the group was registered by Malaysia at 21st place.

Figure 14. Change in GCI Rank on Innovation 2005–2006



Conclusions

Pakistan's ranking reflects relatively low scores for "basic requirements" and "efficiency enhancers" but relatively high scores for "innovation factors." Because of the higher weights assigned to the first two pillars for countries at relatively low income levels, Pakistan's score is somewhat lower than it would be had all weights been assigned equally. Pakistan's strength in innovation, discussed below, can be maintained while more attention is given to basic factors and efficiency enhancers.

Pakistan can improve some of its low rankings very quickly. Improvements achievable in the short term include the promotion of cell phone, computer and Internet usage. Other short term improvements can be registered in the area of macroeconomic indicators, especially reduction in government budget deficits and inflation. It may also be possible to improve some health scores quickly such as the prevalence of tuberculosis or even infant mortality, provided the appropriate public health measures are taken.

Some improvements will require long-term sustained effort, such as expanding primary, secondary and tertiary enrollments. The government focus on improved access to health and education should make a steady positive impact on the basic health indicators over the medium term.

Pakistan's relative strength in innovation and business sophistication is impressive but does not advance Pakistan's ranking as much as it might because these scores are not given significant weight for low-income countries.

Pakistan can also advance its score by reinforcing its recent progress in public confidence of government institutions while focusing in improving corporate governance and the judicial system.

Private sector leaders can improve competitiveness by focusing on corporate governance and modern management of human resources.

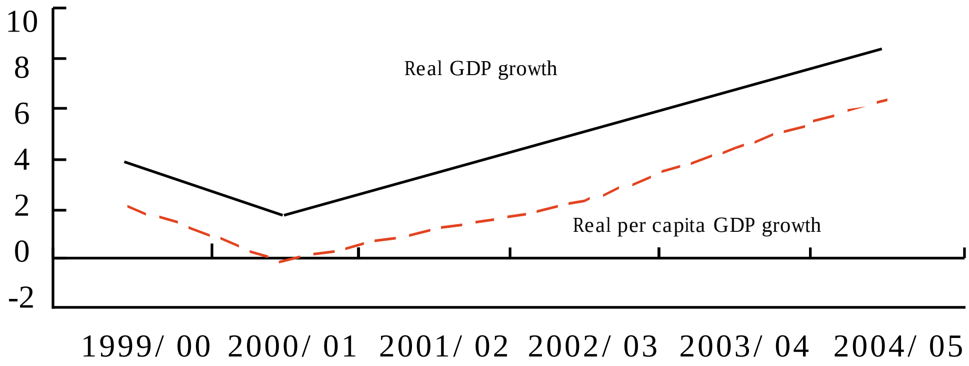
2. Enabling Pakistan’s Competitiveness

Since 2001, Pakistan has been among the fastest growing Asian economies, achieving annual growth of over 6 percent in the past four years, and proving itself resilient to external shocks such as the devastating 2005 earthquake and sharp increases in the international price for oil. For eleven years the country served as the base of support for the war in Afghanistan against the Soviet Union; it acted as host to 3.5 million Afghan refugees, many of whom still remain. In 2005, it was struck by a devastating earthquake that destroyed much of the infrastructure in a wide swath of the northern districts and Azad Kashmir, killed an estimated 80,000 persons, and left several hundred thousand homeless and be left of their assets. These people have to be fed, clothed, housed, and cared for until their villages, roads, and other infrastructure are rebuilt. In the current year it was hit by a 35% rise in the price of crude oil. Yet the economy continues to expand, with GDP growing by 6.6% in real terms during 2005/ 06. The fundamental economic task for the government is to continue this momentum while making it more secure and broad-based.

Disciplined macroeconomic management and the implementation of first generation economic reforms have led to increased confidence in the macro-environment and increased efficiency in both the public and private sector. The country recorded significant progress in controlling the external deficit, continuing to liberalize the trade regime, reducing the fiscal deficit as a percent of GDP, lowering the ratio of debt to GDP, substantially increasing external reserves, bringing inflation under control, and increasing expenditure on the social sectors.

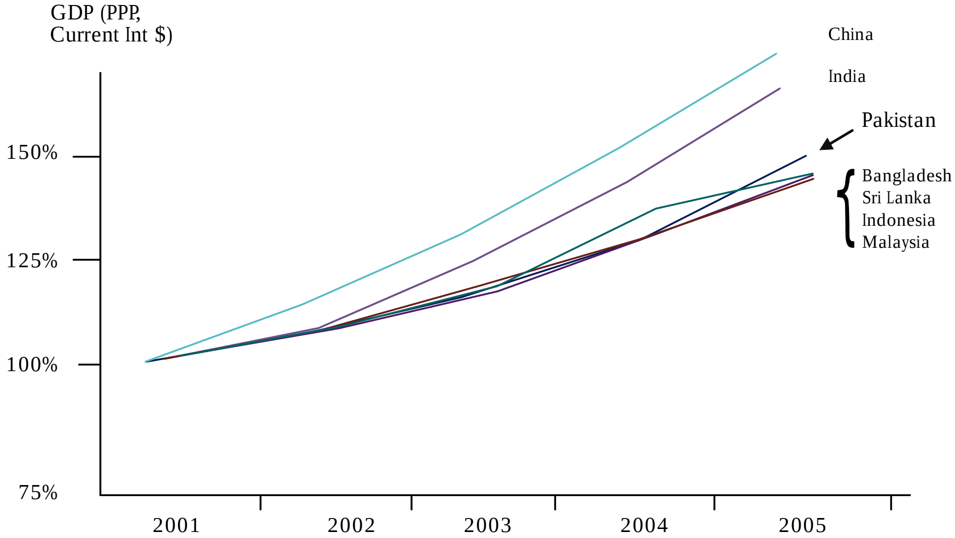
Since 1998/ 99, Pakistan's economy has turned around dramatically. During 1996/ 97 to 1998/ 99, per capita GDP growth averaged less than 1% a year. The country's external accounts were subject to extreme pressures. By the end of that period, foreign exchange reserves covered barely four weeks of imports. Public debt had risen to about 90% of GDP; this is well above the level of 60% beyond which multilateral financial agencies become seriously concerned. A more immediate problem was that the burden of servicing the debt increased, and in 1998 the country

Figure 15. Pakistan: Economic Growth, 1999/ 2000–2004/ 2005.



Source: IMF

Figure 16. Regional Growth in GDP since 2001



Source: World Bank 2006, JAA Calculations

could not meet all its debt service obligations. The deteriorating macroeconomic situation took its toll on the social indicators — the proportion of the population living below the official poverty line increased from 25% in the early 1990s to 32% in 2000/ 01.

The new government that assumed office in 1999 moved swiftly to change direction. It took advantage of the debt relief offered by creditors and supported by programs from the IMF and the World Bank, put in place macroeconomic policies and institutional and regulatory reforms that stabilized the situation and strengthened the drivers of growth.

The government strategy, developed in coordination with major multilateral organizations, had three main objectives: to accelerate the economy's growth; to shield it against external shocks; and to reduce the extent of poverty in the country. The government deployed all the standard tools of stabilization, while also strengthening structural reforms. It introduced policies that impacted on its objectives in multiple ways. Fiscal reforms increased revenues and reduced transfers to state-owned enterprises; this not only reduced the budget deficit but also freed up resources for the social sectors. Monetary policy was tightened; this not only helped to control inflation, but also established a more competitive real effective exchange rate that worked towards building up foreign exchange reserves as a cushion against external shocks. Structural reforms, including the privatization of public enterprises, reinforced the private sector's confidence that it would once again be assured of its role as the leading engine of economic growth.

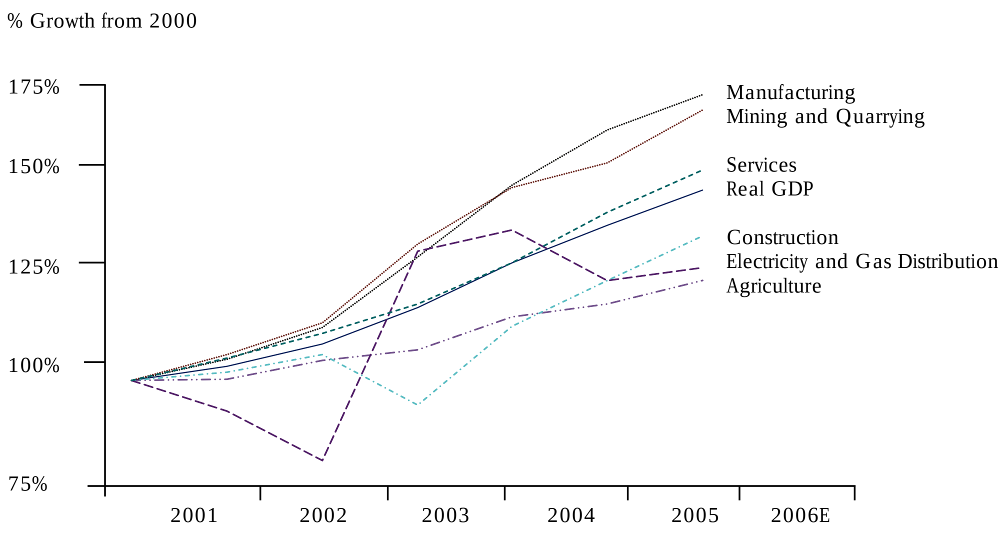
These measures quickly reversed the decline that had set in at the end of the 1990s. The growth of GDP per capita (in real terms) increased to over 6% in 2004/ 05 compared with essentially zero in 2000/ 01 (see Figure 15). The main generators of growth were manufacturing, exports, and services. The recovery was supported by substantial increases in agricultural production. Much of the growth of the GDP came from increases in productivity, since from 1999/ 2000 the investment ratio remained more or less constant at 16 –17% of GDP.

In the early part of the recovery, a boom in exports acted as the main propellant of GDP growth. Thereafter, private consumption (benefiting from rising real incomes) became increasingly important, and by 2004/ 05 domestic demand became the most important source of GDP growth. The accelerating economy inevitably induced a surge in imports, so that the current account balance (excluding official transfers) dipped to a deficit of almost 2 percent in 2004/ 05. This level of deficit can be comfortably financed through official transfers and other sources of funds (such as receipts from privatization). However, the authorities are monitoring these trends in order to ensure that the level of the deficit is kept within manageable bounds, and that its composition is not unduly skewed towards the import of consumer goods.

2.1 The Generators of Economic Growth

A main driver of economic growth has been the strong expansion in manufacturing and services, with construction and mining accelerating in the past two years. After a growth spurt in 2003 and 2004, growth in manufacturing is leveling off. However, the slowdown in manufacturing has been countered by high rates of growth in services, construction and mining, and quarrying. Investments in electricity and gas distribution are expected to come on line in the next three to four years.

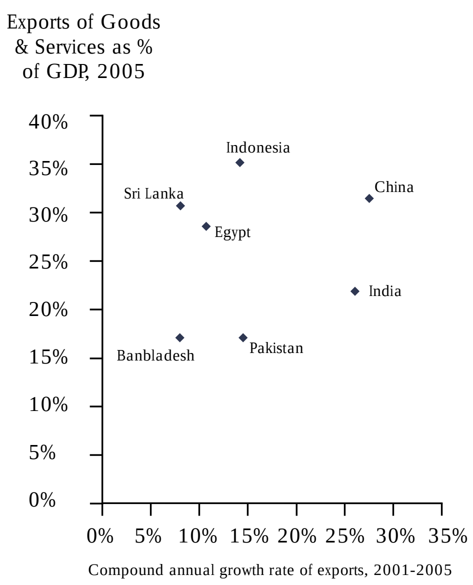
Figure 17. Sector Growth Since 2000



Another major impetus to growth came from exports, which have grown at double-digit rates since 2001. However, recent figures indicate that the new trade environment and market dynamics are placing significant pressure on the volumes in traditional export sectors and leading to a short-term deterioration of the export values. The stable macro environment and the improving banking system are enabling the private sector to make the investments needed to increase productivity and firm-level competitiveness, but this alone will not be enough. Improvements to infrastructure and the business environment are seen as key to reducing the competitive disadvantage to exporters, especially in the textile and light manufacturing industries. Focused attention from public and private sector leaders on releasing the export base will be critical to sustaining and accelerating export driven growth. Pakistan will have to continue making the necessary investments to attract a high value export base.

The government has been successful in attracting FDI, which has grown at an impressive rate. However, this year only 7% was in manufacturing and much of the FDI is from the sale of assets and investments in the telecommunications infrastructure. Attracting foreign investment in productive sectors will be an important component of future growth.

Figure 18. Export Performance Since 2001

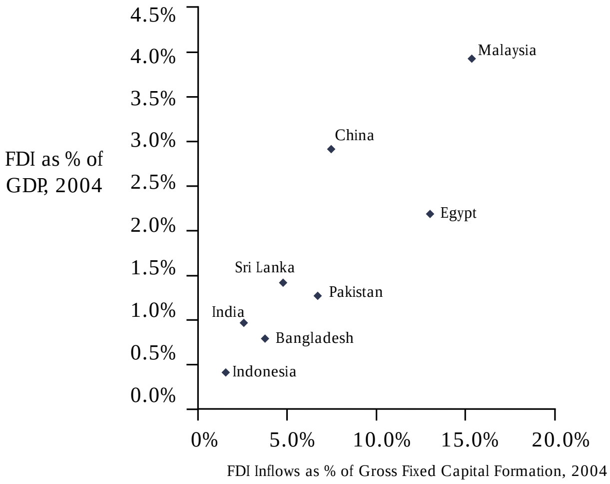


Source: World Bank 2006, JAA Calculations.
Note: China and India figures represent only 2001-2004.

Macroeconomic balance was in large measure achieved by greatly improved fiscal discipline. Government spending as a percentage of GDP dropped from 26% in 1991 to 17% in 2004/ 05.[6] In the past year, inflation

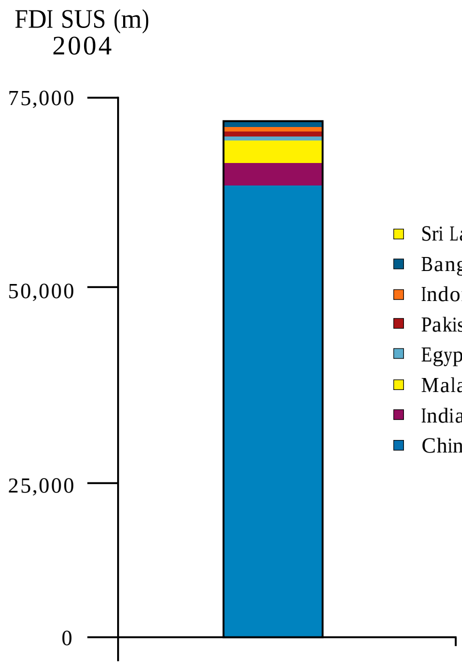
[6] UBS Report

Figure 19. FDI Performance 2004



Source: World Bank 2006, JAA Calculations

Figure 20. FDI inthe Region 2004



	FDI SUS (m) 2004	FDI SUS (m) 2004
Sri Lanka	233	8.8%
Bangladesh	449	193.8%
Indonesia	1,023	165.6%
Pakistan	1,118	16.6%
Egypt, Arab Rep.	1,253	39.2%
Malaysia	4,624	20.2%
India	5,335	-2.6%
China	54,936	5.6%

Source: World Bank 2006, JAA Calculations decreased from 9.3% to 7.9%, and it is projected to decrease further to 6.5% in 2007. In the past six years, the debt/ GDP ratio dropped from over 90% in 2000/ 01 to under 60 percent in 2004/ 05. The fiscal deficit, which from the 1970s to the 1990s hovered around 7– 8% of GDP, was cut to less than half that level. Despite the recent increase in spending to support the earthquake recovery, to strengthen security, and invest in upgrading of infrastructure, the deficit remains under control. In March 2006, the GoP successfully issued 10 - and 30 - year sovereign bonds to the international market totaling USD 800 million, reflecting the established confidence in Pakistan from the international investor community. Government policies managed to greatly reduce external vulnerabilities. The budgetary improvements and the external debt relief combined to

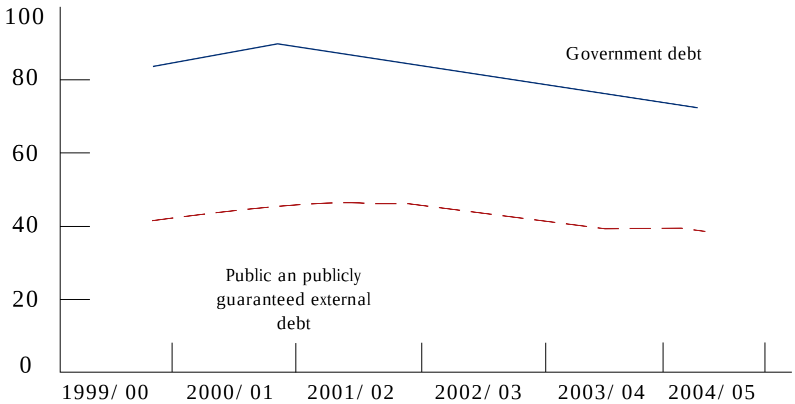
Table 5. Fiscal Performance, 1998/ 99–2004/ 05

	1998/ 99	1999/ 00	2000/ 01	2001/ 02	2002/ 03	2003/ 04	2004/ 05
Tax revenue	11.0	10.7	10.6	10.9	11.5	11.0	10.0
Nontax revenue	2.4	2.8	2.7	3.3	3.4	3.3	4.1
Defense related reciepts	0.0	0.0	0.0	0.0	1.1	0.8	1.0 1/
Grants	0.4	0.9	1.0	1.9	2.5	0.6	0.8
Expenditure	18.1	18.7	17.2	20.0	18.5	17.3	16.9
Current Expenditure	15.7	16.5	15.5	15.9	16.6	14.0	13.6
of which:							
Interest payments	6.0	6.5	5.6	5.6	4.3	3.5	3.4
Domestic	4.9	5.2	4.4	2.2	3.5	2.8	2.8
Foreign	1.1	1.2	1.2	1.4	0.8	0.7	0.6
Defense	3.5	4.0	2.5	3.4	3.3	3.3	3.3
Development Expenditure and net lending	2.5	2.2	1.7	4.0	1.8	3.3	3.3
Budget balance (including grants)	-4.6	-4.6	-3.3	-3.6	-1.4	-1.8	-2.0

Source: National authorities; and Fund staff projections and calculations.
1/ Figure for end March 2005

reduce the ratio of external public and publicly guaranteed debt to GDP to 28% by end-2004/ 05, from 45% in 2001/ 02. Export growth and higher remittances from expatriate Pakistanis (the latter encouraged by a realistic exchange rate and the improving macroeconomic situation) greatly strengthened the balance of payments, so that by the end of fiscal year 2004/ 05 international reserves covered nearly five months of imports of goods and nonfactor services. This level of reserves also reduced the vulnerability of the economy against sudden outflows of capital, because they covered over 250% of short-term external liabilities, compared with 11% in 1999/ 2000.

Figure 21. Debt Indicators, 1999/ 2000–2004/ 2005



Source: IMF

Table 6. Pakistan Current Account Performance 1998/ 99–2004/ 05

	1998/ 99	1999/ 00	2000/ 01	2001/ 02	2002/ 03	2003/ 04	2004/ 05
Current Account (Excluding official transfers)	-3.8	-2.9	-2.7	0.1	3.8	1.4	-1.8
Balance of trade and non-factor services	-4.1	-3.0	-3.2	-0.8	-0.4	-2.7	-6.8
Interest payments	2.1	2.2	2.3	2.2	1.5	1.1	0.9
Private transfers (net)	2.8	2.7	3.4	4.2	6.9	6.4	7.1

Source: State Bank of Pakistan; Ministry of Finance; and Fund Staff estimates.

Structural reforms gained additional thrust. Some liberalizing reforms had been initiated before 1999; these were largely aimed at easing constraints on interest rates, trade, and the capital account. After 1999, the liberalization of the trade and exchange-rate regimes accelerated, and financial sector reform was given a vigorous boost. Pakistan's banking sector is now mostly in private hands, and has become notably more efficient. The government has also reinforced supervision and improved the prudential regulation of this sector. The tax and customs administration has been strengthened, and customs tariffs and tax rates reduced and rationalized. The regulatory framework in a number of key sectors — particularly telecommunications, electricity, and oil and gas — has been improved. These reforms have been sustained, and thus the environment of uncertainty surrounding macroeconomic policy that prevented entrepreneurs from planning for the long term has diminished significantly. Business confidence has therefore increased and the investment climate improved.

However, continued vigilance, discipline, and careful management are required, given current conditions. The high growth of domestic demand has led to a significant increase in the current account and trade deficits. Currently the deficits are being financed through one-off investment flows — this is unsustainable in the long run and will require adjustments of monetary and/or exchange rate policies.

2.2 Social Indicators

Despite recent improvements in the poverty picture, nearly one-quarter of Pakistan's population continues to live below the poverty line, and reducing this figure constitutes the foremost challenge for the authorities. The main imperative for increasing the country's productivity and competitiveness is to enable it to reduce poverty. Data from the recent Household Integrated Economic Survey suggest that the success of the macroeconomic policies has had a significant pro-poor effect. The share of Pakistan's population living below the poverty line declined by over 10 percentage points from 2000/ 01 to 2004/ 05. The decline was impressive, amounting to more than twice the size of the increase recorded in this indicator during 1996/ 97–2000/ 01.

A number of key social indicators also show a significant improvement over the past three years. (See Tables 7 and 8). However, the government is conscious that more needs to be done — some important indicators have not improved (Table 9), and social spending must increase still further just to match that of some of the other countries in the region.

Table 7. Key Social Indicators, 2001–2005

	2000/ 01 PIHS 1/	2004/ 05 PSLM 2/
Population ever attended school	51	55
Gross enrollment at primary level	72	86
Gross enrollement at middle school	41	46
Literacy	45	53
Male	58	65
Female	32	40
Urban	64	71
Rural	36	44
Children immunized	53	77
Urban	70	87
Rural	46	72
Treatment of diarrhea in children 5 years and under	82	91
Urban	87	92
Rural	81	90

Source: Government of Pakistan.
1/ Pakistan Integrated Household Survey.
2/ Pakistan Social and Living Standard Measurement. This survey was conducted using Core Welfare Indicators Questionnaire (CWIQ) methodology with a sample size of 76,520 households. Data are not necessarily comparable.

Table 8. Intermediate Outcome Indicators, 2001–2005

	2000/ 01	2001/ 02	2002/ 03	2003/ 04	2004/ 05
Health Sector					
Utilization rate of first level care facilities (average cases/day/facility)	34	113	115	110	112
Population covered by lady health workers 1/	30	41	44	50	58
Immunization coverage of children/pregnant mothers	76	80	69	65	n.a.
Birth attended by skilled birth attendants	13	13	14	12	11
Percentage of first-level care facilities not experiencing stock-outs of five key supplies	26	28	35	27	25
Share of first level care facilities meeting staffing norms	30	34	30	n.a.	n.a.
Education sector					
Number of functioning schools (in thousands)	145	150	148	149	151
Primary	133	133	134	135	137
Middle	13	13	14	14	14
Share of functional schools with basic facilities					
Water	51	51	50	52	52
Electricity	21	21	22	30	n.a.
Sanitary	37	36	48	49	49
Share of trained teachers	96	98	98	98	n.a.

Source: Pakistani authorities.
PRSP Secretariat PRSP—Second Quarter Progress Report 2004/ 05, March 2005.
1/ Lady health workers are outreach workers providing preventive health and family planning services through house-to-house visits.
2/ As of December 2004.

Table 9. Social and Demographic Indicators, 2003

	Pakistan	South Asia	Low-Income
2003 Population, mid-year (millions)	148.4	1,425	2,310
2003 GNI per capita (Atlas method, USD)	430	510	450
Recent estimates (latest year available, 1997–2003)			
Poverty (% of population below poverty line)	33	…	…
Life expectancy at birth (years)	64	63	58
Infant mortality (per 1,000 live births)	76	68	82
Access to an improved water source (% of population)	90	84	76
Literacy (% of population age 15+)	53	56	63
Gross primary enrollment (% of school-age population)	86	95	94
Male	…	103	100
Female	…	88	88

Source: World Bank.

The government intends to continue with fiscal reforms. An important aim is to widen the tax base so as to raise tax revenues as a share of GDP. This will provide the authorities additional funds for the social sectors, and also improve the equity of the tax system. Higher revenues must also be captured in order to increase the transfer of resources to the provinces. A number of reforms have made the tax system more efficient, so far as existing taxpayers are concerned. The next step is to increase the number of taxpayers, largely by extending the tax net to better cover sectors, such as agriculture and services, whose contribution to the nation's fiscal resources falls short of their share in the GDP. The government is also reviewing the performance of public enterprises, particularly public utilities, with a view to containing and reducing their deficits and thereby freeing up more fiscal resources.

2.3 Governance Issues

Critical questions of governance impact both at the federal and provincial levels and determine to a considerable extent the sustainability of long term productivity improvements. Governance is a very broad category, covering political, administrative, judicial, police, financial, and other matters. All these subjects shape to a significant degree the efficiency with which economies function and, consequently, their productivity.

The GoP is taking action to address key problems in all these areas. Access to justice is being improved through a program that encompasses judicial policy and administration, projects for reducing delays, improving judicial training and legal education and strengthening the legal profession, facilitating the resolution of commercial disputes, and drafting and amending legislation. The government recognizes that bringing about fundamental reforms in this area will require sustained effort. To this end it has embarked upon a long-term program with financial and technical support from international agencies such as the Asian Development Bank.

The government also recognizes that the full impact of policies and projects is achieved only if they are implemented expeditiously and effectively. It is therefore pursuing measures to strengthen and reform the civil service.

A high-powered committee has been appointed to review all aspects of the functioning of the civil service, and is expected to report shortly with concrete recommendations.

A key plank in the government's strategy to improve the productivity and competitiveness of the provinces is a major decentralization of political and administrative powers, supported by a substantial increase in budgetary resources.

The devolution of authority has shifted the responsibility for the delivery of basic social services from the provincial government to elected local governments. The federal government expects this decentralization of power will make the public sector more accountable to the beneficiaries and will thus lead to a more efficient delivery of key social services (such as basic education, primary health care, rural water and sanitation, policing, justice, and community infrastructure programs). The decentralization reform presents a major opportunity to improve service delivery, particularly in the field of public education, and bring accountability closer to the people. The provincial and district governments, being closer to the public than the federal authorities, must directly confront the issue of inadequate education services and will be under greater pressure to improve the system.

The federal authorities have also strengthened the revenue flow to the provincial governments by amending the 1997 National Finance Commission (NFC) Award. The amended Award was announced on January 28, 2006 and will stay in force until a new NFC Award is promulgated. Under the amended Award, the share assigned to provinces from the divisible pool of revenues has been increased from 37.5 to 41.5%. Moreover, unlike previous NFC Awards, which allocated a fixed share to the provinces for five years, the amended Award establishes a series of increases, rising from 41.5% in 2006/ 07 to 46.25% in 2010/ 2011. The new Award will also increase the amount of federal subventions to the provinces from 2.4% to 3.8% of the divisible pool. Other adjustments under the new Award will increase the overall share for provinces out of the federal divisible pool in 2006/ 07 to 45.33%, and this will increase every year until it reaches 50% by 2010/ 11.

In the initial years, the increased funds to provinces as a result of the amended Award will be relatively modest. It is estimated that in 2006/ 07 they are likely to gain only about 5% more revenues than they would have under the original 1997 NFC Award. However, the amounts will steadily grow and it is estimated that by 2010/ 11 the increase will have reached nearly 16%. The Award also earmarks the revenue from 2.5% of the General Sales Tax to be passed on to the local governments; this could increase the amount of federal revenues going to them by 60%.

Thus, the political devolution will increase the political authority of the provincial and local governments, while the new NFC Award will provide them with the financial wherewithal with which to discharge their responsibilities. This is likely to lead to quicker and more forceful action in key sectors that should increase the efficiency and competitiveness of the provincial units.

2.4 Potential Areas of Increased Competitiveness

Pakistan's location and the country's physical characteristics offer a number of major opportunities for supporting economic growth. However, the realization of this potential will require investment in some sectors as well as the strengthening of some institutions and policies. A brief assessment of the main areas of potential, and the investment and policy changes that will be required to develop them, are outlined below.

With borders and close ties to China and India, Pakistan recognizes its unique geographic position, triangulating the two largest and fastest growing economies in the world. Pakistan is positioned to become a world-class manufacturing and services hub that connects China, India and Central Asia. Taking advantage of its position will require making further reforms and infrastructure investments while still balancing security issues. The first economic zone dedicated for China is opening in Lahore. In addition, Pakistan, along with international partners is investing USD 5 billion in a non stop national trade corridor project that will run from the Chinese border to the Arabian Sea.

In the 2006 World Bank Pakistan Growth and Competitiveness Report, it was suggested that the pace of Pakistan's economic growth and development will be strongly influenced by its competitiveness in world markets. Both external and internal factors affect export competitiveness — and one of the main internal factors is the supply side cost of transport and transport service quality. On August 18, 2005, the Prime Minister of Pakistan initiated the strategic framework for the National Trade Corridor Improvement Program (NTCIP) which links the Afghan border, close to Peshawar, through Lahore to Karachi and Port Qasim and includes the link to Khunjrab; the corridor handles the major part of Pakistan's external and internal trade. The NTCIP is intended to promote competitiveness and enhance efficiencies through the creation of world-class infrastructure, efficient logistics chains, and an improved interface between the private and public sectors.

Although major investment in Pakistan's main transport infrastructure is still required, especially in the highway sector, many of the essential capital assets for an efficient, competitive transport sector already exist. The port infrastructure is adequate for present demand and the main line rail track infrastructure could support a much higher level of freight operations. Policy and institutional changes in the way that the transport sector is organized and managed would result in substantial gains in productivity and cost reductions as well as establishing the basis for increased private sector investment in the sector. Introducing such changes may not be easy, as some may be at variance with entrenched interests, but they are needed to provide the transport industry required to support a rapidly growing economy that can compete in the global market.

Ports

Current Status

- Sea freight rates for both container and bulk cargoes are in line with regional and international levels, taking into account the size of the container flows.
- Sea transit times to some major markets are slightly better than for Pakistan's competitors and worse for others. But this is largely a feature of geography and distance.
- While Customs was traditionally a major constraint, with very cumbersome and time-consuming manual systems, it is beginning to achieve significant improvements in clearance times and is in the process of further major streamlining of procedures. It is, however, still perceived as problematic by port users.

Weaknesses

- High port costs and high port profits, resulting in higher charges to users do not contribute to the goals of a sound overall economic policy, increasing openness to the world economy and stimulating trade.
- Long dwell times for inbound containers, resulting in congested terminals and the need to construct additional facilities.
- Ports with relatively shallow draft, which will increasingly limit shipping connections as the size of container vessels on direct services increase.
- A weak, fragmented and relatively under-developed freight forwarding/ logistics sector, which has yet to provide the breadth of services and levels of vertical integration which are increasingly found elsewhere.

The port authorities, particularly the Karachi Port Trust (KPT) are still overstaffed and unnecessary labor regulations (enforced by the Karachi Dock Labor Board) still persist, raising the cost of services to users. While cargo handling charges are comparable with international ports, shipping charges are high and the port authorities are very profitable. The government needs to assess whether such financial transfers from users to the ports are really in the best interest of development or whether lower charges and lower port profits would have a more positive impact on trade and economic development.

On April 27, 2006, the KPT Board of Trustees approved a 15% reduction in KPT "wet charges" (relating to port dues, pilotage, berthing and use of KPT tugs) effective from July 1, 2006 — a key step toward lowering external transport costs and thus making Pakistan's trade more competitive. The KPT had earlier reduced these charges by 15% in FY04, the first reduction in its history. The cumulative 30% reduction in port charges should benefit traders at large and make the port more cost effective. It should also result in more trade through the Karachi Port, which is the premier port of Pakistan, handling almost 70% of external trade.

Table 10. Pakistan's Port Efficiency Compared with Coparable Benchmarks.

	KPT	QICT	Sri Lanka (SAGT)	Hong Kong	India (Navay Sheva)
Containers handled per crane hour	25	24	25	30	25
Containers handles per ship hour	55	60	70	100	65
TEU per metre of quay p.a.	400	680	1000	1800	2000
TEU per terminal hectare p.a.	18,000			40,000	43,000
Container Dwell Times (days in the terminal)	10	10	5	4	6
% of containers examined physically	100%	100%	<5%	<5%	High
Waiting times for berths, hour per ship	0	0	0	0	24
Waiting to service time ratio	0	0	0	0	0.5
Handling charges per TEU, or tonne	113	105	35/150	140	80
Ships dues/ship call, 2800 TEU ship	$30,000	$28,000	$5,500	$6,000	$25,000
TEU or tonnes per staff member p.a.	900		1200	1600	3000
Water Depth (m)	10.5	11.5	13	14	12
TEU handled p.a. (million)	1.4		2.2	14	2.2

Source: World Bank, 2006

Roads/Trucking

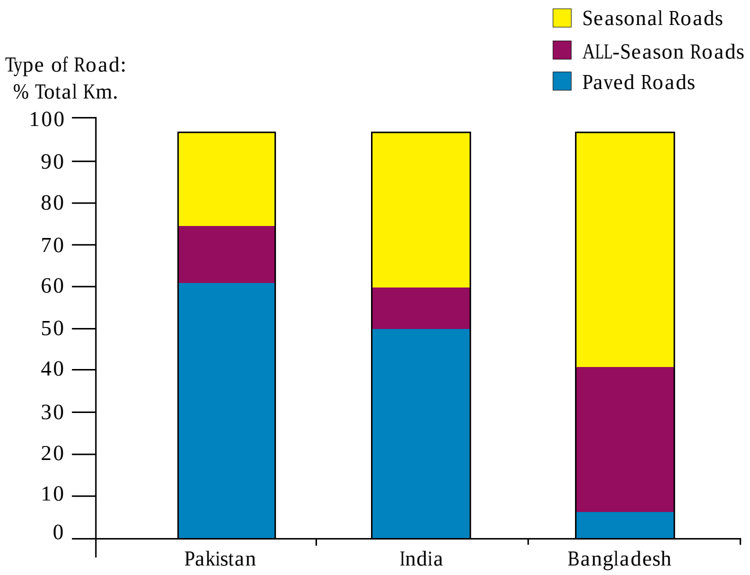
Current Status

- There is an adequate supply of road transport which, for break bulk and bulk cargo, offers some of the lowest road freight rates in the world, but with very low service levels.
- Where service quality is important, Pakistan's exporters have improvised relatively effective (if rather ad-hoc) arrangements with the road transport industry to monitor the flow of exports and ensure delivery times at port, though at significantly higher freight rates than are normal.

Weaknesses

- Main road infrastructure which requires major investment to provide the capacity and quality required for rapid and reliable road services.
- A trucking sector that operates old and technologically outdated trucks, offering low freight rates but long transit times and unreliable service quality unless shippers are prepared to introduce additional and costly measures.
- Import regulations and tariff structures that inhibit the modernization of the trucking fleet.
- A trucking sector which has low private costs but high external costs in terms of vehicle overloading (leading to road damage and high accident rates) and congestion.

Figure 22. Pakistani Infrastructure



	Pakistan	India	Bangladesh
Rail Track Length	11,515	63,122	4,443
Ports	5	152	2
Turnaround time at Ports (days)	1.5	3	1.5
Airports	44	60	10
International Airports	4	11	2

Source: World Bank, 2006

Present trucking services are largely low cost and low quality, provided by the informal sector . Such services are unlikely to sustain the growth and development of an increasingly complex, externally oriented manufacturing sector competing in international markets and required to meet international standards for delivery times and reliability. A competitive trucking sector will normally attempt to accommodate changing customer requirements and preferences, but such adaptation can be greatly facilitated by the appropriate policy framework and enabling highway infrastructure.

Railways

Pakistan Railways (PR) is a reasonably large passenger railway which carries some, largely public sector, freight. The quality of its mainline infrastructure and the geographical configuration of economic development and freight demand (large, long distance flows concentrated on very few origin-destination points) should mean that rail has the potential to be a substantial player in the freight market which it has largely ceded to road transport. Infrastructure investment in communications and signaling is required, but the primary investment priorities for a substantially increased freight presence are some additional motive power and the replacement of the four-wheeler wagon fleet.

Investment will, however, have a limited impact unless the underlying business and management environment within the railway sector is fundamentally transformed. PR is a government department with operating priorities set by passenger traffic, a large network of lines and services operated for social or strategic reasons or out of sheer institutional inertia, and a management outlook dominated by public sector constraints. If PR is to compete effectively and the railways are to regain their role as a primary transport mode for long distance freight, substantial changes will be required in its governance, finances and operation management/ priorities.

Airports

The GoP has announced its plans to construct two new airports, one each in Islamabad and Gwadar, costing USD 300 million and USD 133 million respectively. Work with commence at the end of 2006 and will utilize indigenous resources. At the Public Accounts Committee meeting in Islamabad, a top official said recently that a project to expand Multan Airport (at a cost of USD 49.5 million) would be initiated at the same time. Defence Secretary Lt Gen. Tariq Wasim (retd.) said the government and the Civil Aviation Authority had enough resources to initiate and carry forward all three projects at least for the first two years. The Secretary, however, said that if the need arose, the government would consider borrowing in order to complete these activities.

The Government's new position on the construction of airports is contrary to what the media reported in the past. Some officials recently have been reporting that new airports would be constructed on Build Operate and Transfer basis. The Defence Secretary said the government had acquired some 3,200 acres of land for Islamabad airport and had made payment to the owners. Secretary Tariq Waseem revealed the government was in the process of selecting design consultants and short-listing contractors to execute these projects.[7]

Electricity

Pakistan's energy supplies are highly dependent on oil imports, the cost of which accounts for a large share of the country's total import bill. In addition, national power demand is outstripping supply. This is a trend likely to continue for some time, given that Pakistan's production capacity needs are projected to reach a level of 162,590 megawatts (MW) by 2030, from a level of 15,500 MW in 2005. Only 55% of Pakistan's population has access to electricity from the national grid. The remaining 45% use kerosene, wood, and other bio-fuels for lighting, cooking, and heating. In fact, Pakistan has one of the lowest per-capita consumption of energy in the world. To address the energy shortage and as part of its decentralization policy, the government has delegated authority to the provinces to develop their own generating capacity of up to 50 MW to meet their energy needs. Installation of small-scale power generation technologies located close to the load being served, or distributed generation, has significant advantages. It will not only help meet the power shortage, but also ensure greater power reliability and quality. Also, the government has decided to put greater emphasis on renewable energy (RE). In May 2003, it announced that it had set a target of 10% RE (2,700 MW) in the country's energy mix by 2015 and had established the Alternative Energy Development Board.

Conclusion

The economic leadership in Pakistan has achieved significant progress in the past five years, but recognizes that there are still weaknesses in infrastructure and the business environment and is embarking on an ambitious set of second-generation reforms focused on releasing constraints to competitiveness. Pakistan is focused on creating an environment in which the economy can reach its full potential. Sustained economic growth

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7. Source: Momberger Airport Information site:
http://www.airports.org/aci/aci/file/ADN%20%20Momberger/ACI%20Oct%20ADN.pdf)

can only be achieved with a dynamic private sector, efficient bureaucracy, free media, and an independent judiciary. The government has already implemented reforms that have led to an improved climate for business, but much remains to be done. Institutions and regulations are slow and burdensome, labor and capital markets are inefficient, infrastructure and skills require upgrading to make growth possible, and standards of production and quality must be brought up to international levels. This will require a coordinated effort at the federal, provincial, district and municipal level. The next chapter discusses in more detail the current state of economic reform and competitiveness in each of the provinces.

3. Catalyzing Provincial Development

In order to increase the competitiveness of Pakistan it is necessary to improve the productivity of its provinces. The GoP recognizes that different policies will be required to maximize the development of each province — one size does not fit all. To this end, the government has encouraged the provincial governments to work with international agencies such as the World Bank, the Asian Development Bank, and the United Kingdom's Department for International Development to prepare detailed economic reports describing their economies, analyzing the main issues, and formulating recommendations for action. These reports will enable the federal and provincial governments to target each region's shortcomings and build on its strengths. It will also enable civil society to join in the debate on economic priorities and permit donors to judge more precisely where their assistance should be directed. Reports for three out of the four provinces have been completed, and two of the provinces have already held meetings with donors based on the analyses and recommen-dations of the reports.

The strategy for developing the provinces is two-pronged. First, there are a number of issues that are common to all the provinces that must be addressed chiefly by the central government. Second, there are issues that are specific to each province, especially health, education, and many of the microeconomic constraints highlighted in the Global Competitiveness Report, that must primarily be tackled by the provincial authorities, but in some cases may require federal support.

Policies Affecting All of the Provinces

The most important issues that impact the development prospects of all the provinces are:

- The maintenance of a stable and competitive macroeconomic environment that permits entrepreneurs to make decisions and allocate resources in an economically efficient manner.
- The improvement of governance, particularly the empowerment of

government below the federal level, so that these authorities can (a) be directly accountable to stakeholders for the delivery of key services, and (b) be able to react quickly to changing requirements.

Growth Targets

The reason for increasing the productivity and competitiveness of the provinces, and indeed of the country, is to enable citizens to afford a better life. Higher incomes are an essential element of achieving this goal. In a modern economy, the bulk of incomes are generated from employment; therefore, the basic element in the economic strategy of each of the provinces is the creation of more jobs. This means that the growth of the provincial GDPs must be accelerated in order to increase the demand for labor. The provincial governments are being encouraged to set targets for the growth of the economies that are linked to this fundamental policy objective.

What growth rates of the GDP should the provinces target in order to absorb all the additions to the labor force and to start reducing the ranks of the previously unemployed? Of course there are differences among the provinces, and thus the precise target growth rate will differ. However, preliminary estimates suggest that, by and large, a 1% growth in provincial GDPs leads to about a one-half percent increase in employment. Again speaking broadly, their labor forces are growing at roughly 3% a year; this means that the provincial GDPs must grow at least at 6% a year to provide jobs for all the new entrants. Obviously GDP growth must be higher in order to cut into the backlog of unemployment. At some risk of oversimplification, therefore, one could say that the overall challenge for the provinces is to increase the growth of their GDPs to around 6.5% a year. The strategies outlined below are designed to increase the productivity of the provincial economies so as to accelerate their growth to around these levels.

Factors Specific to Provinces

Macroeconomic and governance issues affect all provinces to more or less the same degree. However, each of the provinces is also affected by factors that are specific to it, such as location in relation to the main markets, distance from the sea, the area of the province, the size of its population, the status of its human development indicators, access to natural resources, and so on. Over the last several decades, the interaction of the general and the specific influences on the provinces has caused their economic performances to diverge. It must be remembered that even relatively small differences in growth rates compounded over a period of, say, three decades, can lead to substantial differences in the level of the GDP. Per capita growth rates and provincial GDP growth rates are shown in Figures 23 and 24.

Figure 23. Provincial Per Capita GDP 1981 to 2005
(PKR in 1981 prices)

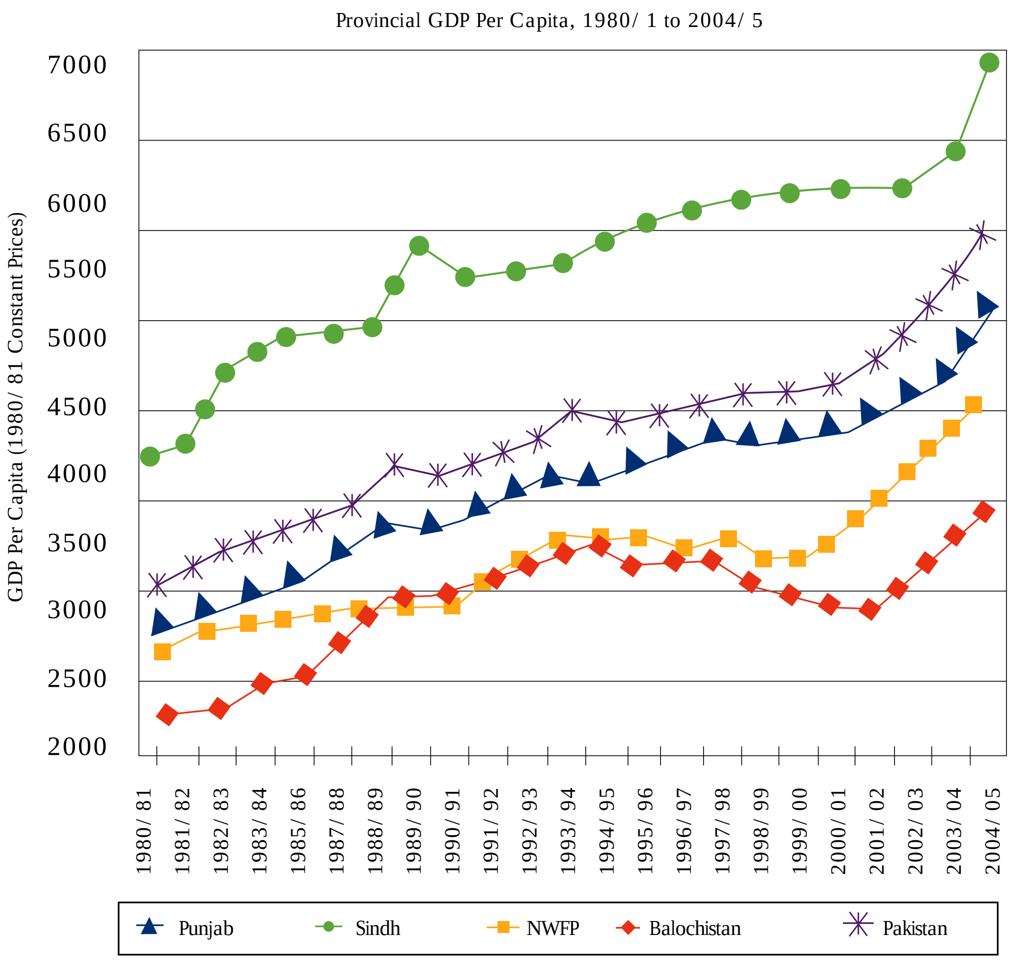
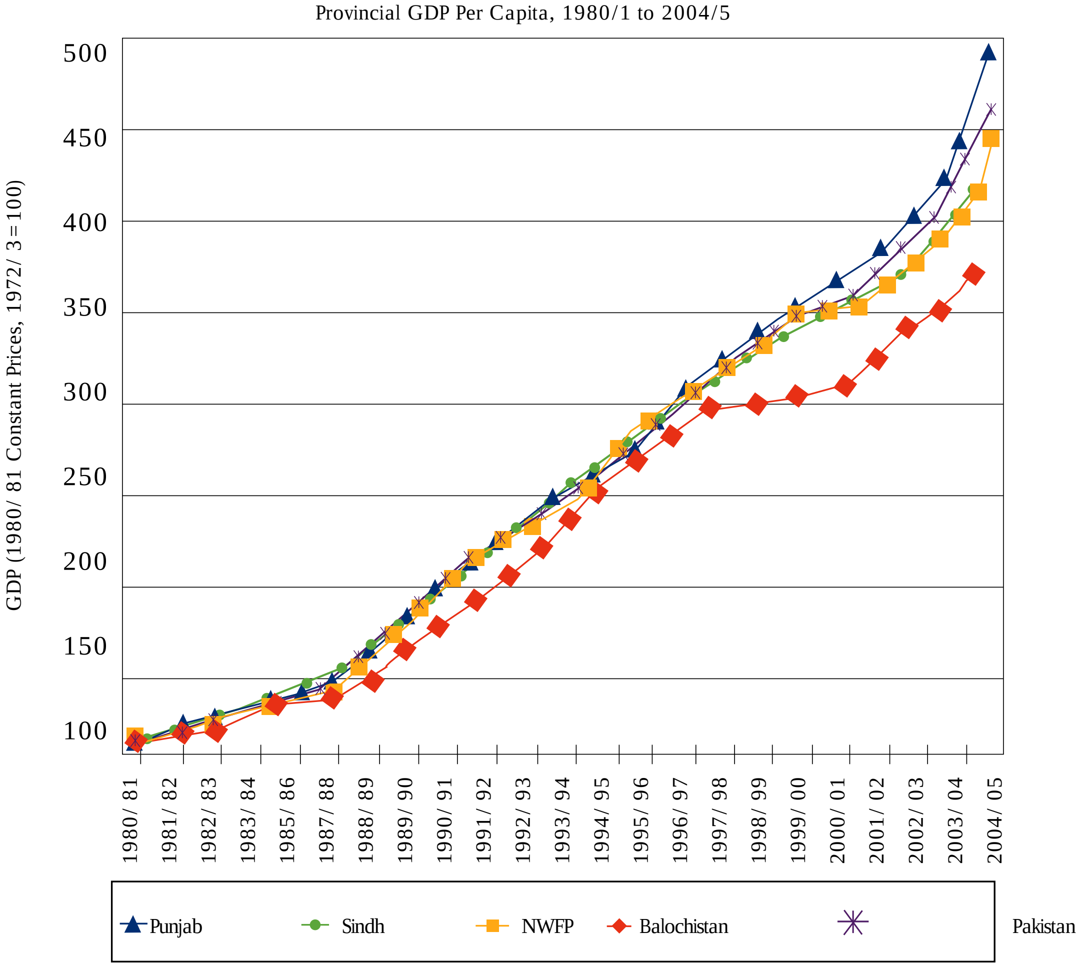


Figure 24. Growth of Provincial GDPs 1973–2006, at 1981 Prices

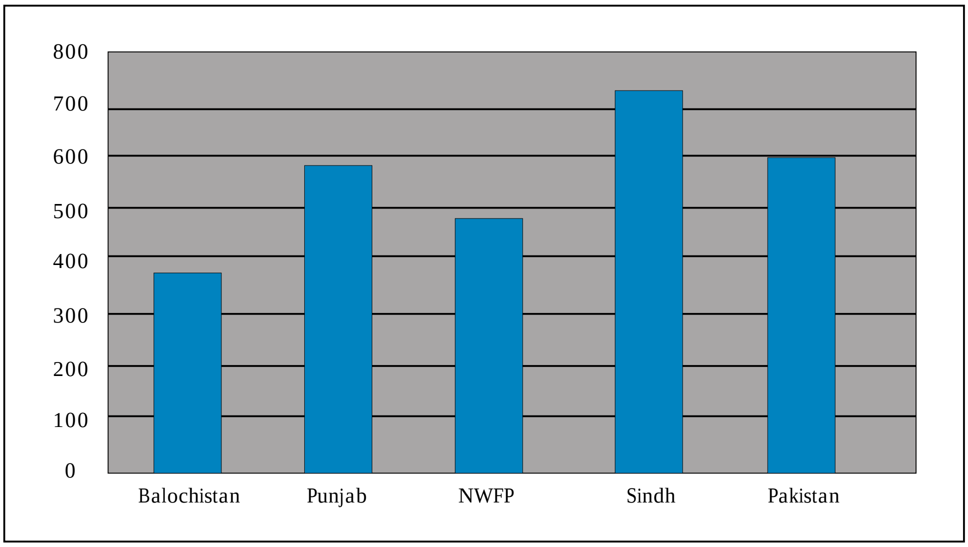
(Index number, 1973 = 100)



It should be stated explicitly that official statistics for provincial GDPs have not yet been finalized. However, estimates that are generally consistent with the official methodology have been prepared by professionals and by institutions such as the World Bank. Until such time as the official numbers become available, these figures are being used by the provincial authorities in their planning exercises. The analysis in this paper is based on the same data.

Balochistan has the lowest per capita income and the weakest growth performance of all the provinces over the last decades, and Punjab has the strongest. According to the method used by the World Bank Atlas, GDP per capita in 2004 amounted to USD 410, compared to USD 480 for NWFP, USD 580 for Punjab, USD 760 for Sindh, and USD 600 for Pakistan overall. (Figure 25). From 1973 to 2005, Balochistan's real GDP is estimated to have increased at an annual average rate of 4.1% compared with 4.8% for the NWFP and Sindh, and 5.1% for the Punjab. In real per capita terms, from 1980/ 81 to 2005 Balochistan's growth rate averaged 2.1% a year, that of the NWFP and Sindh 2.2%, and that of the Punjab 2.8%.

Figure 25. Per Capita Incomes, 2004 (USD)

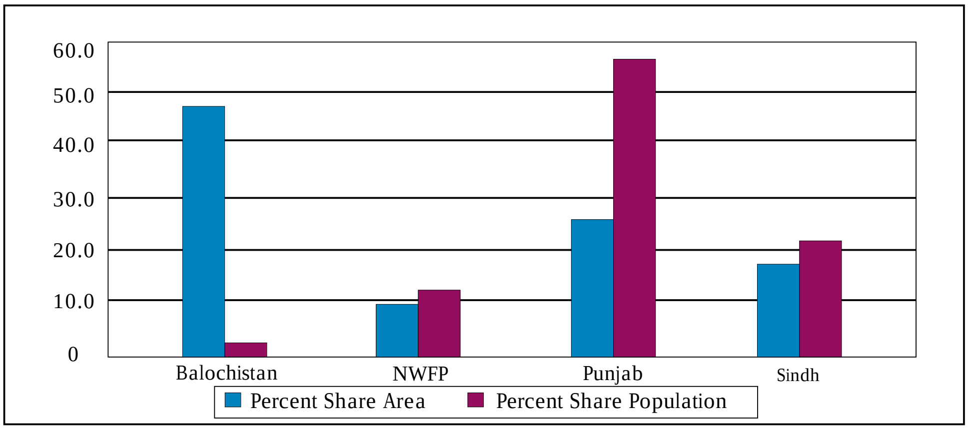


Source: World Bank Atlas

3.1 Balochistan

The basic development issue for Balochistan is that while it accounts for nearly 45% of the land area of Pakistan, it is home to only 5% of the population. This combination results in many of the province's inhabitants being thinly dispersed over wide areas — in 2005, Balochistan's population density at 19 persons per square kilometer was only 5, 8, and 9% respectively of that of the Punjab, Sindh, and the NWFP. (See Figure 26).

Figure 26. Share of Provinces in Area and Population of Pakistan, 2005



This dispersal has three main consequences:

- The critical mass of skills required for specialization is present in only a few localities.
- Markets are smaller, thus losing economies of scale.
- The cost of providing a unit of service, including governance, is higher than that in the rest of Pakistan.

However, Balochistan is generously endowed with locational and mineral advantages that with the proper development of its human resources, could more than offset the challenges presented by a small population scattered in a large surface area. In terms of land area, it is the largest province of Pakistan; it accounts for 70% of the country's coastline; it possesses a deepwater port at Gwadar; it is ideally situated for trade with Iran, Afghanistan, and the Persian Gulf countries; it can be linked for trans-shipment trade with China; it produces one-third of the natural gas in the country; and it contains extensive deposits of coal, marble, copper, chromites, lead, gold and other minerals. Thus, Balochistan's mineral and locational assets give it a potential competitive edge that could enable its economic performance to rival that of the other provinces.

How can Balochistan's competitive edge be honed? A five-point strategy is being developed, the key components of which are:

- Increasing investment, by addressing the concerns of the private sector and by the public sector undertaking large-scale outlays in infrastructure primarily roads, power, and ports.
- Shifting the economic structure to faster-growing sectors (manufacturing and mineral extraction), by encouraging foreign direct investment in the extraction and use of coal, copper, chromites and other minerals, and by developing the new port city of Gwadar as an industrial powerhouse.
- Making the maximum use of Balochistan's coastline and of Gwadar's potential, by completing the infrastructure to connect the new port with Pakistan's industrial and commercial centers; by modernizing and expanding the province's fishing industry; by establishing enclaves for tourism; by developing the port as a transshipment hub for imports into China and for transit trade to Afghanistan and the Central Asian republics; and providing incentives for industries (particularly those with a significant import content) to locate in the developing industrial estate.
- Enhancing labor skills, by investing heavily in education and training, and by developing partnerships between the public and private sectors to ensure that the skills imparted are those demanded by the market.
- Improving the efficiency of resource use, particularly water, by eliminating subsidies (such as that on electricity) and other measures that distort price signals and thereby encourage the uneconomic use of scarce resources.

It is estimated that as a result of these measures, the growth of Balochistan's GDP can be stepped up to a sustained rate of about 6.5-7.0% a year, compared with the average of 4.5% a year over the last 15 years. Moreover, the development of Balochistan's mineral resources and its coastline (for ports, fisheries, industry, and tourism) will add substantially to the competitive ability of the entire country.

Gwadar Port, Balochistan, Pakistan

Gwadar port is Pakistan’s newest deep-sea port located on the country’s southwestern coast between Afghanistan and Iran. The port is located approximately 400 kilometers from the Straits of Hormuz, a major shipping route for tankers delivering oil from the Middle East. China financed the construction of the port as well as the construction of a highway connecting Gwadar port with Karachi, a port city on the Arabian Sea. China’s investment in the two projects totals around USD 1.2 billion. Port of Singapore, a management company based in Singapore, will take over the management of the port at the end of January 2007, with plans to begin full operation in March 2007.

It is expected that the port will generate significant economic returns for both Pakistan and China. Bilateral trade between the two countries has averaged an annual increase of 30 percent between 2000 and 2005. In 2005, bilateral trade totaled USD 4.26 billion, with most of the trade balance in China’s favor. A bilateral free trade agreement was signed at the end of 2006. With its status as a Duty Free Port and a Free Economic Zone, it is hoped that the port will further increase commercial activity and strengthen trade linkages both bilaterally and regionally.

The development of the port forms part of a larger infrastructure development program that includes road and rail development in other provinces, including laying new railway tracks connecting Pakistan to China and Afghanistan.

3.2 The North West Frontier Province (NWFP)

Two characteristics of the NWFP shape its main development challenge:

- It is distant from seaports. The NWFP is located far from Pakistan's ports. The costs of imported inputs are therefore higher than for the other provinces, and also it costs more to transport exports to countries other than those that are physically adjacent to the NWFP. These factors compel the authorities to develop an industrial strategy that focuses on the production of products that use a large proportion of indigenous raw materials, or those that are light in weight but high in value. It also means that the strategy should make the maximum use of inputs, such as hydel power, with which the province is generously gifted.

- It is a front-line state. The NWFP served as a front-line state and provided a haven for more than three million refugees from Afghanistan during the eleven-year war in the Soviet occupation of that country and in the civil war that followed. This role inevitably put a tremendous strain on the province's physical and social infrastructure and created problems of security.

The government's development strategy rests on four pillars. These are:

- Rapid, private-sector-led economic growth. The authorities are clear that job creation must be the foremost object of their development strategy and that this can most efficiently be done by the private sector. The private sector will therefore be given the incentive to take the lead in generating output growth and sharply expanding the demand for labor.
- Improved indicators of education and health. This must be done to improve productivity and to enable the poor both to contribute to and to benefit from economic growth. The strategy will lay particular stress on improving the education and health status of females.
- Stronger social safety nets. It is almost inevitable that some families, for health, locational, or other reasons will be unable to share in the fruits of economic growth. It will be necessary to

strengthen the social safety nets so as to protect such persons from extreme poverty.

- A specific development plan for lagging regions. Some areas of the NWFP, such as the mountainous regions, suffer from particular disadvantages relating to access, shortage of rainfall, and so on. The province's development strategy envisages the formulation of a specific plan to accelerate the growth of the more backward areas.

The authorities have already started implementing parts of this strategy. The economic and social reforms of the past few years are beginning to show results. The Federal Bureau of Statistics' 2004/ 05 Pakistan Social and Living Standards Measurement Survey indicates that the province's key social indicators are beginning to improve, and that it has made progress in narrowing the gender gap.

The Drivers of Growth

The government has identified the main drivers of growth in the NWFP, and the province's Annual Development Plans are seeking to implement the strategy.

- The key engine of growth will be the private sector. The authorities have initiated a dialogue between the government and the private sector to clarify their respective roles in the economy. The government will increasingly focus on its core functions of maintaining security and enforcing regulations that ensure a level playing field for all economic actors. High-level committees have been set up to maintain active communication between the public and private sectors and to assure the private sector that the new strategy is here to stay.

In addition to maintaining an overarching dialogue with the private sector, the authorities are also committed to helping address the critical issues in specific activities in which the NWFP is likely to be competitive. The chief areas that offer such possibilities are:

Manufacturing based on materials that are indigenous to the province, or comprising low-weight, high-value products. In this context, the province has considerable potential for the production and export of gemstones, marble, granite, and construction materials, the latter particularly for Afghanistan's reconstruction. In the low-weight, high-value category, the province is moving into more sophisticated fields, such as pharmaceuticals, and is also taking advantage of its considerable timber resources for the production of matches, furniture, and similar items.

The authorities are aware that in order to make the province a more important producer of marble, a number of regulatory and institutional improvements must be implemented. The principal area requiring reform is the clarification of ownership rights. Greater clarity and security in this area will improve the private sector's access to finance, and make it worth while to invest in better technology for extraction and in training of workers, particularly for finishing and polishing the stone.

The Construction industry is an important element in the government's program, because it has multiple links with other industries and sectors, and because it has the potential to provide a large number of jobs. In this area, too, the government is studying some institutional reforms. The province's construction industry derives a considerable part of its demand from public works projects. The procedure for contracting has left something to be desired, and the government is now considering the introduction of a standard set of contracts in this area, and taking steps to simplify and unify the registration of firms and contracts.

Energy: An area that offers major possibilities is the generation of hydel power. The NWFP currently generates nearly 4000 MW, but the province's potential is a large multiple of this amount. Moreover, at present the bulk of the electricity generated in the province is sold to a central government agency which then sells them to consumers, including those in the NWFP, at a higher price.

The government is looking at two possibilities. First, as at present, the province can earn revenue by selling electricity on the national grid. A second interesting possibility is that the province could set up electricity stations that, while covering their costs, could sell power within the NWFP

Marble and Granite Industry in North-West Frontier Province

There are at least 40 types of marble being mined in Pakistan and initial estimates indicate reserves of approximately 160 million tons of marble and 414 million tons of granite across the country. In 2004, almost 2000 operational quarries produced an estimated 100 million square feet of marble and granite. The vast majority of the marble and granite quarried comes from North-West Frontier Province. The industry represents a small fraction of total GDP and less than 1% of current exports; however, it has the potential for significant export growth if it is able to develop a skilled, specialized labor force to produce consistently high-quality products.

In order to capitalize on the industry's significant potential, several innovative initiatives have been undertaken, which include:

- Establishing model quarries to disseminate best practices in quarrying techniques so as to increase productivity, train workers on appropriate techniques and sophisticated machinery, and produce a high quality, consistent product;
- Facilitating the development of supporting services for the industry such as transportation, handling, and financing;
- Introducing a marble and granite marketing database on the types and specifications of the products available in Pakistan;
- Developing standards for product quality in order to satisfy export demand;
- Training processors to produce better quality products and to use upgraded technologies.

at a lower price than the power provided on the national grid. Elements of the private sector have maintained that the lower price for electricity would offset a significant part of the transport disadvantages that arise from the province's geographical location. This measure would substantially increase the competitiveness of the province's industries. Of course, the two possibilities are not mutually exclusive, and the government can profitably pursue both.

Tourism: The NWFP is well endowed with monuments such as ancient Buddhist monasteries and Ghandara sculptures, and museums that would attract cultural and historical tourism. It also possesses many scenic sites, such as high mountain ranges, alpine valleys, and rivers and streams that would interest tourists in search of leisure in natural surroundings. In the long run, tourism can offer an important source of income and employment, especially as it tends to be a labor-intensive activity. In the immediate future, the government's strategy is to concentrate on attracting domestic tourists, particularly to the northern areas. The longer-term strategy is to establish the hotels, roads, and other infrastructure that would make the region more accessible and secure for international tourism.

Agriculture: will play a central part in the NWFP's development strategy. Most of the poor live off agriculture, and particular parts of the sector offer considerable potential. The basic idea in the strategy is to move away from simple food self-sufficiency in cereals, and to increasingly emphasize food security and rural income growth. This is so the province can deploy its scarcest resource, irrigated land, in uses that provide the highest returns. This will generate funds with which to buy cereals and other products for which the NWFP does not possess a comparative advantage. Food security thus does not have to mean food autarky. The proposed strategy does not of course mean that the province will stop producing cereals altogether. Rather, it means that individual farmers and the province as a whole will both benefit by moving inputs into high-value activities, especially livestock (for meat, wool, leather, and dairy products) and horticulture.

Forests: The NWFP is home to about 40% of the forest resources of Pakistan. Hence, the development strategy envisages special attention to the conservation and proper use of these resources. A policy environment for the sustainable harvesting of timber will require both a reform of institutions and an increase in well-directed investment. The institutional reform largely comprises the strengthening of ownership and user rights that would encourage the joint management of forestry resources by the community and the private sector. Additional investment in facilities and training will be required to support the province's research in forest conservation and range management.

3.3 The Punjab

The Punjab is Pakistan's most populous province, accounting for about 60% of the country's population. The province has a very rich agriculture and is, indeed, the bread basket of Pakistan. It is also a major producer of cotton, fruits and vegetables. The province has a substantial manufacturing base that encompasses a wide range of industries, including cotton textiles, food-processing, engineering, electronics, sports goods, leather garments, surgical instruments, ceramics, cement and building materials, pharmaceuticals, and others. The Punjab possesses a considerable number of universities, colleges, and institutions of higher education, including those for engineering, computer sciences, medicine, dentistry, commerce, business administration, and arts and the media, in addition to liberal arts colleges.

The quality of its human resources is fast improving, because the province is putting increasing stress on expanding education. Taking the most recent years, total enrollment (pre-primary to grade 10) increased by nearly 20% between 2003 and 2005. The move towards gender parity in enrollment and retention has also accelerated at the middle school level; girls in 2005 accounted for 41% of total enrollment compared with 36% in 2003. These trends augur well for the development of a more productive and diversified labor force.

The private sector employs almost nine-tenths of the workforce of the Punjab, so the main impetus for growth and competitiveness must come from this sector. The key growth issue for the Punjab is to mobilize the full potential of the private sector. Harnessing the energies of the sector will require both reforms to institutions and increases in investment. In combination with bilateral and multilateral donors, the provincial government is developing a strategy that will increase productivity, accelerate growth, and improve the delivery of key services.

In most surveys of the business environment conducted by agencies such as the World Bank, the Punjab ranks at or near the top. It is therefore not surprising that this province is home to a vigorous private sector. Indeed, the private sector is maturing and in some areas has made substantial contributions to society (see box on Sialkot).

Private Sector's Initiatives: The Example of Sialkot

A key center for labor-intensive small-scale industrial enterprises, the Sialkot regional cluster is poised for accelerated growth. A relatively small city with an estimated population of approximately half a million, Sialkot is nonetheless internationally renowned for its export-intensive manufacturing sectors, in particular its three relatively well-developed industrial clusters producing surgical instruments, sports goods, and leather garments. Annual exports from the region are now about $700 million, contributing nearly 7 percent of Pakistan's exports. The business community in Sialkot has successfully pursued a number of initiatives over the years:

Sambrial Dry Port. As early as 1986, city residents collaborated to set up the Sialkot Dry Port Trust, the first ever dry-port established in the private sector in Asia. The main objective of this venture was to provide customs clearance through a one-window operation at the city's doorstep, thereby facilitating participation by exporters and importers. The number of exporters subsequently increased substantially, enabling total exports to rise rapidly. The total annual value of exports from the port has increased more than twenty-fold since its inception.

City Package: Since excessive travel time and inconvenience was an important factor inhibiting potential clients and visitors, the private sector raised funds to build better approach roads to the city. An innovative financing plan was agreed with the Punjab Government, whereby the Chamber of Commerce raised PKR 130 million through deducting 0.25 percent of export earnings at source. While the government initially agreed to contribute PKR 3 for every rupee raised, it eventually withdrew from the scheme after contributing PKR 100 million. Several key roads were nonetheless reconstructed and expanded through the scheme, and drainage work undertaken, making a dramatic difference to the image of Sialkot.

Other self-help schemes and partnerships: Road improvement work was undertaken in the Sialkot Industrial Estate through a PKR 5 million self-help scheme, which in turn was matched by a grant from the district government and a contribution of PKR 10 million from the city package. Similarly, when residents realized that the unplanned and uncontrolled growth of tanneries in populated areas of the city posed a serious public health risk, the business community and the Provincial Environment Protection Agency set up the Sialkot Tanneries Zone, to which all tanneries will be relocated.

Sialkot International Airport initiative: The private sector's most ambitious undertaking to-date has been to initiate construction of an international airport on a build-own-operate basis. Members of Sialkot International Airport Limited (SIAL) contributed 5 million each to raise a total of PKR 800 million. A further, PKR 200 million is expected to be raised through soliciting smaller contributions from 200 additional members. Land acquisition for the project was financed through funds advanced from the government at favorable terms. While initial estimates of the cost of the project were Rs 1.7 billion, this could rise to around Rs 2.5 billion. SIAL is presently examining several options to meet the shortfall in funds through additional equity financing. In the meantime, construction work on a 3.6 km runway, equivalent in specification to that of Lahore International Airport, is well under way.

Motorcycles for the police: In 2003, the exporters' association donated 36 motorcycles to the Sialkot police force in order to make it more mobile and to strengthen security.

Source: World Bank: PAKISTAN – Punjab Economic Report

The strategy to increase the productivity of the Punjab's economy and to improve its overall competitiveness incorporates several strands. The most important areas to be addressed are:

The business environment: The development strategy for the Punjab aims to address the main issues more forcefully so that the private sector can release its full dynamism and thereby increase the productivity and competitiveness of Pakistan's biggest province. Surveys of the business environment in the Punjab have shown that the chief constraints on business are a mix of institutional weaknesses and insufficient investment in certain sectors.

The chief institutional weakness relates to property rights in land. The government has made a start in identifying the main issues in this area, which essentially arise from the absence of a government guarantee that the person mentioned in the record-of-rights is the true owner of the property. Other complications arise because, in many circumstances, the registration of land is not compulsory. This system is of long standing. The government is working on ways of modifying and reforming it, and has run pilot projects in computerizing the existing ownership records in a number of districts.

Other institutional impediments identified by the private sector as particularly business unfriendly are being addressed. Thus, inspections by safety organizations (particularly those under arcane legislations such as the provincial Boiler Act) are increasingly being coordinated so as to reduce the disruptions to the working of enterprises; multiple/nuisance taxation that raises the cost of production is gradually being eliminated; and labor laws are being examined with a view to reforming those that force many enterprises to remain small, and those that encourage the hiring of casual rather than permanent workers.

Two important areas in which further investment is required is infrastructure, particularly a reliable supply of electricity, and the development of human resources. Improvements in the latter have already started to come about, as was mentioned at the start of this section. The supply of power depends upon actions by the federal government, and is being taken very seriously, as is reported elsewhere in this report.

The Construction Sector: The province's development strategy pays particular attention to the construction sector, which has a high multiplier effect on employment. The Federal Government has recently taken a number of steps to address one of the biggest problems constraining this sector, namely, the relatively undeveloped state of the housing finance sector, much of which results from the difficulties in enforcing foreclosure laws in the event of a default (another institutional weakness). The Government of Punjab has picked out a number of other key legal, fiscal, and administrative barriers hindering faster development of the housing and construction sector to which it is turning its attention. The government's economic report — prepared in conjunction with major multilateral and bilateral organizations — identifies these as rationalizing the stamp duty on property related transactions, narrowing the differential in property tax on renter and owner-occupied property, reducing development charges for change of use of property from "residential" to "commercial," and imposing a penalty for leaving land idle.

Small and Medium Enterprises: The Punjab's development strategy also recognizes the vital role played by small and medium enterprises (SMEs). The private sector in the Punjab accounts for almost 90% of total employment. The bulk of private sector employees — estimated at over 85% in 2002 — work in businesses with fewer than 10 employees. Thus if the economy of the province, and particularly the industrial economy, is to improve its productivity, then the authorities must pay special attention to the problems of the SMEs. A significant start has been made through the activities of the Small and Medium Enterprises Development Agency (SMEDA) which collects information, provides technical assistance, and other support. The province is developing additional policies to address the major problems faced by SMEs, which have been identified as access to finance, the availability of suitable technology, knowledge of markets, and the ability to obtain labor with the relevant skills.

Cities as Growth Engines: The strategy also takes advantage of the greater population density and urbanization of the Punjab. The province has an overall population density more than 3½ times that of the rest of Pakistan, and is home to five cities with over one million inhabitants and another ten with over 200,000 inhabitants. These cities can serve as growth poles for the provincial economy, because the agglomerations of population both markets that are large enough to encourage production on a scale that should reap significant economies, and also provide clusters of skills that should make such production possible. Some such clusters have already developed in the Punjab — Sialkot is well-known for its industrial clusters manufacturing sports goods and surgical instruments, Gujranwala and Daska for light engineering, Faisalabad for textiles, and so on. The Punjab is formulating plans to develop skill clusters in further localities, including small urban centers as well as mega-cities.

Agriculture: The strategy for improving productivity does not overlook the Punjab's role as the agricultural heart of Pakistan, and the substantial part that this sector plays in the provincial economy. Agriculture accounts for about 28% of Punjab's output and provides employment to over 40% of the workforce. Over the last 20 years, the Punjab's agricultural sector has grown at around 4–5% per annum (higher than the averages for Pakistan and South Asia, as well as low-income countries overall).

However, much of this growth has resulted from the application of larger amounts of resources. In the next phase of agricultural growth, improvements in productivity are expected to occupy a more central space. A number of reforms have been identified that will enable greater productivity growth in this sector. These include:

- Shifting the production structure toward rice and cotton, while ensuring a moderate growth in wheat production.
- Improving the competitiveness of cotton by introducing higher-yielding varieties.
- Diversifying production, especially by encouraging higher value horticultural and livestock products. Such a move also offers greater opportunities for employment creation, because these high value activities tend to be labor-intensive.
- Seeking opportunities in import substitution, if a competitive advantage can be clearly demonstrated.

There are, of course, areas in which more could be done to enhance productivity. The government must increase public investment, particularly on irrigation, water management, and agricultural research. Water has become the major constraint on the growth of agriculture, and the government will have to take all the steps necessary — including capital spending and institutional reform — to increase its productivity. The additional spending will require more resources, and since these are likely to be in short supply, the provincial government will have to create the required fiscal space by letting the private sector fund activities (for example, livestock, breeding farms and veterinary services) that are not demonstrably public goods. The government should also improve cost recovery, especially for canal maintenance (where the recovery still averages only 25%).

An important area for increasing the competitiveness of the agricultural sector is the reform of wholesale markets. An efficient marketing system is a prerequisite for the agricultural diversification that forms an important plank of the development strategy, as it allows farmers to move away from the production of cereals and other relatively low-value crops to those that command the highest return in the market place. Wholesale markets form a critical link between producers in the rural areas and consumers in urban centers. The government therefore needs to focus on the modernization of wholesale markets and the expansion of the market information system. Greater involvement of the private sector in market development will economize on public expenditures in this area.

The agricultural sector of the Punjab offers great potential for raising incomes. Indeed, the World Bank judges that greater investment in the sector, supported by institutional strengthening, should enable the Punjab to exploit its excellent resource base and geographical advantage to tap into the rapidly expanding markets for high value products in Asia, the Middle East, and other high income countries.

3.4 Sindh

Sindh's locational, physical, and human assets endow it with an enormous potential for sustained high growth. It is a coastal province, strategically located between Europe and the Far East, with well-developed links to Middle East routes. It possesses two deepwater ports, which could enable it to serve as an important hub in South Asian trade. The biggest international airport in Pakistan is located in Karachi, the capital of Sindh. The province is well connected by road and rail networks with rural markets and with other commercial and industrial centers of the country. This network reaches to Afghanistan and can easily be extended to India. The province has a large and sophisticated manufacturing base that comprises heavy industries — such as steel, shipbuilding, chemicals, motor vehicles, and engineering — as well as light industries such as textiles, electronics, food processing, and other consumer products. Indeed, Sindh accounts for about 40% of the large-scale manufacturing output of Pakistan. A strong entrepreneurial class has grown up, which is supported by a large pool of educated labor. The province has many institutions of research and higher education.

However, in the last decade the performance of Sindh's economy has not equaled its potential, largely because the lack of political stability discouraged private sector investment. The province now aims to put that right.

The basic development strategy formulated by the Sindh authorities comprises two key elements: (i) accelerating the province's growth performance by establishing a competitive business environment in the urban areas, and by diversifying the economy and addressing the problem of water in the rural areas; and (ii) investing in people by improving the delivery of key social services. The strategy is realistic in recognizing that the economy of Sindh is segmented — Karachi, non-Karachi urban Sindh, and rural Sindh — each of which requires a somewhat different approach.

Surveys of businessmen and stakeholders have indicated that the major constraints to investing in Karachi are:

- A distorted land market that has reduced the land available for commercial and residential use. The major impediments arise from unclear property rights, inappropriate zoning laws, pro-tenant legislations, and high taxes on property related transactions.

- The delays and costs of enforcing contracts. This is being addressed by judicial reforms that will increase the number of judges, provide them with additional and more specialized training (especially for dealing with the commercial disputes), and other measures, such as increasing the non-salary budget for police investigations and enforcement.
- Deficiencies in urban infrastructure, especially electricity, water supply, and sanitation. This requires a combination of efforts by the central and the provincial governments. Major investments in electricity generation and transmission are in the works, while the devolved local governments are focusing on improvements to water supply and sanitation.

Although the problems of non-Karachi urban Sindh in some respects resemble those affecting Karachi, particularly as regards deficiencies in infrastructure (especially electricity supply), a number of city-specific issues need special attention. Thus, in the second and third largest cities in Sindh (Hyderabad and Sukkur), businessmen identified the lack of skilled labor as their main problem, while access to land ranked lower. Again, entrepreneurs in the interior of Sindh viewed law and order as the chief disincentive to investment. The situation was said to be stabilizing, but a perception problem remained.

In rural Sindh, the government must tackle three main issues in order to raise productivity.

- The growing scarcity of water. This will require improving the productivity of water through a more effective and transparent water management system; by providing incentives to move away from water-intensive crops (such as sugar cane); and by supporting diversification away from the crop sector to livestock, fisheries, and non-farm activities.
- Inadequate diversification of the economy, largely because of poor connectivity. The government is moving to improve connections

between rural areas and Karachi and reduce congestion at airports and seaports through improvements in transport and investment in storage facilities.

- Inadequate service delivery. This will require raising the capacity of government institutions (for example by strengthening the role of the Sindh Public Service Commission in hiring and transferring civil servants), and by introducing more competition in the provisioning of public services. A start has already been made towards the latter through programs such as Community Supported Schools and Fellowship Schools; these should now be expanded to additional areas.

Recent developments have been encouraging. In recent years, Pakistan has emerged as one of the fastest-growing economies in Asia. The government's market-friendly policies have been successful in attracting investment and have generated a broad-based recovery in the manufacturing sector, in which Karachi has participated. Sindh's cotton farmers and textile manufacturers have benefited from the removal of quantitative restrictions on global trade in textiles and garments (Sindh is a prime producer of raw cotton and of cotton textiles). The province, and particularly Karachi, also shared in the rush of remittances that poured into Pakistan in the period following 9/11. Sindh has substantial reserves of coal and natural gas and is potentially an energy-surplus province; therefore rising international energy prices offer it an opportunity of mobilizing additional finance for development. Most importantly, the province has been largely free from the urban unrest that plagued it in the late 1980s and early 1990s. Thus, Sindh now has the right combination of circumstances to recover its economic dynamism and to act as a leader in strengthening the competitiveness of Pakistan.

4. Looking Forward, Moving Forward

This report has presented a snapshot of Pakistan's competitiveness in 2006. It has indicated both the country's strengths and weaknesses. It has suggested a comprehensive approach to improving the competitiveness of Pakistan. Success will be measured by improvements in Pakistan's performance on the Global Competitiveness Index. The Competitiveness Support Fund has set a goal of moving Pakistan from its most recent rank of 91 to a rank between 60 and 65 by 2010. This will require improving Pakistan's competitiveness in a number of ways.

This chapter presents specific recommendations to improve competitiveness within an overall comprehensive framework. If these recommendations are followed, it will be feasible for Pakistan to be among the top 50% of countries listed in the Global Competitiveness Report within a relatively short number of years. Improvements in competitiveness, in turn, will enable the government to achieve its ambitious targets of high economic growth, employment growth and continued rapid progress in poverty reduction.

This chapter also lays out a process for mobilizing support for competitiveness in Pakistan. The PowerPoint presentation that accompanies this report should be disseminated to Pakistan's leaders and opinion shapers. These include cabinet ministers, parliamentarians, provincial governors, chambers of commerce, business associations, economic press, university rectors, deans of economic, legal and business faculties, heads of research institutions, trade union leaders, think-tanks, NGOs and civil society leaders. A series of presentations should be made based on the results and findings of this study and feedback from these groups should be elicited. Their inputs should be incorporated into a revised set of priorities and initiatives for a proposed "Competitiveness Agenda 2007-2008."

The framework for competitiveness requires active efforts by both government and the private sector. While the government implements its reforms in the macro and microeconomic business environment, private sector leaders must also respond by improving business strategies and operations, including corporate governance, compliance with global standards and human resource management. In the end, it will require that business leaders reposition their companies and their industries in world markets. At the same time, it is necessary to begin preparing a new generation of business managers and entrepreneurs who can lead Pakistan forward to new levels of competitiveness in future years.

Improving the Macroeconomic Environment

The Government of Pakistan's economic team, including the Ministry of Finance, must maintain and improve the sound macroeconomic policies that have served so well in recent years to help Pakistan achieve higher rates of growth. Inflation must be kept within single digits. The budget deficit, temporarily expanded to meet the needs of earthquake victims, must now be reduced. Overall debt as a percentage of GDP has already declined remarkably to 55% of GDP. The successful result of passing legislation limiting the debt to 60% of GDP has sent a powerful signal to the financial markets. Fiscal and monetary policy will also be helpful in increasing federal savings and investment as a percentage of GDP. With support from worker remittances and increased foreign investment, the government will ensure continued growth in foreign currency reserves that contribute to the balance of payments, which in turn support the financial security of the country. Through tax modernization, the government will be seeking to enhance revenues while lowering rates, expanding the base and simplifying compliance. This will set the macroeconomic environment for growth. However, a good macroeconomic environment, while essential, must be complemented by an excellent microeconomic environment — the environment that affects day-to-day productivity and business operations at the firm level.

Improving the Microeconomic Environment

The Government of Pakistan has turned its attention to improving the microeconomic environment for growth. A comprehensive approach is needed. It is important to reduce the obstacles to the formation of new businesses and the growth of small and medium enterprises. The time and cost of transportation from the port of Karachi to the factory floor must be reduced. The GoP has been playing a very dynamic role in encouraging industry leaders to come together, formulate strategies for growth and implement initiatives to turn these strategies into realities. SMEDA has been playing an active role in supporting the effort to foster the development of competitive industry clusters and the growth of small business. The government will focus on continued progress in judicial reforms and the effective application of the rule of law to commerce, including the enforcement of contracts and the fair resolution of disputes. The government has recently ranked well in the GCR on the use of market mechanisms, but it is also necessary to promote competition and improve anti-trust efforts.

The country must improve enrollment rates at all levels of education while improving the relevance of this education. The government's notable progress in improving access to education will continue. This progress has been recorded in Pakistan's rankings in the GCR this year. At the secondary and tertiary level, entrepreneurship training, management training and information technology must be expanded. Schools need to focus on equipping students with marketable skills as well as life skills such as communication, teamwork, conflict resolution and household finance. It is important to equip young people with the aptitudes as well as the attitudes needed to secure employment. Education leaders have a vital role to play in making citizens aware of competitiveness challenges and in mobilizing solutions in science, technology, law, economics, engineering, architecture, accounting, business and other areas. Our schools must be judged on how well they provide their students with marketable skills and the aptitudes and attitudes to secure good jobs when they graduate. Industries and their education and training providers need to work more together to define skills gaps, skill standards, current deficiencies and new training programs. All universities and vocational schools need to improve their placement programs and industry outreach activities.

Technological readiness and innovation can be fostered by improved linkages among research institutes and their respective industries. Support for patent registration will help Pakistani individuals and institutions to register international patents and to boost their investment in research and development. Policies also need to be in place that lead to rapid expansion in utilization of digital technologies including cell phones, computers and the Internet. The GoP, following the example of China and other countries, should join the "one child one computer" program that is now gaining momentum worldwide.

Provincial and local governments should be encouraged to develop their own regional economic development strategies and to provide an environment conducive to mobilizing private investment. They should simplify procedures for business registration, instruct civil servants to adopt a service-oriented approach, implement investment promotion programs and encourage worker training schemes.

The private sector has a critical role to play. In the end, productivity can only be delivered by real individuals that improve their productivity and real companies that improve their strategies and operations. Therefore, private firms must play a leadership role in boosting Pakistan's competitiveness. As the GCR points out, corporate governance and accountability must improve among Pakistan's private companies. The government can help provide the regulatory framework for improved corporate governance and accountability, but corporations must implement the policies that protect the rights of shareholders. The Government can reform its tax policy, lower rates and reduce the cost of compliance, but the private sector must respond to this with a culture of voluntary compliance. Private companies need to modernize their use of human resources, delegate authority, use incentives and invest in training. The GoP is supporting private and public initiatives to boost the competitiveness of industry clusters through the USAID financed PISDAC project and through the Competitiveness Support Fund. These initiatives have encouraged business leaders to take responsibility for designing and implementing strategies to repositioning their industries in world markets.

Pakistani firms must lead the way as export champions and position themselves as compliant with global labor, consumer and environmental standards. Failure to adopt world class labor standards will risk erosion of confidence from international investors and buyers, who increasingly insist on the rigorous adoption and enforcement of such standards. Pakistan can position itself in the world economy as a country in full compliance with such standards. This will also help improve Pakistan's image and "brand name" abroad.

Leaders in the banking industry must build on the impressive recent gains in efficiencies that have resulted in lower "spreads" between deposit rates and loan rates. They must develop new products that further improve access to credit that can expand home ownership, free up "dead capital" and allow families to improve their dwellings and standards of living. Financial access should be expanded without risking the health of the financial sector, by improving credit risk reporting through means such as credit bureaus. This will require revisiting federal legislation and credit bureau regulation.

Press leaders and the media have a role to play in fostering broad public understanding of competitiveness and mobilizing the support of people in helping to achieve the results presented above.

How Can Pakistan Improve Its Rankings in the Competitiveness Report?

The government has made considerable progress in recent years in improving Pakistan's actual competitiveness as demonstrated by GDP growth, poverty reduction and public debt as a percentage of GDP, among many other indicators of progress. So why hasn't there been more progress in Pakistan's rankings in the World Economic Forum Global Competitiveness Index (GCI)? Pakistan's rankings on other indices such as the Business Competitiveness Index (BCI) and Doing Business indices have far outstripped the GCI. Does this particular index penalize Pakistan? What can be done to improve Pakistan's ranking in the short term as well as in the medium and long term?

1. How Low Does Pakistan Really Rank?

Pakistan's rank improved from 94th to 91st place but its performance is actually better than it appears. The raw score also improved from 3.51 to 3.66, where 7 represents the highest score possible. The CSF has analyzed the performance relative to all other countries, taking into account the increased number of countries included in the latest report. By normalizing the scale and placing all countries on a percentile basis from 1 to 100, one finds that Pakistan improved its rankings from the 19th percentile to the 28th percentile. Therefore it is well on its way to joining the top 50% of countries by 2010.

Pakistan can target and achieve an average improvement of 8-10 places a year over the next four years to enter the range of 60-65th place. To do this, the GoP will have to take specific steps and will encourage provincial governments to do the same. To ensure continuity, the CSF should verify the hard data provided to the WEF. The GCR survey should be implemented by the same organization each year and the sample size should also be increased to ensure the integrity of the results.

2. What Caused The Current GCI Ranking?

The World Economic Forum changed its methodology and this has penalized Pakistan. The Growth Competitiveness Index of Dr. Jeffrey Sachs was replaced two years ago by the current Global Competitiveness Index. This index includes new indicators related to health and education that tend to penalize Pakistan, causing a fall of about 8 places from the old to the new index. Furthermore, the new index has 9 "pillars" with different weights.Unfortunately, the new index tends to give particular weight to some areas where Pakistan, as a low-income economy, is weak (health and education) and minimize the weight other areas (such as innovation) where Pakistan is strong. This change in methodology helps explain why Pakistan's progress in the rankings has been more modest than its recent economic performance and impressive reforms would otherwise suggest. To some extent, the GCR has moved the goal posts and changed the scoring system. Nonetheless, it now provides an annual benchmark to measure future progress.

The GCI did capture a number of notable improvements that confirm the significant achievements of the Government of Pakistan economic team. Progress on financial sector reform was clearly recorded in the GCI. Improvements in government efficiency were similarly captured and showed notable improvements. Public perception regarding honesty of and efficiency of government officials improved notably.

3. What Can Be Done to Improve the Rankings in the Short and Medium Term?

There are four major strategies that can have a major impact on Pakistan's ranking among nations in a relatively short period of time. The GoP should focus on bringing up the lowest rankings, correcting the recent declines in some rankings, playing defense by protecting those areas that are strong, and shaping a positive public perception of its notable successes and ongoing efforts. If these strategies are implemented and Pakistan succeeds in raising its rank to the 60-65 range, it will be among the most dynamic developed and emerging economies in the world.

Strategy #1: Bring Up the Lowest Rankings

Pakistan can improve its overall ranking by focusing on improving the components of the ranking where it most fell short. Its worst performance by far was within Pillar 4 on Health and Primary Education (where it ranked 108^{th}) and Pillar 5 on Higher Education and Training (104^{th}), though its rankings in both areas are improving.

Health and Primary Education

Pakistan's ranking on health and primary education went up by 7 places despite the entry of new countries. The GCI is therefore recognizing that access to health and education services has expanded recently, but more needs to be done. The reported rates of tuberculosis increased last year, hurting the country's score. However, perceptions of health problems worsened in the survey data.

Secondary and Tertiary Education and Training

The overall enrollment rates for secondary and tertiary education, while also improving, are still relatively low. As Pakistan continues to improve its enrollment rates at the primary, secondary and tertiary levels, scores will continue to go up. It is also important to improve the private sector perception that these schools are actually training people to have marketable skills. More in-service technical and management programs, such as the proposed Center of Entrepreneurial Excellence in Karachi, can also help improve the score. The use of "finishing schools" to help provide marketable skills to post-secondary and even post-university students can also help. These intensive programs focus on subjects like computers, English, basic business skills and life skills, and can have a notable impact in a relatively short period of time on the ability of school-leavers to get jobs.

Strategy #2: Correct Recent Declines in Scores

Pakistan saw declining rankings in 5 of the 9 pillars. The most significant decline was in the macroeconomy pillar. The change in the raw score was actually quite modest, down from 4.32 to 4.19. However, this was sufficient to knock Pakistan below 17 other countries that it had ranked above the year before. Pakistan's macroeconomic management is actually reasonably good when looked at overall. The ranking was affected by two indicators — inflation and budget deficits. The unexpected shocks to the economy from the earthquake led to a temporary surge in budgetary expenditures. Without this, the deficit would have been more modest. It should be lower this year than last. The spike in energy prices led to a temporary increase in inflation which should also come down this year.

Although Pakistan's strongest ranking is on market efficiency, which remains high at 54, it lost 13 places last year. The drop from its previous ranking of 41 was based on a relatively small decline in its raw score from 4.23 to 4.34. This is an example of how small changes in the raw score can cause a significant change in country rankings.

Pakistan lost 7 places in technological readiness. The most damaging rankings were in the penetration of cell phones, computers and the Internet. The numbers used should first be verified to see if they were up to date.The government can improve these rankings relatively quickly by creating the market conditions by which many people have access to these technologies. In fact, cell phone usage is growing significantly in Pakistan and computer and Internet utilization are growing as well. Yet at the same time, other countries are also rapidly increasing their use of these technologies. Providing more cell phone licenses and lowering taxes on phones is one way to expand penetration. Similar initiatives can be undertaken to stimulate markets for Internet utilization in both urban and rural areas through expanded wireless access. There are a number of international initiatives to expand computer availability to students, such as the "one child one computer" initiative of the MIT media lab, through which China and other countries have agreed to a mass purchase of very inexpensive USD 100 computers with basic software. Intel and MicroSoft are countering this by seeking to develop a low-cost computer-software package for mass use in emerging economies. Pakistan should be among the first to take advantage of these offerings, which will boost educational performance and productivity.

Strategy #3: Play Defense: Maintain and Build on Recent Gains

Business Sophistication

Pakistan can maintain its current areas of strength and build on them further. At 66, the rank for business sophistication is relatively good (although down from 57 last year). To improve the rankings for pillar 8 (business sophistication), it is important to improve corporate governance, including transparency and protection of minority shareholders. A corporate governance initiative could bring about a dramatic and near-term improvement. The other area that could increase this score significantly would be a private-public initiative focused on improving the human resource function at private firms. Poor delegation, poor use of incentives and low investment in human resources are the major weaknesses in Pakistan's private sector which otherwise ranked fairly well. Anti-trust policies that favor competition and discourage oligopolies and cartels will also help spur continued competitiveness.

Innovation

Pakistan's ranking improved from 71 to 60 (with raw scores improving from 3.02 to 3.27). These scores were based on both hard data and on survey data. However, the survey data helped Pakistan's score considerably. Continued high scores in this area will require improvements in hard indicators such as the number of patents filed and the percentage of GDP spent on R&D. Therefore, it is important to implement programs that encourage and help Pakistani scientists, inventors, businesses, universities and think-tanks to file patents and to encourage practical R&D through both policy mechanisms and the encouragement of closer linkages between research institutes and universities on the one hand and Pakistan's industries on the other. New royalty schemes could be introduced to encourage universities and their faculties to participate actively in practical research areas of short and medium term benefit to Pakistan's economy.

Strategy #4: Public-Private Dialogue on Competitiveness

To ensure that Pakistan's rankings reflect its true underlying strengths, two steps need to be taken. First, the hard data on which the rankings are based need to be checked with the sources in order to ensure that the report reflects the best and most recent data available in Pakistan. Second, it is important that the annual survey be conducted in a way that is consistent from year to year and is professionally administered. To the extent that the broader population and those surveyed are aware of recent achievements and current government initiatives, the survey results will provide an accurate barometer of Pakistan's competitiveness. For example, not all people are aware that the major reforms in the financial sector implemented by the government have resulted in reduced "spreads" — a major indicator of efficiency.

Therefore, it is important to effectively communicate and disseminate recent achievements and ongoing initiatives while also soliciting inputs from leaders on further initiatives to improve competitiveness. This should be done through an expanded media campaign and face-to-face meetings. If the government listens to the concerns expressed and takes steps to address concerns that are legitimate, this will build confidence and create a virtuous cycle of improved investor confidence.

If these strategies are implemented, Pakistan can expect to see a dramatic improvement in its future rankings. The implementation of the recommendations contained above would likely lead to an increase in Pakistan's competitiveness rankings by 8-10 places per year to between 60 and 65 on the GCI by 2010. More importantly, it will mean that Pakistan was successful in implementing a variety of competitiveness related initiatives and has made progress toward its goal of rapid economic growth, accelerated poverty reduction and improved standards of living. This in turn will provide for a stronger and more self-reliant economy.

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