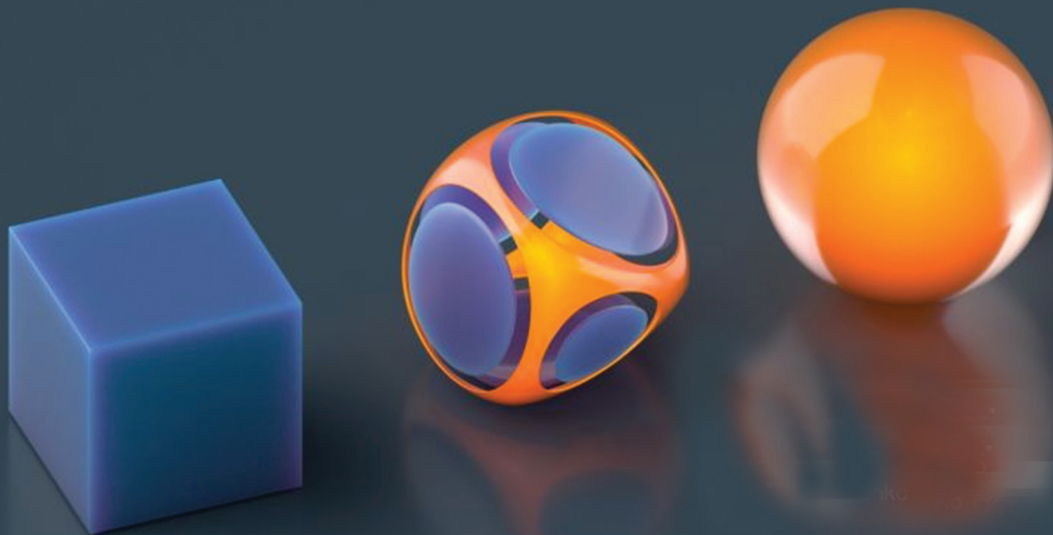


EAG Papers: The Vision

# New Vision for Economic Transformation

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Rethinking Resource Allocation  
and Productive Structures



Economic Advisory Group

November 9, 2021



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**Economic  
Advisory  
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This document is a collective contribution by the members of Economic Advisory Group, an independent group comprising individuals from academia, policy, and the private sector. An independent think tank Policy Research Institute of Market Economy (PRIME) has formed this group and serves as its secretariat.

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# 1. Motivation

This document presents a vision for economic transformation, with a focus on understanding key factors which have prevented this from happening in the case of Pakistan. It draws from the experience of other emerging economies and leading economic research on how countries have successfully transformed their economies by letting their productive structures adapt and evolve over time. In this respect, the current document is a significant departure from the traditional focus on achieving growth by reinforcing existing structures of the economy. While such traditional approaches did deliver many episodes of growth spurts, these always proved to be short lived, often leading to the build-up of large imbalances and, ultimately, crises.

A key requirement for any economy to undergo significant transformation is that economic resources must be allowed to move from less productive to more productive activities. In a market economy, this critically depends on whether the incentive structure is allowed to evolve such that returns from investing in more productive activities are

indeed higher than those from less productive activities. This document argues that the key reason why Pakistan has not undergone a similar transformation as, let's say Vietnam, is because excessive protection and lack of structural reforms have prevented economic resources from getting reallocated to more productive endeavors. Businesses that become unproductive and are unable to compete must be allowed to fail for economic resources to move towards more productive businesses that are better able to compete globally. Unless this issue is addressed, any desire on the part of policymakers to see the structure of the economy transform towards the production of more value-added goods and services will remain a pipedream.

# 2. Countries become what they make

## i. The missing transformation

A cursory look at data shows that the structure of Pakistan's economy has remained ossified over the past many decades. Figure 1 plots the composition of Pakistan's export basket in 2000 and in 2019. The data in-

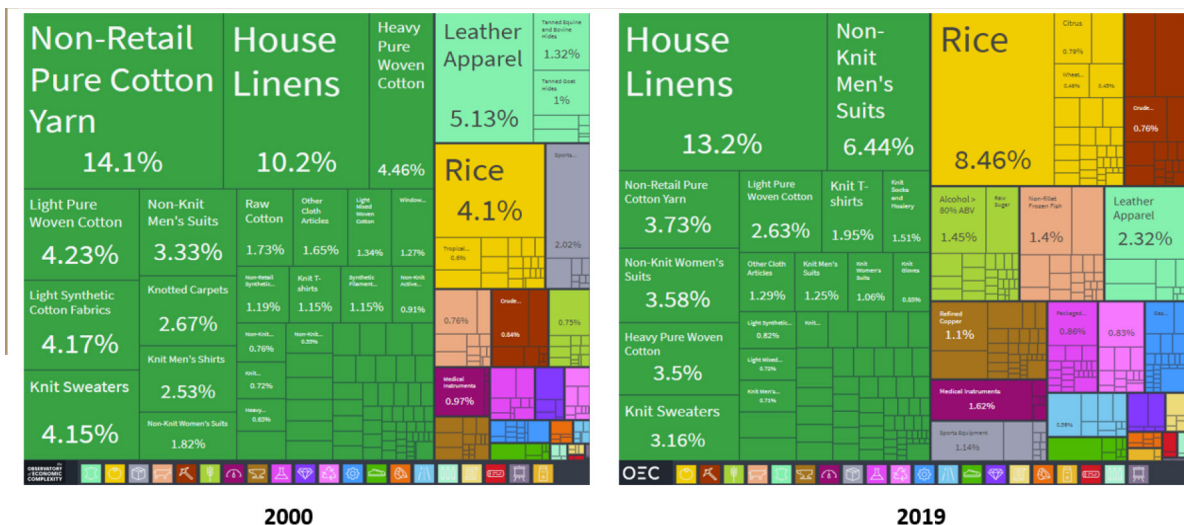


Figure 1: Composition of Pakistan' export basket (Source: The Observatory of Economic Complexity)

cludes exports of goods; and is taken from the Observatory of Economic Complexity. What stands out the most is the lack of economic transformation which the country has experienced since 2000. In 2019, Pakistan’s export basket continues to be dominated by similar low value-added manufactured goods and primary products, as in 2000. Going even further back in time presents a similar picture.

In contrast, similar data for Vietnam tells a different story. Vietnam has successfully trans-

formed its economy, moving it towards producing high value-added manufacturing goods. Specifically, Vietnam’s production structure has moved away from low value-added products towards high and moderately sophisticated sectors such as electronics, chemicals, value added textiles, and tourism. Such transformation is not limited to Vietnam alone, but extends to other emerging economies, including Thailand, Philippines, and China, amongst others.

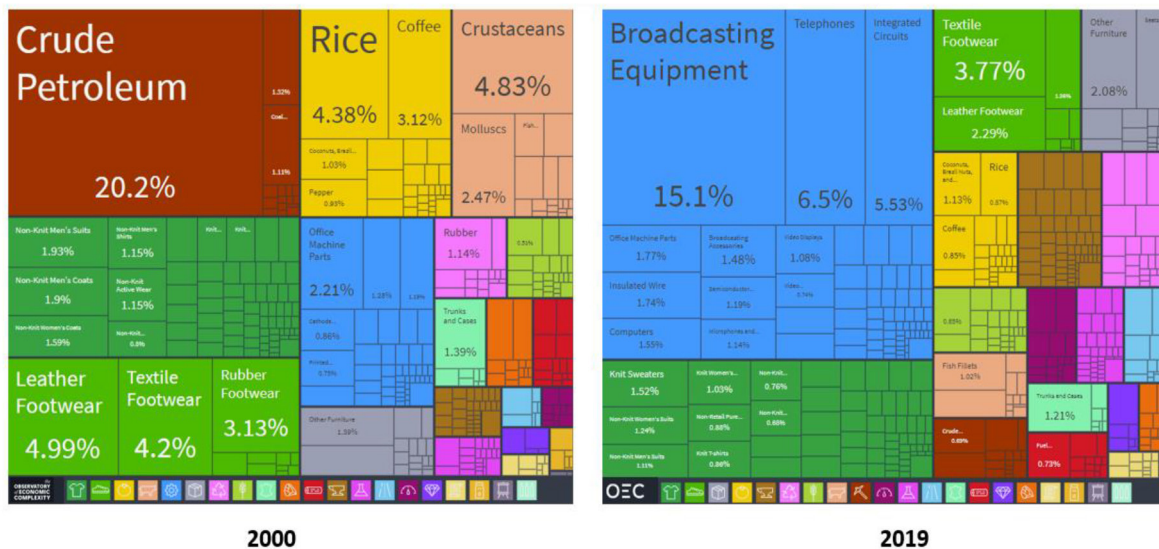
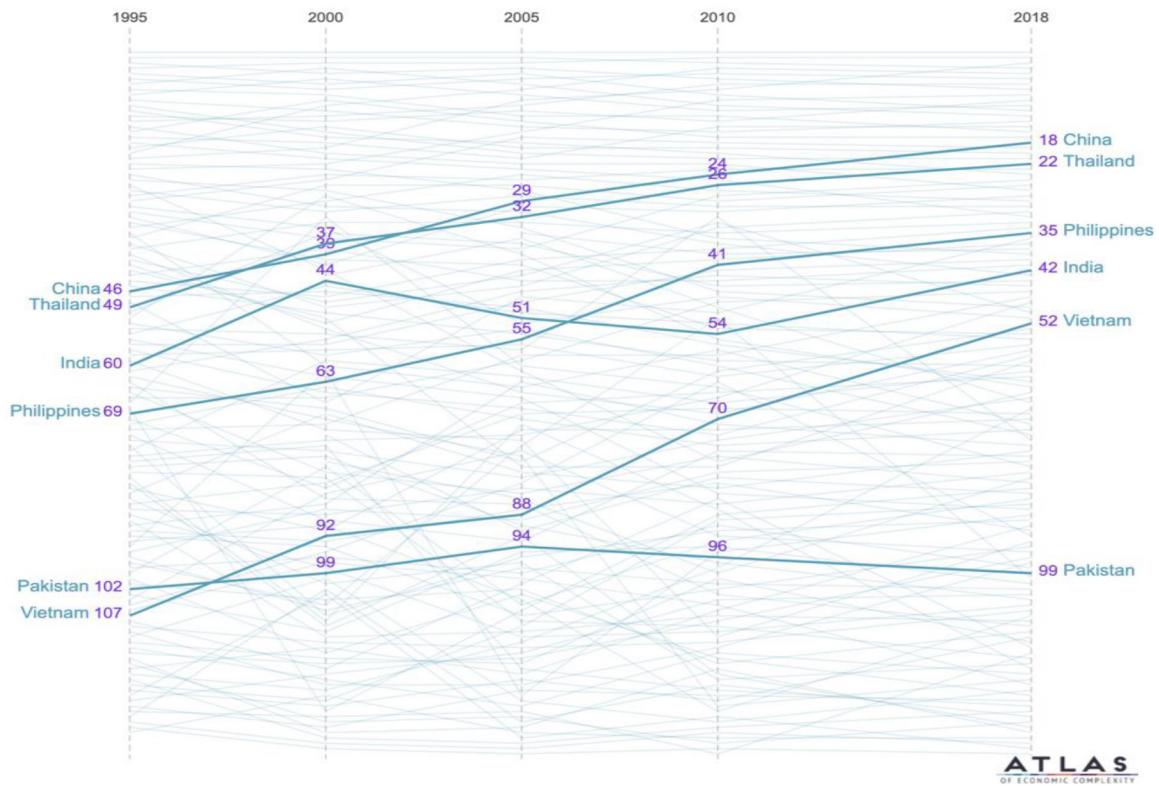


Figure 2: Composition of Vietnam’s export basket (Source: The Observatory of Economic Complexity)

What is it that these countries did which policymakers in Pakistan have overlooked, when designing policies aimed at developing the country’s economy? The answer is that these countries succeeded in putting in place an economic environment that encouraged the improvement in their capabilities necessary for their export base to climb up the complexity ladder.

**ii. Lacking capabilities**

Apart from failing to transform the sectoral makeup of its production structure, Pakistan has also fallen behind in gaining capabilities necessary for producing high value-added products within existing sectors. For example, while Pakistan added 21 new products in its export basket since 2003, these only contributed \$2 per capita to the value of its exports. In contrast, Thailand and Vietnam added 34 and 48 new products, contributing \$213 and \$1,020 per capita to the value of their exports, respectively.



**Figure 3: Economic Complexity Index (ECI) Rankings**

Pakistan’s inability to produce high value-added products is reflected in its ranking on the Economic Complexity Index (ECI). ECI is based on countries’ relative sophistication levels; and reflects locally available capabilities at any point in time. Countries exporting a large variety of products that few other countries can make are ranked higher on the ECI than those making a narrow range of products that many other countries also make. Figure 3 shows

that Pakistan ranks 99 out of 133 countries. More alarmingly, over the last decade, Pakistan’s economy has become relatively less sophisticated, declining 20 places in ranking. In contrast, Thailand’s (22) and Vietnam’s (52) ECI ranking improved by 9 and 11 places, respectively.



Pakistan’s lack of sophistication is reflected in most products it exports, including value-added textile products. Figure 4 shows that almost all of its export basket is made up of less complex products, and has remained so for decades. This is worrisome as the level of complexity is a strong predictor of a country’s growth potential.

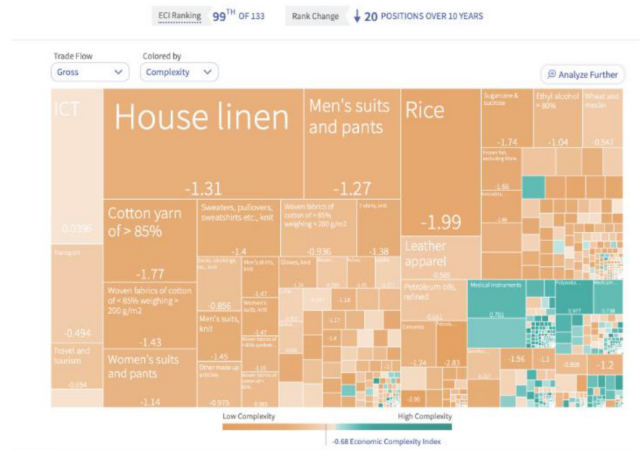
Hausmann and Hidalgo (2010) show that the sophistication of products made by countries matters more for long-term prosperity than simply the value extracted from them. They find that, in the long run, economic growth of countries is driven by the complexity of their respective economies. The relative positioning of countries on the index also seems to explain much of the variation in income levels across countries. By the same token, where there is deviation from the relationship between income and the corresponding level of complexity, it predicts the country’s future growth potential. For example, Vietnam, which is ranked 41 positions higher than Kazakhstan, despite having less than a third of the latter’s per capita income, is expected to grow significantly faster than the mineral-rich exporter. Effectively, the complexity of economies not only infers the actual level of income, but also their latent potential.

### 3. What is needed for transformation?

**“In dealing with actual economies, the barriers (for resources to move) may be more important than the frontier.”**

– Franklin Fisher

The above statement by Franklin Fisher is fundamental to the discussion in this document. What is needed for transformation is that economic resources continue to move from less productive to more productive activities. When this is not possible for reasons to be discussed later in this document, increasing



**Figure 4:**  
Complexity of Pakistan’s export basket

the quantity of resources will always fall short of transforming the economy. It is no wonder that despite building an extensive network of impressive motorways, Pakistan continues to remain stuck in a low-growth trap.

#### i. International evidence

An increasing number of studies show that countries that have been successful in reducing such ‘barriers’ have seen an increase in their productivity and, subsequently, an improvement in their export performance. Meza et al. (2019) show that 41% of the increase in Mexico’s productivity between 2003 and 2012 was because of improvement in allocative efficiency, i.e. due to economic resources moving from less productive to more productive activities. Improvement in allocative efficiency was an important part of productivity growth during Chile’s decade-long period of growth following the debt crisis of early 1980s (Chen and Irrazabal, 2015).

Significant inefficiencies due to the inability of resources to move to their most productive use continue to persist in developing economies. However, low hanging fruit is also present that policymakers in these countries can target. Hsieh and Klenow (2009) show that, by eliminating barriers to the flow of resources, productivity in the manufacturing

sector can increase by 100-128% in India and by 86-110% in China. If these are the gains for economies that have already undergone transformation, economic gains for Pakistan must be significantly greater.

## ii. The incentive structure

In a decentralized economy, it is the evolving nature of the incentive structure that plays a critical role in ensuring that resources continue to flow from less productive to more productive activities. For example, as more productive opportunities become available, offering higher returns, firms find it worthwhile to move in this direction.

However, there can be significant barriers that can stop this from happening by keeping the return on less productive activities artificially higher, or, alternately, returns on more productive activities artificially lower. These barriers can take the form of excessive government intervention, limited market size, and other forms of market failures.

## 4. Pakistan: the barriers to transformation

John Power, writing in 1963, succinctly summarized the state of Pakistan's economy at the time. While pointing to what appeared to him as simply "a lot of plain inefficiency" across the economy, he further commented that policy choices in Pakistan focused on,

**"doing many things poorly instead of fewer things well."**

Sectors	Effective Rate of Protection (2019)
Dairy Products	165%
Sugar	123%
Food products n.e.c.	245%
Beverages and tobacco products	167%
Textiles	77%
Wearing apparel	185%
Leather products	77%
Wood products	76%
Petroleum, coal products	79%
Motor vehicles and parts	143%

**Table 1: Effective Rate of Protection**  
(Source: Varela et al., 2020)

Unfortunately, in light of the evidence presented above, not much has changed since then.

## i. Fatal Conceit

"many studies and anecdotes detail how corruption, regulation, or direct government involvement distort the allocation of resources from their most efficient use, especially in poorer economies."

- *Restuccia and Rogerson (2017)*

Why is it that economic resources in Pakistan have failed to move towards the production of more complex goods? The short answer is that subsequent policy interventions have worked towards ensuring that the returns from engaging in the production of less complex goods continue to remain high. As a result, there is no incentive for resources to move towards more productive endeavors.

Table 1 shows the effective rate of protection for key sectors that make up our export basket (excluding motor vehicles). The key takeaway is that the reason our export basket (and productive structure) has continued

to remain concentrated in low value-added less complex products is because these enjoy a high degree of protection. Worse still, this protection has come at the expense of the average citizen, who has continued to finance the lifestyle of the few in the hope of an economic transformation that has failed to transpire for decades.

The influence of poorly designed policy interventions is not only limited to the tariff structure. In the agriculture sector, undue in-

fluence of large landowners in legislature has resulted in state intervention through support prices, import restrictions, and direct and indirect subsidies, which have all contributed to anticompetitive practices and adversely affected consumer interests. Resulting price distortions in food commodity markets have had the perverse effect of incentivizing large landlords to use their holdings in an unsustainable and suboptimal way, thus retarding any improvement in productivity. Box 1 offers a snapshot of some of Pakistan's subsidies.

### **Box 1: The Use and Abuse of Subsidies: In the name of exports!**

- Pakistan's history is replete with subsidies aimed at facilitating exports. These include Bonus-Voucher Schemes, Refinance Scheme, Cash Compensatory Rebates, Freight Subsidy, and R&D Support;
- However, these have often been sector specific, and never incentivized firms to diversify towards new more complex products and enter new markets;
- In effect, these interventions prevented the incentive structure from evolving and, as a result, further reinforced existing rigidities;
- The interventions have also been susceptible to misuse, e.g. the recent real estate boom was partly fueled by concessionary finance obtained under the re-finance scheme, particularly part II;
- In the absence of any noticeable transformation, it is clear that these subsidies incurred significant costs on taxpayers.

*Source: Muhammad Ashraf Khan (unpublished paper)*

Likewise, the plethora of archaic regulations and a complex tax structure has increased the compliance costs for businesses. This has discouraged them from accessing formal banking channels and entering new markets. State intervention in key sectors of the economy through sclerotic regulations and mismanaged state-owned enterprises (SOEs) has also discouraged economic resources from getting allocated to their most productive use.

Finally, uncompetitive practices often operate under a legal cover. For example, provincial sugar factories control acts allow sugar mills to operate as local monopolies:

“... cane grown in a reserved area shall not be purchased by a purchasing agent or by any person other than the occupier of the factory ...”

– *Punjab Sugar Factories Control Act 1950*

#### **ii. Market failures**

In addition to excessive government intervention, market failures can also act as a barrier to resources moving to more productive activities. For example, due to limited information on the loan applicant and lack of credit history, banks may not be willing to finance promising businesses. These credit frictions can amplify further when businesses expand

into new sectors or markets where the banking system lacks the expertise to assess the creditworthiness of loan applications.

Likewise, the lack of integration with regional and world markets may mean that businesses may fail to reach scale and, as a result, remain stuck in a low productivity trap. According to the World Population Review, the annual median income for Pakistan is \$1,530. The limited purchasing power of the domestic consumer means that, in the absence of integrating with the rest of the world, there will never be enough demand for high value-added industrial goods. As a result, Pakistan's industrial base will remain concentrated in low valued-added less complex goods. The development economists, during the 1950s and 60s, worried about a similar problem facing small developing economies. Irwin (2020) writes, "Prebisch also worried that economic efficiency would be sacrificed if developing countries, with their very small domestic markets, tried to pursue a policy of self-sufficiency." This ultimately led many developing economies to abandon import substitution and, instead, seek greater regional and global integration (Irwin, 2020).

Other areas where markets may fail include investment in research & development, investment in human resource, implementing standardization of regulations to comply with requirements of foreign markets, providing adequate social security to the masses, and protecting the environment.

## 5. Rethinking Policy

The challenge policymakers face is how to design an incentive structure that allows resources to continue moving from less to more productive activities, in response to changes in the economic environment. Specifically, this requires replacing protection against national and international competition for specific sectors with adequate support necessary for overcoming clearly identified market failures.

The key objective is to catalyze the private sector's own self-discovery process (Hausmann & Rodrik 2002). It is imperative that less productive businesses which are unable to compete are allowed to fail to allow economic resources to move towards innovative and more productive businesses. Putting in place an incentive structure which continues to facilitate this process will allow Pakistan to accumulate greater capabilities and, as a result, help deliver sustained prosperity to its citizens in decades to come. In what follows, we organize our policy proposals under four broad themes. These are: i) integration with regional and global markets; ii) revisiting pricing regimes; iii) human capital development; and, iv) industrial strategy.

### i. Integrate with regional and global markets

While the earlier trade theories focused on a country's intrinsic characteristics as the only driver of a country's comparative advantage, later theories have gone further and also emphasized the role of both internal and external economies of scale. It is these later theories which help explain the emergence of global value chains, including the increased importance of intra-industry trade in global trade (Krugman, 1980).

The appreciation of the role economies of scale play, however, goes further back. Irwin (2020) notes that the Argentinian economist Raul Perbisch also worried "that economic efficiency would be sacrificed if developing countries, with their very small domestic markets, tried to pursue a policy of self-sufficiency." Irwin shows that the small size of domestic markets became the key reason for why many development economists of the 1950s, who were earlier supportive of import substitution policies, became either skeptical or critical of the usefulness of import substitution policies. For example, Ragnar Nurkse's early questioning of import substitution later turned to outright criticism. By the end of the 1950s, he argued that import substitution would draw resources away from the export sector and

“may lead to costly and inefficient production in import substitutes.”

The limited size of Pakistan’s domestic market can be gauged by appreciating the fact that the median per capita annual income in Pakistan is almost the same as the price of latest iPhone 13 Pro. In other words, the limited purchasing power of domestic market is inadequate to allow the scale advantage required to achieve high level of productivity in the production of industrial goods.

As a result, failure to integrate with the rest of the world means that Pakistan has been unable to take advantage of the vast opportunities offered by the global marketplace (Ahmed et al., 2015). This has stymied innovation and productivity gains among Pakistani manufacturers, making them uncompetitive for the global market, and therefore, unable to scale up and create jobs (Ahmed, 2018). Box 2 illustrates the lack of Pakistan’s global integration.

### Box 2: Pakistan’s Insignificant global and regional integration

- Globally, intra-regional trade averages 40% or more, while for Pakistan, it is less than 5%.
- Pakistan is not a part of any significant regional trade agreement, such as RCEP.
- The country is strategically located, but does not allow other countries to trade through it.
- Pakistan is isolated in terms of international trade.
- Imported goods incorporated into exports are 5%, compared to 40% for Malaysia and Vietnam.

*Source: Presentation by Dr. Manzoor Ahmad, Senior Management Course, National Institute of Management (2020).*

## Policy Suggestions:

- a. Reduce custom and regulatory duties, and replace these with a uniform tariff across all sectors and product categories;
- b. Redesign existing schemes (such as the SBP’s export finance scheme) to incentivize export of new products and/or to new markets;
- c. Focus on being competitive for parts of Global Value Chains (GVCs) for products, rather than for the entire product, and on moving up GVCs;
- d. Strengthen industrial and infrastructure capacity so as to attract efficiency-seeking FDI (which is more geared to boost exports) rather than market-seeking FDI;
- e. Actively engage with regional trading blocks with the aim to either join these or enter into an FTA with them. Potential candidates include RCEP and AfCFTA (PRIME, 2021);

- f. Engage with regional countries and work towards signing bilateral FTAs;
- g. Work with national and sub-national trade bodies to help businesses conform to international standards;
- h. Improve border infrastructure along the western border and facilitate Central Asian countries in using Gwadar port for their trade.

### ii. Revisit pricing regimes

In a decentralized economy, prices play an important role in coordinating production activity across the economy and, in the process, help achieve efficient allocation of resources. This lack of appreciation for prices as an important part of the allocative mechanism has led to significant distortions in almost every sector. For example, a higher support price for sugar cane has increased the total area under sugar cane cultivation. This has come at the expense of a decrease in the area under cotton cultivation.

For example, the fixing of support prices for certain agricultural commodities have had the perverse effect of incentivizing suboptimal usage of agricultural land holdings and sluggish improvement in yields. A higher support price for sugar cane has increased the total area under sugar cane cultivation, often at the expense of cotton crop. Similar allocative distortions are also observed in the production of wheat. The Punjab government was paying around Rs21 billion in annual interest payments on loans taken to procure wheat in preceding years. The total financial loss from 2010-11 to 2016-17 equals Rs163bn. This is again a direct consequence of support prices, which are significantly higher than the market clearing price.

Energy is another critical sector with significant distortions. Low natural gas prices in preceding years decreased the incentive for firms to invest in gas exploration. Foreign investment in oil and gas exploration declined roughly 50 per cent between 2012 and 2017. With the depletion of gas in operational fields and limited exploration activity, the production of natural gas fell from a peak of 36.6bn cubic metres to 34.7bn cubic metres over the same period.

In contrast, higher energy prices in the United States during the last two decades played an important role in incentivising investment in exploration activity. It also played a critical role in the exploration of shale gas. These developments have decreased US dependence on imported fuel.

### **Policy Suggestions:**

- a. Replace support prices in the agriculture sector with crop insurance for small farmers. The recently launched Kissan Card can be utilized to achieve this objective;
- b. Liberalize the licensing regime for setting up factories;
- c. Revisit the provincial sugar factories control act and relevant laws, and reform them with the objective of promoting competition;

- d. In line with recommendations under tariff reforms, have a uniform tariff on the import of any commodity;
- e. Allow businesses to import any commodity anytime without requiring any approvals;
- f. Allow businesses to store commodities to incentivize the development of storage infrastructure;

### **iii. Invest in youth and women: modernize skill development infrastructure to meet the needs of 21st century business**

According to the International Labor Organization (ILO) 2019 estimates, in Pakistan, output per person, which is a measure of labor productivity, grew at the annual rate of only 1.4 percent between 2000 and 2019. In contrast, the same figure for India and China is 5.3 percent and 7.0 percent, respectively. Consequently, Pakistan's output per worker is roughly one-ninth that of the United States, while that of India's is around one-sixth and of China's is approximately one-fourth of the US.

An important reason for the poor state of human capital in Pakistan is the design of the prevailing education system. After completing schooling, students are expected to pursue further studies in traditional universities. While there are technical and vocational institutes offering technical education, the need to pursue higher education in universities is amplified by most white-collar jobs, including many government jobs, requiring some kind of degree certification from universities as a signaling and screening device. Moreover, lack of acknowledgement that the university education takes longer, is expensive, and may add little value to the job match has led to significant underinvestment in both the structure and capacity of Technical and Vocational Education and Training (TVET) sector.

In addition to issues around accreditation, the TVET sector suffers from limited training capacity, outdated workshops and laboratories,

archaic teaching methods, and antiquated curricula. Against the requirement to upskill approximately two million youth annually, excluding those entering into other avenues of tertiary education, the present training capacity is only for an estimated 400,000.

## Policy Suggestions:

### Mainstreaming vocational education

- a. Revisit the education structure and mainstream the TVET sector. This requires introducing TVET pathways, starting from schooling and going all the way to higher education. The Metric-TECH initiative currently under consideration is a step in the right direction. However, the student journey must be carefully thought through before putting this in practice;
- b. Government must also fast track initiatives to recognize and strengthen the skills set of workers operating in the 'informal' sector. A significant fraction of workers already acquire skills through informal channels e.g. ustad-shagird at workshops. The skill set of this pool of workers can be easily recognized and upgraded without significant investment;
- c. The job criterion for many of the government jobs must also be revisited and aligned with technical education wherever possible. This will create an incentive for private sector to invest in TVET sector while at the same time discouraging the mushrooming of universities the country has seen in recent decades;

### Strengthening and expanding TVET sector

- d. There is also a need for targeted interventions for Skill Development Programs:
  - i. Introduce and strengthen High Tech / End Trades e.g. Artificial Intelligence, Robotics, 3D Animation,

Game Development, Android / IOS Apps Development, Cloud Computing, Internet of Things, CNC Machine Operator, Graphic Designing, Renewable Energy Management, Deep Learning, Cyber Security, Industrial Automation;

- ii. Introduce programs to train the workforce for Manufacturing (Small, Medium & Large Industry including value added Textile Industry, such as Garments;
  - iii. Increase and strengthen skills training programs for Agriculture, Horticulture, Livestock, Dairy, Poultry and Fisheries;
  - iv. Focus on Hospitality, Tourism and Hotel Management;
  - v. Enhance programs providing training for Domestic Skills for Women (Dress making, Fashion and Textile Designing, Beauty Services and Creative Arts);
  - vi. Develop and strengthen skills programs for Electronic & Print Media, Transport & Logistics.
- d. Modernize TVET workshops/institutes to teach digital and other market relevant skills:
- i. Expand Capacity to train one million by 2024;
  - ii. Enhance Quality of TVET delivery - Set Standards, Develop/Standardize Qualifications;
  - iii. Setup High-Tech Skills Centres;
  - iv. Build international affiliations: Joint Degrees, Mutual Recognition of Pakistani Qualifications.
- f. Increase Access & Equity;
  - g. Maximize Industry Ownership through apprenticeship legislation and time-bound and target-specified incentives;
  - h. Embed digital, data science and industry 4.0 related skills in the Single National Curriculum at the primary and secondary level.

#### iv. Industrial strategy: from picking winners to rewarding innovators

The policy landscape in Pakistan has historically been dominated by sectoral policies. Worse still, these policies have continued to prevent our economic resources from moving toward more productive activities. While it was hoped that these will gradually lead the country towards the production of more complex high value-added products, the evidence presented in section 2 and 4 of this document suggests these policies have instead prevented the economy from undergoing any productive transformation.

Sectoral policies are also at the risk of being hijacked by lobby-groups who spend significant resources in capturing a greater share of taxpayers money, while continuing with dedicating resources towards production of less complex products (see section 2). The new industrial strategy must move away from sustaining existing production structures towards incentivizing innovation and more complex production activity, with the aim to replace poor performing less-productive rent-seeking businesses.

Moreover, any industrial policy must also bring cities at the forefront. Nadeem ul Haque has frequently highlighted the role of cities as engines of growth in the modern economy (Haque, 2020). However, while policymakers in Pakistan have gone at great lengths to provide land for industrial activities in the form of special zones, little attention has been dedicated towards improving the land use within cities. Schuetz (2019) explain how land use laws (or zoning regulations) can constrain or promote socio-economic activity in important ways. The implications range from the availability of affordable housing to increasing productivity through clustering of economic activity (when zoning regulation promotes mixed use spaces), both of which are crucial for efficient allocation of resources. Gyourko and Molloy (2015) review the relevant literature in the context of housing and find that welfare costs of poor land use laws can be

substantial. Shertzer et al. (2018) conclude, *“zoning may be more important than either geography or transportation networks – the workhorses of urban economic geography models – in explaining where commercial and industrial activity are located.”*

Finally, an important roadblock in the way of industrialization is also the distorted and complex tax structure. Bukhari and Haq note, *“Another important factor that discourages compliance with tax laws is the extremely complicated and cumbersome nature of procedure involved in being registered with the revenue authorities. Even the corporate and educated class finds it difficult to comprehend, follow and observe the simultaneously applicable innumerable legal obligations, what to talk of the illiterate and ordinary man on the street. If a survey is conducted with respect to merely the advance tax provisions (almost 66 in number), it would reveal how a person is supposed to be aware of so many avenues where either tax is being withheld or he is himself paying income tax and the consequences of these taxes, the credit of which he may or may not be allowed to take while filing his return. In the first instance, a highly meticulous record of all such transactions that invoke taxes would have to be maintained and secondly, an even higher level of grasp over the law would be required to apply it.”* (Bukhari and Haq, 2020).

In this context, steps must be taken towards simplification of tax laws. While efficient tax administration is equally important, it is a mistake to expect improvement in tax administration without radically overhauling the tax code. It is easy to appreciate that a convoluted tax code does not only increase compliance costs, especially for small taxpayers, but also introduces avenues which can be exploited by tax officials for personal enrichment.



## Policy Suggestions:

### Cities and zoning regulations

- a. Revisit zoning regulations with the aim to expand mixed-use areas within cities and promote clustering of socio-economic activity (PIDE, 2021);
- b. Shift focus from facilitating development of housing societies in peripheries towards reducing land use restrictions on the development of high-rise low-income housing in cities and expansion of urban public transport;

### Simplification of tax policy

- c. Withdraw exemptions, and simplify income and sales tax regime for all. This includes reducing the number of classifications which exist under existing tax for tax purposes;
- d. As suggested by Bukhari and Haq (2020), replace existing indirect taxes at provincial and federal level with 'Harmonized Sales Tax.'
- e. Automate tax administration with the aim to minimize direct interaction between taxpayers and tax officials;

### Other key elements

- f. The new industrial strategy must also complement the policies mentioned elsewhere in this document to facilitate transformation of productive structures;
- g. Revisit existing sectoral policies and replace these with a system of incentives that reward the entrepreneurial endeavor irrespective of sectors, i.e. rewards product development, brand development, and penetrating new markets;
- h. Develop financial markets to increase sources of funding for businesses;
- i. Work with relevant departments at the

- j. national and sub-national level to reduce compliance costs for businesses with respect to obtaining access to utilities, paying taxes, and trading across borders;
- k. Work with the judiciary to reduce contract enforcement costs for businesses, and other necessary legal reforms;
- l. Work with city governments to reform zoning regulations to facilitate domestic commerce and reduce the cost of commercial space for businesses (PIDE, 2021);
- m. Address the rigidities in the labour market. This remains a critical barrier to growth in most sectors. A cursory visit to Chinese enterprises working in Pakistan (e.g. Sundar in Lahore) reveals why labour was brought from China. It is not just a skills question, it is also the rigidities in labour laws and their implementation that prevent formalization of labour/contracts;
- n. Focus on public investment reform, which is important as the private sector is not interested in going to vast parts of Pakistan. In such a scenario, the government's ability to design and execute publicly funded projects and enabling infrastructure is critical. Almost all multi-year projects in PSDP and ADP suffer from time and cost-overruns;
- o. Build capabilities to implement Public Finance Management (PFM) laws. Several federal line ministries need to build capacity to understand this legislation. It needs to be understood whether the PFM laws at national and sub-national level are comprehensive enough to preempt medium term fiscal crises (e.g. unfunded pensions burden to double in a few years); Simplify tax policy and build autonomy in tax administration. Examine how other countries have insulated their tax machinery from political influence. Expedite Pakistan Regulatory Modernization Initiative (PRMI), which promises to take away a lot of control from the taxman.

## 6. Conclusion

We advocate rethinking policy in a holistic way and provide specific policy suggestions. This document acknowledges the important role governments can play in helping overcome market failures and investing in capabilities which are essential for a successful economy. However, in the context of Pakistan, ill-conceived state interventions have undermined efficient allocation of resources thus reducing general welfare of the society. For example, the fixing of support prices for certain agriculture commodities have had the perverse effect of incentivizing suboptimal usage of land holdings and sluggish improvement in yields. Likewise, subsequent governments have continued to provide incentives to uncompetitive industries, thus preventing resources to move from less productive to more productive economic activities.

In this document, we present a new vision for transforming Pakistan's economy. While the policy areas and suggestions are diverse, they are all geared towards putting in place an incentive structure which transforms Pakistan's economy into an economy with high

degree of economic complexity, and hence greater relevance and potency in the context of the 21st century globalized world. We organize our suggestions under four themes: revisiting pricing regimes which currently govern agriculture and commodities sectors; re-vamping of the education system with the aim to introduce and mainstream pathways for vocational training at the level of higher and post-secondary education; reduction in tariff and non-tariff trade restrictions and greater integration with regional trade blocs; and, finally, rethinking industrial policy with special emphasis on improving land-use within cities and simplification of the tax code.

We believe that it is only through these policies that the economy can progress beyond its outdated and ossified structure. A change of mindset and a putting in place an incentive structure which is aimed at building capabilities and continuously allocating resources from less productive to more productive activities is necessary for achieving any meaningful transformation.

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