Working paper

International Growth Centre

A growth vent anchored in history and geography

Ijaz Nabi

April 2013

DIRECTED BY
LSE
UNIVERSITY OF OXFORD

FUNDED BY
UKaid
from the British people

A Growth Vent Anchored in History and Geography*

Ijaz Nabi

April 14, 2013

The author is Visiting Faculty, Lahore University of Management Sciences and Country Director International Growth Centre, Pakistan. Valuable assistance was provided by Kiran Javaid and Maryam Tareen at the Development Policy research Centre, LUMS.

*This article has appeared as Chapter 14 in Rashid Amjad and Shahid Javed Burki edited volume, " Pakistan: Moving the Economy Forward", Lahore School of Economics, May 2013.

A Growth Vent Anchored in History and Geography[1]

1. Introduction

In explaining economic growth, economists invariably turn to analytical frameworks such as the Harrod-Domar Growth model and its many extensions (e.g. Solow, 1956). The main drivers of growth in such models are capital, labor and, more recently, knowledge (Romer, 1990). The models are handy in that they allow us to separate out growth due to increase in capital and labor from productivity led growth associated with the quality of overall economic management. This separation is useful because it brings the focus on efficient use of available resources rather than an insatiable quest for ever more investment.

Another approach is to look at episodes of rapid and sustained economic growth and identify the big ideas (vents for growth) that make them happen. The big ideas stimulate, borrowing from Keynes, the "animal spirits" and result in both higher investment as well as higher productivity growth. The discussion presented in this chapter takes this approach. It is argued that Pakistan has enjoyed several episodes of rapid economic growth since 1947 that are associated with changes in technology, institutions and legal systems that support the rolling out of a big idea (growth vent). Those growth vents have run their course. Pakistan now has to seek a growth vent that results in geographically balanced growth and thus can be sustained politically for a prolonged period of time.

This requires tapping into lucrative markets outside the borders in the neighborhood in a manner that creates several growth nodes viz., Karachi, the Arabian Sea coastline of Sind and

---

[1]The paper is based on a presentation by the author at the annual conference of the Lahore School of Economics, May 2012 and an article based on that paper in Lahore Journal of Economics, Volume 17, September2012. It has also benefited from comments/suggestions on several previous presentations as well that include a regional conference organized by South Asia Free Media Association (Lahore, November 2010), Pakistan History Society meeting at Lahore University of Management Sciences (Summer 2011) and a panel discussion at Woodrow Wilson Centre (Washington DC, April 2012). A summary version of the argument, *Lifting Up the India-Pakistan Trade Game*, was published as Op-ed in The Hindu, (March 28, 2012)

Baluchistan, Lahore and Peshawar. This paper reviews Pakistan's recent growth vents and their impact on the economy in terms of creating a vibrant Indus basin market. It then argues that the new growth vent Pakistan seeks requires re-creating the historical trade routes. This will be good for regional equity in Pakistan and will also give a new energy to the Indus Basin market.

The discussion owes a debt to Sibt-e-Hassan (Pakistan Main Tehzeeb Ka Irtiqa) and Aitzaz Ahsan (The Indus Saga and The Making of Pakistan) for stimulating the ideas further extended in this paper's economic framework that emphasizes the role of Pakistan as a regional hub of economic activity and thus a bridge between Iran, Central Asia, China and India.

2. Pakistan's major growth episodes

There were five major growth episodes in the region that constitute Pakistan in the last one hundred years:

Canal irrigation: Starting in the 1860's, the Indian sub-continent saw a remarkable expansion of the irrigation system. For 60 years, the average annual increase in the area under canal irrigation was a phenomenal 50,000 acres (Stone, 1984, p. 340). Punjab, Sindh and parts of Khaiber Pakhtunkhwa were major beneficiaries of this phase of canal expansion in British India.

Canals were preferred over previous modes of irrigation not only because of the lower unit costs but also because they extended the range of cropping options for the farmers, as they could water the crops at their own discretion. These benefits resulted in intensive as well as extensive cultivation of land, thereby increasing production and hence the rate of return in agriculture. Several complementary developments, such as a legal framework governing land related transactions, a network of roads and railways and public services such as education, health and policing, kick started economic growth in the regions constituting the Indus basin market and brought about a substantial increase in income and living standards for nearly a hundred years.

The Korean War and import substituting industrialization: The second major growth vent is associated with the Korean war. Economic managers of Pakistan took a strategic decision in 1949 not to devalue the rupee with respect to the dollar when Britain devalued the pound and India (rupee was linked to the British Pound) had followed suite. Pakistan's rationale was that capital goods had to be imported in order to industrialize and therefore rupee had to be strong. World events that followed supported Pakistan's decision. The Korean war, breaking out soon after the Second World War, led to stock piling because of the fear of shortages of critical raw material. Jute and cotton produced by Pakistan benefited from the resulting price increase (in four months, the price of 289F Punjab cotton rose by 80.3 percent from Rs. 81/maund to Rs. 146/maund). This strengthened the rupee and resulted in the accumulation of reserves. India, a major importer of Pakistani cotton and jute, had countered Pakistan's decision not to devalue the rupee by banning imports from Pakistan. This provided Pakistan the opportunity to diversify exports to non-traditional markets and look to foreign trade as a source of sustained economic growth. The fiscal account also turned favourable, as government revenue increased on account of the export duties imposed, contributing an additional 2 percent of GNP (Hasan, 1998, p. 113).

By not devaluing the rupee, the government kept the cost of imported capital goods low. This was accompanied with import controls, especially on consumer goods, that slanted the incentive regime in favour of industrial production (Zaidi, 2005, p. 93) and launched the era of import substitution industrialization (ISI) in the 1950s. The policy followed by Pakistan has been summarized as "produc(ing) anything that can be reasonably produced domestically... once production has started domestically, ban imports of competing goods so as to save foreign exchange" (Lewis, 1969, p.70).

Import substituting industrialization proved to be very successful, particularly in the heavily-protected consumption goods industries. Textiles also expanded spectacularly. However, heavy protection also extracted a price; the lack of competition resulted in less efficient production (Hasan, 1998, p. 116). The strategy also resulted in high concentration of wealth both regional as well as interpersonal. It was alleged at the time that 22 families controlled 80 percent of the assets of the country. Manufacturing was concentrated primarily in Lahore, Karachi and Faisalabad that together accounted for 60 percent of the total value added in 1959-60. This disparity persisted for a decade and contributed to the dissatisfaction that eventually resulted in East Pakistan separating from the federation.

<u>The Green Revolution</u>: Ayub Khan's government began to focus on agriculture in the 1960's that had stagnated as policy energy and incentives (especially via the exchange rate) were directed to implementing import substituting industrialization. During the first half of the 1960's, there was massive investment in irrigation: link canals were dug, Mangla dam was constructed and the number of tube wells in creased from a few hundred in 1960 to 75,000 by 1968 and a whopping 156,000 by 1975 (Zaidi, 2005, p.30). The timely availability of water was necessary to introduce a technology package of high yielding varieties (HYV) of seeds, fertilizers and pesticides focused on two crops initially: Mexi-Pak (adapting research from Mexico to Pakistan) and IRRI rice (research based in the Philippines). Their output inreased by 91 percent and 141 percent, respectively, in 10 years from 1960 to 1970 (Zaidi, 2005, p. 29). Between 1965 and 1970, average wheat yield rose by around 50 percent per hector (Hamid & Tims, 1990,

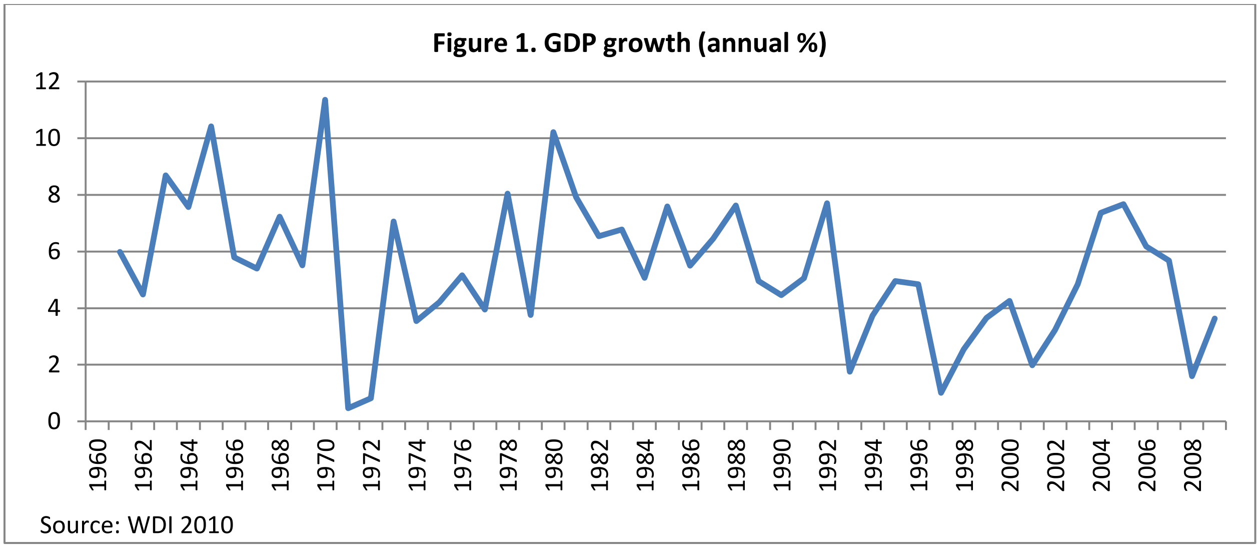
p.14). The agricultural growth rate started rising in the early sixties within the band of 3 – 6 percent but after 1966, when all the agricultural inputs were improved, growth rates jumped to 10 percent per annum.

Overseas migration and remittances: The 1970s and 1980s were characterized by a large outflow of labour, both skilled and unskilled, from Pakistan to the Middle East region. This was facilitated by a liberal labour export policy. The number of migrant workers increased from 79,000 per annum in 1970s to 107,000 in 1980s and remittances jumped from US$565 million to US$2.3 billion per annum. The high volume of remittance income was geographically spreads benefitting even the less well off regions. At the household level, remittances improved the living standards of recipient families, propelling them to a middle class status. The foreign exchange sent home by workers also had macro-economic benefits, allowing high volume of imports at a relatively stable exchange rate. But there was a downside. Remittances fuelled, consumption led growth for nearly three decades contributed to the loss of international competitiveness of manufacturing. This was both because of the high level of the equilibrium exchange rate as well as the broader consumption favouring policy environment (energy pricing, credit allocation, tax regime, public investment in transport etc, see Nabi, 2010). This manifestation of the Dutch disease in Pakistan ha contributed to the anaemic grwoth of manufacturing and the paucity of high prodictivity, high wage jobs.

War on Terror: A major growth spurt occurred under Musharraf in 2002-7. For its role in war on terror, Pakistan was rewarded in terms of concessionary capital from the International Financial Institutions (IFIs). There was also substantial write –off and rescheduling of external debt and increase in foreign direct investment. Remittances, that had fallen sharply in the preceding years, shot up again as confidence in the Rupee was restored. This resulted in a substantial improvement in Pakistan's balance of payment, which recorded a surplus of $2.7 billion in the early 2000s (Mullick, 2004). GDP growth, which was at 3.1 percent in 2001/02, began to rise reaching 6.8 percent by 2006/7. From a deficit of 0.3% of GDP in 2000, the current account balance improved to a surplus of 4.9 percent of GDP by 2003.

However, the end years of this growth phase (2006-2008) coincided with rising inflation and energy shortfalls. The share of investment and manufacturing in GDP and employment did not show any increase, the growth in imports far exceeded that of exports and the tax-to-GDP ratio stagnated. Growth and its salutary effects, therefore, were short lived.

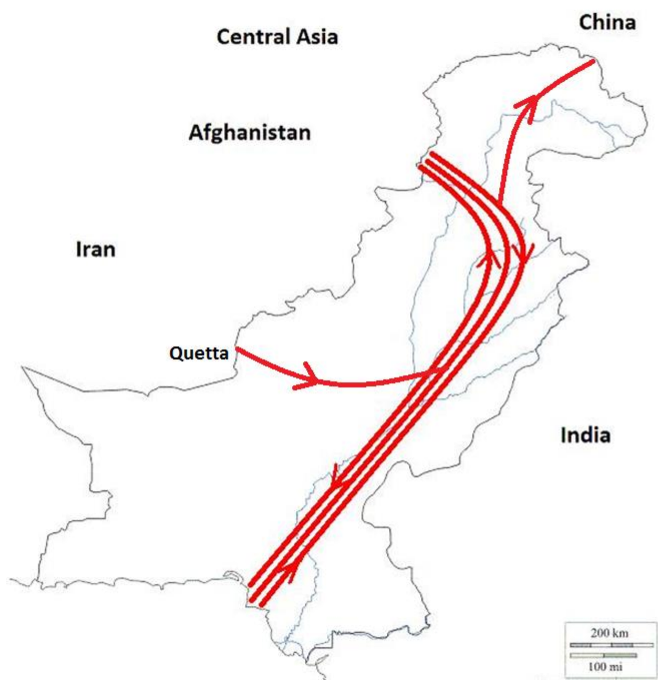
Figure 1 shows the oscillating growth pattern, the boom and bust cycles, of Pakistan's growth. There appears to be ten year cycles. The 1960s and the 1980s (with growth in most years above 6 percent) were the decades of robust growth, while 1970s and 1990s (with an average growth rate of around 4 percent) saw modest growth. The decade of 2000 experienced high growth in 2001-2007 followed by a slump starting in 2008.



Assessing the growth vents in term of their effect on regionally balances growth, the canal colonies would rank number one, followed by the Green Revolution. Protection and industrialization would be a distant third both because it could not be sustained and also because it resulted in unbalanced growth. Migration to the Gulf is number four simply because the primary stimulus comes from outside and we have not yet found a way of climbing up the skills ladder; the growth vent is thus vulnerable. The externally financed, geopolitically driven growth spurts under Zia and Musharraf fail the sustainability criteria; the latter was decidedly unbalanced geographically and also increased inequality across income groups.

Another way to look at the growth of the last six decades is in terms of the creation, perhaps for the first time in history, of an integrated Indus Basin market. A strong and interdependent market for products, labor and financial flows has been created between the border with India on the East and the Indus river on the West. Pakistan's economic managers wisely invested in a communications infrastructure spanning railways, ports, roads, postal system and telephones that has been key to the development of the Indus Basin market. Spokes in the Southwest extends the market to Quetta in Baluchistan and in the North-east with the regions of the Karakorams and the Hindu-kush. The market enjoys perhaps the best connectivity of any sub-region in South Asia. The National Trade Corridor (NTC) links Peshawar, through Lahore to Karachi and Port Qasim and 'handles the major part of Pakistan's external and internal trade.' (World Bank, 2006, 8) 'The bulk of Pakistan's international trade, about 40 million tons per annum… is transported by road along this main corridor. Almost all of this trade (95 percent) is handled by the two seaports of Karachi and Port Qasim, located about 50 km from each other. Pakistan's trade is characterized by a concentration of movements within the country (mainly along the NTC), a small number of export destinations and import origins." (World Bank, 2006, 17). This connectivity has facilitated Pakistan's growth spurts and the sharing of welfare from that growth across a wide region.

Figure 2: Pakistan's Indus Basin market along the North-South Trade Corridor



3. Searching for a New Growth Vent

While the growth episodes helped create a vibrant Indus Basin Market and resulted in robust growth for several decades, the North-South focus also turned Pakistan into a lop-sided economy. Despite a relatively small coastline compared to our land borders with three major economies (Iran, China and India) and one important region (Central Asia), our economic connectivity with an increasingly globalizing world is via one port city, Karachi, that constitutes a mega growth node. This strategy worked well for sixty years but, given the congestion on Karachi ports and the complex and volatile politics of the city, may now have run its course.

This paper argues that a new growth vent, one that will yield a prolonged period of growth as the canal colonies did a hundred years ago, requires tapping into lucrative markets outside our borders in a manner that creates multiple entre-ports for growth (such as Lahore, Peshawar and other ports on the Sind/Baluchistan coastline). Such a growth vent will enable the country to achieve a sustained growth path that will not be as susceptible to the vicissitudes of the politics of one mega growth node.

A Historical Perspective

Pakistan's border regions have shared systems of economic transactions and cultural ties with neighboring regions that lie outside its current borders. The area that is now Pakistan was home to one of the earliest civilisations of the world. For centuries this region constituted a central position in relation to the rest of the world, a place where different societies mingled, sharing cultural ties and making economic transactions. Cities such as Lahore, Multan and Peshawar, and those in Upper Sind lay on trade routes connecting lands to their west – Iran, Central Asia and China - and those to the east – India - and as such became centres of trade, commerce and culture and brought prosperity to regions they commanded.

Lahore in Punjab was the centre of trade, commerce, finance and education for a region that included Indian Punjab, Haryana, Jammu and Kashmir valleys and Himachal Pradesh to its east, and linked these regions with Persia and Central Asia to its west. Lahore was cut off from the lands in the West with the coming of the British and from the East soon after 1947 as aresult of India-Pakistan feuds.

The ancient walled city of Peshawar, has cast a large shadow on South Asia's culture. Famous South Asian actors (the Kapurs, Dilip Kumar and Shahrukh Khan) hail from Peshawar as do several world squash champions. The prominence of Peshawar is on account of the fact that the merchants of the walled city constituted a prosperous hub of economic transactions between South Asia and the Central Asian territories. The influence of trade on the surrounding Pashtun areas would also have been substantial. Imperial rivalry between Russia and Britain cut off Peshawar from its northern markets and 1947 severed access to the Indian markets. The pool of economic transactions for Peshawar shrank dramatically. It is also noteworthy that the modern silk route through Hazara and Gilgit Baltististan on the China border is an attempt to recreate the ancient trade links that were severed during the colonial times.

Sind is hugely significant in shaping our religious/cultural psyche embedded in the venerated Sufi tradition of Islam. The Sufi saints chose to settle in Sind along the Indus because there were receptive host communities that benefited from the trade routes between markets in territories that now lie in India and Iran through Baluchistan.

These cultural centres have defined themselves historically as parts of much larger regions that lie outside the borders of the modern nation state of Pakistan. Indeed, historically, these centres were better connected with trade and cultural centres outside the modern nation state of Pakistan than those that lie within it. This has posed a challenge for the nation builders of Pakistan. Hemmed in by the colonial borders on the one hand and the hopelessly bad relations with India on the other, Pakistani policy makers have attempted to reshape the country's economic geography. As a departure from historical patterns that emerged over centuries, they created the North-South corridor defined by our new borders which, as discussed earlier, facilitated the major growth vents of the last six decades.

Figure 3: The cultural influences that have shaped Pakistan

Back to the Future?

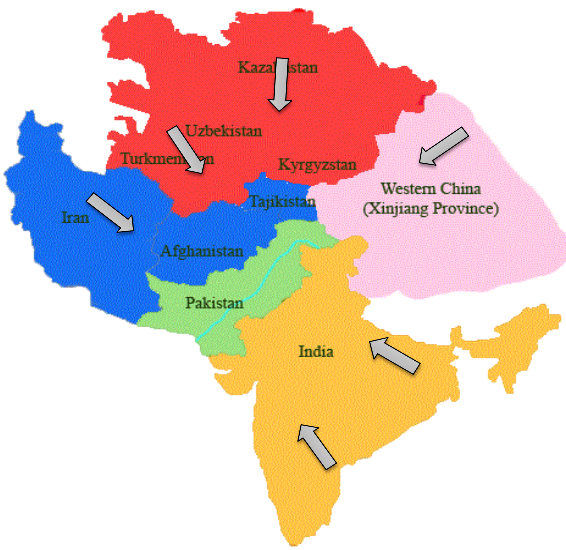
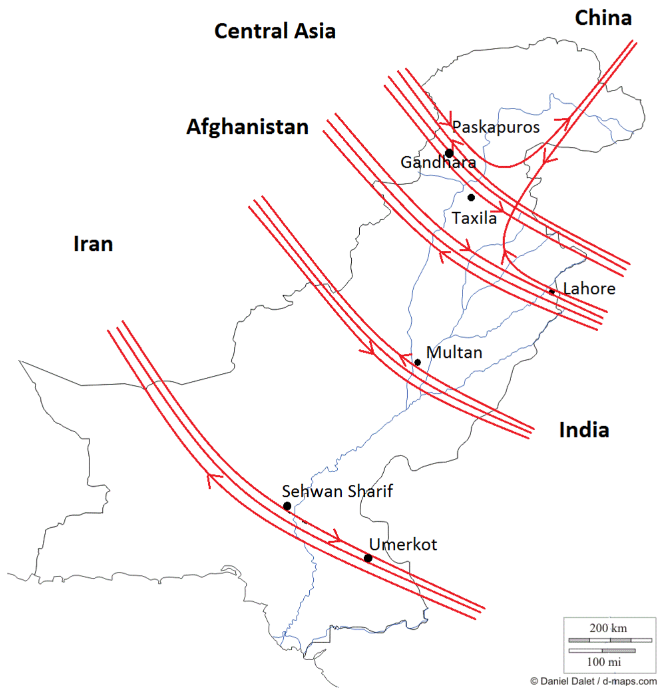


Figure 4: ....and the East-West trade routes they spawned



The changing world around our land borders

As recently as the 1980's, it did not matter that the old East-West trade routes lay abandoned. China was in a long slumber and was performing far below its capabilities as a potential economic giant. Western China, in particular, was mired in low growth and that was the more relevant China for Pakistan. In Central Asia, the mineral wealth was exploited in the interest of Russia. And India, with its low "Hindu" growth rate, was shackled to a heavy handed and stifling regulatory framework born out of Fabian aspirations and a decaying colonial bureaucratic heritage. In the last thirty years, all this has changed.

China, under Deng Xiao Peng, came out of its slumber in the early 1980's and has since become an economic power house with growth rates of 10 percent per annum for over two decades. China is undergoing a major restructuring to deepen growth beyond the pacific coast to Western China and thus bring it to Pakistan's land border in the North. The rising Chinese middle class constitutes a huge consumer market for Pakistan's products. Also China's high savings could be a deep pool of investment for Pakistan. An economy of a billion plus people with the potential to grow at 10 percent for more several decades beckons from our Northern land border.

India followed China a decade later with the reforms of Prime Minister Narasima Rao. The cumbersome regulatory framework is being dismantled by India's economic managers. The spectacular growth in the IT sector has given a India "techi" shine that is attracting world's attention. India is on an impressive growth trajectory of 7-8 percent growth per annum and is now recognized as a major emerging economic power. In short, another economy with a billion plus people, high savings and rising living standards lies beyond the long Eastern land border.

Across the North-Western border, beyond troubled Afghanistan and our own volatile tribal belt, are the newly independent Central Asian Republics (Turkmenistan, Uzbekistan, Kazakhstan, Kirgizstan and Tajikistan). Rich in natural resources no longer siphoned off by the Soviet behemoth, the Central Asian Republics are engage with the world to exchange their mineral wealth for goods and services that satisfy growing consumption and rising living standards of their citizens.

Beyond the Western Border lies Iran, rich in oil and natural gas that it would be free to sell to the needy South Asia in exchange for skilled manpower and consumption goods once its strategic interests are allied with the welfare of its citizens.

5: What is needed?

The East-West economic routes (that go beyond trade in goods and includes energy flows and movement of workers and flows of investment), and the growth vent associated with them, will not be realized till there is peace in Afghanistan, our tribal belt straddling the Afghan border is stabilized and Balochistan re-engages with the federation effectively. Furthermore, without normalizing trade with India, the Indus Basin would be a T-junction rather than a cross roads of economic transactions that would circumscribe the welfare gains from the new growth vent.

Stabilizing the Durand line

To contribute to peace in Afghanistan, the concept of strategic depth needs to be revisited and cast in terms of deepening of economic transactions. The residents on both sides of the Durand line understand well the welfare gains to be garnered via economic synergies between Peshawar and Jalalabad on the one hand and Kandahar and Quetta on the other. Pakistan's light engineering sector can service the rich agricultural lands in Afghanistan and in turn be a market for Afghanistan's cash crops whose demand would extend to all of South Asia.

Pakistan's financial sector and the flourishing private school networks could provide key services assist Afghanistan to build its own systems. The extension of roads beyond the Durand line and trade facilitating infrastructure at the border would be the precursor to trade in Afghanistan's substantial mineral wealth.

Throughout history, Pakistan's land poor tribal belt has looked to out migration for sustenance. Canal irrigation in Peshawar valley and the plains of Mardan was a major growth vent in the past and many tribesmen settled on the lands and brought about lasting productivity improvement and prosperity. During Pakistan's import substituting industrialization phase, Karachi became a magnet for jobs and entrepreneurial activity which attracted a large number of tribesmen. As a result, Karachi today is the largest Pathan city where people with strong connection with the tribal belt dominate the transport sector and its networks throughout the Indus Basin market. As trend economic growth declined in Pakistan and job creation slowed down, people from the tribal belt found opportunities abroad, especially in Saudi Arabia and the oil rich Gulf states. With the decline in tribal economic dependence on Pakistan, the relationship with the federation weakened and has contributed to the ongoing militancy. The relationship of mutual dependency between the federation and the tribal belt needs to be restored. This will require higher economic growth in Pakistan, ensuring that the tribal belt benefits from regional trade via the transport networks and upgrading skills in the area to allow the citizens to secure higher wage employment in the oil rich Middle East.

Centrality of Balochistan

Balochistan will be central to Pakistan becoming a regional hub for trade in goods and energy. The province's strategic location makes it pivotal both for the East-West as well as for the North South trade routes. The historical trade route linking markets in Indian Gujrat, Upper Sind and Iran traverses through Balochistan. The trade route to Kandahar in Afghanistan and beyond to Central Asia also traverses through Balochistan. Thus peace in Balochistan and upgrading of infrastructure and transport networks along the East-West routes will have to be priority both for Balochistan's development as well as for Pakistan's overall economic growth.

Balochistan also offers exciting prospects with considerable economic benefits in terms of a second North South trade corridor. These arise from the province's 800 kilometer long Makran coast location on the Arabian sea and the Indian ocean. According to some estimates "90 percent of inter-continental trade and two thirds of all petroleum supplies travel by sea. Globalization relies ultimately on shipping containers, and the India Ocean accounts for one half of all the world's container traffic. Moreover, the Indian Ocean rim land from the Middle East to the Pacific accounts for 70 percent of the traffic of petroleum products for the entire world. Indian Ocean tanker routes between the Persian Gulf and South and East Asia are becoming clogged, as hundreds of millions of Indians and Chinese join the global middle class, necessitating vast consumption of oil" (Robert D. Kaplan , "Monsoon: Random House, New York, 2011).

Kaplan goes on to write, "If there are great place names of the past ----Carthage, Thebes, Troy, Samarkand, Angkor Wat---- and of the present Dubai, Singapore, Tehran, Beijing, Washington ---- then Gwadar might qualify as a great place name of the future".

"so imagine now a bustling deepwater port with refuelling and docking facilities at the extreme Southwestern tip of Pakistan, more a part of the Middle East than of the Indian Sub-continent, equipped with highway and oil and natural gas pipelines that extend northeast all the way through Pakistan ---cutting through some of the highest mountains in the world, the Karakorams---into China itself, from where more roads and pipelines connect the flow of consumer goods and hydrocarbons to China's middle class fleshpots farther east. (B. Raman, "Hambantota and Gwadar---an Update, "institute of Topical Studies, Chennai, India, 2009). The pipelines would also be used to develop China's restive, Muslim far west; indeed, Gwadar looked poised to cement Pakistani and Chinese strategic interests (Robert G Wirsing, :Baloch Nationalism and the Geopolitics of Energy Resources: The Changing Context of Separatism in Pakistan", Strategic Studies Institute, U.S. Army War College, Carlisle, PA, April 17, 2008). Meanwhile, another branch of this road and pipeline network would go from Gwadar north through a future stabilized Afghanistan, and onto Iran and Central Asia. In fact, Gwadar's pipeline network would lead into a network extending from the Pacific Ocean westward to the Caspian Sea. In this way, Gwadar becomes a pulsing hub of a new silk route, both land and maritime: a mega project and gateway to land locked , hydro-carbon rich Central Asia ---an exotic twenty first century place name."

Thus both Islamabad and Quetta have much to gain from a joint strategy of economic growth based on regional trade. This requires strengthening the relationship of mutual dependence and trust. To that end, the 18th amendment of the constitution and the supporting 7th award of the National Finance Commission in 2010 was an important first step. The constitutional amendment virtually eliminating the concurrent list transfers most of the responsibility for economic development to the provinces. To back this up financially, 7th NFC award has reduced the federal share of the pool of resources and substantially increased Balochistan's share. This follows from greater weight to underdevelopment and thin population density (that increases the cost of service delivery) in the distribution formula. In turn, Balochistan needs to develop the capacity to utilize the additional resources more effectively. The NFC award presents opportunities to that end. National investment priorities to promote regional trade could be dovetailed with complementary Balochistan investments via the provincial Annual Development Plan to implement a comprehensive strategy for upgrading infrastructure that supports larger volumes of regional trade.

The federation also needs to revisit the sensitive issue of natural resource pricing because of the perception that the federation is skimming off large rents. Natural gas is a case in point. Subsidizing natural gas for urban residential consumers, most of them in Punjab and Karachi, by keeping well-head prices far below international prices fuels resentment.

The land grab in Gwadar has not helped in building trust between the Baloch and the Federation. It is alleged that as Gwadar's prospects brightened with the construction of the port, the rich and well-connected from Karachi, Lahore and other parts of Pakistan bribed low ranking local officials to allot land at rock bottom prices and then sold it off to developers at much higher prices thus skimming off huge speculative rents. The Baloch regard this as theft and site it as an example of the unfair treatment meted out to them by the federation. Solutions such as a turnover tax on each land transaction that is deposited in a fund for the exclusive use of the Baloch in Gwadar would help allay such perceptions.

These examples show that regional equity needs to be built explicitly into Pakistan's national development strategy. The fact that Balochistan has less than 5 percent of Pakistan's total population of 180 million but has most of its mineral wealth and coast line should be enough incentive to pursue such strategies.

Engaging with India

A number of studies (Nabi and Nasim, 2001; Naqvi and Nabi 2008; Khan, 2009; Nabi, 2012) have estimated the salutary impact of India-Pakistan trade liberalization on Pakistan's economy both in term of overall trade volumes as well as on the vast majority of stakeholders. Pakistan's role as a hub of regional trade is incomplete without the East-West trade (and also the North South) routes extending to India. This is illustrated in the trade flow chart of Figure 13 that shows greater vibrancy of the Indus Basin economic transactions following the re-establishment of the East-West trade corridors. Liberalizing the economic relationship with India takes on greater urgency to enable Pakistan to enjoy the current entry point comparative advantage in the cost of doing business, and especially the advantage in infrastructure efficiency. This advantage will be eroded as India reduces business costs and improves its infrastructure. Had Pakistan liberalized twenty years ago, it would have enjoyed the entry point advantage of a much better overall investment climate that has eroded over time.

Recent (August 1, 2012) liberalization of the investment regime by India (that lifts the ban on Foreign Direct Investment from Pakistan into India) and the earlier announcement by Pakistan to move from a positive list to a negative list based bilateral trade (granting of MFN) are welcome developments. However, for trade to resume on a meaningful scale, several remaining stumbling blocks need to be addressed.

The granting of MFN status to India was accompanied by the announcement of a long and unwieldy negative list of 1200 items. It was stated that the list would be phase out in a year. This time table must be adhered to. MFN status to India must be accompanied by setting up a bilateral commission to address the issues that are closely tied up with India and Pakistan having a normal economic relationship that results in sustained benefits. The commission would focus on:

<u>(i) Goods and services related non-tariff barriers</u>: The objective would be to use the WTO framework for addressing Indian (and Pakistani) non-tariff barriers and then bring these into the strategic regional trade policy framework outlined above. Develop institutional capacity (<u>National Tariff Commission</u>) to address non-tariff barriers and anti-dumping complaints with a view to promoting trade rather than hindering it.

<u>(ii) Land routes:</u> The maximum benefits from a more liberal trade regime with India will come from land routes that minimize response time to market forces; open up as many land routes as possible, building on the old road and railway networks all along the border from the Kashmir region to the Arabian Sea.

<u>(iii) Travel:</u> Travel (visa, air/road/railway transport) must be facilitated to promote competitive trade in goods and services that benefits small and medium sized firms, to tap into the large pool of Indian skilled workers, gain access to Indian farm and other technology and encourage cross border tourism.

To create a sustained momentum for liberalizing trade and investment flows, it would be useful to set up a regional trade forum (comprising the private sector, academia and the media), that monitors the working of the bilateral commission mentioned above. The forum should identify barriers to trade embedded in the trade policy, the payment system and communications (including travel); the forum should also help identify losers from liberalizing trade with India and suggest ways to compensate them and should help in formulating a broader regional trade and investment promotion strategy.

<u>India's role in promoting bilateral and regional trade</u>[2]

[2] This discussion is based on Ijaz Nabi (2012), *Lifting the India-Pakistan Trade game,* The Hindu, March 28, 2012

All paths to economic development and prosperity do not have to be routed through sweat shops catering to affluent western consumers. A large and vibrant Asian regional market would constitute a significant and, given demographic shifts, growing part of global demand for products. India's long term strategic interest is to help create that Asian market. That, in turn, requires strengthening Pakistan to be an effective regional hub that connects the Asia-wide market.

Successful management of the new liberalized India-Pakistan trade regime to scale it up to a full-fledged economic relationship will be key. In the short term, it may well mean exercising voluntary restraint on exports that hurt small and medium sized Pakistani manufacturers. It would also require focusing on export of machinery and technology to Pakistani firms that currently import these at high cost from more expensive developed country sources. Joint ventures and other investment strategies would need to be developed to set up production units for the Asia-wide market. Visa regime will have to be liberalized and travel facilitated so that small entrepreneurs develop cross border business linkages and gains from liberalization are shared more widely.

Strengthening international competitiveness

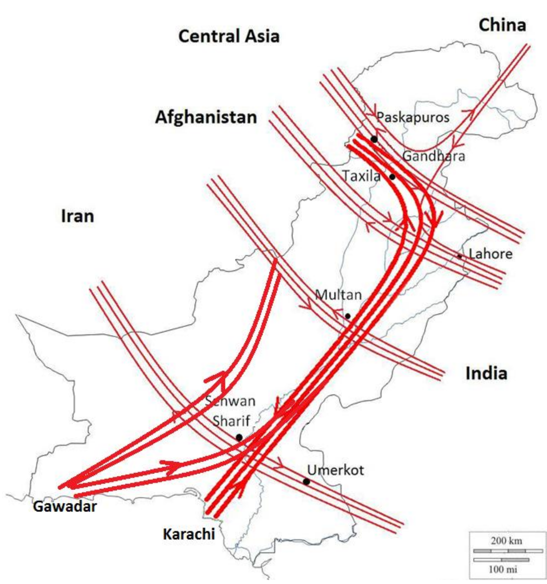
Sustained welfare improvements for the citizens of a regional hub arise when it transitions from a transportation hub of goods and energy to become a manufacturing hub that creates high productivity, high wage jobs in multiple regional growth nodes. Such a transition requires strengthening Pakistan's international competitiveness as a manufacturing base. Key to that are skilled workforce, modern infrastructure (ports, roads and energy), substantially improved governance to improve service delivery and a development framework that promotes investment and manufacturing over consumption. Several bodies of work have been completed recently that detail ongoing/proposed reform in each of these areas[3]. This body of work needs to be distilled to draw up an agenda of reform for the medium term to strengthen Pakistan's international competitveness and thus make the transintion from a transportation hub to a manufacturing hub that sustains high growth and creates employment opprortuntities that improve living standards across Pakistan.

---

[3] These include: (Planning Commission (), "A New Growth Framework, Nabi (2010), " Economic Growth And Structural Change in South Asia: Miracle or Mirage", Education and Skills, Governnace reform, National transport corridor, Fiscal Reform, Industrialization, Provincial economic reports and clusters by World Bank, Beaconhouse report).

Reopening the historic East-West trade routes and connecting the enrgy rich economies of Central Asia with the fast developing economies of India and China will bring rich reward to Pakistan as the regional trading hub. Modernization of the North-South corridor will deepen and enlarge the land mass and polulation base (stretching to Central Asia and Western China and India) that seeks access to the Indian Ocean via multiple ports along Pakistan's Makran coast on the strategic Arabian sea. Pakistan will benefit initially as the transport hub faciltating this access. Strengthened international comeptitiveness, furthermore, has the promise of converting Pakistan from a transportation hub to a manufacturing hub thus increasing economic transactions manifold. This will bring a new vibrancy to the Indus Basin market (Figure 5) spurring high and regionally balanced economic growth, raising producitipcty and high wage employment, and thus bringing about sustained improvement in citizen welfare.

Figure 5: Enhanced vibrancy of the North-South (Indus Basin) trade flows from re-opening of the historical East-West trade routes.



6. **Concluding remarks**

Pakistan's recent growth performance is worrisome because it is far below trend growth rate and, given population growth, threatens the objective of sustained welfare improvement of citizens. Furthermore, this poor growth performance is in stark contrast to rising prosperity within the region. China, India, Central Asian republics and Iran are all doing well. A review of the major growth "vents" of the last sixty years shows the important role of policy in promoting economic growth. The policy, furthermore, helped create a strong and well-integrated Indus Basin market, perhaps for the first time in history, via investment in communications and a regulatory framework that allowed the market to promote a network of integrating transactions throughout the Indus basin. The fact that countries outside the region were caught up in internal turmoil and poor economic governance also helped strengthen the Indus basin market because Karachi became the principal trading hub for all regions of the country.

The regional outlook is different now. While Pakistan's growth vents have run their course, China and India, both billion people plus economies, are the new growth engines of the world, Central Asian republics are ready to exploit their mineral wealth for the welfare of their own citizens and so will Iran as it begins to engage with the world.

The fast improving regional prospects underscore the importance of Pakistan's centrality as a connector of regional markets. The paper shows that this is a familiar role. Historically, Pakistan's three region, Peshawar valley and Hazara in the North, Lahore and Multan in the Centre and Upper Sind in the South were on the East –West trading routes that connected markets in the East (now India) with markets in the West (now Central Asian republics and Iran) . As regional trading hubs, they enjoyed cultural richness and economic prosperity and were hugely influential in shaping the South Asian identity.

The paper argues, furthermore, that reopening the historical East-West trade routes to trade in goods and energy will give a renewed strength to the Indus basin market by increasing the flow of economic transactions. It will also help restore the economic and cultural vibrancy of the sub-regions and will promote more equitable growth. The new growth vent, one that will give sustained high growth for several decades, thus entails Pakistan re-occupying its centrality a hub for regional trade. This, in turn, requires stabilizing the Durand line and re-engaging with Baluchistan in a mutually advantageous economic relationship.

Becoming a regional hub also entails normalizing economic relations with India. The transactions dynamics of a T-junction (regional trade without India) are different from those of a hub (regional trade with India included). A good beginning has been made with resolving the MFN status and liberalizing the bilateral investment regime. This should be followed up by paring down the negative list, addressing the non tariff barriers, allowing multiple trade points along the border and most importantly, facilitating travel for business and tourism. A liberal visa regime will make small businesses stakeholders in regional trade which is essential to keep the process on track given the political pitfalls in India-Pakistan relations.

Finally, to realize the full benefits of a regional trading hub requires strengthening international competitiveness to become a manufacturing hub. This will create regionally balanced, high productivity, high wage employment and will result in welfare improvements for the citizens well into the future.

References

Ahsan, Aitzaz, (1996), The Indus Saga and the Making of Pakistan, Oxford University Press, Karachi.

Caroe, Sir Olaf, (1958) The Pathans, Oxford University Press. Karachi

Hamid, N., &Tims, W. (1990). Agricultural growth and economic development: The caseof Pakistan (Working Paper no. 13). Paris: OECD Development Centre.

Hasan, P. (1998).Pakistan's economy at the crossroads: Past policies and present imperatives. Karachi: Oxford University Press.

Kaplan Robert D. , "Monsoon: The Indian Ocean and the Future of American Power", Random House, New York, 2011

Khan, Mohsin S. (2009), *India-Pakistan Trade: A Roadmap for Enhancing Economic Relations*, Peterson Institute for International Economics Policy Brief No. PB09-15. Washington DC.

Lewis, S. (1969). Economic policy and industrial growth in Pakistan. London: George Allen and Unwin Limited.

Ministry of Commerce (1996), *Pakistan-India Trade: Transition to the GATT Regime,* Government of Pakistan, Islamabad. (Mullick, 2004).

Mullick, H. (2004,summer). US foreign aid and economic growth: A post-9/11 case study of Pakistanas a key ally in the war against terrorism. Proceedings fromPennsylvania Economic Association Conference, Pennsylvania.

Nabi, I (2012), *Lifting Up the India-Pakistan Trade Game*, Op-ed in The Hindu, March 28, 2012.

Nabi, I (2012), "Pakistan-India Trade: Preparing for a Better Future", Woodrow Wilson Center.

Nabi I (2010). " Economic Growth And Structural Change in South Asia: Miracle or Mirage", Development Policy Research Center Monograph.

Nabi, I., & Nasim, A. (2001). Trading with the enemy: A case for liberalizing Pakistan-India trade. In S. Lahiri (Eds.), *Regionalism and Globalization: Theory and Practice* (170-197). London: Routledge.

Naqvi Z. and Nabi I. (2008) " Pakistan-India Trade: the Way Forward", in M. Kugelman and R, Hathaway edited, <u>Hard Sell: Attaining Pakistan's Competitiveness in Global Trade,</u> Woodrow Wilson Center, Washington DC 2008

Pakistan Business Council (2011), *Regional Trade Panel Report*.

Raman B. , "Hambantota and Gwadar---an Update, "institute of Topical Studies, Chennai, India, 2009).

Romer, P, (1990), "Endogenous Technical Change", Journal of Political Economy 98, S71-S101.

Sibt-e-Hassan, 1974, Pakistan Main Tehzeeb Ka Irtiqa, Maktaba-e-Danyal, Karachi.

Solow, R. (1956), "A contribution to the Theory of Economic Growth" Quarterly Journal of Economics 70, 65-94.

Stone, I. (1984).Canal irrigation in British India: Perspectives on technological change in a peasant economy. Cambridge: Cambridge University Press.

Wirsing Robert G., :Baloch Nationalism and the Geopolitics of Energy Resources: The Changing Context of Separatism in Pakistan", Strategic Studies Institute, U.S. Army War College, Carlisle, PA, April 17, 2008

World Bank, Doing Business 2010.

World Bank, World Development Indicators, Various years.

World Bank (2006), Export Competitiveness report.

Zaidi, S. (2005). Issues in Pakistan's economy (Eds.). New York: Oxford University Press.

The International Growth Centre (IGC) aims to promote sustainable growth in developing countries by providing demand-led policy advice based on frontier research.

Find out more about our work on our website
www.theigc.org

For media or communications enquiries, please contact
mail@theigc.org

Subscribe to our newsletter and topic updates
www.theigc.org/newsletter

Follow us on Twitter
@the_igc

Contact us
International Growth Centre,
London School of Economic and Political Science,
Houghton Street,
London WC2A 2AE

International Growth Centre

DIRECTED BY

LSE

UNIVERSITY OF OXFORD

FUNDED BY

UKaid from the British people

Designed by soapbox.co.uk