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Heterogeneous fragility: The case of Pakistan

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About the commission

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Introduction

1

Pakistan presents a complex case for the study of state fragility and its impact on economic growth and development. The country has long been perceived to be at an advanced risk of economic and political instability due to uneven economic growth, and heightened militancy, especially along the Western border. However, since 2013, it has recorded progress on many indicators. In 2017, GDP growth rate rose to a decade high of 5.3%, while civilian casualties from terrorism incidents declined to an eight-year low of 600 over the preceding calendar year (Economic Survey 2017: 8). These recent gains have emerged alongside other long-term positive trends. Between 2002 and 2014, Pakistan's headcount poverty rate fell from 34.7% to 9.3% (World Bank 2016: 27).¹ Similarly, poverty as measured through the multidimensional index decreased from 55.2% in 2004 to 39% in 2015 (UNDP 2016: 3). Finally, the country's ongoing process of political consolidation also remains on track, as a democratically-elected parliament is expected complete its five-year term for only the third time in the country's history.

Pakistan, furthermore, retains robust and resilient federal institutions. These include:

- A strong central bank, the State Bank of Pakistan.
- A modern military that has gained considerable success in fighting Islamist and ethno-nationalist insurgencies in recent years.
- A well-established centrally-recruited and administered civil service.
- Modern telecommunications.
- One of the world's largest irrigation networks that is brokered by the federal government and managed by the country's constituent provinces.

Despite strong federal institutions and encouraging recent developments, concerns about Pakistan's fragility continue to persist. This is on account of several regions and administrative jurisdictions of Pakistan that exhibit fragility and instability trends similar to cases such as Algeria, Lebanon, Rio de Janeiro, and the Democratic Republic of Congo. Much of this localised fragility is linked to deeper or fundamental causes, such as the country's heterogeneous ethno-

¹ The progress recorded in eradicating poverty led the government to revise its line to a higher benchmark in 2016, which recorded a new headcount rate of 29.5%.

linguistic make-up, internal conflicts during historical state building processes, and a geographic location that has repeatedly placed it in close proximity to various global conflicts.

Nevertheless, fundamental causes such as geography and history are less amenable to policy interventions that seek to tackle fragility, and its relationship with economic development. Therefore, from an actionable perspective, it remains more feasible to focus on five proximate dimensions:

- State legitimacy.
- State effectiveness.
- Private sector development.
- Security and conflict.
- Resilience to shocks.²

Across the five proximate dimensions of fragility, we find considerable variation between different regions and administrative units in Pakistan. This poses an analytical challenge: how do we adequately capture and analyse macro-stabilising trends without overlooking the real challenges confronting policymakers with respect to instability and fragility in different pockets? Conversely, how do we analyse the risk of severe instability without looking at a range of well-entrenched, mitigating factors?

To overcome this challenge, this country report introduces a methodological framework of 'heterogeneity of fragility'. It argues that Pakistan exhibits a high degree of geographic and scalar variation across the five dimensions of fragility, which limits the utility of country-level macro-analyses. Large parts of the country demonstrate developmental symptoms that are closer to those found in states acknowledged to be stable and well-functioning. However, other regions exhibit characteristics that correspond more closely to countries at higher-degree risk of meltdown.

This heterogeneity is analytically captured by deploying a spatially disaggregated design to study the manifestation and extent of fragility across the five dimensions. It will use four geographic-scalar cases for this purpose:

1. Fragility at the level of the federal government, where the overarching issues are utilising state institutions to address regional pockets of violent conflict, and governing and coordinating development in a federation consisting of four multi-ethnic provinces with distinct cultural traditions and histories.
2. Fragility in the province of Balochistan, wherein the headline issue remains instability due to poor development outcomes, geo-strategic security complications, and high-levels of sectarian and intra-provincial ethno-nationalist conflict.
3. Fragility in the Federally Administered Tribal Areas (FATA). A peripheral region that faces chronic underdevelopment, pervasive presence of non-state militancy, and regional spillovers from conflict between multiple state and

² See annex for a discussion on the five proximate dimensions of fragility.

non-state actors present in Afghanistan.

4. Fragility in the city of Karachi, Pakistan's largest metropolis and the country's main economic hub. It experiences high degrees of criminality and ethnic conflict, and poor service delivery as a result of non-functional local government institutions.

This report draws on a variety of primary and secondary data sources, as well as existing analysis on the dynamics of fragility corresponding to the geographic-scalar case under consideration.



Assessing state fragility in Pakistan

2

The following matrix establishes the framework for evaluating the selected geographic-scalar cases along the five dimensions of fragility.

Pakistan fragility matrix

Scale	State legitimacy		State effectiveness		Private sector development		Security and conflict		Resilience	
	Status	Resp.	Status	Resp.	Status	Resp.	Status	Resp.	Status	Resp.
Federal Gov.										
Balochistan										
FATA										
Karachi										

To contextualise this analysis, it is worth laying out underlying causes such as institutional inheritance, social demography, and geographic location, which influence a number of downstream measures of state fragility across all four cases.

Historical state-building conflicts

Pakistan's struggles with instituting political stability can partly be traced back to its initial conditions of statehood. The country was formed as a seceding state with large resource constraints during an uncertain and hostile process of decolonisation. The acrimony of partition with India meant that the leaders of the new state assumed power in a heightened state of insecurity. The country's two wings were separated by 5000 miles, and shared land borders with its much larger and more powerful neighbour. The threat perception felt by the leadership resulted in greater resource diversion towards military capacity, and the adoption of a national security prism for overall governance. Thus the challenges of

forging and securing a new governing setup from scratch were met through the bureaucratic concentration of financial and administrative authority at the central tier of government (Jalal 1990).

Compounding state-building troubles was a persisting inability to resolve domestic power-sharing conflicts, due to weakly-institutionalised political parties. The party at the centre of the Pakistan movement, the Muslim League, was led by members of the Muslim elite bureaucracy based in provinces of British India with Muslim minority populations. Pakistan, on the other hand, was formed out of provinces that had a Muslim majority. The disjoint between local ethnic elites, elected from areas that eventually formed Pakistan, and an unelected bureaucratic elite that took up control of the federal government created considerable friction. The Muslim League's lack of institutionalisation, and its inability to act as a legitimate platform to resolve political conflicts between elites at different tiers, resulted in further fragmentation and instability (Tudor 2013). As discussed ahead, the unresolved tension between the centre and the provinces would subsequently go on to become a major driver of instability and fragility.

By close of the first decade of statehood, the country was run by unelected civilian bureaucrats, under largely ad-hoc constitutional arrangements. In 1958, 11 years after partition, power in Pakistan was assumed by the military through a coup d'état under General (later Field Marshal) Ayub Khan. With the army's formal foray into power, and its curtailment of all political activity, Pakistan highly-centralised mode of governance was consolidated.

The institutional arrangements established in early years of statehood cast a considerable shadow on political developments in subsequent decades. In particular, representative political institutions such as political parties and legislatures remained weak, while power-sharing conflicts between federating units (provinces) and the federal government continued to generate instability (Jalal 1990: 190-210). These destabilising trends, bolstered by acts of collusion between civilian and military elites, resulted in two more elongated periods of highly-centralised military rule between 1977 and 1988, and 1999 and 2007.

Heterogeneous make-up

Pakistan's multi-ethnic composition acts as another important driver of fragility and instability. The provinces and regions of British India that constitute modern-day Pakistan were largely congruent with particular ethnic groups. However, the process of partition from India and the large-scale migration that followed in its aftermath changed both the demographic composition of particular regions, and led to political power configurations that saw the over-representation of particular ethnic groups over others. At different time periods the Urdu-speaking migrant elite (Muhajirs) and the Punjabis, which carry a demographic plurality in the overall population, have exercised disproportionate control over the state apparatus, driving perceptions of exclusion and marginalisation among smaller ethnic groups (Adenay 2007: 142).

In recent years, internal migrations due to local and regional conflicts, as well as an increasingly networked economy, have further complicated the demographic make-up of different regions. Punjab, the most populous province, possesses an ethnic Punjabi majority and an increasingly assertive Seraiki-speaking minority. The province of Balochistan, named after its indigenous Baloch population,

now also carries a sizable Pashtun population based in its northern regions. The province of Khyber-Pakhtunkhwa is home to Pashtuns and Hazaras, while Sindh's population consists of Muhajirs, Pashtuns, Baloch, and the indigenous Sindhi population.

Table 1: Major ethno-linguistic groups in Pakistan. Data: 1998 Census

No.	Language Group	Population percentage
1	Punjabi	44.17
2	Pashto	15.45
3	Sindhi	14.1
4	Seraiki	10.5
5	Urdu	7.8
6	Balochi	3.7
7	Others (Dari, Hindko, Brahvi, Baltit etc.)	4.28

Apart from linguistic diversity, Pakistan's sectarian and religio-communal make-up is also the basis for protracted forms of conflict. Officially, the country is 95% Muslim, along with sizable Christian and Hindu minority populations (PBS 1998). However, sectarian divides within the Muslim population are pervasive. While the Pakistani state does not officially recognise sect as a census category, it is estimated that 15% of the country's total population is Shia Muslim, while the remaining Muslim population is subdivided between Deobandi, Barelvi, and Salafi sects. In the last three decades, mobilisation along sectarian lines have contributed to the development of entrenched fissures, and led to considerable violence and instability in many different parts of the country (Ispahani 2015).

Geography and geo-strategic compulsions

Finally, Pakistan's geographic location produces a variety of internal and external pressures that have contributed to long-term instability. On its west, Pakistan shares a 2400 km porous border with Afghanistan, which has seen protracted conflict over the last four decades. The region's involvement in the Cold War and the Afghan Jihad during the 1980s, and then in the War on Terror since 2001 has resulted in a number of spillovers into countries bordering Afghanistan and beyond (Yusuf 2014).

On its east, Pakistan shares a hostile border with India with which it has fought two major wars and a number of skirmishes. The instrumental utilisation of non-state militants, both by the Pakistani military and by neighbouring countries, for strategic gains have resulted in considerable blowback and exacted a sizable economic and social toll. The Pakistani government estimates that since 2001, total economic losses suffered by the country due to ongoing conflicts in the region amount to \$123.13 billion (Economic Survey 2017: 280).

Fragility at the centre

3

Under Pakistan's current constitution, approved and ratified in 1973, the country is envisioned as a federal republic with four constituent provinces and several federally governed regions. In practice, however, substantive federalism was only established in March 2010 with the passage of a major constitutional amendment that granted the provinces exclusive control over several fiscal instruments and removed the centre's jurisdiction to legislate on a number of domains. The legal-administrative changes were complemented with a revised revenue-sharing formula, the 7th National Finance Commission (NFC) award, which increased the share of provinces in the total divisible revenue pool (Mustafa 2011).

With a backdrop of these major developments, the federal government faces a number of challenges. These include:

- Coordinating resource distribution and resource conflicts between provinces
- Raising sufficient revenue for federal government expenditure.
- Enabling private sector growth.
- Combating non-state militancy in a number of regions across the country.
- Ensuring resilience in the face of major economic and environmental shocks.

The following sections will look at Pakistan's current status with regards to the five dimensions of fragility and the array of responses developed by government policymakers.

Federal Government fragility matrix

Scale: Federal Government		
Dimension	Status	Response
State legitimacy	Low levels of inter-provincial trust and cooperation; some strong and popular federal government institutions (military, supreme court)	18th Amendment, NFC Award, Creation of CCI
State effectiveness	Weakness of institutions performing coordinating functions at the federal level. Low bureaucratic capacity	Revenue and governance reform
Private sector development	Fragile growth and tenuous macroeconomic conditions persist. Weakness of judicial dispute-resolution and contract enforcement mechanisms	IMF-led stabilisation, Deficit reform, liberalisation, energy sector investment and CPEC spillovers
Security and conflict	Violence by non-state actors in different regions. Uneven provision of law and order services in urban areas	National Action Plan (NAP), military (Zarb-e-Azab) and paramilitary operations
Resilience	High	Investing in federal coordinating mechanisms; strengthening federal government institutions; reducing economic vulnerability

State legitimacy

The state's strategy towards popular legitimacy in the first 20 years after independence was to implement a well-funded development framework, in coordination with donor assistance from the US. Pakistan made impressive infrastructure investments, enabling the development of a substantial manufacturing base from scratch, and the adoption of 'green revolution technologies' that led to high agriculture growth rates (Tubewell). Pakistan thus enjoyed a stellar average GDP growth rate of 6% per annum between 1947 and 1967 (Zaidi 2015: 231). However, the legitimacy gains from early success in economic management were largely concentrated in West Pakistan. In East Pakistan, sentiments of resentment and exclusion were pervasive among a citizenry who felt that they did not benefit from economic growth. The de-legitimisation of the state along concerns of equity in the eastern wing generated a secessionist ethno-nationalist movement, which in 1971 ultimately led to the creation of Bangladesh.

Since 1971, intra-elite conflicts along provincial and ethnic lines have periodically continued to pose challenges to overall state legitimacy. The three demographically smaller provinces, Sindh, Balochistan, and Khyber-Pakhtunkhwa, have hosted large-scale and occasionally conflictual mobilisation seeking greater administrative and fiscal autonomy, a dilution of the influence exercised by the most populous province, Punjab, and a greater share of resources from the federal government. During two periods - the late 1970s, and the late 2000s, - autonomy movements in Balochistan have taken on secessionist overtones.

Such process-based legitimacy concerns have, in recent decades, been compounded by issues of state performance. Since the 1970s, Pakistan's macroeconomic performance has been lacklustre. Slow growth in exports, unstable donor assistance, and poor revenue collection have resulted in periodic balance of payments crises and substantial curtailment of the public investment programme (Nabi 2013: 6). From 2006 onwards, the country has also seen the emergence of crippling energy shortages featuring outages of up to 12 hours in urban and 18 hours in rural areas (Kugelman 2013: 3). This combined with deterioration in law and order and spillover of conflicts from Afghanistan, has contributed to the erosion of citizen trust in public institutions and policies. In 2017, public opinion polling revealed that approval ratings of parliament and the federal government stood below 50%, while the only institutions that scored highly on citizen trust were the Supreme Court (78%) and the Military (80%) (Gallup Pakistan 2017).

Legislative / policy response

Since 2008, policymakers have initiated substantive efforts to address legitimacy-based drivers of fragility. Chief among these are the 18th constitutional amendment, which enhanced provincial autonomy through devolution and granted greater fiscal and administrative powers to province-based policymakers³, and the 7th NFC award that significantly increased the amount of annual fiscal transfers made to the provinces from the federal revenue pool. Additionally, it has also made some progress towards addressing horizontal inequities – the proportionate share awarded to each province – that historically contributed to a great deal of mistrust between the federating units (Nabi and Shaikh 2010).⁴

Table 2: Distribution of ational Revenue

	Presidential Order 2006	7th NFC Award
Provincial Share in Divisible Pool	46.25%	56% increasing to 57.5%
Grants and Subventions	3.75%	-
Indicators and Weights Population	100%	82.0%
Poverty		10.3%
Revenue Generation		5.0%

³ Finances of the provinces were significantly strengthened under the 18th amendment. The provinces now have the right to raise domestic and foreign loans with the approval of the National Economic Council (NEC). They are also eligible to collect the entire amount raised by excise duty on oil and natural gas.

⁴ In principle, the NFC award is based on four key indicators that include HDI, backwardness, fiscal effort, inverse population density (IPD), and revenue generation. In this award, population gets a weight of 82%, poverty and backwardness 10.3%, revenue collection and generation 5% and inverse population density 2.7%

	Presidential Order 2006	7th NFC Award
Inverse Population Density		2.7%
Given the Weights indicated above, the provincial share in the Divisible Pool works out as follows:		
Punjab	53.01%	51.74%
Sindh	24.94%	24.55%
Khyber Pakhtunkhwa	14.88%	14.62%
Balochistan	7.17%	9.01%

Source: Khwaja and Musleh ud din 2013

The federal government has also attempted to improve levels of citizen trust and enhance state legitimacy through a number of performance-based measures. Since stepping into power in 2013, the Pakistan Muslim League-Nawaz (PMLN) government directed considerable focus towards resolving the energy crisis. With the help of China, under the China-Pakistan Economic Corridor, a number of early harvest power plants have been commissioned for construction, which are expected to add 10,000 megawatts of electricity to the national grid by early 2018 (Kugelman 2015: 6). It has also signed a long-term governmental contract with Qatar for the import of Liquefied Natural Gas (LNG), to meet persistent natural gas shortages.

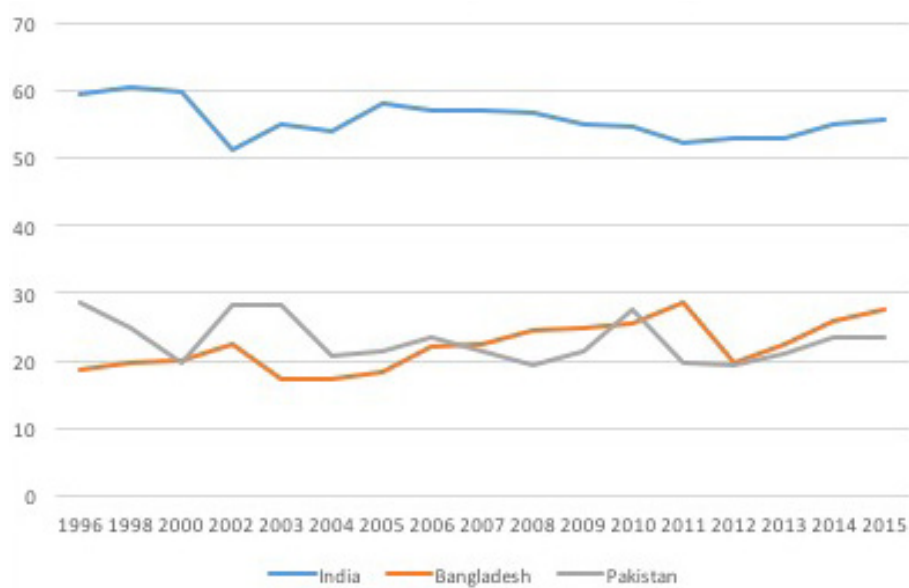
While these recent investments in the energy sector are geared to boost economic growth and rebuild citizen trust in the government, several areas of concern still remain. In particular, problems with demand-based management of energy resources and the governance of publicly-owned power distributors are still to be addressed. These remain key obstacles in improving performance-based measures of state legitimacy.

State effectiveness

Pakistan's federal government institutions exhibit considerable variations in terms of their capacity to deliver effective services. While the military operates as an internally coherent and rules-bound institution, the performance of the civil services has deteriorated in recent years. Perceptions of rent-seeking and corruption have increased, while performance on a number of key areas – such as rule of law, collecting sufficient revenue, and coordinating governance across four federating units – remains inadequate.

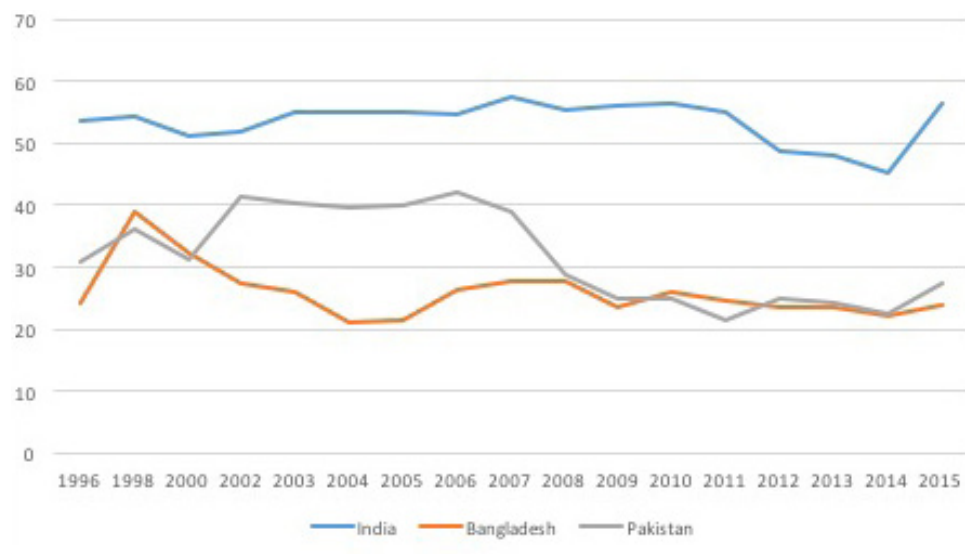
The country compares poorly with its neighbour India on a number of governance measures. In terms of government effectiveness and control of corruption, it ranks within the bottom third percentile of all countries included in the World Bank's Worldwide Governance Indicators (WGI). More worryingly for government policymakers, there has been little improvement in its relative position on these indicators over the last 20 years.

Figure 1: WGI Rule of Law, percentile rank



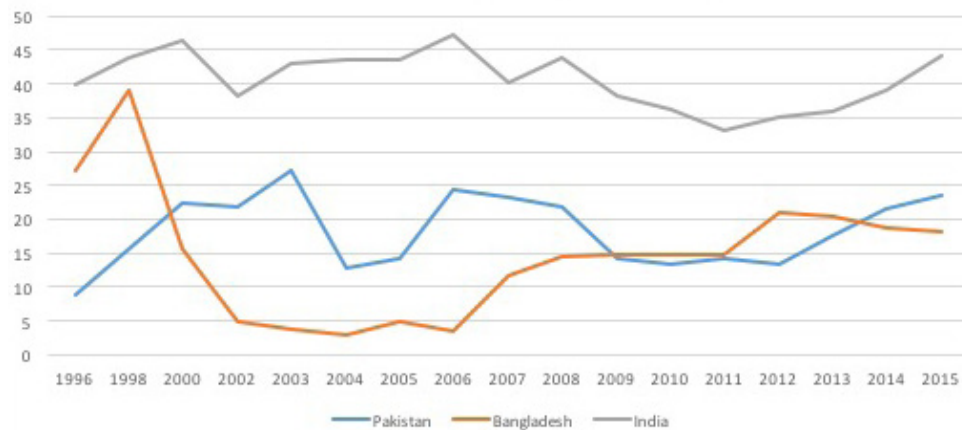
Source: WGI dataset

Figure 2: WGI Government Effectiveness, percentile rank



Source: WGI dataset

Figure 3: WGI Control of Corruption, percentile rank



Source: WGI Dataset

The performance of the federal government in collecting sufficient revenue – another key measure of state effectiveness - has remained fairly weak. The federal government’s main tax authority, the Federal Board of Revenue, has performed poorly despite numerous attempts at reform. Pakistan’s tax-to-GDP ratio, at 10.5% in FY2017 is low for countries at similar levels of income. Falling from 14% in 1989/90, it has demonstrated few signs of improvement in recent years (CDPR 2013: 1). While there has been some improvement in overall collections, which posted 15% growth in FY2017 (Economic Survey 2017: 65), this has taken place on the back of a range of indirect taxes and withholding measures on existing taxpayers, suggesting that the state does not currently have the capacity or the intent to expand its revenue base. In total, 0.75 million taxpayers currently file for taxes out of a registered tax-base of 3.1 million, and an estimated taxable population of approximately 4.5 million. This represents 0.5% of the total population of Pakistan, which is low compared to the corresponding figure in India that currently stands at 5% (CDPR 2013: 2). A significant amount of tax revenue is lost due to a number of politically expedient exemptions granted to agricultural income, military and non-military pensions, and capital gains from sale of real estate.





The problem of revenue collection in Pakistan

An obvious implication of sluggish revenue collection is that Pakistan's central government has limited resources for current and development spending. This results in borrowing of upwards of 4% of GDP to meet budgeted expenditure (World Bank 2017). The issue of a strained revenue base at the centre has also gained greater intensity with passage of the 7th National Finance Commission (NFC) award. The existing award, while addressing long-standing vertical and horizontal inequities in resource distribution, places no incentives on provinces to improve their own revenue generation efforts. Currently, provinces generate 8% of total revenue, whilst undertaking 26% of total expenditure. The NFC award envisioned provincial revenues to rise by 44.4% between FY 2010 and 2016, however they fell short of this target by 8%. As the award constitutionally mandates a 57.5% transfer of the federal divisible pool to the provinces, it also generates fiscal constraints for the central government when federal revenue collection stagnates or falters. ■

Finally, the initiation of devolution through the 18th amendment in 2010 has introduced new challenges for the federal government in terms of coordinating between the four federating units and regulating economic activity. The institution designed to oversee such major tasks – the Council of Common Interest (CCI) – has not been made fully operational. The body is obligated to meet every quarter, and is headed by the Prime Minister with the chief executives of all four provinces as members. However, meetings have been irregular, and progress in institutionalising its role in regulating key issues of resource distribution and regulation has been very slow (UNDP 2013: 31).

Problems also continue to underscore the performance of the federal government's main development strategy institution, the Planning Commission. A number of structural factors, such as the growing role of the private sector, the informal nature of the economy, and devolution of important legislative areas to the provinces, make the Commission's job of devising a central framework of development much harder. However, with recent influx of Chinese investment through the China-Pakistan Economic Corridor (CPEC), the Commission has been tasked to act as a central node planning large-scale infrastructure investments, and coordinating between different institutions across the central and provincial governments. Recent evaluations proffer that it is currently under-equipped for this particular task due to both low-levels of existing capacity, and encroachment of other institutional actors, such as the Ministry of Finance (Ikram 2011).

On the other hand, several federal government institutions continue to exhibit high degrees of effectiveness. Chief among these are the military, which has successfully combating various Islamist and ethno-nationalist insurgencies, and the central bank, the State Bank of Pakistan (SBP), which has utilised its autonomy to build internal capacity for viable policymaking and effective regulation of the banking sector. Similarly, another key coordinating institution, the Indus River System Authority (IRSA), remains highly effective in designing and implementing surface water-sharing arrangements between the federation's four constituent provinces.

The following table provides a status overview of key planning and coordinating institutions that are central to the federal government's effectiveness:

Federal Institution	Responsibility	Current Status
Council of Common Interest (CCI)	Mediating between provinces on issues of resource-distribution, national policy matters, and regulations.	No permanent secretariat, irregular meetings, lack of ownership on part of federal government and largest province (Punjab).
State Bank of Pakistan (SBP)	Central bank overseeing monetary policy and regulation of financial sector.	Strong institution, with high-levels of capacity for effective regulation and policymaking. Recent years have seen some erosion of autonomy on issue of foreign-exchange rate determination.
Planning Commission (PC)	Coordinating planning and investments across a range of actors (global, federal, and provincial) in the economy.	Low-levels of capacity; 18th amendment devolved key social sectors and development expenditure mechanisms to provinces leaving PC with reduced de jure authority. Planning and approvals of large-scale infrastructure projects, such as those under CPEC, still lies with Planning Commission, thus enhancing need to improve internal capacity.
National Finance Commission (NFC)	Distributing federal divisible pool revenue between provinces.	New award to be determined after final population census results next year. Existing award contains little incentives for provinces to enhance revenue efforts or curtail population growth. Fiscal space for federal government constrained and increasingly reliant on provincial surpluses.
Indus River System Authority (IRSA)	Develop surface water-sharing arrangements between provinces.	Highly effective in resolving inter-provincial water resource conflicts.
Regulators: PTA (telecom), NEPRA (electricity), OGRA (oil and gas)	Regulating key areas of economic activity; ensuring protection of citizen rights.	Under the 18th amendment, regulators were to be placed under the CCI with joint custody of federating units. However, there has been no progress on this front. Government has attempted to increase executive control over regulators by placing them under their corresponding Ministries.

Official response

There have been a number of initiatives to improve state effectiveness. These have experienced uneven implementation and mixed outcomes. Civil service reforms designed to increase state effectiveness, attract better quality candidates, reduce corruption, and improve accountability have remained stuck at the design stage. In its most recent iteration, the federal government planned to create a new cadre of senior managers, with the option of recruiting from the private sector. However, the reform was opposed by senior bureaucrats and

other vested interests, and eventually shelved (Government of Pakistan 2015a).

Numerous attempts at improving revenue generation and reforming tax governance have proven to be largely unsuccessful. The government continues to use tax exemptions as a political tool through ad-hoc statutory regulatory orders (SROs), despite repeatedly committing to ending this practice (International Monetary Fund 2016: 15). In a bid to keep up with growing expenditures, indirect measures (such as withholding taxes and sales tax) have become an integral source of government revenue, constituting 57% of total tax collection. Similarly, on account of political expediency, there have been no major attempts to bring in high-value sectors such as agriculture and retail and wholesale trade into the federal government's tax net.

Finally, reform initiatives geared at improving the performance of key federal coordinating and regulating institutions continue to yield mixed results. Major reforms of the State Bank of Pakistan, first initiated in 1997, have helped build a strong central bank, capable of carrying out its policymaking and regulatory functions effectively. Similarly, the performance of the telecommunications regulator, the PTA, has been fairly impressive, with telecom connectivity reaching 75% of the population, and mobile broadband penetration posting double-digit growth between 2010 and 2016 (PTA 2017). However, performance of regulators in other key sectors, such as electricity (NEPRA), and oil and gas (OGRA) has deteriorated without any serious attempt at redress. Since 2015, the autonomy and capacity of these institutions, especially with regards to dealing with inter-provincial regulatory work, have also been curtailed by the federal government.

Private sector development

Following nearly 10 years of anaemic growth, Pakistan has witnessed an uptick in economic performance since 2014. In 2017, it posted a decade-high growth rate of 5.3%, and became one of the top performing economies in the region.

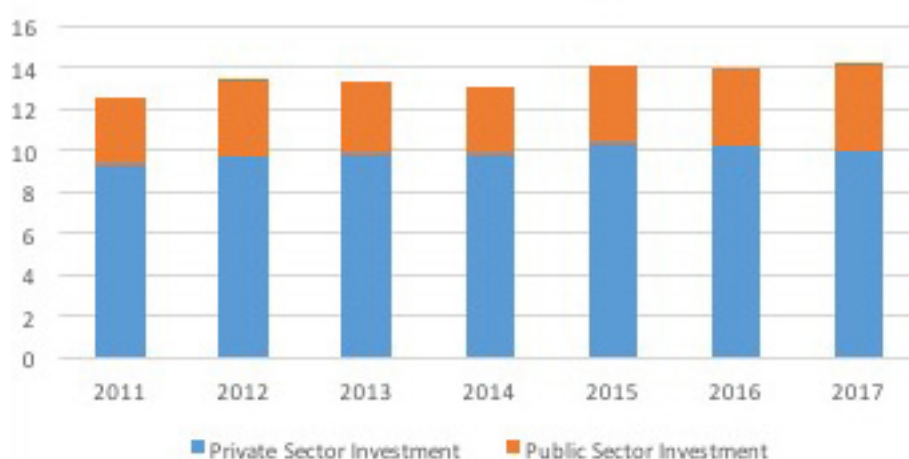
Figure 4: GDP Growth Rate 2011-2017



Barring a brief interlude during the 1970s, Pakistan's economic growth has largely been directed by a strong private sector. As mentioned earlier, rapid economic growth during the first two decades after statehood was made possible by a privately-owned and run manufacturing base, enabled by the state's development framework. In recent years, the state's commitment to private-sector led growth has seen the private sector's share in the total economy cross 85% (ADB 2008).

Nevertheless, structural problems continue to hamper private-sector participation and the country's overall growth trajectory. Despite operating in a fairly liberalised economy with few controls, private sector investment as a percentage of GDP has shown a miniscule rise from 9.29% in FY2011 to 9.90% in FY2017. Gross fixed investment has risen from 12.52% to 14.18% during the same period. This is well below the performance of other countries in the region, such as India (28%) and Bangladesh (19%). Overall, the average investment rate in South Asia between 2010 and 2016 was 34%, compared to only 13% for Pakistan (World Bank 2017a).

Figure 5: Pakistan Gross Fixed Investment as percentage of GDP



Source: Econ Survey 2017

Several key constraints continue to limit private-sector investment in the economy. These include macroeconomic instability (such as periodic balance of payment crises), security-related challenges, shortcomings in the energy infrastructure, and problems in governance of business activity. The country ranks a low 144th on World Bank's Ease of Doing Business scale, scoring 51.77, a point below the South Asian regional average score of 52.87 (World Bank 2017b). It ranks particularly poorly on measures associated with enforcing contracts, resolving disputes, getting electricity, paying taxes, and registering property.

As cumbersome and protracted processes of setting up and running a business are associated with formalising economic activity, many entrepreneurs prefer to operate along informal lines. While there are no rigorous estimates, most existing accounts suggest that the size of Pakistan's informal sector is approximately 70% of current GDP (Amjad & Burki 2015). Growth in the informal private sector presents a long-run problem for Pakistan, as informal enterprises function outside the tax net, maintain low-levels of productivity, and offer insecure and low-paid employment to workers. Currently, 73% of all non-

agricultural employment is in the informal sector (Govt. of Pakistan 2015b).

Enabling the development of a strong private sector is not just a prerequisite for long-term growth, it is also key for the country's overall stability. Pakistan's current demographic profile raises the stakes on this particular dimension. Pakistan is the most urbanised country in South Asia, with an estimated 37% of its population (about 75 million individuals) residing in urban centres (Pakistan Census 2017). Urban areas have grown at an average rate of 3% per year since 1947 and the urban share of the population is expected to rise to 50% by 2030. In other words, urban areas will host a total of 116 million people in another 16 years (World Bank 2014). Residing on this increasingly urban landscape is a large young population, with an estimated 64 % of 183 million citizens below the age of 30 (UNDP 2016). The labour market requirements of an overwhelmingly young and increasingly urbanised population can only be met sustainably through strong private sector-led growth, especially in employment-generating sectors such as manufacturing.

However, despite a promising start in the first two decades of statehood, the share of manufacturing (both large and small-scale) in Pakistan's economy has stagnated at around 20% of GDP (Economic Survey 2017). Instead, the economy's structural shift away from agriculture has been towards the services sector, which now contributes just over 58% to GDP. This shift is also exemplified by a decline in investment in the industrial sector from 38% in 2000 to just under 20% in 2010, alongside a corresponding rise in investment in fast-growing services (transport, retail/wholesale, communications) from 12% in 2000 to 24% in 2010 (Sanchez-Triana et al. 2014: 33).

Official response

The government has made several positive efforts to improve the climate for investment and growth in recent years. It concluded a successful IMF Extended Fund Facility programme in September 2016 that improved macroeconomic stability. Significant investments have been made in energy infrastructure to improve electricity flows for industrial and commercial users. These are expected to produce strong positive outcomes, as a 10% decrease in outages causes firm revenues to increase by 0.14% and value-addition by 0.36% (World Bank 2017a).

The most concerted strategy to boost economic growth comes in the shape of the China-Pakistan Economic Corridor (CPEC). The bilateral development plan between the two countries will see an investment of \$54 billion through soft loans provided by financial institutions in China for a number of road, energy, and transit communications projects in Pakistan. Alongside investments, a series of Special Economic Zones (SEZs) are being set up for Chinese companies to invest in in partnership with Pakistani firms (Ministry of Planning 2016).

The benefits of CPEC for private sector growth, especially in manufacturing, are expected to be indirect and will be realised over the short to medium-term. In the first instance, Pakistani firms in construction are partnering with Chinese contractors to build highways, power plants, and rail and transit projects in different parts of the country. Once these are built, improved access to energy, the presence of Chinese partners, and better infrastructure is expected to kick-start domestic private sector activity (World Bank 2017b: 3).

Some of the initiatives undertaken by the government, especially with regards to macroeconomic stability, have already had a positive impact, as exemplified by a rising GDP growth rate. However, a number of areas still require considerable attention. Dispute-resolution, secure property rights and law and order remain pressing concerns. The judicial system is overburdened with backlogged cases in the lower courts now in their millions. Similarly, corruption and lack of capacity in police departments remain strong impediments to creating a safe climate for investment. These problems would have to be addressed with greater urgency in order to remove bottlenecks towards increasing private sector participation.



The privatisation process

The government's performance in restructuring or privatising public sector enterprises has been mixed. Between 2013 and 2015, the government sold 20% of shares of the United Bank Limited (UBL) at a cost Rs 38.2 billion, 5% shares of the Pakistan Petroleum Limited (PPL) at a cost Rs 15.34 billion, 11.46% shares of the Allied Bank Limited (ABL) at Rs 14.44 billion, 41.5% shares of the Habib Bank Limited (HBL) at a cost Rs 102.34 billion and 88% shares of the National Power Construction Corporation (NPCC) at a cost Rs 2.5 billion. Since then, however, the reform process has slowed down considerably. Much of this is due to domestic political challenges posed by opposition parties and public sector unions. In particular, the restructuring/privatisation process of loss-making public-sector enterprises, such as Pakistan International Airlines (PIA), the government-owned power distribution companies (DISCOs), and the Pakistan Steel Mills (PSM), has not moved ahead substantively (International Monetary Fund 2016: 18). Reinvigorating these processes will be key in improving revenue flows for development expenditure and creating enabling spaces for private sector growth.

Security and conflict

Between 2005 and 2015, Pakistan experienced significant violence in terms of frequency, scope, and magnitude. An examination of the incidence of violence during this period reveals a variety of conflict actors, new and old (including armed domestic and transnational non-state groups); varying patterns of violence in different regions, both high and low intensity in nature; and an unprecedented number of civilian and law-enforcement casualties, estimated to be upwards of 50,000 (USIP 2015).

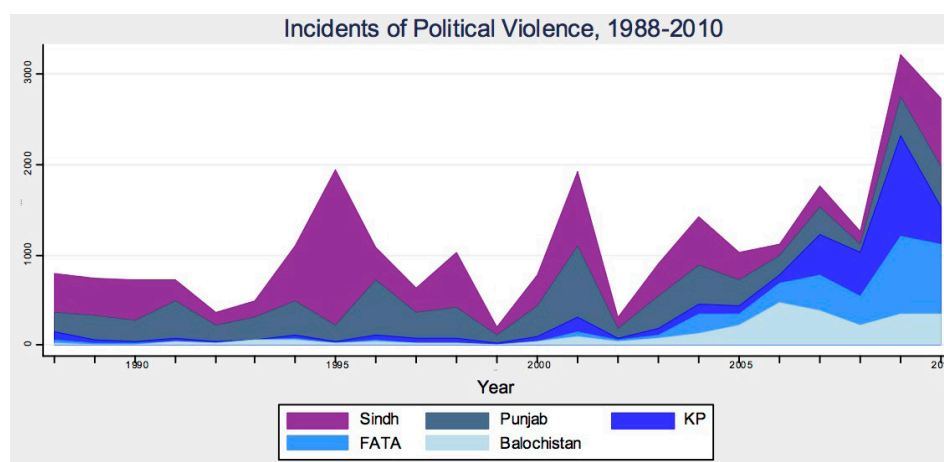
Pakistan's experience with extreme high-intensity levels of violence has been reported in a number of prominent empirical studies. The Uppsala Conflict Data Programme identifies Pakistan as one of six countries that qualifies to be in the category of "war," having crossed the unfortunate figure of 1000 battle-related deaths in a year's time. The Global Peace Index (GPI) positions Pakistan among the ten least peaceful countries in the world. It suggests that, since 2004, Pakistan has ranked among the top five countries showing the fastest decline in peacefulness globally. Pakistan ranked 149 out of 162 countries in the 2012 GPI and slipped to 157 for the year 2013 (USIP 2014: 5).

Broadly, conflict has taken along transnational ideological lines (Islamist

militancy), sectarian lines (Deobandi Sunnis vs. Shias), and ethnic lines (gang wars in Karachi, ethnic secessionism in Balochistan). The escalation of violence has both external and internal drivers. Externally, the country's overall security situation is also shaped, both directly and indirectly, by relations with its neighbours and the role of globalised conflicts taking place in the region. Internally, a number of long-standing sectarian fractures, social unrest due to socio-economic and political marginalisation, the spread of militant Islamist ideologies, and poor provision of law and order have all contributed to instability and conflict (Hussain and Malik 2014). Violence is largely concentrated along the Afghanistan border in the Federally Administered Tribal Areas (FATA) and the province of Khyber Pakhtunkhwa (KP). Other regions of Pakistan lying along the border with Afghanistan, such as Balochistan, have also experienced a significant escalation in violence post-2005.

Both the location and quantum of violence departs from longer historical trends. Conflict-data collected between 1988 and 2005 shows country-wide levels of conflict remained fairly consistent, with FATA, KP, and Balochistan suffering fewer incidents of violence compared to Punjab and Sindh. However, this trend broke from 2005 onwards with a sharp rise in incidents in these three border regions. Over the same period, levels of violence in Punjab and Sindh have remained largely in line with previous trends, showing the geographically-confined nature of Pakistan's recent conflict and security challenges (Shapiro and Gulzar 2012).

Figure 6: Incidents of political violence.



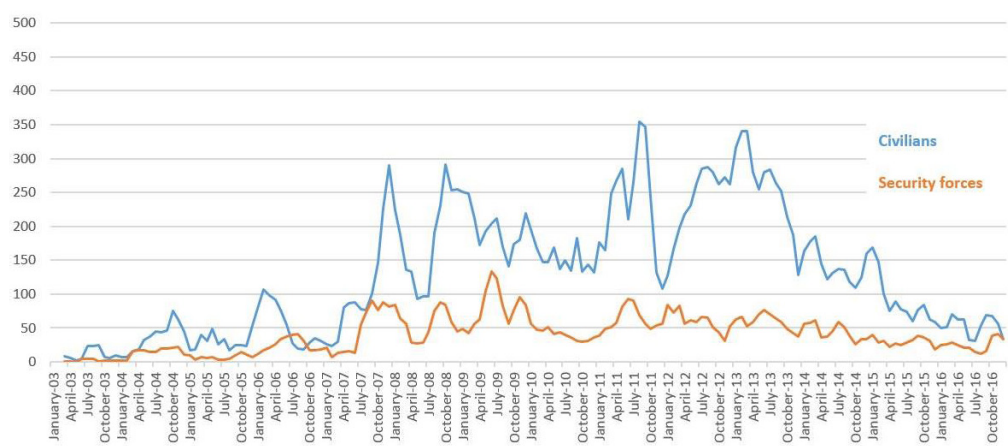
Source: IGC

Official response

Pakistan's internal and external security policy is determined by the armed forces. Its response to pervasive conflict has been through a variety of military operations, which have been largely successful in both limiting the spread of conflict and reducing overt incidents of violence. In 2014, the military launched a large-scale operation titled 'Zarb-e-Azb' to uproot militant groups that had established strongholds in tribal areas bordering Afghanistan. The operation has been successful in eradicating bases, and capturing or neutralising the

leadership of several major terrorist groups, thus leading to a gradual reduction in the number of terrorist incidents across the country. Alongside these operations, the military has also successfully pushed for the creation of military courts through a constitutional amendment to expedite cases against captured militants (USIP 2016: 14).

Figure 7: Terrorism casualties decline in Pakistan



Source: South Asia Terrorism Portal.

To supplement the military's strategy, the federal government and the provinces have also developed a National Action Plan (NAP) to counter deeper causes of violence. The plan sets out a number of actionable items, such as monitoring religious seminaries and mosques for extremist content, introducing changes to the penal code to create harsher punishments for hate speech, developing coalitions for interfaith harmony, and promoting tolerance through public political discourse. However, lack of capacity of civilian law and order institutions and a lack of urgency on part of the political leadership has produced limited progress on these policies (USIP 2016: 21).

Resilience

Pakistan exhibits varying degrees of resilience to different kinds of potential shocks. The existence of strong federal government institutions, such as the military and the higher judiciary, have prevented regress into further instability. The high-levels of trust enjoyed by the military in particular has created a conducive environment during large-scale military operations. In Swat (2010) and FATA (2014), over a million residents each were displaced due to escalating levels of conflict. In both instances, local populations cooperated with the evacuations, remained housed in internally-displaced population (IDP) camps, and were safely repatriated within a two-year period.

Federal government institutions have also been effective in responding to large-scale natural disasters, such as the Kashmir earthquake in 2005, which left 4 million individuals homeless, and Indus plain floods in 2010 and 2011, which affected over 20 million. National coordinating institutions such as the

Earthquake Relief and Recovery Authority (ERRA) and the National Disaster Management Authority (NDMA) were able to channel large amounts of government and international donor funding towards relief and recovery efforts implemented by provincial and local government institutions. The responsiveness of local civil society and political actors also played a key role in tackling challenges posed by the disasters (Fair et al. 2017).

Recent developments, such as substantive democratisation and improved power-sharing arrangements, have also generated resilience within the macro-political system. Centrifugal tendencies in federating units have largely subsided, and while core electoral bases are provincially segregated, the three largest political parties, the Pakistan Muslim League-Nawaz (PMLN), the Pakistan Peoples' Party (PPP), and the Pakistan Tehreek-i-Insaf (PTI) are all contenders for national power.

Nevertheless, the country remains vulnerable to economic shocks. Despite achieving a degree of macroeconomic consolidation between 2013 and 2016, a number of key indicators demonstrate considerable risk. Foreign exchange reserves remain under pressure as exports have fallen by 20% since 2013. Remittances, long held as a stable source of foreign exchange, have also stagnated on the back of an economic slowdown in the Middle East, and even registered a small fall in 2017. Pakistan is also heavily dependent on energy imports (oil and increasingly LNG), which have raised the trade deficit to an all-time high of \$28 billion in FY2017 (Economic Survey 2017: 131).

The pressures placed by widening current account deficits and falling reserves highlight a structural problem for Pakistan's economy. Put simply, the country's inability to generate foreign exchange reserves through productive activity, such as exports, create repeated external sector crises, which precipitate IMF-led bail-outs. This remains a recurrent theme through the last 3 decades, and shows no signs of abating.

Thus the country's resilience to exogenous economic events, such as a sharp increase in energy prices, remains particularly low. This vulnerability has been compounded by recent policy decisions, such as the government's purposeful management of the exchange rate, which has kept the Rupee overvalued by as much as 15% in recent years. This has proven to be considerably detrimental to export competitiveness. Furthermore, institutional protections against exchange rate manipulations, maintained through the independence of the central bank, are at risk due to increasing pressure from the Ministry of Finance.

Fragility in Balochistan

4

Balochistan is Pakistan's largest province by area and its least inhabited in terms of population. The province carries a number of natural resources, such as large deposits of coal, copper, lead, and gold. It is also the largest supplier of natural gas to economic centres all over Pakistan, and hosts two-thirds of the country's coastline along its southern border.

However, despite these significant natural and locational resources, it is one of the country's poorest and most underdeveloped regions. According to the UNDP's Multidimensional Poverty Index, 71% of households in the province are classified as poor, compared to a national average of 37%. In rural areas of Balochistan, the incidence of poverty is even higher at 85% of all households. Worryingly for policymakers, while the overall incidence of multidimensional poverty dropped from 18 points from 55% to 37% of households between 2004 and 2015, Balochistan's incidence fell by only 10 points from 81% to 71%. In fact, the incidence of poverty actually rose in 3 districts, Harnai, Panjgur, and Killa Abdullah, of the province during this period. Out of the five poorest districts in Pakistan currently, four are in Balochistan (UNDP 2015: 15-23).

There is considerable state fragility in Balochistan compared to Pakistan's other federating units. An array of conflicts – tribal, sectarian, and ethno-nationalist – have emerged in the last two decades, plunging parts of the province into sustained instability. Compounding these issues is the province's severely underdeveloped socio-economic base, as it continues to lag on all indicators of human capital and economic investment. In totality, the issues mentioned here have perpetuated a larger perception of Balochistan being an unsafe and backward region.

Balochistan fragility matrix

Scale: Balochistan		
Dimension	Status	Response
State legitimacy	Weak political settlement b/w competing groups. Centrifugal tendencies through ethno-nationalist movement.	18th Amendment, NFC Award, Creation of CCI
Increased space for moderate political groups.	Fed. Govt led coalition building (NP-PkMAP). Amnesty scheme for ethno-nationalist activists	Revenue and governance reform
State effectiveness	Poor development outcomes. Weak bureaucratic capacity as measured	CMPRU-led governance reform to improve provincial state capacity. Meritocratic hiring practices institutionalised
Private sector development	Weak private sector growth in formal sector. High degrees of informal and illicit economic activity.	CPEC projects to kick-start private sector growth. WB BER provides useful template for policymakers.
Security and conflict	Violent activity by non-state actors along ethnic and sectarian lines. Regional security imbalances from neighbouring countries.	Military and paramilitary (FC) operations.
Resilience	Medium	Managed political settlement. Improving inter-ethnic relations.

State legitimacy

The narrative of Balochistan's fragility differs widely across different actors. Baloch ethno-nationalists have long held the federal government, and in particular dominant Punjabi politicians, military officers, and bureaucrats, responsible for perpetuating underdevelopment through inequitable distribution of federal resources. The centre's response to these accusations has often been in the form of locating the causes of underdevelopment in the social system of Balochistan, wherein parasitical tribal elites have enjoyed state power and siphoned off federal resources making little investment in the province's development.

The truth likely lies at the confluence of several factors. Balochistan's fragility can, in part, be explained by historical neglect by the federal government as well as the provincial elite. The harsh geography of the province, with low population density and scarce availability of water for agriculture has also played a part, while its institutional inheritance as a buffer region run by tribal elites under British colonial rule can also be identified as among the deeper causes (Mustafa and Qazi 2007: 1799).

From the point of view of state legitimacy, the absence of a stable political settlement between competing ethnic and tribal groups in the province, as well as between different provincial and federal governments have contributed to significant regress. In particular, processes of political competition along ethnic

lines have gained further complexity in recent years due to the transforming demographic composition of the province. According to the 1998 Population Census, the largest ethnic group in Balochistan were Balochi-speakers, consisting of 55% of the population. The next largest group were Pashto-speakers making up 30%. Others included Sindhis (6%), Punjabis (3%) and Seraikis (2%) (World Bank 2008b: 143).

However, since the early 2000s, large scale Pashtun migration from neighbouring Afghanistan as well as conflict localities in FATA and Khyber-Pakhtunkhwa have likely reduced the majority of Balochi speakers. In 2005, it was estimated that Balochistan had seen the influx of close to one million Pashtuns from within and outside of Pakistan (Gazdar 2007). While the two major ethnic groups remain spatially segregated, with Pashtun areas in the North and Baloch areas in the West and South of the province, they compete for resources in the provincial capital (and most developed city), Quetta. The conflictual dynamics of political contestation at the provincial tier have been exacerbated as Baloch residents perceive greater marginalisation due to the changing demography of the region (Gazdar et al. 2010).

Official response

Since 2008, the federal government has attempted to address the decay of state legitimacy through a number of process-based ways. The 18th constitutional amendment delivered on provincial autonomy, with Baloch ethnic political parties gaining greater voice in administrative affairs of the province. It also transferred revenue from excise duty and first use-rights on oil and natural gas to the province in a bid to address a longstanding demand of the provincial government. The 7th NFC Award reduced horizontal inequities between different provinces by adding provisions for underdevelopment and inverse population density to the revenue-sharing formula. The formula adopted has seen Balochistan's share in federal transfers rise from 7.17% to 9.09%, which amounted to an additional Rs. 84 billion of provincial revenue in FY2017 (Government of Pakistan 2017: 22).

Following the 2013 elections, the federal government took a key step in reducing intra-provincial discord by brokering a settlement between tribal elites, moderate Baloch activists, and Pashtun ethno-nationalist politicians. This was carried out through an informal power-sharing formula that has remained intact for the duration of the current government.⁵ The arrangement has helped reduce destabilising conflict between competing ethnic groups, and created an opening for Baloch nationalists to become part of the mainstream political process once again.

While these positive steps have helped reduce some aspects of fragility, performance-based improvements of state legitimacy still require considerable attention. As discussed in the next section, the weak capacity of the provincial bureaucracy to deliver public services effectively continues to be a challenge. This needs to be addressed in order to mitigate a major source of fragility.

⁵ Under the formula, the moderate nationalist party (National Party) is to hold the Chief Ministership of the province for half of the five-year duration of the assembly. During the second half, the office is to be held by a local tribal elite politician. The main Pashtun party (PKMAP) was given key provincial cabinet posts.

State effectiveness

Public institutions in Balochistan suffer from a severe lack of capacity, reflected in an array of poor indicators pertaining to provision of basic public goods. Survey data shows that citizen satisfaction with the delivery of government services, such as health, education, sanitation, and law and order, was the lowest out of all four provinces. These problems are, in part, driven by major skill and labour productivity shortcomings in the provincial bureaucracy: 28% of all sanctioned public-sector jobs are in the lowest skill level category, basic pay scale one, compared to an average of 18% in the other three provinces (World Bank 2008a: 34).

Ethnic heterogeneity in the province also undermines the provincial government's administrative effectiveness. The conflictual nature of political competition means implicit balances need to be maintained in public sector employment in the province, due to the great symbolic value attached to ethnic and tribal affiliation. The factional affiliations embedded in the provincial bureaucracy prevent accountability of underperforming or corrupt public officials, and contribute to politically-motivated hiring practices. On a per capita basis, Balochistan has the largest bureaucracy of all four provinces, with 2.1 sanctioned officials per 100 people. The highest figure in the remaining three provinces is 1.3, in Khyber-Pakthunkhwa (World Bank 2008b: 139).

The problems of the bureaucracy highlighted here further manifest in Balochistan government's capacity to raise sufficient revenues for development expenditure. Provincial tax receipts contribute only 4.4% to total provincial revenue, compared to 8% for the other provinces (Nabi and Shaikh 2010). While some of this can be traced to the underdeveloped economic base of the province, the functioning of a low-skilled tax bureaucracy plays a part in exacerbating the problem.

Official response

In recent years, there have been concerted efforts by both the federal and provincial governments to improve the organisational capacity and effectiveness of public institutions in Balochistan. In 2007, the federal government introduced mandatory two-year service in Balochistan for all centrally-recruited bureaucrats belonging to the elite Pakistan Administrative Service (PAS). The primary rationale was to improve the quality of civil servants available to the provincial government, especially for district-based and other local government posts. Other steps taken to improve quality of service delivery include the institutionalisation of merit-based competitive recruitment for public sector jobs through the Balochistan Public Services Commission (BPSC) and the National Testing Service. By 2016, the number of appointments made to government departments in violation of these procedures had declined by 89% from 1,237 in 2010 to just 136 (PILDAT 2016: 70).

In 2013, the Chief Minister's office established a policy reform unit (CMPRU) to provide research-based policy support for the provincial government. The unit built on previous work by the World Bank (2008a, 2008b) to prepare a holistic provincial growth strategy. A central plank of this growth strategy is effective mobilisation and utilisation of provincial own-source revenue. For this purpose, in 2015, the Balochistan provincial assembly passed legislation authorising collection of sales tax on services, a buoyant fiscal instrument devolved to the province under the

18th constitutional amendment. To operationalise this particular instrument, the government formed the Balochistan Revenue Authority, with a mandate to document the province's tax-base and improve revenue-generation efforts. In its first full year of operation (2015/16), the BRA helped provincial tax revenue grow by 77% compared to the previous year. In the process, Balochistan exceeded its own tax collection target by 44%, becoming the only province to do so (PILDAT 2016: 34).

Recent positive developments aside, there is still considerable scope for improvement in the delivery of basic services. In particular, the local government system put in place in 2010 still requires considerable administrative and fiscal strengthening to improve development outcomes in the province.

Private sector development

Despite an abundance of natural and locational resources, Balochistan's economy remains severely underdeveloped. Its share in the country's GDP remains at a low 4%, while the provincial economy has expanded by only 2.7 times between 1972/73 and 2004/05, compared to 3.6 times in Khyber-Pakhtunkhwa and Sindh, and four times in Punjab (World Bank 2008). Sectorally, 61% of all economic activity is concentrated in two low-productivity sectors: agriculture, and transport and storage (Govt. of Balochistan 2017: 10).

Overall, it is estimated that there are 150,000 firms operating in Balochistan, the vast majority of which are small and informally organised. The scale of private sector activity can be gauged by the fact that 97% of all firms in Balochistan employed between one and four individuals, which is the highest proportion across all four provinces (MTDF 2013: 45).

Most private sector enterprises are service providers that cater to local demand and include confectionaries, restaurants, small traders, auto parts vendors, processed/dry fruit merchants, and transporters. Industrial activity in the province is limited to the Hub region, because of its proximity to Karachi, and rice mills and brick kiln industry in the district of Jaffarabad. Limited access to finance, weak infrastructure, and on-going instability have prevented the development and growth of private sector enterprises in Balochistan, especially in its largely untapped mineral and natural resources sectors (MTDF 2013: 42).

Another major constraint for private sector growth is the inefficiency of public institutions. For example, gathering the necessary documents and obtaining clearances to start construction can take up to three months in Quetta, compared with 1.5 months in Lahore and Peshawar. Delays and costs connected with property rights were seen to be particularly onerous in Balochistan – registering property in Quetta cost 11 % of the property value, compared with 7% in Islamabad and double the South Asia average of 5.5%. Stamp duty rates on transferring property were also highest in Balochistan – 5% of the property value versus 2% in the Punjab and 3% in Sindh and the KP province. Transferring the property title took 52 days on average in Quetta compared with 30 in Lahore. Moreover, in certain key areas the situation is becoming worse—in Quetta it took an average of 70 days in 2010 to get an electricity connection, compared with 41 days in 2006 (World Bank 2010 Ease of Doing Business Pakistan).

Official response

The World Bank's "Balochistan Economic Report" (2008a,2008b) provides a template for invigorating growth in the province, and resolving its longstanding development problems. The report has been acknowledged by the provincial government as the basic blueprint on which to base future growth strategies. Drawing on its existing work, the Chief Minister's Policy Reform Unit (CMPRU) is seeking to kick-start private sector investment using the province's natural advantages in fisheries and mineral resources.

Since 2016, the federal government has placed the China-Pakistan Economic Corridor (CPEC) as the central pillar of its development strategy in Balochistan. Under CPEC, a number of highway and communications projects are being implemented in the province, which will provide a much-needed upgrade to its weak infrastructure. The Chinese are also developing a deepwater port in Gwadar, which will boost employment opportunities in the region. There are also plans of setting up industrial zones along major highway projects currently under construction. In total, Balochistan is expected to receive inflows of \$7.1 billion through CPEC infrastructure projects. Thus the trade-based development plan of both Pakistan and China, as enshrined in CPEC, is ideal for Balochistan's economy, given the province's locational advantage (ISS 2016: 12).

Security and conflict

Balochistan is host to various protracted conflicts, which have claimed the lives of over 5000 civilians in the last 15 years. These include the principal conflict between the state and nationalists (armed militant groups), inter- and intra-tribal feuds and clashes, and ethnic and sectarian strife, as a consequence of spillovers from regional conflicts. These situations have, over the years, provided cover for increasing organised violent crime.

The conflict situation is further complicated by the involvement of several foreign states with an economic or political stake in the mineral-rich province.

The nationalist conflict remains driven by themes of lack of control over natural resources and the continued dominance of the military in the province. These grievances have been channelled militarily and resulted in serious human rights violations from both state and non-state actors. Baloch militants have attacked non-Baloch migrant labourers and settlers in different parts of the province, while the Pakistan army has been involved in abducting ethno-nationalist activists and their sympathisers.

Simultaneously, the province has also been the site of sectarian attacks on the Hazara Shia population at the hands of terrorists associated with the anti-Shia militant group, Lashkar-e-Jhangvi (LeJ). These attacks have claimed over 700 lives from the beleaguered community, limited their mobility to a few neighbourhoods in the provincial capital, and destroyed businesses and other livelihoods (USIP 2014: 12).

Finally, Balochistan's multiple conflicts have created an enabling environment for criminal elements and groups to cement their presence and activity in the province. Members of threatened ethnic groups, government personnel, and local nongovernmental and foreign aid workers are frequently kidnapped for ransom.

Such episodes have played a significant role in spreading terror and restricting travel and movement within Balochistan. Approximately one-third of drugs from Afghanistan, the region's major producer, are smuggled via the coastal region of Balochistan. According to the United Nations (UN) Office on Drugs and Crime, approximately \$30 billion worth of drugs are smuggled from Afghanistan via Pakistan to other countries (UNODC 2012). Similarly, there is a substantial market for smuggling arms and weapons from Afghanistan into Balochistan and onto other parts of Pakistan. Balochistan is also the principal route for smuggling migrants from Central Asia, Afghanistan, and Iran to destinations in Europe and beyond.

Official response

The government's response to pervasive violence and instability in Balochistan has largely centred around periodic military operations against nationalist and sectarian militants. These have been met with considerable success, as the ability of nationalist groups to wage violence has been reduced since 2015.

Attempts at removing underlying grievances of the Baloch population, while made in earnest, still have some way to go before they can deliver results. For this to happen, the lack of capacity of the provincial government will need to be addressed, in order for it to deliver on basic social services. Similarly, the trust deficit between Baloch citizens and the state will have to be bridged over time to remove deeper causes of conflict.

Resilience

Balochistan exhibits low levels of resilience to economic, security, and political shocks. The development of power-sharing settlements between competing provincial elites by the federal government has added a positive layer of resilience to the political system. If the arrangement continues into the next term, it will generate institutional barriers to the perpetuation of centrifugal tendencies. Simultaneously, the successful completion of CPEC projects may provide a major fillip to the province's economic base, thus making it more capable of riding out exogenous shocks

However, these sporadic positives are largely negated by the multi-dimensional nature of on-going conflicts. The scale of militancy and its wide-spread geographic nature lie at the root of the province's fragility. The imbrication of these conflicts within regional dynamics also creates a further set of challenges for policymakers and complicates the path out of persistent fragility.

Fragility in FATA

5

The Federally Administered Tribal Areas (FATA) constitute a semiautonomous region bordering Afghanistan consisting of seven administrative agencies. It is governed directly by the federal government through appointed bureaucrats known as political agents, and under a legal arrangement, called the Frontier Crimes Regulation (FCR), that is separate from the country's constitution and penal code.

Within Pakistan, FATA represents another form of fragility, one driven by both internal drivers such as chronic underdevelopment and lack of institutional integration with the mainstream, as well as strong regional spillovers that have caused high levels of conflict in recent years. In particular, the war against the Taliban and other Islamist militants in Afghanistan has exacted a heavy toll on FATA and its surrounding regions. From 2006 to 2015 a total of 26822 fatalities were recorded in the region, including 4375 civilians. Insurgencies led by various Islamist militant organisations resulted into an estimated cost of over \$2 billion and displaced more than 1.8 million people (UNDP 2015).

FATA fragility matrix

Scale: FATA		
Dimension	Status	Response
State legitimacy	Low levels of citizen trust. Lack of institutional integration within the federation. Migrants to Middle East undermined ideological legitimacy of the state.	FATA reforms that expand citizenship rights.
State effectiveness	Local institutions of administration and delivery severely compromised	FATA reforms; donor support to local administration capacity through FATA Development Authority.
Private sector development	Pervasive emigration and capital flight. Illicit trade dominates economic activity due to porous border with Afghanistan.	Donor-funded livelihood and rural development programmes. .
Private sector development	Weak private sector growth in formal sector. High degrees of informal and illicit economic activity.	CPEC projects to kick-start private sector growth. WB BER provides useful template for policymakers.
Resilience	Low	Peacebuilding through local communities.

State legitimacy

A Post Crisis Needs Assessment (PCNA) carried out in FATA in 2010, jointly by the government of Pakistan and the World Bank, concluded that “substantial failures in governance and rule-of-law, and state failure to provide and protect basic citizenship rights to the people of FATA were structural drivers of conflict” (Govt. of Pakistan 2010). At the heart of this failure is the continued exercise of the Frontier Crimes Regulation (FCR), a colonial era law developed to collectively regulate the affairs of tribal communities in consultation with their leaders. While the rationale for deploying this legal-institutional framework by the British government was to create a colonised buffer region, the same legal system has remained in place even after the colonial state was replaced by an independent republic.

According to provisions in the FCR, law enforcement is conducted by the Frontier Corps (a paramilitary force), levies, and khassadars (police and tribal militia). Courts are similarly absent and jirgas (traditional dispute resolution bodies) appointed by Political Agents (chief administrator at the Agency level) and maliks (tribal elders co-opted by the government) hear and decide cases. Judicial and executive powers are concentrated in the office of the Political Agent, who has the right to exercise collective punishment. Superior courts have no jurisdiction over FATA. Till 2011, political parties were not allowed to operate in FATA, and candidates elected ‘independently’ from the seven agencies were responsible for representing the region in the National Assembly and Senate.

The institutional design of governance in FATA by default inhibits the development of a legitimate form of government. Deprived of basic citizenship rights, and governed by a system designed to control populations rather than develop and provide services, the high-degree of alienation among residents of FATA is a logical outcome. Since the early 2000s, the presence of an oppressive state-society compact, in which tribal elites were used as intermediaries to govern the local population, was fully exploited by a range of non-state actors who sought to create independent nodes of authority (Shinwari 2012).

These efforts have been helped by changes in the structure of the local economy as well. FATA households have long provided semi and unskilled labour for economic centres in other parts of Pakistan, in particular Rawalpindi and Karachi. Such employment opportunities historically provided a source of income for households and helped build some semblance of legitimacy of the state, on the back of improving economic conditions. However, faltering growth in recent years has resulted in a reduction in opportunities, which forced skilled labour from FATA to look for opportunities in the Middle East. Between 1981 and 2003, workers from FATA made up nearly 6% of all overseas labour migration from Pakistan, despite being only 2% of the total population (Amjad 2014).

Unmoored from the local economy, some of these workers were influenced by extremist pan-Islamist ideologies popular in the region, which they brought back with them to their places of origin. Subsequently, militant groups utilised the growing foothold of extremist narratives, and tapped into pre-existing grievances with the state to garner support for transnational Islamist militancy (Shinwari 2012).

Official response

Since 2008, there is a growing awareness of how the absence of the state's legitimacy remains a central driver of conflict in FATA. Widespread disillusionment due to both a failure of government institutions to deliver basic services, as well as the lack of voice afforded to residents of FATA were important factors in perpetuating instability and fragility.

Official responses in the aftermath of escalating violence have sought to address some aspects of process-based legitimacy. Efforts to bring FATA into the political mainstream included the extension of the Political Parties Act (2002) to the region in 2011, which permitted local political parties to conduct political activities and campaign for elections in the area. Improving citizen voice in governance was attempted through the FATA Local Government Regulation of August 2012, which sought to establish an elected local council system to build civilian governance capacity. Judicial provisions such as the protection of the right to bail for prisoners were introduced in 2009 and an appellate tribunal was introduced in 2011, though access to the country's higher judiciary was still not an option (USIP 2015). However, due to on-going militant activity, and frequent operations by the Pakistan Army, many of these reforms have remained unimplemented on a variety of emergency-based pretexts.

In May 2014, the government constituted a FATA Reforms Commission with the explicit mandate to 'revisit and redefine' state-citizen relations in the region. The Commission recommended the merging of FATA with the neighbouring province of Khyber-Pakhtunkhwa, with a variety of transitional arrangements to extend legal-institutional systems. To this end a draft bill was developed and deliberated by a parliamentary committee. However, tabling and voting have been delayed due to a number of political and administrative reasons. If passed and implemented, it would signal the single biggest step taken to address the issue of state legitimacy in FATA by policymakers in Pakistan.

State effectiveness

FATA's persistent underdevelopment shows how state institutions remain highly ineffective. The region, along with Balochistan, is the poorest in Pakistan with 74% of all households living in poverty. The literacy rate is 17% compared to a national average of 56.2%, with female literacy at only 3%. There were six times more people per doctor in FATA compared to the rest of Pakistan, while only 43% of the population had access to clean drinking water (compared to a national average of 77%) (Government of Pakistan 2010). Political Agents in each of FATA's seven agencies are ostensibly responsible for carrying out development functions, however they face little performance accountability and are often embedded in local rent-seeking relationships.

Apart from the state's failure in delivering basic social services, FATA's law and order apparatus has also been ill-equipped to deal with security challenges. The Frontier Constabulary, the paramilitary organisation responsible for securing border regions, are ill-equipped for local policing functions. For policing purposes, Political Agents recruit khasadaars (tribal militias) from the local population on the recommendation of tribal elders. They remain underpaid and

receive no formal training to carry out law and order responsibilities. The state does not maintain a system of formal police stations in any of the tribal agencies (FRC 2017).

Existing state institutions, already ill-equipped in the way they've been designed, have been further compromised due to the pervasive presence of conflict. Political Agents, and other state institutions, have been the target of repeated attacks by militant groups that have further compromised their ability to perform basic service delivery functions.

Official response

In 2006, the federal government established a permanent secretariat to provide support to governing functions in FATA. Alongside the secretariat, the FATA Development Authority (FATADA) was also instituted to undertake infrastructure and social development projects with the support of the federal government.

Since the escalation of conflict in the region, FATA has also seen the inflow of at least \$3 billion in development assistance. Aid programmes have focused on both rebuilding infrastructures ravaged by conflict, as well as providing capacity building support to the FATA bureaucracy. However, the continued presence of conflict has diluted the impact of extant efforts to improve state effectiveness in the region.

Private sector development

Economic opportunities have remained limited for the people of FATA. There are few livelihood opportunities, as the local economy is mostly pastoral. Only 7% of the total geographic area of FATA is cultivated with another 1% recorded as fallow, accounting for roughly half of total cultivable land (FRC 2012: 89).

After agriculture, the other major source of employment and private sector activity is cross-border trading. FATA's land border with Afghanistan is an important conduit for trade between the two countries. Pakistan also provides a transit-trade facility to Afghanistan, and most customs clearance of transit goods destined for Afghanistan at sea and land ports in Pakistan are handled by local businessmen. Alongside these activities, there is a very small industrial base in FATA. Manufacturing activity is restricted primarily to small, owner-financed units, operating without formal registration or regulation. Major sectors include stone processing, textile weaving and firearms manufacturing (FRC 2012: 92).

Overall, the legal framework governing FATA has inhibited economic growth. Existing practices of collective punishment and lack of secure property titling act as serious impediments to mobilising local investments, while these problems are further compounded by inadequate infrastructure, such as pervasive electricity shortages.

FATA's porous border with Afghanistan, and the proliferation of geographic areas without any state oversight and regulation have led to the development of a large illicit economy centred around the drug and weapons trade. Afghanistan produces 90% of the world's opium supply and around 33% is smuggled across land routes in Pakistan. FATA and Balochistan are both important conduits in such illicit flows (FRC 2012: 86).

Official response

The government's primary involvement in FATA has been to eradicate militant strongholds and reduce their capacity to attack civilian and security targets across the country. Efforts to revive the local economy have mostly been left to donor-funded programmes that have worked in coordination with the FATA Development Authority.

The government recently launched a programme to develop small hydro-electric power projects in a bid to resolve the region's energy shortages. Other areas of intervention included public-private partnership for mineral development, skills training for local youth, and development of a support programme for marble manufacturing (FATADA 2016: 17).

FATA's long-term stability is, in part, contingent on households being able to access economic opportunities. While the on-going conflict will likely prevent the development of the local economy, investment in skills programmes will allow more FATA residents to seek opportunities elsewhere in Pakistan. Remittances have long played a part in sustaining households in the region, and thus can be placed as a central aspect of development policy. The ability to find work within Pakistan will also improve prospects of state legitimacy and undermine drivers of local discontentment.

Security and conflict

FATA is the most volatile conflict zone in Pakistan. A safe haven for local and transnational terrorist outfits and a hotbed of terrorist activity in the post-9/11 landscape, FATA is often dubbed the most dangerous place on earth. This is an unfortunate reversal as FATA experienced little violence till the mid-2000s. However, the incidence of violence since then has been unprecedented, both on a per capita basis and in absolute numbers (IGC 2013).

Statistics on current levels of violence (recorded between 2009 and 2013) reveal approximately 16,578 casualties involving civilians, security forces, and militants as a consequence of sectarian strife, terrorist-related activity, Pakistan military operations, and the U.S. Predator drone campaign. Between 2002 and 2011, the FATA region experienced 82 mass casualty attacks resulting in 1,392 deaths, amounting to approximately 19% of the national total. These figures suggest that FATA has the highest number of violent deaths in the country. The severity of violence is significant given the region's small population of approximately 3.2 million, around 2.2% of Pakistan's total (USIP 2014: 27).

The flow of arms from Afghanistan to FATA is an important factor enabling militancy and terrorism in the region in recent years. It can be traced to the Soviet-Afghan war (1979–88), when the region became a training ground, operational base, and safe haven for the mujahideen (religious warriors). The mujahideen included Afghans waging jihad (religious struggle) and thousands of volunteers who had poured in from around the world to fight against the Soviet Occupation of Afghanistan. Over the years, many foreign fighters, particularly of Arab and Central Asian origin, were able to integrate in FATA by marrying local women and bringing gifts in the form of money for the local tribes.

Over this period, FATA has also seen an uptick in sectarian conflict between Sunni and Shia populations. In 2007, FATA saw the highest levels of sectarian

violence in the country, with two stints of continuous sectarian violence spanning 24 and 26 in the Khyber and Kurram agencies respectively, resulting in 1,663 fatalities (48%) out of a national total of 3,448 (SATP 2013). While Kurram has been troubled with sectarian violence since 1987, the Taliban presence in neighbouring tribal agencies and their alleged support for Sunni groups is believed to have been a key factor in the exacerbation of sectarian clashes (USIP 2014: 11).

Official response

The government's response to conflict in FATA has largely taken the shape of military action. Between 2001 and 2010, the Pakistani military conducted a number of operations in regions along the Afghan border. By one assessment, Pakistani troop levels along its frontiers with Afghanistan have ranged roughly between 55,000 and 145,000 from 2001 to 2011 (USIP 2014: 15). During 2011 and 2012, the Pakistan military carried out 144 and 107 operational attacks respectively against militants in various agencies of FATA.

Since 2014, the Pakistan military has carried out large-scale clearance exercises in several FATA agencies under its Zarb-e-Azab operation. These have led to the displacement of over a million citizens and incurred a large degree of cost for resettlement, rehabilitation, and reconstruction (USIP 2016). Military operations have been successful in undercutting the capacity of militant groups based in FATA, and have resulted in a reduction in violence in various parts of the country.

However, despite regaining a monopoly over means of violence in parts of FATA, the state has failed to address deeper causes of violence and instability. The lack of concerted development spending to build infrastructure and improve economic growth in the region means local populations are still susceptible to being recruited by militant groups. Similarly, failure to improve state capacity to deliver basic services, and a failure to bring about much-needed reforms to the legal system will continue to alienate local populations.

Resilience

As a whole, the FATA region possesses low levels of resilience. The lack of economic opportunities, along with high degrees of state and non-state conflict mean that long-term pathways out of fragility will remain elusive. Simultaneously, low levels of trust in public institutions and a frayed state-society compact continue to act as drivers of destabilisation.

However, the cooperation extended by local populations during various operations offers some hope for the future. On several occasions, more than a million people were displaced, temporarily settled in various locations, and then subsequently repatriated to their communities. These processes were carried out relatively smoothly and demonstrated the capacity of both government institutions and local communities to deal with large-scale shocks.

Fragility in Karachi

6

The final case from Pakistan is a study of fragility trends in Pakistan's most populous city, Karachi. Home to a population of 16 million, the city is the fifth fastest growing mega-city in the world. It is also Pakistan's main economic hub and hosts the country's only fully-functional port.

Since the late 1980s, Karachi has witnessed episodic lapses of violence, largely along ethnic lines. The city's economic importance is both a result of and a driver of large-scale migration from different parts of the country, over and above an initial migration of people who moved in from India after Pakistan attained statehood. The presence of large-scale heterogeneity, political organisation of ethnic identity, and heightened competition over urban resources have all acted as strong drivers of conflict. Since 2008 alone, conflicts of various kinds have claimed over 7000 lives in the city (USIP 2012: 12).

In this sense, Karachi's contradictory trends of being a vibrant economic centre co-existing with pockets of entrenched dysfunctionality and violence, echo the experience of cities like Sao Paulo, Rio de Janeiro, and Mumbai. While heterogeneity and migration are key drivers of fragility, a headline outcome from analysing Karachi's case is the breakdown of local government institutions, both from a legitimacy and effectiveness point of view. These have contributed to law and order crises, and the development of 'shadow states' where non-state actors merge political contestation with criminality, violence, and the provision of service delivery.

FATA fragility matrix

Scale: Karach		
Dimension	Status	Response
State legitimacy	De-legitimisation of local government institutions. Absence of power-sharing arrangements between political actors.	Sporadic efforts of brokering peace by Federal Govt.
State effectiveness	Dysfunctional local government institutions with high degree of political capture.	World Bank support for municipal administration reform. Privatisation of service delivery apparatus.
Private sector development	Private-sector activity remains vibrant	CPEC-led initiatives in power sector and industrial development

Scale: Karach		
Dimension	Status	Response
Security and conflict	Entrenched criminality around housing and access to land. Political parties utilise violence to settle political disputes	Federal government allocates policing powers to paramilitary forces
Resilience	Low	None

State legitimacy

Over the past three decades, the legitimacy of national, provincial, and local state institutions in Karachi has fractured considerably. The city is the capital of the largely rural Sindh province, run by the Sindhi-dominated Pakistan Peoples Party (PPP). However, the majority of Karachi's residents are non-Sindhi speakers, and the city's largest party remains the Muttahida Quomi Movement (MQM), which emerged from the ethnic mobilisation of Urdu-speakers (who constitute 48% of the city's total population). In subsequent periods, other groups, representing Baloch and the Pashtuns residents have also pushed claims of ethnic-based grievances (Gazdar and Mallah 2013).

The tensions present between competing groups manifests in the breakdown of legitimacy along ethnic lines. In particular, the authority of a rural Sindh-dominated provincial government is widely seen as illegitimate by non-Sindhis in Karachi. These processes have worsened due to the instrumental utilisation of state institutions by political elites for the benefit of co-ethnics. This has largely taken place through disbursement of targeted service delivery and brokering employment in key state institutions, such as the police and education departments (Gayer 2014: 32).

The federal government, which controls the port system and a number of military-run areas in the city, is also perceived through ethnic affiliations. Longstanding grievances of Sindhi, Pashtuns, and Urdu-speakers against the dominant province, Punjab, often map onto their perception of federal government institutions. In particular, the military is seen as more partial to Punjabis, due to a number of security operations against MQM-affiliated militants and its historically skewed patterns of recruitment (Budhani et al. 2010).

These problems have been compounded by the absence of a political settlement between the city and the province that could lead to a representative and functional local government system. For large parts of the city's history, higher tiers of government have exercised unilateral control over the city, thus driving perceptions of marginalisation and exclusion among the local population. In recent years, the period between 2001 and 2008 saw some modicum of stability emerge from the functioning of an empowered local government system. However, the system was rolled back in 2009, reigniting province-city conflicts, and violent contestation between political party-affiliated militants.

Official response

The federal government has sought to enhance legitimacy through paramilitary operations, and brokering period settlements between competing parties. However, these have yielded mixed results. As discussed ahead, overt violence and criminality has declined, but a sustainable way of legitimising local institutions and enhancing the city's control over its own governance remains elusive. In 2015, the Sindh government instituted a local government act that further centralised powers at the provincial tier, including over historically municipal domains such as building control, water and sanitation, and solid waste management.

State effectiveness

Political dynamics directing control and functioning of local government institutions have contributed to the erosion of state capacity in a number of areas. Most notable are failures in delivery of basic social services, land registration and revenue, and law and order. These have contributed to make Karachi one of the least liveable megacities in the world.

To give a few examples, water availability in Karachi fluctuates between four hours per day to two hours every other day. A significant portion of the city's households and commercial users rely on private vendors ('tankers') to provide water at higher prices. The sewage network has not been well-maintained since the 1960s, and all three existing treatment plants are dysfunctional. Industrial waste, which contains hazardous materials and heavy oils, is dumped directly into the sea untreated. Of the 12,000 tons of municipal solid waste generated each day, 60% never reaches a dumpsite and 80% of medical waste is not disposed of properly (World Bank 2017c).

Similarly, the government's development and regulation of land remains weak and ineffective. The city has been in the throes of a housing crisis since 1947, when large-scale migration first took place from India. In the past three decades, the housing market has seen the proliferation of informal settlements (katchi abadis), which now provide residence to nearly 50% of the city's population. It is estimated that the current demand of 80,000 housing units is only met by a supply of 30,000 units per year in the formal sector. The gap is made up by the supply of at least 32,000 housing units in katchi abadis annually. From 2001 to 2013, the urban footprint expanded by more than a quarter with signs of sprawl, without the accompanying investments in services and infrastructure. At the same time, valuable land in central parts of the city remains underutilised, resulting in shortages of land for housing and businesses, an outcome of poor land use planning and fragmented land control across multiple agencies with little coordination (World Bank 2017d).

The state's ineffectiveness manifests itself through its failure to raise adequate amounts of revenue to finance development in the city. The local city government currently collects less than 10% of potential revenues from existing sources such as utility fees and property taxes, resulting in a lack of resources for investment programmes. Due to the segregated basis of political support, the provincial government has also shown little interest in enhancing local revenue

capacity, and has chosen to redirect provincial revenue collected from the city to other areas.

Finally, the local police apparatus remains heavily compromised by pervasive corruption, incompetence, and political interference. This has limited its capacity to control crime in the city. In 2011 alone, there were 1,490 reported vehicle snatchings, more than 12,500 mobile phone thefts, 113 kidnappings for ransom, and 1,683 armed robberies in Karachi. By all accounts, these are significant underestimates and the incidence of crime is much higher (USIP 2012: 24).

Official response

Efforts to improve state capacity and effectiveness have been piecemeal and sporadic. In 2016, the Sindh government signed contracts with Chinese and Turkish companies to outsource solid waste management and other municipal functions through new special purpose vehicles (SPVs). The primary reasons for this were to both concentrate municipal authority at the provincial tier and bypass ineffective local institutions.

In 2017, the World Bank in support of the Sindh government announced a city improvement project for Karachi worth \$98 million. The project aims to build the capacity of institutions responsible for municipal governance, as well as improve living conditions across different neighbourhoods.

Nevertheless these interventions continue to mask the absence of any intent to devolve authority to the city government and build capacity of local institutions that can deal directly with the city's governance issues.

Private sector development

Karachi is the main hub of private sector economic activity in Pakistan. The city generates 12% of national GDP, contributes 25% to federal tax revenue collection, and accounts for nearly 6% of total employment. This is largely on the back of a strong manufacturing and trading base, which contribute 63% to all employment in the city, and the presence of the country's only port (USIP 2016: 5).

Karachi's manufacturing base includes not just traditional labour-intensive manufacturing industries but also heavier and more advanced industries. Within formal sector manufacturing, Karachi accounts for some 42% of national employment in the motor vehicles and transport equipment sector; 35% in the metals, machines, and electronics sector; 32% in the chemical products sector; 21% in the wood products sector, 18% in the textiles sector; and 8% in the food and beverages sector. The city's gross value added (GVA) per worker in 2012 was more than twice that of Pakistan overall. Between 2000 and 2012, Karachi's real GDP grew at a relatively high 5.7% per annum from 2000-2012 (compared to 4.5% nationally) and employment likewise expanded at an impressive rate of 5.1% per annum (World Bank 2017e).

However, while the lapses into instability have not prevented private sector activity in the city, there are still many barriers that continue to hold it back. These include:

- Lack of overall safety.
- A weak land titling and regulation regime that is prone to informalisation.
- Exploitation.
- Fraud.
- Ad-hoc building controls.
- An ineffective and slow system for obtaining government permits.

According to the World Bank's Doing Business survey, starting a business in Karachi takes 12 procedures, 18 days, and 12.4% of per capita income. The government of Sindh province, which controls most primary points of contact for entrepreneurs, carries out all business-related formalities with little automation. The construction of a typical warehouse, for example, takes 15 procedures, 260 days, and costs 9.1% of the warehouse's value (World Bank 2010).

More structural issues with the development of Karachi's private sector include the informalisation of its economy. This has become particularly pronounced in recent years. Although formal sector employment accounts for a larger share of the workforce in Karachi than in other Pakistani cities, the informal sector nevertheless accounted for 67% of overall employment in the city in 2011 (Kamal and Qasim 2012).

Many of these issues are linked to the way the city has grown. Karachi's existing industrial estates have also become increasingly unfit for industrial activity as Karachi's population has swelled and the built-up residential area has expanded outwards well into the historical peripheries. These trends have reduced the availability of labour and placed constraints on land available for commercial and industrial purposes.

Finally, problems of energy shortages and pricing that have hampered private sector productivity elsewhere in the country, continue to persist in Karachi as well. While it is the only city in the country with a private sector run electricity market, the overall availability of both power and natural gas is shaped by its linkages with the rest of the country. These have suffered repeated breakdowns over the last decade.

Official response

The federal government has taken several initiatives to spur economic activity. As discussed in the next section, these have largely focused on improving the law and order situation through the neutralisation of terrorist groups and the targeting of militants affiliated with political parties. It has, under CPEC investment, also initiated the construction of new power plants, and several Special Economic Zones (SEZs) in districts bordering Karachi to solve both the energy and land shortage currently hampering industrial growth. Lastly, the provincial government has initiated several new projects in mass transit and road infrastructure development to facilitate logistics and the labour market. However, meaningful reform that reduces bureaucratic constraints on new enterprises, or

simplification of provincial tax procedures is still missing.

Security and conflict

FATA Conflict in Karachi remains multifaceted, with the presence of ethnic, sectarian, and Islamist militancy. Since 2008, nearly 7000 residents of the city have been killed in inter-group violence of various kinds, and losses worth billions of rupees caused to the local economy. Due to its economic importance, violent destabilisation of Karachi casts a sizable impact on stability in the rest of the country.

The main perpetrators of violence have been criminal gangs and ethnic militants affiliated with and protected by the city's three main parties, the PPP, MQM, and the ANP. At its peak in 2011, politically motivated violence in Karachi alone accounted for 9.6% of all violent deaths in Pakistan (USIP 2012).

Conflict has been driven by a variety of factors, such as heightened electoral competition for national and provincial legislature constituencies and control over valuable resources such as land. In particular, the pressures posed by large-scale migration from other parts of the country, and to a lesser extent, from Afghanistan following 2001, have increased the premium attached to land in closer proximity to the inner city. The weak regulation systems mentioned earlier, and the high amount of rents extractable from control over real estate have made this a particularly lucrative sector for criminal elements. Land grabbers, for their part, use political connections to regularise squatter settlements; gain permission to convert amenity plots (allocated for parks and community centres) into commercial or residential property; and secure permits to develop properties, often purchased for a fraction of their market value after threats or acts of violence.

In recent years, Islamist militancy and sectarian attacks have added further dimensions to the security situation in Karachi. Following the escalation of war in Afghanistan and its spillover in Pakistan's volatile FATA and Balochistan regions, various Islamist militant groups, including the Afghan and Pakistani Taliban, fled military action and took refuge in densely populated localities of Karachi. Between 2009 and 2013, Islamist militants such as the Pakistani Taliban were responsible for 35 different attacks in the city, including several suicide bombings that targeted military and police installations. They also carried out assassinations of several senior police officers working with the counter-terrorism department (Gayer 2014: 76).

The presence of unregulated religious seminaries, run by clerics promoting exclusionary forms of Islam, has also contributed to sectarian conflict in a city with large Shia and minority populations. Various Sunni militant groups carried out over 110 sectarian motivated attacks – target killings and bombings – between 2009 and 2013. Major incidents included the bombing of an annual Shia ritual procession in December 2009 by anti-Shia group Jundullah, that killed 73 individuals. In retaliation, there has been a limited armed response by Shia groups who have assassinated leading figures associated with militant Sunni groups (Gayer 2014: 81).

Official response

The federal government launched a large-scale paramilitary operation in 2014 to de-weaponise Karachi and neutralise militant groups of all types. Initially, the operation targeted Islamist groups such as the Pakistani Taliban, but later expanded its remit to include ethnic militants and criminal gangs affiliated with political parties. The efforts of the federal government have been complemented by the provincial police department and its counter-terrorism wing, which in particular has targeted sectarian militants.

These efforts, along with a variety of regulatory initiatives launched under the National Action Plan (NAP) to monitor religious seminaries and clerics with ties to militant groups, have yielded a positive response. By the end of 2016, violence declined by 66% compared to three years earlier. Target killings of both sectarian and ethnic kinds were down by 72%, extortion cases were down by 30%, and number of reported armed robberies declined by 21% over the same period. There was also a 60% decline in casualties of law-enforcement personnel.

While the success is considerable, there are major gaps that have not yet been addressed by various government stakeholders. The performance of the police department in controlling crime and protecting property is still lacking, while underlying drivers of conflict – such as land-grabbing – have not been tackled through adequate governance reforms. There is also a persisting tension between senior police officers seeking greater operational autonomy for the department and the provincial government which currently exercises control. Most of all, the continued absence of a power-sharing agreement between Karachi's main political party, MQM, and the PPP-led Sindh government, still carries the potential of triggering violent contestation.

Resilience

Karachi demonstrates mixed patterns of resilience in the face of various shocks. The economy of the city, and the activity of the private sector, has proven to be fairly resilient in the face of instability and various kinds of conflict. While there have been periods of slowdown and capital flight, Karachi's overall economic activity has outperformed other cities as well as the national average.

Nevertheless, the city has in recent years demonstrated lack of resilience on other fronts. Political conflicts between party elites have spiralled into destabilising episodes that cause major shutdowns, strikes, and paralyse all forms of social life. This inability to resolve disputes over resource and power-sharing without resorting to violent conflict contributes to overall low levels of resilience for the city.

Finally, Karachi remains highly vulnerable to shocks induced by natural disasters and climate change. The city has in the past seen high levels of damage caused by tropical storms, and the built environment neither conforms to safety and mitigation standards and nor is the city's growth being planned in a way to prevent exposure of its ever-growing population to such disasters. The scarcity of water, and the compounding impact of climate change (such as the creation of 'heat islands') pose further risks and potentially open up new drivers of conflict.

Fragility in Karachi

7

As the analysis in the preceding sections highlights, Pakistan's case presents a challenge for policymakers due to its heterogeneous composition, as well as the heterogeneity of fragility across different geographic and administrative tiers. While the list of desirable interventions to address these issues is extensive, this study proposes a nestled framework that demonstrates the link between five proximate dimensions of fragility, and the levels at which they need to be addressed.

State legitimacy

The issue of state legitimacy presents itself across all four cases under discussion. Historical tensions between the centre and the provinces, ethnic contestation in Balochistan and Karachi, and pan-Islamist militancy in FATA, are all drivers of fragility along this proximate dimension. However, given the country's political history and an agenda for economic growth that requires providing coordination and resolving disputes across different tiers of government, the issue remains most salient at the level of the federal government.

Mistrust between the provinces and the federal government over a centralised system of governance has been a recurring source of instability and conflict. Since 2008, the government has attempted to address this driver of fragility through a number of constitutional interventions that have enhanced provincial autonomy and increased vertical and horizontal inequities in revenue distribution.

To build on these efforts, there is a need to improve the functioning of coordination institutions that have a mandated role under Pakistan's federal structure of governance. In particular, the Council of Common Interest (CCI) needs to be actualised as a decision-making body, through the presence of a permanent secretariat and regularly convened meetings. Its stated role in overseeing regulation of natural resources, such as oil and gas, and key inputs in economic development, such as telecommunications and the energy market, through the input of provinces, also requires strengthening. This will help resolve both the coordination issues faced by federal government and address a long-standing source of centre-province tensions.

State effectiveness

Improving state legitimacy is tied to both process-based interventions, such as those listed above, and improving the performance of key institutions. For the federal government, in particular, these include the tax bureaucracy and the civil service, which are both central to the state's development agenda.

As Pakistan's historical experience demonstrates, the state's delivery of a national development agenda in the first two decades after partition, helped build its legitimacy and ensured its survival in particularly difficult conditions. Similarly, the federal government's ability to foster growth and expand domestic economic opportunities – a key outcome of state effectiveness – for citizens in regions such as FATA, produced safeguards against internal conflict and centrifugal forces. These broke down once opportunities reduced or dissipated out of the country, thus leading to recurring crises of legitimacy.

In various parts of the country, battling fragility also requires improving the effectiveness of sub-national governments. These include not only local law and order and revenue-generation bureaucracies, but also service delivery institutions. As the case of Karachi shows, dysfunctionality of local governments prevents the resolution of conflicts over political legitimacy, which in turn, generates periodic violent instability.

Private sector development

Private sector activity remains a key pillar of economic development and a central variable in mitigating fragility. Different tiers of government are responsible for providing a variety of supporting roles that generate a conducive environment for greater investment and productivity. Therefore, private sector development is closely tied to state effectiveness, especially with regards to institutions that support and regulate economic activity.

At the level of the federal government, Pakistan's energy crisis remains a longstanding impediment to economic growth. While this is being partly addressed by investment in generation capacity through local resources and the China-Pakistan Economic Corridor (CPEC), complementary improvements in the governance of power transmission and distribution systems are also urgently needed. Similarly, improving the efficacy of the tax bureaucracy and revising aspects of tax policy are also a major area of reform. Key interventions required here are removing discretionary exemptions and broadening of the tax-base to include hitherto untapped sectors, such as agriculture and retail and wholesale trade. This will help reduce the overall tax incidence on manufacturing enterprises. Improvements in the effectiveness of the tax bureaucracy and broadening the base will also help cut back a growing reliance on indirect taxes.

At lower tiers of government, responsibilities include the provision of basic infrastructure for economic activity and an efficient regime of licensing and regulation. There has been some progress on this front, with the Balochistan government (in conjunction with the federal government), initiating construction on several economic zones along with new transportation infrastructure to facilitate regional trade.

From a broader perspective, an uptick in activity in the private sector has

long-term positive implications for overall fragility across several proximate dimensions. Greater economic growth, driven by the private sector, increases employment opportunities, which helps build legitimacy of the state's development agenda. Similarly, it also increases the state's fiscal space, which allows for greater investment in key public goods and services such as health and education.

Security and conflict

Endemic violence and risks to the life and property of citizens are a key driver of fragility and underdevelopment. At various points in its history, Pakistan's experience of violent conflict at the hands of a range of non-state actors has coincided with faltering economic growth. As the analysis across four cases shows, violent conflict has taken place across a range of ideological and structural faultlines, that are shaped by religious, ethnic, and geo-strategic factors. Since 2013, Pakistan's security apparatus, led by the armed forces, have been successful in reducing the incidence of militancy in the three most troubled regions – FATA, Balochistan, and Karachi.

These recent successes have come on the back of targeted operations that have involved deployment of the military and, in many cases, the displacement of local populations. While these have proven to be effective, there is a strong need to undertake interventions that systemically prevent the escalation of local conflicts into violent outcomes. This involves both improving the capacity of local law and order apparatus (policing and the court system), and removing ideological drivers of conflict, such as an absence of trust in the state. Therefore, steps taken to improve state legitimacy, at the level of the federal government and lower tiers, can address key grievances of the population and prevent the proliferation of violent ideologies and non-state organisations.

Resilience

Common across all four cases was the relative lack of interventions that could enhance resilience and mitigate against economic, political, and natural shocks. At the level of the federal government, the persistent economic vulnerabilities posed by a widening trade deficit and a current account imbalance have not been addressed. In FATA, the process of legal reform that would enhance state legitimacy and provide long overdue citizenship rights to its residents has been slow moving forward. Its implementation is necessary to address systemic grievances of the local population and build resilience against the geo-strategic shocks posed by a volatile region. In Karachi, the continued absence of a political settlement between key political actors remains a concern, even while overt episodes of violence have decreased. More importantly, the city is highly vulnerable to climate change induced water shortages, which potentially pose a serious risk in the years ahead. Policymakers' response to this particular challenge has been largely lacking.

Conclusion

8

Each of the four geographic and administrative levels discussed in this paper exhibit multiple drivers and manifestations of fragility across the five proximate dimensions. The analysis also demonstrates that policymakers at different tiers have attempted to address relevant drivers of fragility through a variety of interventions, yielding some positive results. The actions of proactive federal government institutions, such as those responsible for internal and external security, and a recent uptick in economic growth have increased overall stability after a period of faltering economic growth and high levels of non-state violence between 2005 and 2013. This suggests that the localised pockets of heightened fragility, in Balochistan, FATA, and Karachi, have been contained and are at a reduced risk of impacting the country as a whole.

An analysis of the drivers of fragility at different tiers carries key implications for Pakistan's future trajectory. In particular, the country's historical pathway shows that it has struggled with two aspects that have inhibited its overall development. The first is an inability to sustainably build on periods of successful growth and stability, while the second is an inability to resolve long-festered political disputes in a permanent manner.

These two aspects have become highly salient once again in the present as the country experiences another period of improved economic growth and more secure and stable political conditions. The opportunities accorded by greater investment from China and regional trade connectivity need to be harnessed in a manner that ensures their sustainability in the future. Similarly, the important process-based interventions undertaken to mitigate centre-province tensions since 2008, and the reforms initiated in 2016 to enhance legal rights in FATA, both address long standing grievances or disputes at different tiers. These have to be seen through in their entirety to ensure that, as in the past, recent gains are not squandered in the future.

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