PAKISTAN

COUNTRY ECONOMIC MEMORANDUM 2.0

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The main thesis of the Pakistan CEM 2.0:

Pakistan's growth has been stunted by the inability to mobilize *all* of its talent and resources, and to allocate them to productive uses.

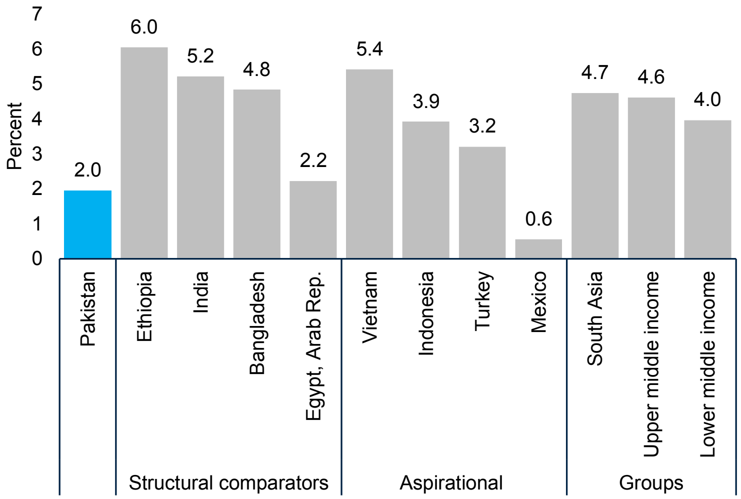
The country's growth prospects are directly associated with the ability of its firms to grow large and productive over time, so that they create good quality job opportunities for the increasing working age population.

Growth has been low…

Since 2000, Pakistan's real GDP per capita growth has been low at around 2.0 percent – almost 2.7 percentage points lower than the South Asian average

Real GDP pc growth

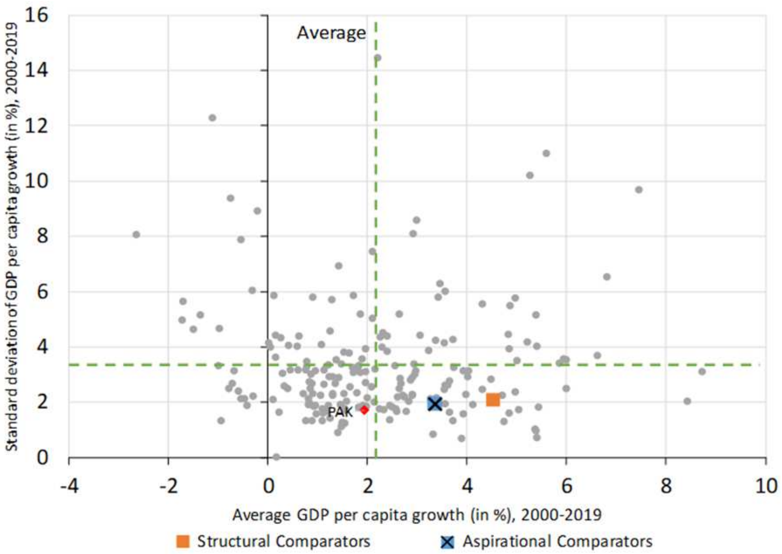
Average growth rate, in percent, 2000-2019



Source: IMF's World Economic Outlook (October 2020) for individual countries, WDI for Groups.

Average and Standard Deviation of GDP pc growth

Average, 2000-2019



Source: WDI

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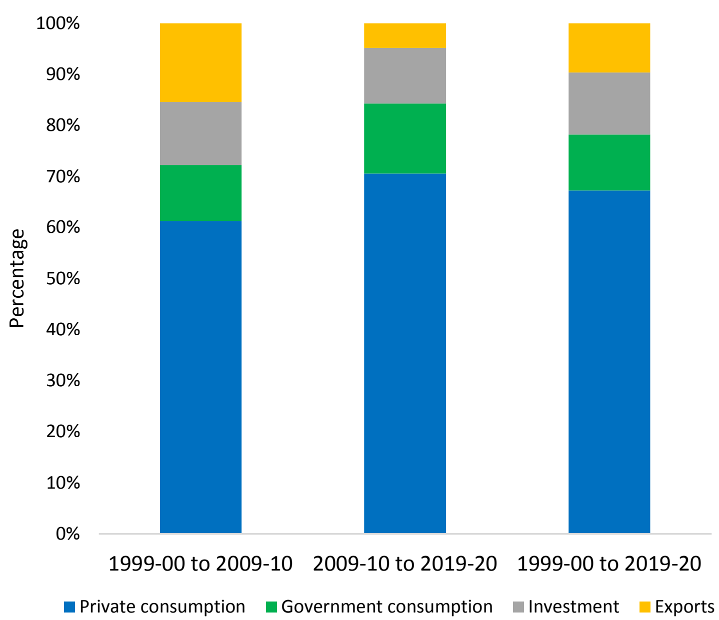
…and consumption driven…

Contributions to aggregate demand

Contributions to annual real aggregate demand growth, in percent



Source: Pakistan Bureau of Statistics, World Bank staff calculations. Data for 2019-20 is projected.

Not only is the contribution of exports and investment to overall growth in aggregate demand low from a long-term perspective and a cross-country comparison, but it has also declined.

During 1999/00-2009/10 – exports and investment demand added on average 1.4 percentage points to aggregate demand growth.

This contribution fell to an average of 0.7 percentage points during 2009/10-2019/20.

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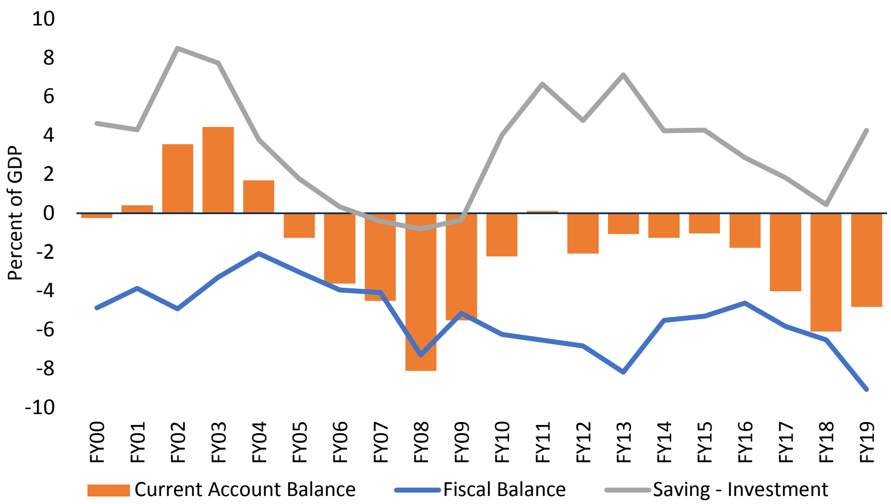
…with implications on macro imbalances and long-term growth sustainability

Saving-Investment Gap, Fiscal Balance and Current Account Balance
Percentage of GDP



Source: IMF-IFS, Ministry of Finance, Pakistan Bureau of statistics and World Bank Staff Calculations

S-I >0: Low investment rates more than offset high consumption (therefore low saving)

G-T>>0: Structural challenges to mobilize revenues to match high government expenditures, resulted in systematic public sector deficits

Current Account Balance: As a result, Pakistan has had current account deficits for 16/21 years since the turn of the century

As a result, risks of balance of payments crisis and macro instability have increased

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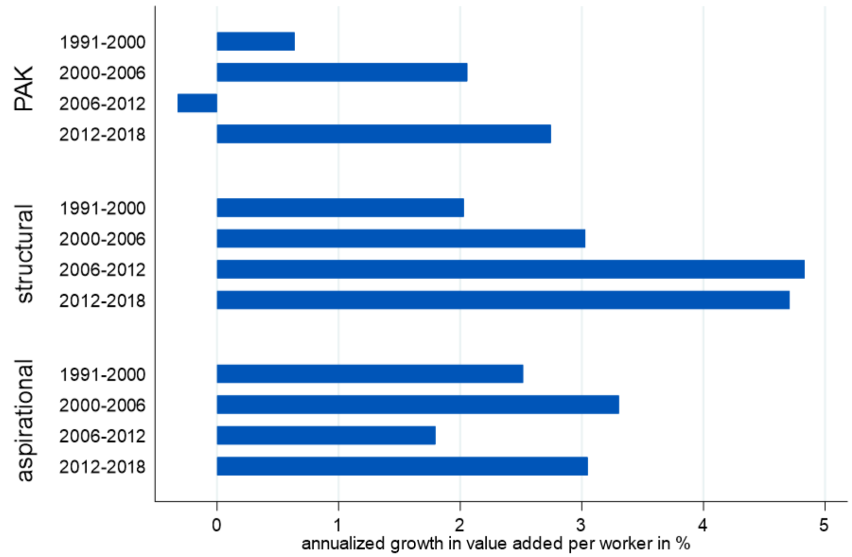
…because low growth contributions of investment and exports are associated with productivity stagnation…

Put in perspective: in 2018, an average worker in Pakistan produced only 38.1 percent more output than in 1991, while one from Vietnam produced 257.6 percent more than in 1991.

Growth in Value Added per Worker

Annual growth, percent

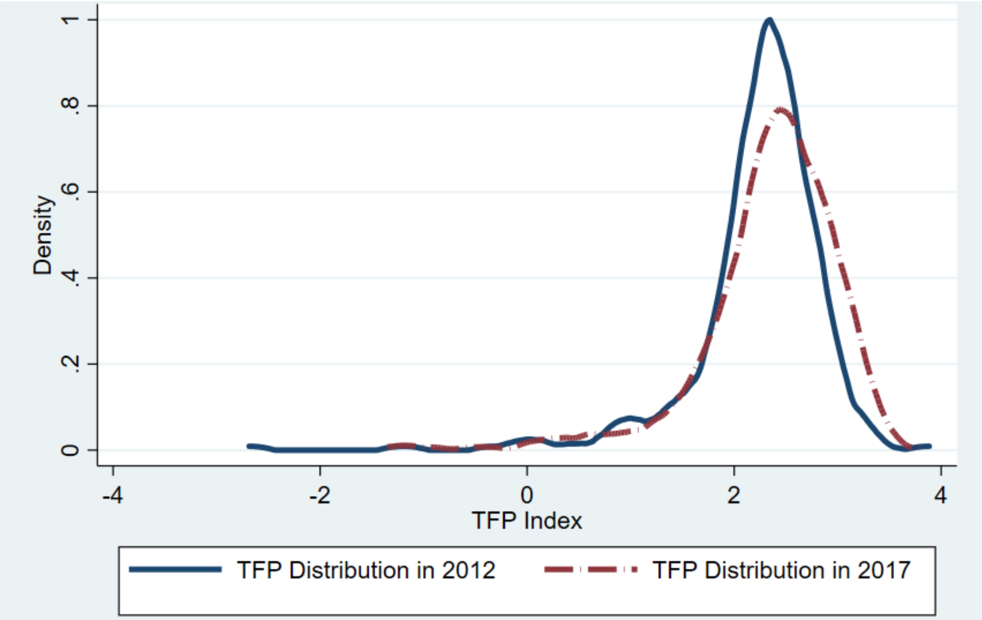


Source: Jobs Group JD Standard Code (JDSC) on the basis of WDI

…which also shows at the firm level…

Evidence for publicly listed firms shows that firm's average productivity between 2012 and 2017 has only increased slightly (and has been mildly falling since 2015)

Distribution of TFP over time
TFP Index



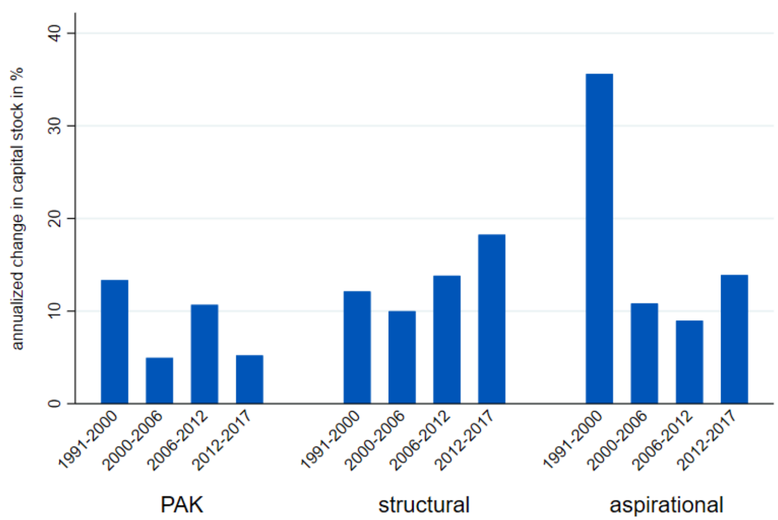
Source: Lovo and Varela (2020)

…and in part driven by lower capital deepening…

Low investment rates, led to a deceleration in capital per worker.

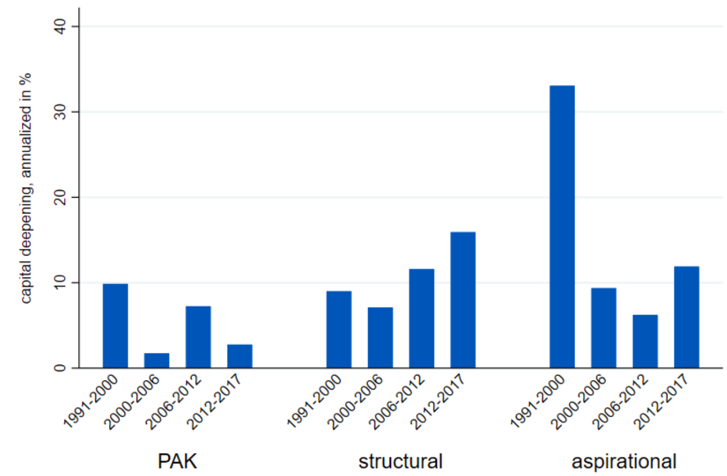
Rate of growth of capital per worker has been falling over time, while it has been growing among structural comparators.

Change in Capital Stock
Annual, percent



Source: Jobs Group JD Standard Code (JDSC) on the basis of WDI & PWT

Change in Capital Deepening (Capital per worker)
Annual, percent



Source: Jobs Group JD Standard Code (JDSC) on the basis of WDI & PWT

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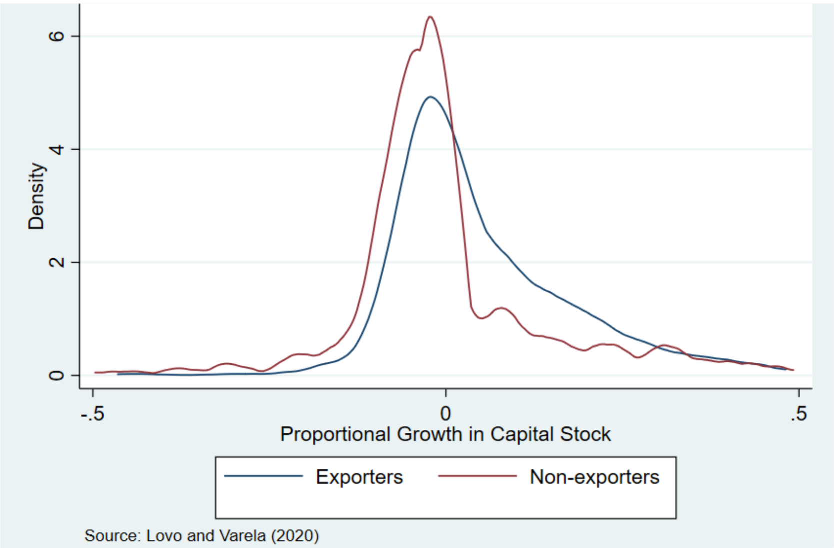
…with many firms are not investing enough even to replace their depreciation…

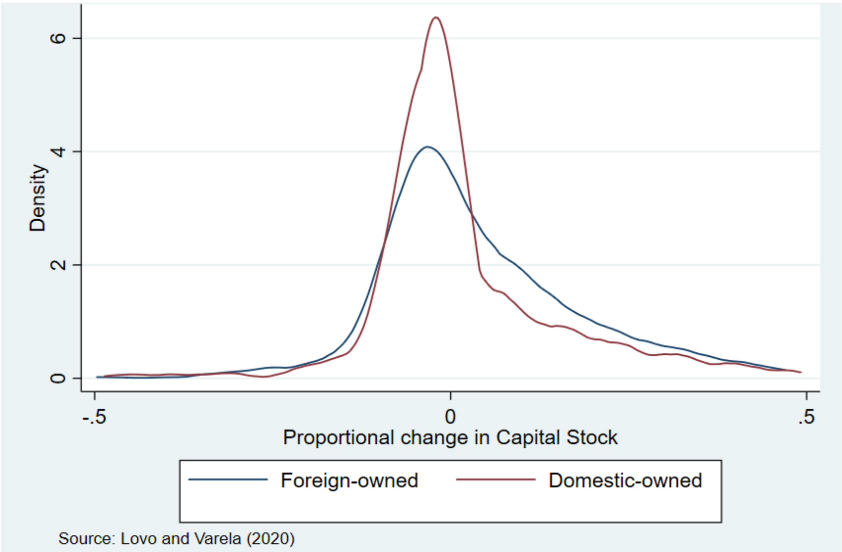
… though exporters invest more than domestic oriented firm

Growth of Capital Stock after Depreciation
Proportional Growth in Capital Stock



… and foreign-owned firms investing more than domestic-owned firms

Growth of Capital Stock after Depreciation
Proportional Growth in Capital Stock



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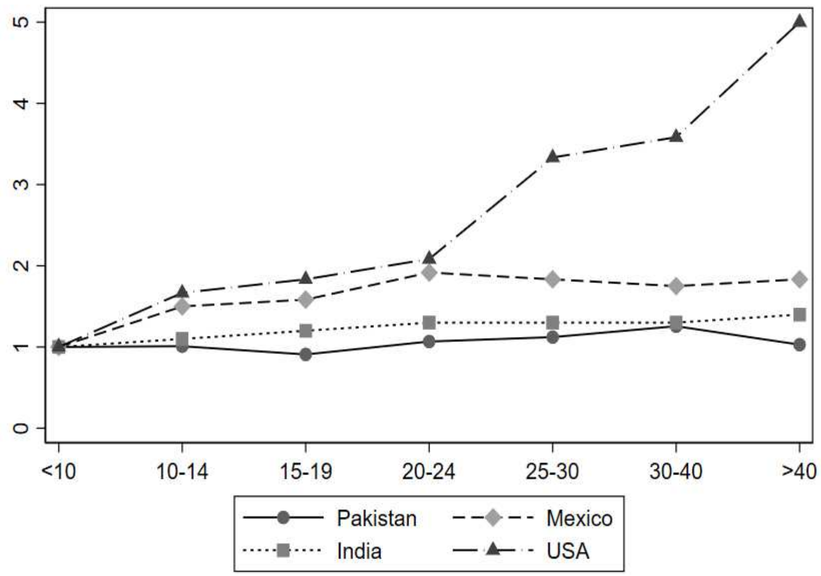
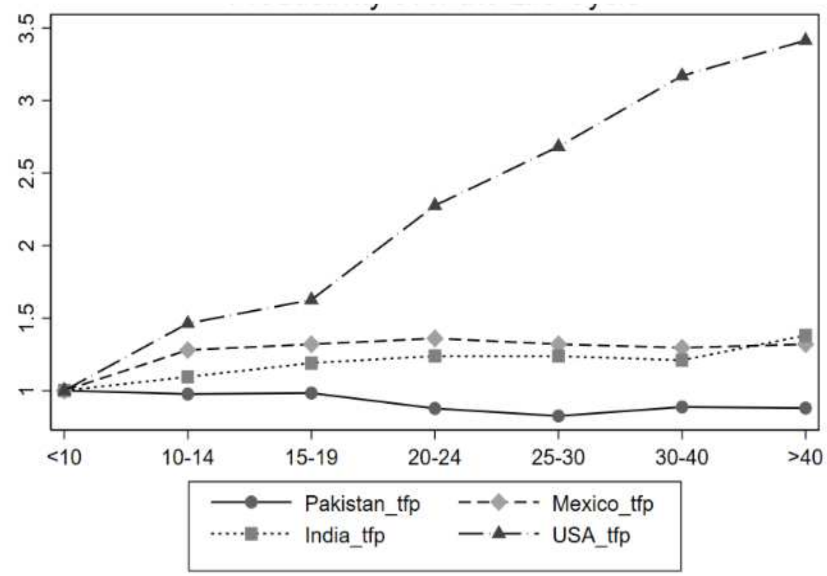
…which means they do not grow large (or 'wise') as they grow old…

Plant Size by Age in the Cross Section



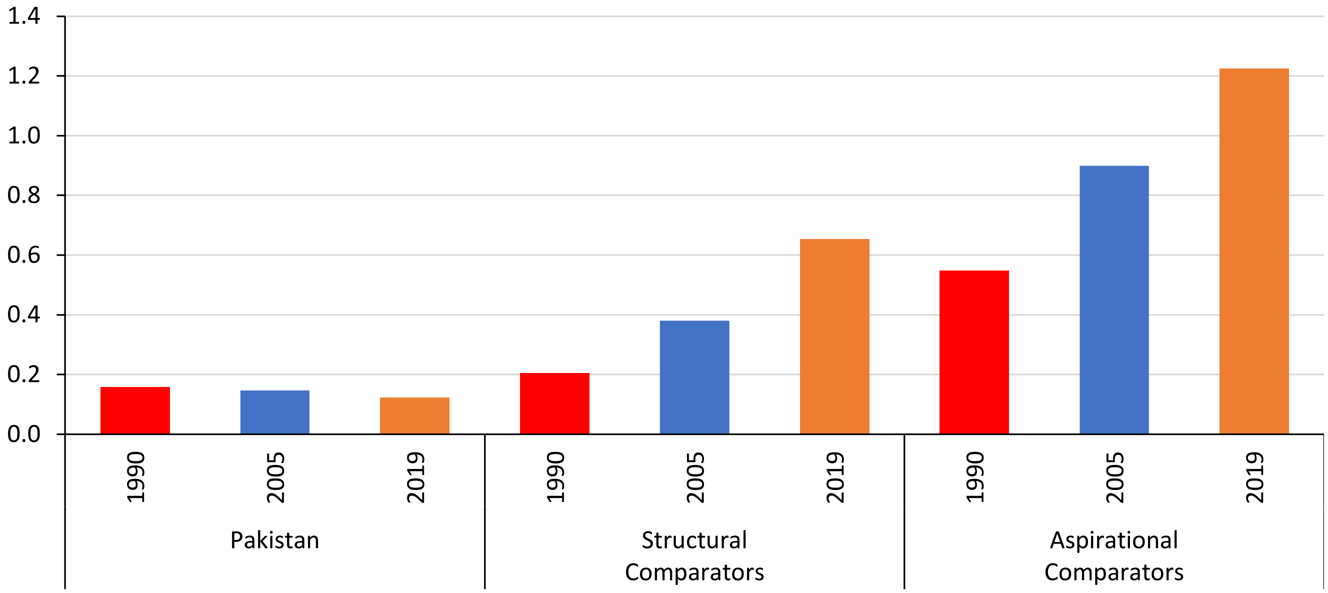
Productivity over the Life Cycle



Source: Mexico, India and USA data come from Hsieh and Klenow (2014), data for Pakistan comes from Lovo and Varela (2020).

…and showing in underwhelming performance of Pakistani firms in demanding global markets…

Global export market shares of Pakistan are in sharp contrast with those of structural or aspirational comparators



In 2005, Pakistani exporters accounted for 0.15% of global exports, in 2019 they accounted for only 0.12%.

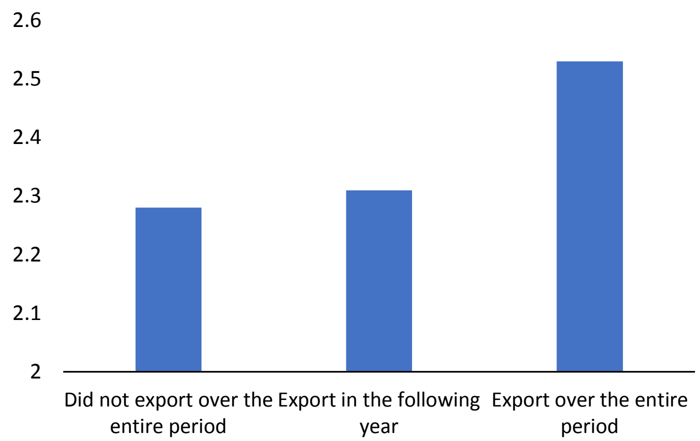
This is suggestive of relative productivity stagnation, and of relatively low scope for future productivity growth.

…in fact, lack of global integration is both cause and consequence of low productivity growth

In Pakistan (like elsewhere) exporting firms do better than inward-oriented ones, and their productivity grows after exporting systematically

…but Pakistan's export orientation is limited so this productivity upgrading opportunity is not fully tapped into.

Average Productivity by Export Status

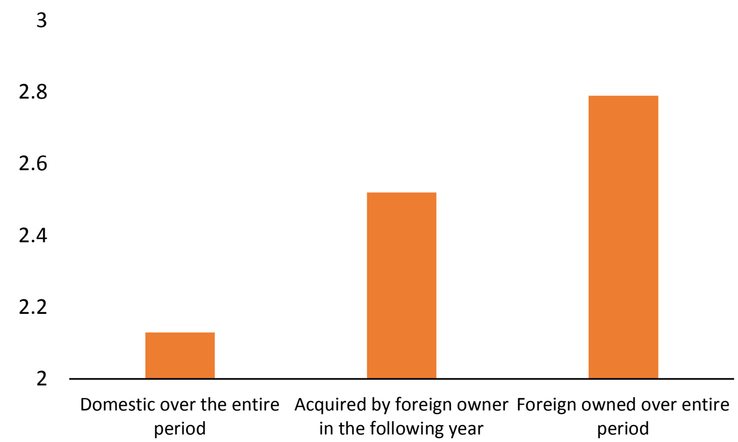


Note: All differences in means are significant at 1% except for the difference in means between the first two columns (not significant). We tested differences in means also controlling for sector-fixed effects and the results are qualitatively similar. Source: Lovo and Varela (2020).

…similarly, firms acquired by multinationals do better than domestic-owned firms, and their productivity grows after being acquired

…but FDI inflows in Pakistan remain low, so this productivity upgrading opportunity is not fully tapped into either.

Average Productivity by Ownership Status



Note: All differences in means are significant at 1%. We tested differences in means also controlling for sector-fixed effects and the results are qualitatively similar. Source: Lovo and Varela (2020).

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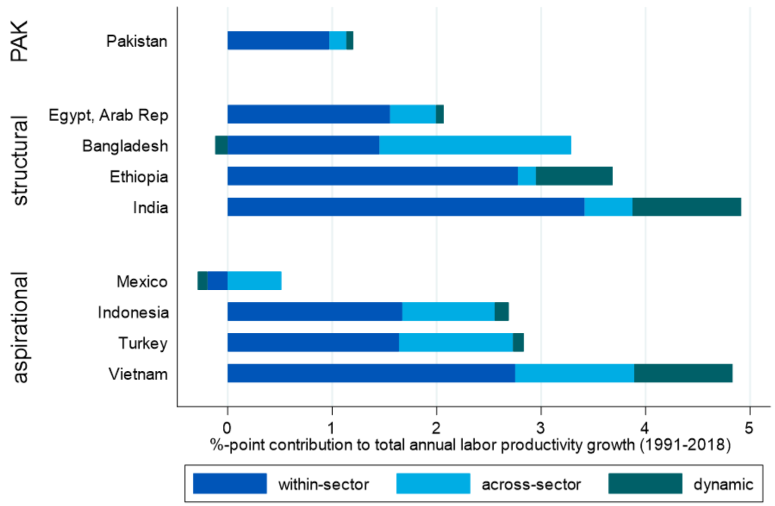
Slow structural transformation is also symptomatic of low productivity growth and quality job creation…

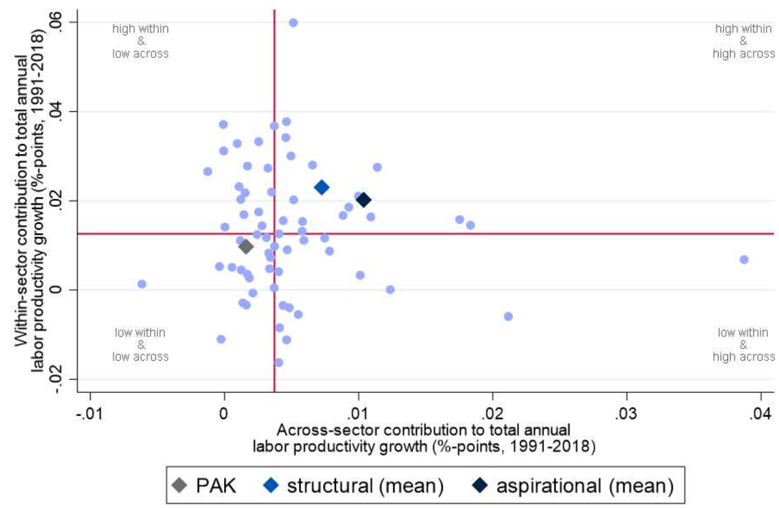
Between 1991-2018, Pakistan experienced sluggish within and low across productivity gains …in contrast with experience among structural and aspirational peers.

Contribution to labor productivity growth (1991-2018)
Percentage point



Source: Jobs Group JD Standard Code (JDSC) on the basis of WDI

Across and within-sector contribution to labor productivity growth
Percentage point



Note: Growth episodes only for LMIC and UMIC countries are considered (unless specified in group of structural and aspirational comparators)
Source: Jobs Group JD Standard Code (JDSC) on the basis of WDI

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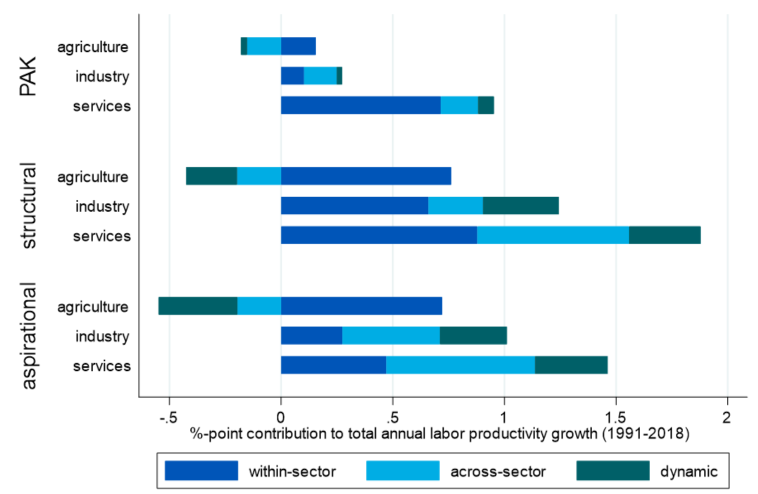
…and while more recently, this process has accelerated

Employment growth has started being faster in industry and services (higher productivity sectors) relative to agriculture (lower productivity sector) since 2012

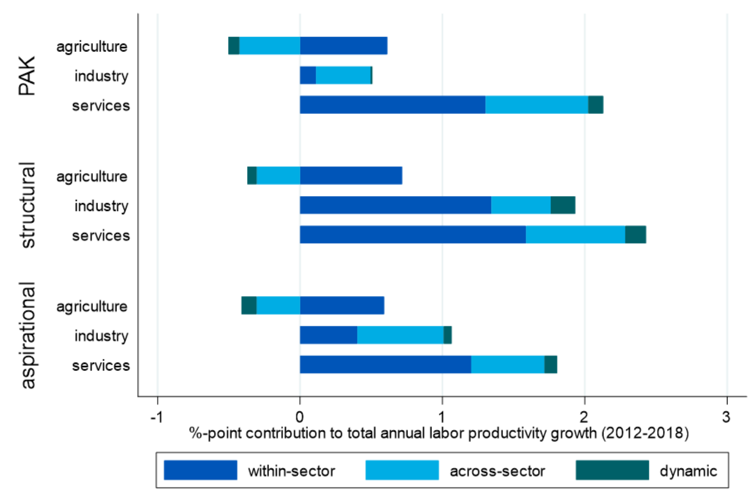
Resulting in a pattern of productivity growth that resembles that observed in structural and aspirational comparators – with structural transformation playing a more prominent role in explaining productivity gains

Contribution to labor productivity growth (1991-2018)
Percentage point



Source: Jobs Group JD Standard Code (JDSC) on the basis of WDI

Contribution to labor productivity growth (2012-2018)
Percentage point



Source: Jobs Group JD Standard Code (JDSC) on the basis of WDI

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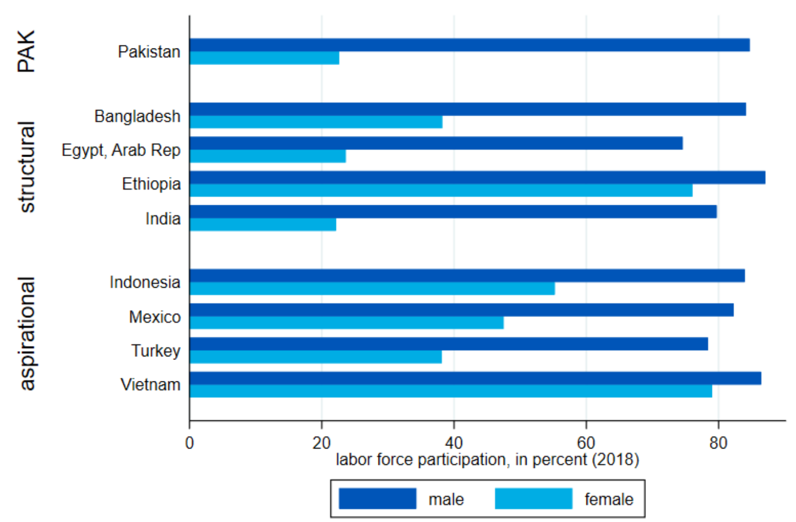
…but a supply constraint – low female labor force participation - may reduce the scope for further accelerations…

In 2018, only 22% of working age women participated in the labor market.

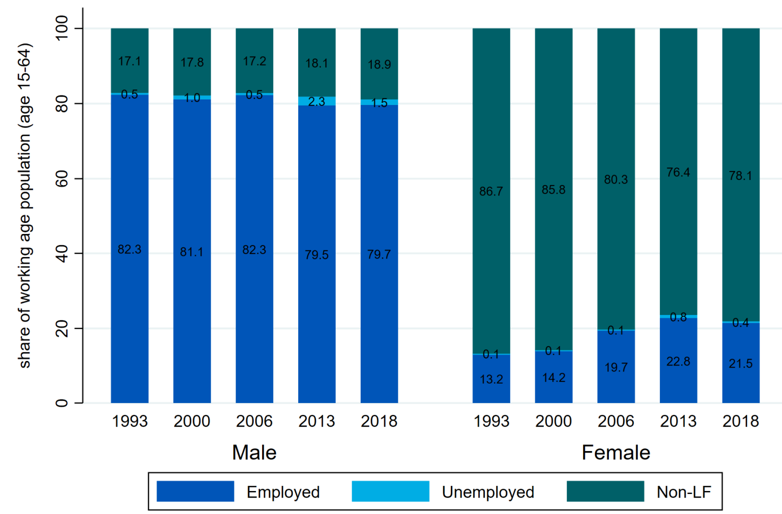
… with the share of males and females in the working age population being similar, this low ratio of female labor force participation is holding back value addition substantially, compared to what would be produced if female and male labor force participation were equal (at 80 percent for both)

Labor Force Participation (2018)
Percent



Source: Jobs Group JD Standard Code (JDSC) on the basis of WDI

Share of Working Age Population (age 15-64)
Percent



Source: Calculations based on LFS rounds of 1992/93, 1999/00, 2005/06, 2012/13 and 2017/18.

In Focus: unlocking productivity-led growth through better allocation of talent and resources – What would it take?

Two guiding principles and three in-focus chapters:

1) **Level the playing field to facilitate productivity-led growth: unlock productive investment and productivity**

   In focus 1: What is holding back productivity growth?
   In focus 2: What is holding back productive investment?

2) **Leverage all talent to stimulate growth by boosting female labor force participation:**

   In-focus 3: The economic costs of low female labor force in Pakistan, and how can increased connectivity boost it?

In Focus Chapter 1: What is holding Pakistan's productivity back?

Problem:

- Pakistan became more inward-looking since 2000
- Lack of dynamism of exports and exporters, with little entry and exit, which altogether reduce scope for productivity gains

Policy inconsistency hinders export growth, at the expense of the taxpayer:

- On one hand, high import duties and a cascading tariff structure implicitly act as an export tax (and increase overall prices for consumers)
- On the other hand, Pakistan actively supports exporters through export finance schemes, rebates on imports and subsidized electricity and gas

Key questions

- *The extent to which productivity stagnation is related to the poor functioning of markets – and which markets in particular act as the most important binding constraint*
- *How protection (both in the form of tariffs and subsidies) prevents exporters from upgrading productivity and what reforms should be prioritized to unlock productivity growth*
- *How do Pakistani firms fare in terms of their productive capabilities compared to competitors and what policy options exist to improve them [Survey on firms' managerial practices to be rolled out]*

In Focus Chapter 2: What is holding Pakistan's investment back?

Problem:

- Private investment as a share of GDP has declined, FDI attraction lackluster
- Shrinking capital stocks in many firms

Factors constraining investment:

- Frequent macroeconomic instability created an uncertain environment
- Financial sector's limited capital is being channeled to the government
- Regulatory complexity and policy inconsistencies have deterred investment
- Quality infrastructure and well-functioning complementary services needed to stimulate and crowd in private investment are lacking.

Key questions to be addressed in the chapter:

- *Why don't firms grow large in Pakistan – role of capital constraints versus relative returns to productive investments?*
- *How to accelerate regulatory reforms to attract efficiency-seeking FDI inflows – the role of international agreements?*
- *To what extent do State-Owned Enterprises (SOEs) in key infrastructure and enabling services sectors make productive private investment projects unfeasible?*

In Focus Chapter 3: What are the economic costs of low female labor force in Pakistan and what can be done about it?

Technology can be a gamechanger, but disparities exist:

- Technology could play a key role in reducing barriers that women face in accessing educational and work opportunities

… however, studies have also shown that women are 37 percent less likely to own a mobile phone and 40 percent less likely to access the internet than men

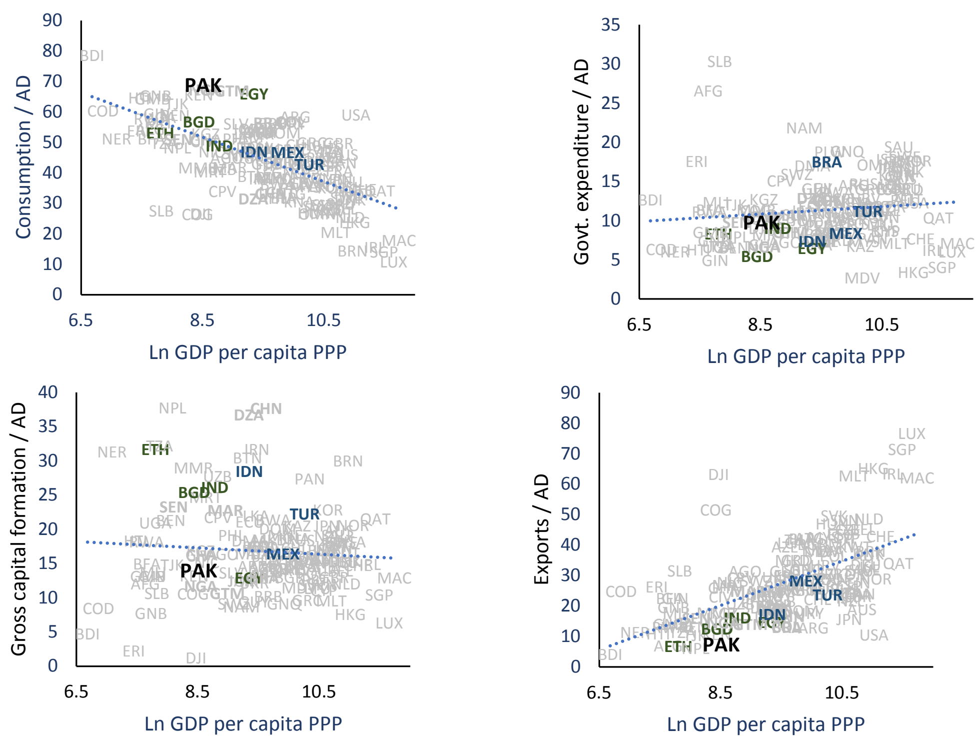
Key questions to be analyzed in the proposed chapter:

- What inhibits female labor force participation, and what are the associated economic costs?
- How increased physical and digital connectivity could boost women's overall access to the labor market as well as their opportunities to find better jobs?
- What skills will be needed to maximize the impact of digital technology on jobs in Pakistan?

Annex

…with investment and exports contributing comparatively less

Contributions to Aggregate Demand: Pakistan Vs World (2018)

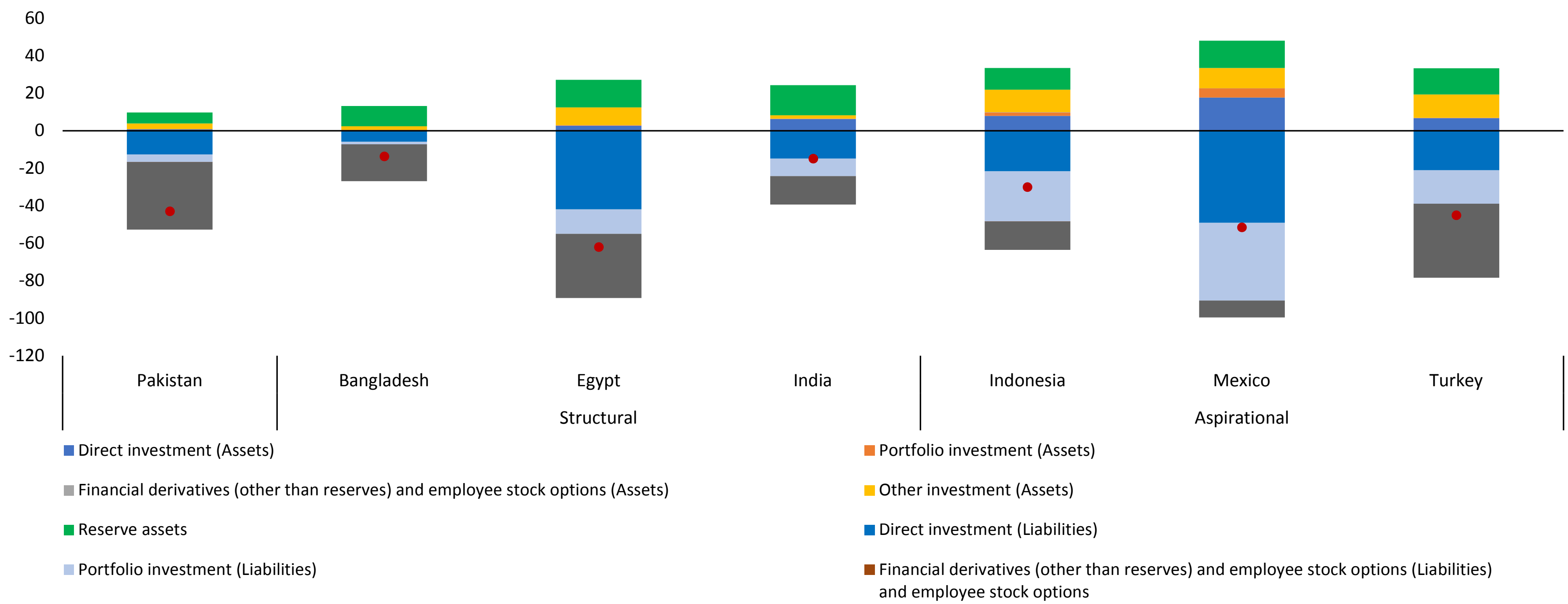


Source: IMF, International Financial Statistics (IFS) and World Economic Outlook October 2020.
Note: "Ln GDP per capita PPP" corresponds to the natural logarithm of GDP per capita, PPP (current international $).

…a negative net international investment position poses risks to macroeconomic stability

Decomposition of Net International Investment Position

Percentage of GDP



Source: IMF and SBP for Pakistan data (Q2 2020 for Pakistan)