

Book Review

Pasha, Hafiz A., *Growth and Inequality in Pakistan: Agenda for Reforms*.
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Pakistan has been held back by sluggish growth of per capita income since the 1990s. Slow growth has been accompanied by high income and wealth inequalities. This new book, by Dr. Hafiz Pasha, is a welcome contribution to the literature on growth and inequality in Pakistan. Dr. Pasha has had a distinguished academic and policymaking career, and he is well qualified to address these issues. The book is an ambitious undertaking. It is divided into 16 sections, including 48 chapters, covering a wide range of subjects. Most of the chapters are stand-alone pieces that are devoted to a specific topic and discuss developments from 2001 to 2018 using data and research findings from various sources. The 2001-2018 period is too short to identify long-term patterns, but it does allow comparisons between the governments of General Musharraf, PPP and PML(N). It is interesting to see how growth and inequality behaved during these regimes. The rate of growth in GDP was the highest under the Musharraf government (since 2001-2002), the lowest under the PPP and in the middle under the PML(N). Comparisons of inequality (as measured by the ratio of income shares of top and bottom quintiles) across these governments suggest a different pattern. Estimates by the Pakistan Bureau of Statistics indicate that inequality began to increase after 2001, and then turned around and decreased after the 2008 elections. World Bank estimates suggest, however, that the turn-around in inequality occurred earlier, in 2004, whilst the Musharraf government was still operating.

The book offers a rich array of facts about economic and social conditions in Pakistan and highlights the very serious problems the country faces. For example, the most recent population census, undertaken after an interval of 19 years, reveals that Pakistan's population is considerably higher than previous estimates by national and international agencies, and implies a rate of population growth equal to 2.4% per year. Such a high rate would put enormous strain on Pakistan's resources and make it very difficult to significantly improve the living standards of the growing population. Pakistan does

not fare well in health and education indicators. As compared to other South Asian countries, as well as other major Asian countries, life expectancy and mean years of schooling were the lowest in Pakistan in 2015. Terrorism and power outages have plagued Pakistan's economy. Dr. Pasha estimates direct and indirect costs of fighting terrorism and power outages and shows these to be a major burden on the economy (the cumulative costs of war on terrorism since 2012-3 are \$250 billion, while costs of outages accounted for 2% of GDP in 2016-7). Are there any promising developments? Dr. Pasha notes that the China-Pakistan Economic Corridor (CPEC) will help finance important infrastructure projects and is seen as a potential "game changer". However, there are also risks associated with CPEC, especially rising costs and the unsustainability of external debt. Thus, it is too early to evaluate its contribution to economic growth in Pakistan.

Pakistan faces significant fiscal and trade imbalances, and there is a thorough discussion of the determinants of these imbalances in this book. On the fiscal side, a basic problem is that the present taxation system generates government revenues that are insufficient to meet government expenditure requirements, and this gap leads to budget deficits and growing public debt. Primary fiscal deficit (deficit excluding debt servicing) is especially of concern since it can increase government debt as a percentage of GDP. The government has been recently running a primary deficit every year. The deficit was brought down to nearly zero in 2015-6 (the last year of the previous IMF program) but it increased significantly in the next two years. Budget deficits have been accompanied by deficits in the balance of trade (exports minus imports). Pakistan's international reserves fell to a low level in 2017-8, which was not enough even to cover two months of imports. Based on the situation at this time (which roughly corresponded to the completion date of the book), Dr. Pasha examined several scenarios for 2018-9, and correctly predicted that "business as usual" would not be feasible and that assistance via an IMF program would be required, as there

would be no good alternatives (such as borrowing from alternative sources or drastic restrictions on imports). He does not, however, sufficiently emphasise the policy blunder that led to this predicament. To avoid devaluation of the rupee, the government squandered large amount of international reserves (which were built up to a high level in 2014-5 partly via external borrowing) to support the value of the rupee. This policy did not prevent a large devaluation, but it did lead to a huge loss of reserves and the need for seeking yet another IMF program.

How are major economic policy decisions taken in Pakistan? In a chapter in the section on governance, Dr. Pasha provides interesting insights about the institutional setup for the formulation of economic policy. The Ministry of Finance has emerged as the principal institution for making policy decisions. The Ministry has focused on short-term budget issues and has not given serious consideration to the long-term consequences of policy actions. The Planning Commission would be an appropriate institution to undertake long-term analysis of economic policy, but it has been reduced to essentially a project approving agency. The dominance of the Finance Ministry in policy making has also weakened the role of the State Bank of Pakistan in conducting monetary policy. The government's need to borrow money to finance budget deficits, for example, puts pressure on the State Bank to lend to the government and thus expand money supply.

The book is a valuable resource for learning about Pakistan's economy. Even those who are well informed about Pakistan will discover interesting facts and find the book rewarding. However, readers looking for an explanation of the basic causes of low growth and high inequality in Pakistan, and/or for solutions to these problems are likely to be disappointed. The first chapter in the section on growth summarises the record of GDP growth in Pakistan since the 1950s. It shows that except for the 1960s and 1980s, the average growth rate for every other decade has been below 5%. The low growth rate since the 1990s is especially disappointing in comparison with Pakistan's South Asian neighbours, notably India, whose growth performance picked up during this period. There is no new insight provided here about the causes of Pakistan's poor growth performance after the 1980s. The first chapter in the section on investment does note that capital formation as a percentage of GDP in Pakistan is substantially below the levels in other South Asian countries. Low capital accumulation could partly account for Pakistan's slow growth rate. A fuller explanation of Pakistan's growth performance, however, would also need to examine the role of productivity growth in Pakistan. The behaviour of productivity growth in Pakistan and factors that might have slowed down productivity growth are not explored here.

In chapters on inequality, Dr. Pasha highlights the finding that inequality was higher under the military governments of General Musharraf and General Zia-ul-Haq than under the democratic governments following them. One suggested explanation is that democratic governments have greater

inducement to pursue policies that benefit the poor. As growth rates were also higher during the tenure of military governments, another possible explanation is that inequality is positively related to growth in Pakistan (statistical analysis in the book finds a positive association between the growth rate and the inequality measure from 1990 to 2014). This link can arise if the growth process is biased in a way that causes the incomes of skilled labor and the owners of capital and land (in the high-income group) to rise faster than those of unskilled workers (in the low-income group). Such a bias need not create a trade-off between growth and inequality. Income distribution policies can be designed to alleviate the effect of growth on inequality.

What policy actions should be pursued to improve growth and reduce inequality? This question is addressed in the final chapter of the book titled "The Reform Agenda". The agenda represents a long list of reforms in ten areas. The proposed reforms are generally reasonable, but often present ad hoc solutions without full explanation of their underlying rationale. For example, to revive agriculture, changes are proposed in the support price for certain products, without explaining the need and the effectiveness of these changes. Similarly, to revive manufacturing, it is argued, without explanation, that there is a strong case for raising tariffs. There are reforms proposed for promoting investment, generating employment, stabilising the balance of payments and managing public finances. Higher investment and greater macroeconomic stability would be helpful for growth, but it is not clear whether the proposed reforms in these areas would be adequate to significantly increase the growth rate in Pakistan. An important omission, moreover, is the lack of discussion of measures to improve productivity growth, which is an important determinant of overall growth. On inequality, Dr. Pasha discusses policies and institutions that provide favourable treatment to rich and powerful groups in Pakistan, but offers no specific policy actions to counteract this favourable treatment and bring about a more equitable income distribution. Nonetheless, stimulating equitable growth in Pakistan represents a major challenge, and Dr. Pasha's timely book makes an important contribution in addressing this issue.