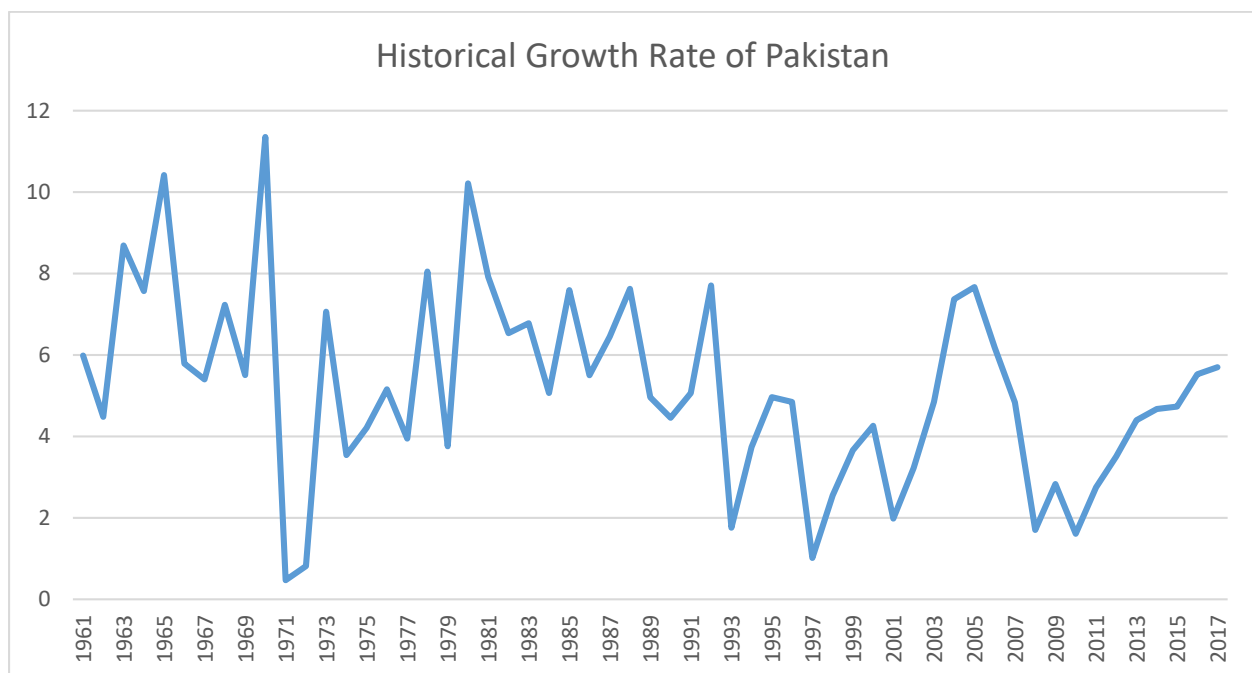


The Importance of Institutions in Economic Development: The Case of Pakistan

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Since gaining independence in 1947, Pakistan has experienced short bursts of economic growth and long periods of stagnation. A nation founded upon many ideological, political, and economic promises, Pakistan still finds itself struggling to keep them 70 years later, as a combination of political turmoil and corrupt institutions has continuously halted any serious progression towards development. While the country has, in recent years, turned into one of Asia's fastest growing economies, the general perception is still one skewed by the skepticism brewed by the well-documented political mishaps and civil unrest of the past several decades.

However, those perceptions have changed over the course of history. In the 1960's, the country was considered a model for economic development in Asia and was amongst the best performing economies in the developing world. It owed much of its strength to the strong performance of its cotton, textile, agricultural, and manufacturing industries, which experienced rapid growth in the years that followed partition in 1947. The economy also benefitted from the privatization and industrialization reforms introduced during the time.



Source: The World Bank

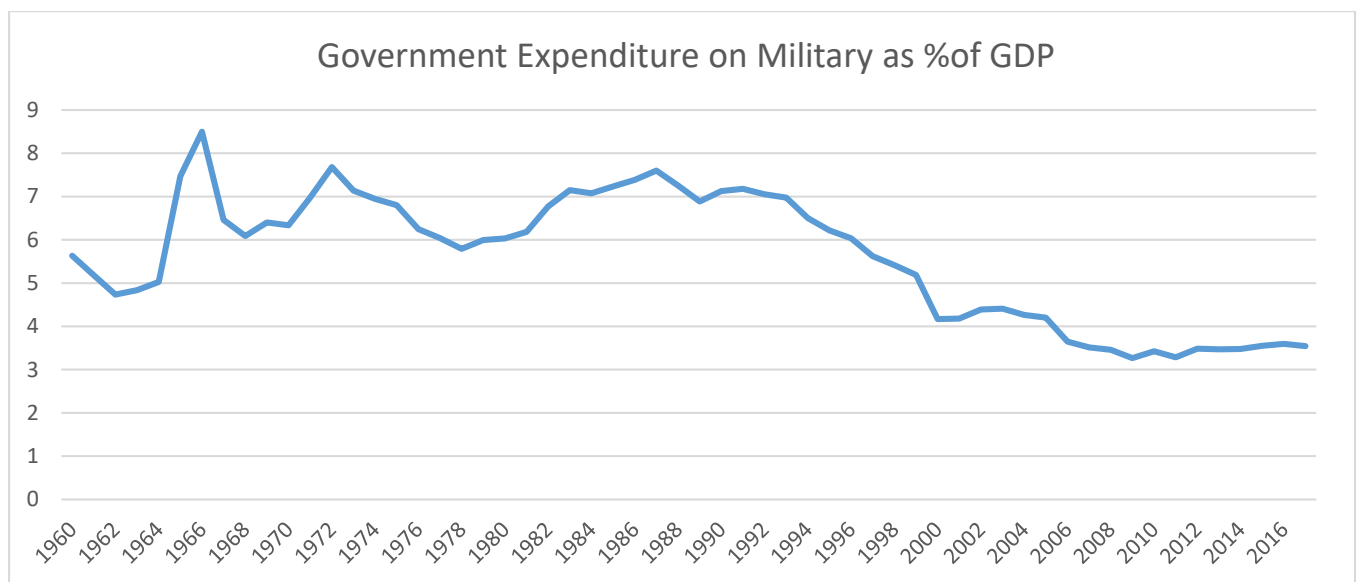
Economic growth in Pakistan was 6.7% on average per annum in the 1960's, with the country outperforming most other nations in Asia and the rest of the world, and rapid development promised a bright future where the people could truly and powerfully announce the nation's arrival on the global stage, both politically and economically.

However, all the initial promise was soon undone with the absence of rigid governance, as a lack of long-term stability and proper institutional framework interrupted economic progression. Corruption ran and continues to run rampant in Pakistan and is one of the primary reasons for the country's stuttering

economic development. Continuous political instability led to multiple military coups throughout the nation's history, which exacerbated the problem posed by Pakistan's lack of a solid governance system, while government intervention in foreign proxy wars in Afghanistan paved way for the rising security threats the country would later face.

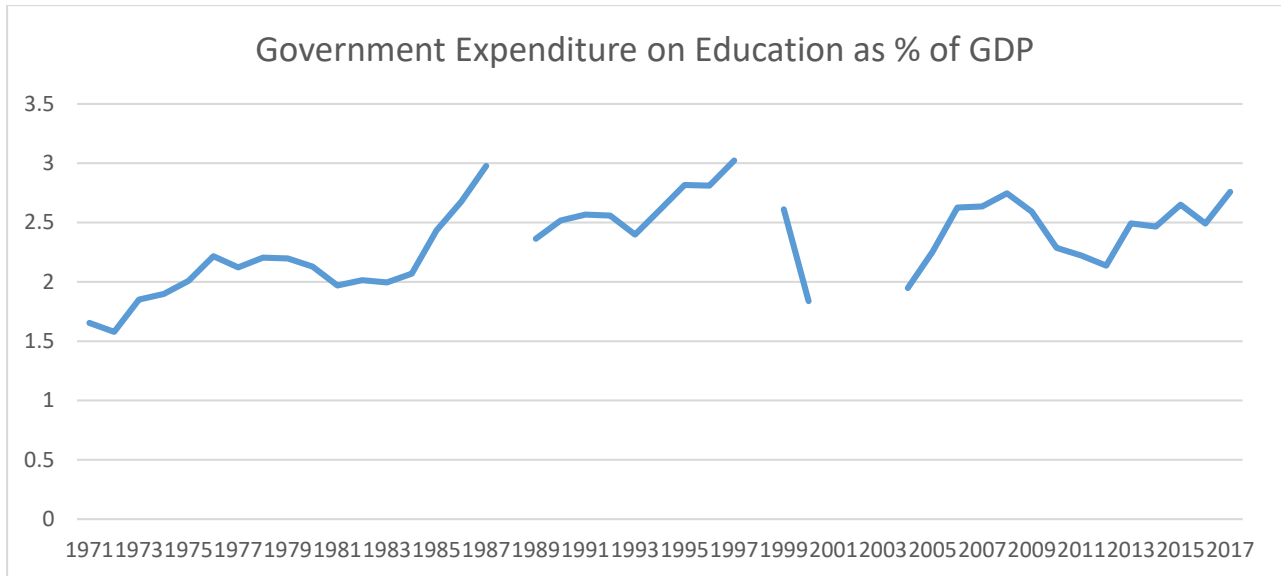
Pakistan is rich in natural resources. As we learned in chapter 3, a country achieves long-term growth as it unlocks the potential of its natural resources coupled with stable institutions and a lack of corruption, in addition to an educated and skilled labor force. While Pakistan undeniably possesses the former in abundance, its shortcomings in the latter has hindered its development. Moreover, Pakistan's continued domestic turmoil has largely deterred foreign investment into the country.

There has also been persistent mismanagement of economic resources. Throughout its history, the military in Pakistan has been a stable and structured institution. The defense industry becomes the main beneficiary of public spending. The graph below shows spending on government military as a % of GDP:



Source: The World Bank

One distinct aspect of the Pakistani economy is the distinction in the quantity and quality of public investment in the military and other sectors of society. While it is not necessarily the amount of spending that affects welfare in the economy, in the case of Pakistan, the country's long history of identifying itself as a security state and heavy focus on militarization has led to better quality spending on the defense industry. Meanwhile, the country has continuously spent poorly on low-quality projects to address some of the severe issues plaguing society: poverty, illiteracy, flailing healthcare provision, energy and electricity shortages, and poor infrastructure.



Source: The World Bank

According to the World Atlas, Pakistan is in the top 20 most illiterate countries in the world. Again, the amount of government spending is not the sole cause for the country’s struggling education system, but more importantly the quality of Pakistan’s spending on addressing its issues in the sector.

After some more promising years in the first decade of the 21st century, the economy of Pakistan once again became the victim of civil instability as the surge in terrorism took its toll on an economy that had been rapidly growing up until the great financial crisis. Economic growth tumbled (again) and the economy suffered from stagflation. Expectations play a significant role on economic performance, and the political turmoil exacerbated the problems which arose from Pakistan’s institutional fragility.

After several more years of hardship, Pakistan experienced something of a rejuvenation. In 2015, the announcement of the China-Pakistan Economic Corridor (CPEC) was met with widespread enthusiasm as China planned to build massive infrastructure and energy projects in Pakistan, prompting many to believe that the USD 62 billion project may just be the impetus that the nation was looking for. The country had also hardened its stance in fighting against terrorist groups, leading to huge drop in the number of attacks. This optimism was rewarded by greater foreign investments into the country, as businesses and investors were hopeful that Pakistan was finally unlocking its potential through massive infrastructure and energy projects. What followed was another upturn and boost in economic growth, with GDP growth increasing to 5.5% in 2016, compared to 1.6% in 2010.

While economic growth had witnessed a substantial increase, the buildup to the country’s general elections in 2018 – which represented only the second time in the nation’s 71-year history that a civilian government is passed over directly to the next – was mired in the same controversies that have plagued Pakistan since independence in 1947: corruption allegations, military intervention, terror attacks, and a population deeply divided on cultural, ethnic, and socioeconomic issues.

These setbacks reflected in the fundamentals of the Pakistani economy, with the rupee suffering the largest devaluation in years against the US dollar, plummeting 14% in the span of 7 months between December 2017 and June 2018. Meanwhile, the aforementioned CPEC project has had an enormous impact on the country’s current account, with the imports required for initiating the infrastructure projects widening its deficit and dwindling Pakistan’s foreign reserves to only 2 months’ worth of imports. While

the allure of CPEC lies in the potential economic growth and development it could bring to Pakistan, there is growing concern amongst Pakistanis – and a host of other nations along the Belt and Road Initiative – regarding the effect of the project on the country’s level of debt. With Pakistan’s track record of weak institutions, compounded by multiple bailouts by the IMF, the BRI puts an enormous burden on the country’s ability to finance the loans used to pay for the project.

Such situations highlight the complexity of truly measuring economic development and progress as many institutions and components within the Pakistani economy still showing worrying signs of instability. More importantly, however, it serves to demonstrate that any upturn in economic fortune does not suggest that long term prosperity is right around the corner. A successful society is not borne out of a healthy economy, but rather, economic development is only sustained once a country irons out corruption and builds a constitutional framework that allows for individuals and businesses to be unconcerned about political unrest, physical safety, and social conflict. A country like Pakistan, as the graph above shows, has gone through many short periods of high economic growth, yet still suffers from problems such as corruption. Investments in education, healthcare, infrastructure, and energy ultimately pave the way for true prosperity. These elections – and every one which follows - represent for Pakistanis across the country a chance to demonstrate whether they understand what is at stake with their vote: building institutions which foster a more sustainable model of progress.

Questions for Discussion:

- 1) If you were elected as the new Prime Minister of Pakistan, how would you choose to deal with the Balance of Payments crisis facing the country? What would be the costs and benefits of the option you chose? (Note: This case study was written in July 2018. You may feel free to read current news to gain a more up-to-date overview of the state of Pakistan, in addition to discussing more topics that were not covered in the case study).
- 2) Choose another country whose economic potential has been untapped due to political or institutional instability. Use historical data to gain an overview of the nation’s highs and lows, and assess what could be done to improve economic development.
- 3) In Chapter 9, we learn how poor countries spend a smaller percentage of their GDP compared to developed nations. Develop on this argument further by analyzing how nations such as Pakistan may actually misallocate government resources towards a particular industry.

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