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**More and Better  
Jobs for Pakistan:  
Can the Manufacturing  
Sector Play a Greater Role?**



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# More and Better Jobs for Pakistan: Can the Manufacturing Sector Play a Greater Role?

Rashid Amjad<sup>1</sup> and Anam Yusuf<sup>2</sup>

## Introduction

With a labour force growing at between 3 and 3.5 percent and an economy mired in stagflation—with growth averaging just over 3 percent in recent years, together with high inflation—Pakistan faces a daunting challenge in providing not just more but better jobs to its young entrants into the labour market. While reviving economic growth and restoring macroeconomic stability remain the top priority of the government and policymakers in the immediate future, the real medium- to long-term challenge is to move the economy onto a trajectory of not just high, but also inclusive and sustainable, growth.

The central issue that this paper analyses is the role the manufacturing sector can play in reviving and sustaining growth while generating more and better job opportunities as it has done in the fast-growing East and Southeast Asian economies. Indeed, it is believed that employment in manufacturing—relative to other sectors and forms of employment—can generate not just better but also more decent employment opportunities in terms of wages, degree of social protection, a voice at work, and protection of workers' fundamental rights.

An area of concern is that, while manufacturing has served as a major driver of Pakistan's economic growth in the past, this role is now showing distinct signs of declining. Its contribution to employment generation has, after a rapid increase, also slowed down as reflected in the sector's share of the total labour force, which has stagnated at around 12 to 15 percent over the past few decades. Within manufacturing, the formal or large-scale manufacturing sector—the harbinger of the creation of better employment opportunities—has contributed a very small portion of the jobs generated, despite

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accounting for over 80 percent (in 2005/06<sup>3</sup>) of the value-added generated by this sector. With a further slowing down in manufacturing, especially large-scale manufacturing, even this limited capacity will be curtailed.

This paper analyses both these important issues in some depth. It reviews the evidence to show that the contribution of the manufacturing sector to economic growth and employment generation has slowed down and identifies the major factors responsible. It then examines whether these obstacles can be overcome and proposes policy measures that would help revive the role of manufacturing—especially large-scale manufacturing—in driving economic growth and generating jobs.

A basic premise of this paper is that, while a macro or sectoral approach does provide us with some broad indications of the growth and job generation capacity of the manufacturing sector, only an in-depth analysis of its changing structure and dynamics will allow us to capture more realistically the forces that currently drive the sector. This analysis leads us to conclude that it is somewhat premature to signal the demise of manufacturing in propelling future economic growth or of its potential to generate more and better jobs for the growing work force.

*Indeed, our findings suggest that the high growth rate of population and the labour force in Pakistan, together with the declining trend in economic growth in the last two decades (which has decelerated sharply in the last five years) is primarily responsible for the lack of creation of remunerative and decent employment. As regards manufacturing, the duality between the large, mainly formal, and documented part of the economy and the small and household, mainly informal, and undocumented economy has been accentuated. The more rapid growth of the latter has been driven by the ready availability of unskilled labour, resulting in the creation of low-quality and low-productivity jobs in poor working conditions. The declining writ of the state, together with increasing corruption and lack of transparency, has also drawn in firms that claim to be informal but which, for all practical purposes, fall in the legal preview of being recognised as formal.*

*The employment-generating capacity of the large-scale manufacturing sector has been seriously curtailed by the high and increasing capital intensity of production, driven mainly by the adoption of modern technology. However, even for the relatively limited number of jobs created, the sector's potential to generate better and decent jobs has been seriously impaired. The declining bargaining position of workers, widespread hiring of contract workers in place of regular employees, governments' indifference to upholding existing labour laws, the absence of labour inspection, and low social protection*

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<sup>3</sup> The last year for which the Census of Manufacturing Industries (CMI) is available.



*coverage have all contributed to poor-quality jobs being created even in the organised sector. The presence of a small-scale, mainly informal, and undocumented sector and the large pool of available unskilled labour at low wages act as a dampener on the creation of better and decent jobs in the large-scale manufacturing sector. In this sense, Pakistan may have reverted to the Lewisian stage of economic development.*

*The major challenge is to reverse this trend. This will require not just the revival of high economic growth but strong and vibrant labour market institutions to translate this growth into decent jobs.*

The study is organised as follows:

In Part I, we start by analysing the structure and functioning of the labour market in Pakistan, and recent employment and labour market developments in the last decade (2000–12) to bring out its major challenges, especially in creating more and better job opportunities and overcoming the discrimination and social exclusion faced by women and vulnerable groups.

In Part II, we review some important studies conducted to analyse employment and labour market developments as they have unfolded, including the role of the manufacturing sector in job generation.

In Part III, we analyse the major drivers of economic growth and employment generation in the last three decades (1980–2010) in terms of sectors and trends in total factor productivity (TFP). We conduct a separate decomposition exercise covering the more recent period 2000–10 to explain the sectoral pattern of growth and its employment and productivity intensity. We also examine profitability trends for these years to determine whether demand constraints have hindered investment.

Part IV concentrates on the role of the manufacturing sector in generating jobs in the economy; we review the sector's performance since the 1960s, including that of large- and small-scale manufacturing. The reasons for the very limited role of large-scale manufacturing in contributing to the creation of more and better jobs are then critically analysed.

In Part V, we identify policies that we deem essential to reviving growth in manufacturing as well as generating decent jobs: these cover macro, trade, and sectoral policies and labour market reforms, including the critical role of well-functioning representative labour market institutions that could foster political commitment to social justice.

## Part I

### The Structure and Functioning of the Labour Market in Pakistan

In analysing labour market developments in Pakistan, a number of key demand, supply, structural, and institutional factors need to be kept in mind—these have an important impact on labour market outcomes as reflected in key labour market indicators.

**Table 1: Sectoral composition of GDP and labour force (percent)**

Sector	GDP			Labour force (10 years and above)		
	1990/91	1999/2000	2009/10	1990/91	1999/2000	2009/10
Agriculture	25.7	25.9	21.2	47.5	48.4	45.0
Industry	25.8	23.3	26.4	19.8	18.0	20.9
Manufacturing	17.5	14.7	18.6	12.2	11.5	13.2
Services	48.6	50.7	52.4	32.8	33.6	34.1

*Source:* Pakistan Economic Survey and Labour Force Survey (various issues).

The first is that, at the time of independence in 1947, the country was primarily agricultural and most industry in adjoining regions that were dependent on its raw materials were located in India. When, just a few years after independence, trade between the two countries almost came to a halt due to rising tensions, Pakistan embarked on a process of rapid import-substitution industrialization behind protective barriers. This resulted in a major shift in labour from agriculture to industry—mainly manufacturing—together with rapid urbanisation. This structural transformation of the economy continued during the 1950s and 1960s but, subsequently, the labour absorption capacity of the manufacturing sector decreased; in subsequent decades, its share fluctuated but did not rise significantly. In 2009/10, it accounted for 13.2 percent of the total labour force while industry as a whole accounted for around 21 percent (Table 1). There has been a corresponding increase in the share of services, which now account for 35 percent of the labour force while agriculture is still the largest employer at 40 percent.

The second factor has been the very high growth rate of population at almost 3 percent a year from the 1960s till the 1980s, when it started to slow down but remained high; at present, it is an estimated 2.1 percent. This has led to a high growth rate of the labour force at over 3 percent in the last three decades. The demographic transition that started in the 1990s with a decline in the dependency ratio and corresponding youth bulge is expected to continue till 2030.

The high growth rate of the labour force and low incomes, and the fact that there is no wide-scale effective social protection available, mean that almost all entrants into the labour market have to work for a living. This means that the supply of labour is adjusted in the labour market. Only a severe shock or a sudden and sustained decline in the economy will lead to a significant rise in unemployment rates. Estimates of employment elasticity, widely used in the literature, which show the ratio of the growth of employment to growth in output or value-added can, therefore, be very misleading.

Third, the growth of the Pakistan economy is characterised by a stop-go cycle with periods of high economic growth being followed by periods of low economic growth. The movement of key employment, poverty, and labour market indicators have not always been in line with these indicators, which has resulted in considerable controversy, especially on poverty movements over the economic cycle.

The fourth has been the very low female participation rate, as conventionally measured. Though there has been some improvement in recent years—partly due to increasing female educational levels, albeit from a very low base—the rate is still very low.

Fifth, a very large proportion of the nonagricultural labour force, estimated to be as high as 70 percent, is employed in the so-called informal sector of the economy, which is characterised by low wages, low productivity, and very poor and hazardous working conditions.

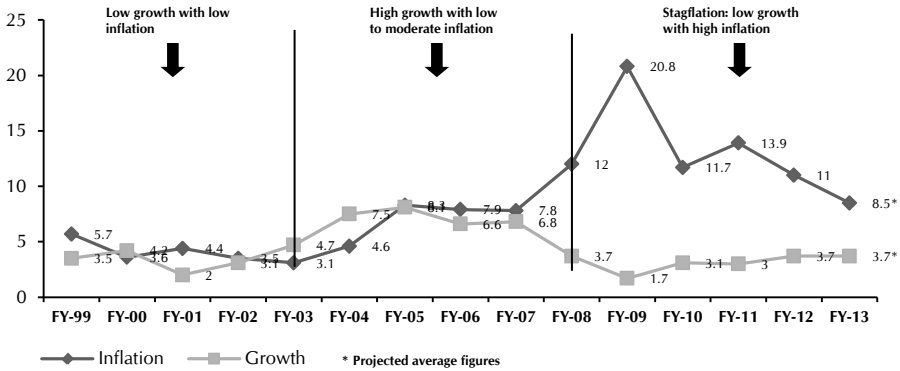
Sixth, labour market institutions, including those representing workers, have weakened considerably—a reflection of the strong pro-market private sector-led policies adopted by successive governments since the 1990s (“deregulation–privatisation–liberalisation”) as well as the fact that Pakistan has been under an International Monetary Fund (IMF) programme with strong conditionalities to restore macro-stability and revive private sector-led growth. These have all contributed to a strong bias against organised labour for the last 25 years.

Finally, most of the official data on labour and employment are of uneven quality and need to be handled with considerable caution. Indeed, any analysis of the employment and labour market situation needs to be crafted with considerable finesse using, wherever possible, data from a number of sources to capture labour market developments. This also means that one has to be very careful when interpreting results from sophisticated economic models and econometric exercises based on this data.

**Recent labour market developments and major challenges, 2000–13**

In analysing recent labour market developments, we cover the period 2000–13, which coincides with the period of General Pervez Musharraf’s military regime (2000–08) followed by the democratic Pakistan People’s Party (PPP) coalition government rule (2008–13). This period saw the economy move through a classical boom–bust cycle with an impressive burst of economic growth in 2002–07 followed by a sharp decline in economic growth and stagflation for the rest of the period (Figure 1).

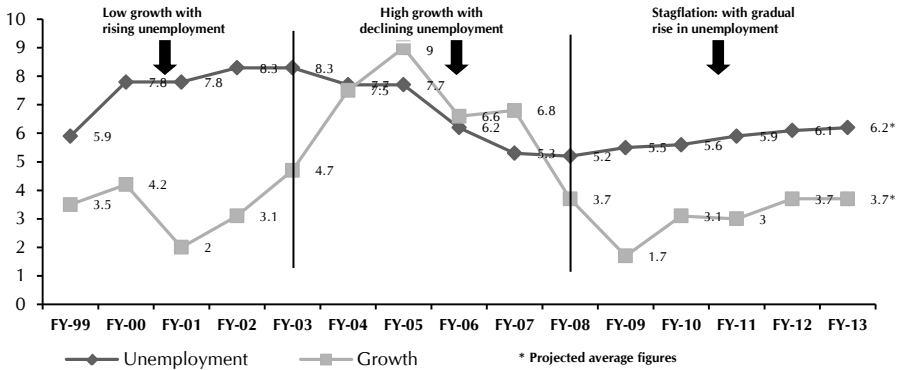
**Figure 1**



Source: Pakistan Economic Survey (2011/12) for FY2000–FY2012; State Bank of Pakistan’s Annual Report (2012) for FY2013.

The strong growth revival under Musharraf’s rule that saw unemployment levels fall from a peak of 8.3 percent in the financial year (FY) 2002 to 5.2 percent in FY2008 was also accompanied by a fall in poverty as measured by the population living below the national poverty line (based on a caloric intake of 2,350 calories). This proportion fell from 34.5 percent in FY2001 to 22.3 percent in FY2006 and further to 17.2 percent in FY2008. Real wages, as measured for construction workers, also increased by around 50 percent in this period (Amjad, 2012).

Figure 2



Source: Pakistan Economic Survey (2011/12) for FY2000–FY2012; State Bank of Pakistan; Labour Force Survey (2012/13) for data on unemployment rate for FY2013.

What happened to these key socioeconomic indicators during the period of deep stagflation that followed? The available evidence suggests that they were not as adversely affected as might have been expected. The unemployment rate rose from 5.2 percent in FY2008 to 6.2 percent in FY2013 and, surprisingly, poverty levels fell further to 12.4 percent in FY2011 as compared to 17.2 percent in FY 2008 as measured by the earlier indicators and surveys. Other evidence, such as the 2012 Pakistan Panel Household Survey (carried out by the Pakistan Institute of Development Economics), though not fully comparable, also shows that there was no major increase in poverty levels during the period of low growth and double-digit inflation. The real wages of agricultural workers increased though those of construction workers fell during this period. (see Amjad (2012) and Newman (2013) for details.

As expected, these results, especially the decline in poverty, have led to considerable controversy. Amjad (2012) has tried to address this issue by arguing that, despite the economic slowdown and high inflation, poverty and the labour market were favourably affected by (i) the almost twelve-fold increase in remittances from just over USD1.5 billion in FY2001 to around USD12 billion in FY2012 (or around 5 percent of GDP in the latter year); (ii) improved terms of trade in favour of agriculture as the PPP doubled the procurement price of wheat, the major agricultural crop, and other support prices; and (iii) a significantly large and vibrant undocumented economy. That this “resilience” of the Pakistan economy resulted in poverty levels not falling or only marginally declining is, however, strongly contested. Nonetheless, a recent study by the World Bank (2013) tends to back the view that poverty levels did not increase, at least based on data for the Punjab (60 percent of the population), which is seen to be more reliable than data for the other three provinces (Newman, 2013).

### ***Why has Pakistan not reaped the demographic dividend?***

A major thrust of this paper is that Pakistan's continuing high growth rate of population at around 2.1 percent and a labour force variously estimated as growing at 3.0-3.5 percent acts as a strong headwind against the country building up any real momentum towards high, sustainable, and inclusive growth.

Against this somewhat depressing scenario has been the welcome news that Pakistan is now passing through a demographic transition with much hope of an accompanying "demographic dividend". Almost 20 years have passed since the advent of this demographic transition in the early or mid-1990s, and the question now is why Pakistan has not reaped the demographic dividend. Amjad (2013c) argues that, to benefit from such a dividend, the economy must grow at a fast enough rate to find productive employment for the youth bulge, i.e., the growing number of young people in the total population. Unfortunately, the overall growth trend has declined in the last 25 years. The second factor standing in the way of reaping the demographic dividend is the labour force's low level of education and skills (Table 2).

**Table 2: Distribution of labour force by level of education (among those aged 15–24)**

Year	Illiterate	< Primary	Primary	Middle	Matric	Intermediate	BA+	Total
1990/91	53.0	5.0	16.7	10.9	9.6	3.0	1.7	100.0
2001/02	48.6	50.7	52.4	32.8	33.6	34.1	2.3	100.0
2010/11	35.3	4.6	21.4	16.4	13.8	5.3	3.3	100.0

*Source:* Labour Force Survey (various issues).

Does the youth bulge and declining dependency ratio not in itself propel economic growth as earlier authors have argued and studies on India seem to suggest?<sup>4</sup> While Pakistan's economic performance does not support such causation, it could be argued that its economic resilience may well be because of its young entrants into the labour market and their growing share in the population as well as the labour force. Amjad (2013c) suggests that Pakistan, in view of its continuing low economic growth and lack of employment opportunities, may be reaping the demographic dividend through the manifold increase in remittances, which is caused partly by increasing overseas migration, mainly by young migrants, as well as an increase in their skill levels, including that of many professionals, engineers, and business managers.

<sup>4</sup> See Aiyar and Mody (2011) who argue, based on the growth performance of Indian states, that unlike Bloom and Canning (2004) they do not find the demographic dividend to be conditional on specific policies or the social environment.

Such an explanation, however, needs more rigorous analysis. Even if true, it should not distract from the real challenge of taking advantage of this window of opportunity that the demographic transition has opened up and reaping the demographic dividend for the national economy. Amjad (2013c) details policies essential for this to happen both on the demand side—primarily the revival of economic growth—and in the medium and long term, i.e., by increasing enrolment in primary and secondary education, especially for females, and instituting a demand-driven skills training system.

### *Growth in the informal and undocumented economy*

That a large part of the urban economy is characterised as informal is well recognized in Pakistan as it is for most developing countries. Official data sources estimate that its share of nonagricultural employment has increased in recent years from an estimated 65 percent in 1999/2000 to 73.5 percent in 2010/11 (Pakistan Bureau of Statistics, 2012). It has never been easy to define the informal economy, despite attempts, including by the International Labour Organisation (ILO). In Pakistan's case, though, the definition used to estimate the size and number employed in the informal sector—as enterprises employing fewer than ten workers together with all household enterprises owned and operated by own-account workers irrespective of size—makes it even more difficult to come up with precise estimates. Clearly, there could be firms employing fewer than ten workers that may be registered and so would fall in the bracket of the organised sector. That said, there is little doubt that the majority of workers in the nonagricultural economy are part of the informal economy and that it has grown in recent years.

Essentially, informality should be viewed as a continuum: different enterprises have different characteristics of informality as well as the extent to which they deviate from the criteria for a formally registered firm. The question then is: why do enterprises prefer to remain informal? Based on findings from the World Bank's enterprise surveys conducted in 2002 and 2007, Manes (2013) suggests that this is because regulations impose such high costs that "firms find it profitable to remain informal to avoid them" and that "basic business costs, such as that for taxes, labour and safety, are just too high" (p. 476). He goes on to argue that the costs to the firm of registering and becoming part of the formal structure are just not attractive enough (in terms of access to finance, contracts, land, etc.) and that unless this happens, such firms will have no incentive to conduct their business in the formal economy.

This interpretation is perhaps too generous to firms that take the guise of informality in order to avoid labour laws and regulations (including those related to safety and conditions of work), avoid taxes and, in many cases, are

also involved in theft or underpayment of bills for electricity, gas, and other utilities. It will always be “more profitable” to indulge in such activities, which cannot be simply condoned. The economic and social costs, especially for workers, are far too high. That said, it must also be kept in mind that firms prefer to remain informal not only to save costs and earn higher profits but also to avoid harassment by corrupt government officials. Based on the World Bank 2007 enterprise survey, Manes (2013) states that, “senior management in large firms spent on average 13 percent of their time dealing with regulations—almost three times what smaller firms spent (5 percent). Large firms met or were inspected by tax officials almost seven times a year compared to three times for small firms .... Only 6 percent of small firms noted that labour market regulations affected their decisions to hire and fire permanent workers compared to over four times that share of large firms .... Consequently, the informal sector has been estimated to be as large as 35–40 percent of the official economy” (p. 457).

It should also be kept in mind that, as the country’s security and law and order situation has deteriorated, the “writ of the state” has been considerably eroded. This has also created conditions for enterprises to avoid rules and regulations on the one hand in the guise of remaining informal and led to an increase in corruption and harassment by government functionaries on the other.

It is also important to differentiate between enterprises that operate in the informal economy and those that are undocumented. The undocumented or “shadow” economy covers those economic activities that are not reflected in the officially recorded national income accounts and may include formal as well as informal enterprises. Additionally, economic activity being undertaken in the undocumented sector of the economy must not be confused with the illegal economy, which is not, in any case, included or covered in the official statistics. The undocumented economy grows for a number of reasons, including the underreporting of sales, poor coverage by official data-gathering agencies, or just because many firms choose to ignore or do not provide the required information even though they are legally bound to do so. It thus becomes more difficult to capture the size and dynamics of the national economy. For the purpose of this study, this is especially true of the manufacturing sector, both large-scale and small-scale, as its contribution to GDP is significantly underestimated.<sup>5</sup> We take up this issue in greater detail in our analysis of the manufacturing sector.

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<sup>5</sup> This is, for example, reflected in the fact that the last Census of Manufacturing Industries was conducted in 2005/06 and that the results of the most recent census (2011/12) have been delayed simply because firms, especially in the province of Sindh, have just not filled and returned the questionnaire sent to them.



### ***Female participation in the labour market***

A positive development in recent years has been the significant rise in the female labour force participation rate. However, the very low level from which it has risen and the fact that the absolute low level remains dismal also needs to be put into perspective.

The ratio of female employment to the working-age population increased from around 11 percent in 1990/91 to 21 percent in 2010/11. The major part of this increase took place during 2001/02 to 2005/06—the years of economic recovery and high growth—after which the rate of increase has slowed down. One reason for this increase is that males moved from agriculture to higher-wage nonagriculture employment and were replaced by the female members of the household—mainly young women—primarily in the raising of livestock. This also explains the increase in female employment in the category of unpaid family workers and the declining share of female salaried workers in total female employment from 33.1 percent in 1999/2000 to 14.5 percent in 2009/10, after which it increased marginally to 16.6 percent.

The low participation rate of females in the labour market in Pakistan has been an area of considerable research and debate, ranging from arguments that women's participation in activities such as household work is not measured and that other farm and related work is not sufficiently captured, to the argument that cultural and other factors prevent them from seeking work outside the household. A study conducted jointly by the ILO and the Ministry of Labour and Manpower (2009) in Faisalabad district, a prosperous region in Punjab, provides some interesting insights. The major reason given by females aged 15–29 for not entering the labour market was family or personal responsibilities (67 percent). Of those not working, only 28 percent were enrolled in education or formal training compared to 91 percent of nonworking males in this age group. This reflects the high gender gap in secondary and tertiary education. The lack of employment opportunities is, therefore, not the major reason for females not entering the labour market as much as it is the broader issue of “family or personal” responsibilities, which clearly covers a wide range of sociocultural and socioeconomic issues besides just household work and raising a family.

Is the increasing share of females in higher and secondary education going to make some difference to female participation in the labour market? There are growing signs of women working in the retail sector in major cities or starting their own businesses, mostly run from their homes, to cater to the increasing demand of a rising middle class for readymade garments and food items. Women are also far more visible in government and public sector offices and departments as well as in managerial positions. Trained female nurses are also

finding employment in the Gulf and neighbouring Middle East countries. However, this issue has not yet been empirically investigated.

An important implication of the low participation rate of females in the labour market, as reflected in the overall low ratio of employment to working-age population, is that each working man and woman still had to provide for nearly two nonworking persons in 2010. This dependency ratio is much higher than the South Asian average and will remain high in the absence of a substantial increase in female participation rates. It also strengthens the argument that Pakistan cannot reap the demographic dividend if those of working age do not enter the working-age population besides the lack of job opportunities for those who do.

***Labour market institutions: The weakening bargaining strength of workers***

Sustained productivity growth allows people's living conditions to improve over time. However, for this to happen, two further conditions need to be met. The first is that growth in productivity should be accompanied by an increase in employment—given the rapid growth of the labour force—otherwise it will result in higher unemployment and poverty. The second is that, while productivity growth may be a necessary condition for improvements in living conditions, it is not in itself a sufficient one. Ensuring that the gains in productivity translate into higher wages and better living conditions depends critically on the bargaining position of workers, especially in the manufacturing sector, which is the focus of this paper. However, it is important to maintain a balance between the creation of more jobs and better jobs in an economy with a high growth rate of the labour force. This brings into focus the need for a well functioning labour market and labour market institutions that ensure both efficient and equitable labour market outcomes.

This section briefly reviews the evidence on the behaviour of real wages in the large-scale manufacturing sector, wage differentials between the formal and informal economy, the coverage of social protection, and the membership of registered trade unions in Pakistan.

Table 3 shows that average real wages in the large-scale manufacturing sector barely increased during the 1990s and rose by about 7 percent during the boom years between FY2003 and 2007. Data are not available for recent years but, given the very high food inflation rate (around 80 percent between FY2008 and FY2011), average real wages in large-scale manufacturing probably declined.

**Table 3: Average daily employment and yearly real wages (at 2000/01 prices) in large-scale manufacturing (all industry categories)**

	1990/91	1995/96	2000/01	2005/06
Number of reporting establishments	4,792	4,474	4,528	6,417
Average daily employment (all employees)	622,234	561,821	689,692	941,285
Average daily employment (production workers)	492,301	440,276	560,905	751,586
Nonproduction workers	129,933	121,645	128,787	185,677
Average real wages per year (all employees)	98,760	102,070	99,190	106,861
Average real wages per year (production workers)	87,670	91,430	86,920	93,535
Average real wages per year (nonproduction workers)	140,770	140,500	152,610	143,352

*Source:* Census of Manufacturing Industries (CMI) as reported in Irfan (2008) till 2000/01 and CMI 2005/06 for that year.

Unfortunately, data are not available on the large majority of workers engaged in manufacturing in the small-scale and informal economy. However, at least during the 1990s, with little or no increase in large-scale manufacturing employment, average real wages in the small-scale and informal economy probably declined. In all probability, following the short-lived resurgence in economic growth during FY2003–FY2007, real wages declined post-2008 in the small-scale and informal economy.

Table 4 reflects the poor bargaining position of workers in the informal economy and discrimination in the labour market against females. Data for 2003/04 (Irfan, 2008) show that monthly wages for regular employees were 65 percent higher than for those in the informal economy. Monthly wages for female regular employees were almost 100 percent less than that of their male counterparts in the formal economy, with a similar differential in the informal economy. Even in the case of government regular employees, females' monthly wages were, on average, less than 20 percent that of males. This shows that there were far fewer women in higher grades/positions, reflecting their lower average wage.

**Table 4: Monthly wages of regular and all wage employees by type of enterprise and sex, 2003/04**

Type of enterprise by sex		Monthly wages (PRs)		Wage ratio (regular to all)	Distribution of employees (%)		Regular employees (%)	Wage ratio (all to regular)	
		All employees	Regular employees		Regular	All		Rural	Urban
Both sexes	Government	6,585	6,656	1.01	40.40	21.0	96.70	0.75	0.75
	Formal	4,501	5,596	1.24	28.92	23.8	61.10	0.51	0.52
	Informal	2,875	3,027	1.05	30.92	55.2	28.70	0.82	0.82
	Total	4,045	5,237	1.29	100.00	100.0	52.05	0.69	0.72
Male	Government	6,719	6,794	1.01	39.50	21.4	96.40	0.77	0.71
	Formal	4,939	5,868	1.18	29.30	23.4	65.30	0.55	0.51
	Informal	3,055	3,187	1.04	31.00	55.2	29.20	0.84	0.82
	Total	4,278	5,401	1.26	100.00	100.0	39.90	0.52	0.50
Female	Government	5,663	5,722	1.01	47.40	19.3	98.00	0.59	0.61
	Formal	2,111	3,022	1.43	25.40	26.6	38.00	0.49	0.54
	Informal	1,737	1,540	0.89	27.10	54.1	20.00	0.73	0.59
	Total	2,595	3,900	1.50	100.00	100.0			

*Source:* Irfan (2008): Tabulations based on Labour Force Survey data.

What of the trends in social protection? Post-2008, there has been a substantial, almost fivefold, increase in expenditures on social protection and social safety nets under the PPP government, from 0.16 percent of GDP in 2008/09 to 0.79 percent in 2012/13, yet it is difficult to gauge, based on the existing data, if this increase also benefited workers in the manufacturing sector (Malik & Pop, 2013).

In large-scale manufacturing, an estimated two-thirds of the labour force serve as contract labour and therefore enjoy no social protection (Jamal, 2010). The total number of workers covered by different social protection schemes is around 6.1 million or around 10 percent of the labour force. The Employers Old Age Benefit Insurance (EOBI) scheme in July 2013 covered just over 3 million workers in both industrial and commercial enterprises (EOBI website). This is around 5 percent of the total labour force. The total number of beneficiaries between July 2012 and December 2012 was 373,433, which is 25 percent higher than the figure for the corresponding period in 2011 (Pakistan Economic Survey for 2012/13).

It is possible that those in small-scale and household manufacturing may be benefitting from social assistance programs, including the direct income Benazir Income Support Programme (BISP). The BISP was launched in 2008

to cover 7 million households and provides a monthly PRs1,000 stipend for the female heads of qualifying households (identified through a score card). It is not, however, possible to identify which households and workers in manufacturing may be benefitting from this scheme. Nonetheless, based on the evidence, we can conclude that a small part of those who work in manufacturing are covered by social security or social assistance programmes.

The number of workers who are members of trade unions could be one measure of workers' bargaining strength in negotiating with employers and the government for improved wages and better working conditions. It is difficult to obtain reliable data because it is possible that many registered trade unions claim a higher number of workers as members than actually exist and, more importantly, as active members who participate in trade union activities.

Table 5, which is based on official sources, suggests that the numbers have fluctuated since 1990, but that an estimated 450,000 workers were registered as members of trade unions in 2005. This may be on the high side but it is still only 1 percent of the labour force and around 4 percent of the nonagricultural labour force.

It is not just in terms of numbers that the bargaining position of workers has declined. Since the 1990s, there has been a marked shift towards pro-market private sector-led growth with a strong bias against organised labour. The Labour Policy 2002 severely curtailed workers' fundamental rights of association and collective bargaining. Even though it has been replaced by the more balanced Labour Policy 2010, which is committed to upholding international labour standards, in practice state institutions are indifferent to upholding existing labour laws.

What about the impact of minimum wages, which the government has announced at different intervals and especially during the last ten years? Again, recent data are not available but Irfan (2008) estimates that, in 2003/04, around 25 percent of all wage earners were paid less than the minimum wage and that the number was much higher for nonregular workers (39.2 percent) than for regular workers (14.1 percent). Given that two-thirds of workers in large-scale manufacturing are contract workers and, therefore, fall into the category of nonregular workers, a very high proportion of these worked below the minimum wage.

**Table 5: Trade union membership and industrial disputes, 1990–2008**

Year	Union membership			Industrial disputes		
	Total registered trade unions	Total number of registered trade unions reporting	Membership of reporting unions	Number of disputes	Number of workers involved	Number of person-days lost
1990	7,080	1,763	359,633	99	65,918	186,726
1991	7,027	1,441	288,803	94	116,306	582,694
1992	7,185	1,834	415,768	40	73,357	398,128
1993	-	1,685	374,731	28	17,133	404,564
1994	7,273	1,718	325,677	25	15,434	341,196
1995	7,426	1,718	337,617	24	10,919	63,626
1996	7,349	1,594	293,530	30	18,566	203,323
1997	7,355	1,534	296,257	30	7,865	283,342
1998	7,356	1,478	305,340	20	6,097	122,519
1999	7,382	1,493	301,164	6	3,937	182,151
2000	NA	1,376	301,332	4	225	667
2001	NA	1,260	275,646	4	711	7,078
2002	NA	1,201	247,539	4	516	12,160
2003	7,183	2,493	455,304	18	8,189	47,719
2004	7,104	2,422	444,795	15	8,724	95,124
2005	7,129	2,428	431,542	19	10,177	102,932
2006	7,029	2,405	NA	17	7,988	85,751
2007	7,051	2,404	NA	21	11,245	102,149
2008	6,793	1,209	NA	17	5,924	26,668

*Source:* Pakistan Statistical Year Book (various issues) as cited in Irfan (2008) till 2006 and for subsequent years based on the same source.

## Part II A Review of the Literature

We start with the seminal study conducted by the ILO's Asian Regional Team for Employment Promotion (ARTEP) titled "Employment and structural change in Pakistan: Issues for the Eighties" (ILO/ARTEP, 1983), which was jointly written by a team comprising ILO specialists and leading economists from the academia in Pakistan.<sup>6</sup> It was also perhaps the first study of its kind that was carried out specifically at the request of the

<sup>6</sup> The team included Naved Hamid, Akmal Hussain, Ijaz Nabi, Omar Asghar Khan, Vaqar Ahmed, and Rashid Amjad (who also acted as coordinator of the study and put the report together).

Planning Commission to serve as an input to the formulation of Pakistan's Sixth Five-Year Plan (1983–88).<sup>7</sup>

The report's key contribution was that it analysed important structural changes that had taken place in the agriculture and manufacturing sectors during the 1960s and 1970s and which directly affected labour absorption and employment relations in these two sectors. After reviewing the overall employment and labour market situation, the report separately analysed: (i) changes in the agrarian structure and their implication for the demand for labour, (ii) the impact of past and existing industrial policies on employment generation for the large and small-scale manufacturing sectors, and (iii) overseas migration and its impact on the domestic labour market. Based on this analysis and projections of labour supply over the Sixth Plan period 1983–88, it made the following specific policy recommendations:

- In the 1960s, far-reaching changes had taken place in Pakistan's agrarian structure as a result of the "green revolution" and substantial increases in crop productivity had led large landowners to resume land from tenant farmers. As a result, the size structure of landholdings had polarized further between large and small farms, together with a significant increase in landless labour. It was, therefore, important to ensure that labour absorption into agriculture was not further eroded. The report recommended (i) giving priority to increasing cropping intensity, productivity, and labour-intensive cropping patterns through increased inputs, especially of fertilizer and water; and (ii) moving to global prices as the basis for setting domestic prices as the former favoured labour-intensive crops such as cotton and rice. It also argued strongly against labour-displacing mechanisation and recommended that subsidised credit should not be provided for such machinery. Moreover, it argued, adopting a realistic foreign exchange rate instead of an overvalued exchange rate was preferable because the latter favoured the import of capital-intensive machinery (most agricultural machinery at that time was imported).
- The report attributed the extremely disappointing performance of large-scale manufacturing in generating additional employment mainly to economic policies that subsidised the use of imported machinery and to the high capital intensity of imported capital goods. It set out a number of policies that would remove the existing policy bias against small-scale manufacturing. These focused on the exchange rate, credit, and tariff regimes, given their potential for creating low-cost jobs in relation to the

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<sup>7</sup> The employment chapter in the Sixth Five-Year Plan (1983–88) was based on the ILO/ARTEP (1983) study.

much higher costs associated with large-scale manufacturing as well as being efficient users of capital in terms of high value-added.

- Based on a cost-benefit analysis of the substantial labour migration that had taken place—mainly to the Middle East in the 1970s—the report recommended that Pakistan’s comparative advantage lay in sending abroad semi- and unskilled workers rather than highly skilled workers or professionals. It argued that substantial public resources had been invested in the latter and that sending this category abroad was also resulting in domestic shortages. It recommended, somewhat optimistically, that professionals going abroad should be asked to pay back part of the cost of their subsidised professional studies, especially those who had studied on overseas scholarships funded by the government.
- Analyzing in depth the most recent surveys of small and household manufacturing industries, the report showed that the small-scale sector had grown very rapidly at over 8 percent per annum in the 1970s, and that the growth of some industries, such as engineering goods and plastics, had been driven by remittances, especially in rural areas. This had led to new and rising demand for consumer durables such as washing machines and refrigerators as well as other consumer goods such as plastic containers and utensils.
- Given the large numbers of skilled and semiskilled workers going abroad, the report recommended a number of measures to increase the supply of skills such as by encouraging formal sector firms to hire apprentices and setting up skills training institutions in the public sector.

The thrust of the report was that, during the Sixth Plan 1983–88 period, the highest priority should be given to (i) employment generation, given the projected high growth of the labour force at over 3 percent; and (ii) reducing the existing high levels of poverty, given that nearly one-third of all households were below the poverty line. It warned the government against being lulled into inaction by the temporary easing of the labour market situation as a result of the large migration overseas, especially to the Middle East.

As a follow-up to this report, the ILO/ARTEP undertook another study (1986), again at the request of the Planning Commission, as a mid-term review of the employment and labour market situation. The study evaluated the extent to which the recommended policies had been implemented and determined what further measures were needed on the basis of this review. In addition to the earlier sectors covered, including overseas migration, the report also analysed employment trends in the public sector and the role of the construction sector in stimulating employment, given its forward and



backward linkages with the rest of the economy. The report gauged the functioning of the urban and rural labour markets, especially wages and incomes, as well as trends in poverty levels. It emphasised the need for policies that could overcome the skills constraint and reduce skill mismatch in the economy. The report also made a strong case for strengthening the institutional machinery for employment and human resource planning and monitoring, including in the Planning Commission, for improving the collection of data on labour market indicators, and for setting up a comprehensive labour market information system.

The ILO/ARTEP's (1986) review of the first two years of the Sixth Plan period showed a dramatic slowdown in overseas migration to the Middle East and, therefore, accentuating pressures on the labour market. Realising the gravity of the situation, the new government of Prime Minister Junejo set up the National Manpower Commission in August 1987, which included senior government planners and representatives of the private sector and educational institutions. The commission was tasked with preparing a comprehensive plan for human resource development in the country and providing initial inputs for the Seventh Five-Year Plan (1988–93). Its terms of reference included: (i) determining the size and dimensions of the problem of unemployment and recommending both short- and long-term policies to deal with it; (ii) examining the imbalance between general education and vocational training and education to help minimise the wastage of resources and effectively respond to employment and skills demand in a cost-effective manner; (iii) suggesting measures to provide employment to professionals, including doctors and engineers; (iv) considering the special problems arising from the emigration of Pakistani workers and return migrants and suggesting measures to promote migration overseas as well as those for returning workers; and (v) examining the special problems of women and suggesting measures, including training and services to enlarge and strengthen the participation of women in economic and other national activities.

As many as seven technical committees were set up to analyse these issues. At the same time, in 2008, an ILO/UNDP/Planning Division project was started to support the work of the National Manpower Commission and to provide inputs to the formulation of the Seventh Five-Year Plan. This project published a total of 14 reports including a proposed strategy for employment and human resource development in Pakistan (Cameron & Irfan, 1990).

Given the importance the government was according to employment issues in the late 1980s, the World Bank (1989) also undertook a study to examine Pakistan's employment issues and prospects. It took as its point of departure the two ILO reports (ILO/ARTEP, 1983, 1986) as well as a seven-volume

report by the ILO/ARTEP (1987) on the impact of out- and return-migration on domestic employment in Pakistan.

To some extent, the World Bank (1989) played down the government's concerns that stemmed from the fear of return migration from the Middle East as well as rising unemployment among professionals, especially doctors and engineers. It argued that return migrants would, at best, add to about 5 percent of the increase in the labour force and that they were, in any case, economically better off and usually more skilled than the rest of the population. Additionally, doctors and engineers came from middle-class family backgrounds though the report admitted that they could pose socioeconomic and even political problems for the government if they resorted to street unrest. While recognising that major structural changes had taken place in the rural economy following the green revolution and resumption of land from tenants by middle-size and large landowners, the World Bank argued that these were not necessarily a negative development if they resulted in the rising average productivity of labour. Its major concern was Pakistan's continuing high population growth rate, which had resulted in the high growth of both the labour force at over 3 percent and of its youth component. The report also showed that large-scale manufacturing employment had stagnated at half a million since the early 1970s and that most of the growth in employment in manufacturing had taken place in small-scale, informal, and household manufacturing.

An important contribution of the report was that, unlike the earlier reports, it analysed the impact of existing World Bank (1989) government regulations and labour laws on different sizes of firms. The very large firms and government enterprises, it argued, were subject to stringent labour legislation. Medium as well as small enterprises, on the other hand, were subject to labour regulations but managed to circumvent most labour laws while simultaneously benefitting from protective legislation (e.g., tax holidays, tariff protection). The third category at the extreme consisted of wholly unregulated enterprises that operated outside the purview of labour laws and generally did not receive any benefits from the government. Such firms could be affected to varying extents by government policies, especially as related to the tariff and exchange rate regime. The report also pointed out that these small-scale manufacturing firms and household enterprises had surpassed large-scale formal enterprises—as shown by the ILO/ARTEP (1983)—in both labour absorption and output growth. As a result of the increased demand for labour rather than wage erosion in this sector, real wages had in fact increased.

These findings as well as its analysis of the rural labour market led the World Bank (1989) to conclude that, given the general wage flexibility in

response to changes in labour supply and demand and corresponding wage movements between sectors, *labour markets in Pakistan were competitive and linked*. The report went on to state that, “*there is no distinct or parallel labour market in Pakistan, one for the formal and the other for the informal sector but a continuum of markets*” (p. v). The World Bank did, however, seriously contend that extending labour laws to small-scale and informal enterprises would adversely affect their growth, which had been extremely high, at over 8 percent, between the late 1970s and mid-1980s.

Overall, the studies conducted in the 1980s by the ILO and the World Bank agreed that, in the medium and long term, Pakistan faced the serious challenge of finding employment for its fast-growing workforce. These reports emphasised the supply side in improving the dismal education and skill levels of the workforce and demand-side measures that would encourage the growth of small-scale and informal manufacturing as well as farm and off-farm employment. The ILO also placed an emphasis on sectors that could stimulate employment growth in the short term, especially construction and within it housing, given their high forward and backward linkages with the rest of the economy. A study by Godfrey (1986) for the ILO made a strong case for the housing sector and for encouraging labour-intensive exports as a major driver of employment generation by dismantling the anti-export bias in government policies and investing in skills development.

### *Employment-based poverty reduction strategy for decent work in Pakistan*

In order to encourage national ownership of developments plans and policies and to help erase the general impression that these were dictated by major donors, the World Bank launched the framing of Poverty Reduction Strategy Papers (PRSPs) as a prerequisite for developing countries applying for grants, loans, and debt rescheduling. At around the same time, the ILO, under a new director-general who took over in 1999, extended its focus on the creation of more jobs to the concept of decent work, which entailed rights at work, remunerative and productive employment, social protection, and a voice at work. The emphasis on employment and jobs thus shifted from more work to better and decent work, the creation of which would also help reduce poverty and overcome discrimination and social exclusion.

Working closely with the Planning Commission and the United Nations Development Programme (UNDP), the ILO undertook a number of studies starting in 2001 (see ILO, Planning Commission, & UNDP, 2004) to develop policies for poverty reduction through the generation of employment opportunities that would result in decent work. An important objective of

these studies was to help incorporate decent work into the PRSP-I—then under preparation by the Ministry of Finance—as well as the Medium-Term Budgetary Framework (as the development plan was renamed) being prepared by the Planning Commission for the period 2005–10. The initiative was also timely: for the past three years, the economy had been under a severe IMF stabilisation programme to restore macroeconomic stability, which had resulted in rising poverty and unemployment.

The major studies undertaken related to employment generation policies for poverty reduction, the relationship between the functioning of the labour market and poverty, overseas migration, and social protection.

An important contribution to this work was Gazdar's (2004) study, which argued that, in framing anti-poverty policies, it was necessary to analyse the structural factors mediating poor people's access to labour markets and job opportunities. To quote, "Anti-poverty policy ought to pay greater attention to structural changes which may lead to improved market conditions of the poor. In other words, a poverty reduction policy might be concerned not only with overall growth and employment generation, but also with institutional change" (p. 169).

More specifically, in the context of the organised sector, Gazdar (2004) questioned the prevalent orthodoxy that the main source of labour market friction lies in public sector over-employment, rigid labour regulation, or restrictive practices on the part of unions. His argument was that an analysis of labour market functioning would show that there are "socially driven" labour market frictions that are as harmful, if not more, as any rigidities imposed by government regulations or trade unions: "In other words, even in the absence of public regulation and union activity, the labour market is likely to be uncompetitive, 'unfree', and unequal" (p. 169).

As regards the organised manufacturing sector, he analysed the increasing shift towards contract work both within and outside the factory premises. Under this contractor or *thekedar* system, there is no direct contract between the worker and the management, and all transactions relating to work, pay, or other conditions are mediated through the *thekedar*. The system reduces costs for enterprises by circumventing labour regulations, social security obligations, wage policy, and the possibility of collective bargaining. By allowing this shift, fluctuations in economic activity could be seen to make labour markets more flexible and reduce labour rigidities. These advantages, of course, had to be weighed against the advantages of having a regular long-term factory employee, which would ensure a reliable and skilled workforce. Although Gazdar (2004) pointed out the need for more in-depth

study of these institutional arrangements, he concluded that, “Rather than resembling competitive market conditions, [it] is premised on monopsonistic market conditions for employers, whereas workers are unable to realize the premium on their skills, knowledge of the sector, and reputation. ... Moreover, the institutionalisation of the thekedar system leads to a particular form of work organisation that may not be conducive to firm expansion and technological innovation” (p. 180).

***Pakistan’s labour market: regulation, job creation, and skills formation in the manufacturing sector***

An opposite view arguing for much greater labour market flexibility to encourage faster job creation and skills formation in manufacturing was not long in coming. As the Musharraf government pressed on with a strong pro-private sector-led growth strategy and started what became known as the second-generation reforms, the World Bank (2006) undertook a detailed study of the manufacturing sector to improve the investment climate by suggesting reforms in labour laws and institutions, the vocational training system, social security, and welfare programs. The study, which was undertaken for the Ministry of Industries, Production, and Special Initiatives and the Ministry of Labour and Manpower, examined two critical constraints to the investment climate—labour regulation and the skills gap—so as to improve both employment outcomes and industrial productivity.

Drawing on results from an Investment Climate Survey of nearly 1,000 mainly manufacturing businesses in eight industries during 2002, the World Bank (2006) concluded that labour regulation in Pakistan was excessive by international standards. The existing labour laws and regulations had raised the cost of long-term employment relations so high that the private sector was not creating good-quality jobs as it should nor was it helping to finance the training needed to train the industrial workforce to compete in global markets. The basis of the report’s international comparison of excessive labour market regulation was, “ironically”, as the World Bank put it, “that the share of temporary workers in Pakistan businesses is one of the highest by any international standard, standing at 36 percent against, for example, 15 percent in India and 3 percent in Bangladesh” (p. iv). This excessive labour regulation had led to very low employment generation, i.e., output elasticity of employment, and had it not been for the recourse to hiring contract labour, the elasticity would have been even lower. The study recognised that temporary employment undermined the incentives for workers and for firms to participate in or sponsor on-the-job skills formation; this was one reason that firms reported skill shortages and only 15 percent sponsored such training.

To “fully capitalise” on the impressive ongoing labour reform process, the report therefore recommended reforms in labour regulation that would reduce firing and hiring costs as well as the costs of complying with such legislation. It proposed redundancy as a legitimate ground for dismissal, removing time limits on labour contracts (which were higher in Pakistan than in other South Asian countries), and reducing compliance costs by simplifying inspection schemes, working condition reforms, and mechanisms for the collection of social security contracts.

On reforms in the vocational training system, the report pointed out that the existing system suffered from excessive fragmentation, quality, scale, and lack of private sector ownership. It rightly stressed that, given its resource constraints, Pakistan needed to concentrate on access to primary and intermediate general education and reduce dropout rates. It also argued against earlier attempts to introduce vocational education in intermediate schools and a matriculation tech-stream at the secondary level. Finally, it recommended improving the working of the newly set-up National Vocational and Technical Education Commission (NAVTEC), offering on-the-job training, and expanding the currently very restricted internship programmes offered by large enterprises.

On social security, the report recommended the meaningful representation of workers and suggested that employers provide external control over the allocation of funds and the type of services offered to help improve governance. It also argued for expanding coverage but only after undertaking reforms that ensured high-quality services for covered workers and at a reasonable cost to employers.

It is important to note that the World Bank (2006) report made no mention of international labour standards or the fact that the Industrial Relations Ordinance 2002, which had been adopted without tripartite consensus, had been subject to strictures by the independent Committee of Experts set up by the ILO (the ordinance curtailed workers’ rights of freedom of association and collective bargaining). The report also made no mention of the strictures on labour inspection policies being followed by the government or of trade unions even as labour market institutions.

It would need some investigation to see if any of the report’s recommendations on increasing labour market flexibility were seriously considered or incorporated in existing labour market regulations. Suffice to say, most studies and, importantly, most employers did not find the existing labour legislation a major—leave aside binding—constraint on either the investment climate or increasing output. Indeed, more recent surveys

conducted by the World Bank (see Manes, 2013) have confirmed that this was the case. The labour market was already sufficiently flexible and the fact that most large enterprises relied on contract workers showed not so much that the labour regulatory framework was restrictive but that it was neither effective nor being seriously implemented. In this sense, the earlier World Bank (1989) report had captured much better the reality of the functioning of the labour market, as had the earlier ILO reports. The latter had also concentrated on embedding employment into the government's development plans and strategies and identified sectors and investments that could result in more productive and higher levels of employment.

### *Finding the path to job-enhancing growth*

The World Bank must be given credit for realising in recent years—including through constant prodding by the ILO—that the real issue is not of increasing labour market flexibility in developing countries. Except for a few sectors (mainly public enterprises), developing countries' labour markets are already flexible in terms of employment practices. Instead, the real challenge is to create not just more, but better, jobs. At the global level, the World Bank's flagship *World Development Report 2013* was on jobs and its regional report on South Asia (World Bank, 2012b) was on more and better jobs in South Asia. These reports also suggest a greater convergence of views between the World Bank and the ILO on the role of well-functioning labour market institutions (see, for example, Amjad, 2013b).

It is, therefore, not very surprising that the most recent World Bank country economic memorandum submitted to the newly elected government that took over in June 2013 is on finding the path to job-enhancing growth (see World Bank, 2013). The central tenet of this report is that Pakistan has the potential to recover high growth and create formal and informal jobs. The real challenge lies not in creating low-productivity jobs but better jobs as well in sustaining growth acceleration in the medium term. This, the report argues, will not result from just reviving high growth but also from ensuring that the growth is accompanied "by a shift from low-skilled to high-skilled jobs. From farming and self-employment to wage employment. And—to some extent—from informal to formal employment. This process is called job-enhancing growth" (World Bank, 2013, p. 5).

The report outlines a number of measures for reviving growth to at least 7 percent to absorb the expected growth in the labour force. These measures are both for the short term (overcoming energy shortages and regaining macroeconomic stability) as well as for the medium and long term (improving the law and order situation and undertaking economic reforms, including

trade and banking reforms, to increase productivity, efficiency, and global competitiveness).

While the report makes a number of important recommendations for fostering high growth that would generate jobs faster, it is less clear on the measures needed to create better jobs. It does not argue that a lack of labour market flexibility prevents the creation of more and better jobs, but, at the same time, it also does not seriously examine the positive role that labour market institutions can play in creating better jobs—especially by guaranteeing rights and a voice at work through their elected representatives. In this sense, the World Bank still has some hurdles to overcome in making its case for the creation of better jobs.

In this study, we also critically examine part of the World Bank's (2013) analysis, especially as it relates to the paper's central theme of the manufacturing sector's role as a major driver of employment growth in Pakistan.

### **Part III**

## **The Major Sources of Economic and Employment Growth in Pakistan**

It is important to analyse the changing role of different sectors in driving economic growth as well as their past contribution to job generation to be able to gauge the role they can play in the future development of the economy and their potential for creating productive and decent employment opportunities.

### ***Recent studies on sources and patterns of economic growth and employment in Pakistan***

Not only has economic growth taken place in spurts in Pakistan, but the overall trend growth rate has also declined since the 1990s. Both these cyclical fluctuations and the contribution of different sectors to the slowing down of economic growth have been the subject of close enquiry. We review the latter as this is more relevant to our analysis.

A recent study by the World Bank (Lopez-Calix, Srinivasan, & Waheed, 2013) explores Pakistan's growth patterns during the period 1980–2010 through a growth accounting framework applied to four factors of production—capital, labour, human capital (measured by years of schooling), and land (measured by arable land). This is applied to the overall economy as well as the three major sectors—agriculture, industry, and services. The study separates the individual contributions of labour productivity (output per worker) and labour accumulation (employment) to



real output growth and then estimates the contribution of capital, human capital, land, and TFP to labour productivity. TFP is measured by the residual term and taken to represent the contribution of changes in technology and the efficiency with which inputs are used. The results of this exercise are shown in Table 6 below.

**Table 6: Sources of annual growth in labour productivity, FY1981–FY2011**

		Average annual percentage rate of change							
Period	Real output growth	Investment as % of GDP (constant prices 2000)	Employment growth	Output per worker growth	Output per worker: Percent contribution of				
					Physical capital	Human capital	Arable land	TFP	
Total economy	FY81-FY90	6.1	18.18	1.8	4.3	1.2	0.9	-0.2	2.4
	FY91-FY00	4.4	18.79	2.4	1.9	0.8	-0.2	-0.3	1.5
	FY01-FY10	4.8	16.56	3.8	0.9	0.1	0.6	-0.4	0.6
	FY81-FY11	5.0	17.69	2.7	2.2	0.7	0.4	-0.3	1.4
Agriculture	FY81-FY90	4.0	1.95	1.8	2.2	1.4	0.4	-0.7	1.2
	FY91-FY00	4.4	2.11	1.6	2.8	1.0	-0.1	-0.6	2.4
	FY01-FY10	2.7	1.64	3.2	-0.5	0.0	0.1	-1.8	1.2
	FY81-FY11	3.6	1.88	2.3	1.3	0.8	0.1	-1.1	1.5
Industry	FY81-FY90	7.7	5.77	2.0	5.6	1.7	0.7	0.0	2.1
	FY91-FY00	4.2	6.87	1.0	3.2	2.7	-0.1	0.0	0.6
	FY01-FY10	6.1	5.26	5.0	1.0	-0.9	0.5	0.0	1.5
	FY81-FY11	5.8	5.87	2.7	3.0	1.0	0.3	0.0	1.6
Services	FY81-FY90	6.6	10.47	2.8	3.7	0.6	1.2	0.0	1.8
	FY91-FY00	4.5	9.81	3.7	0.8	0.2	-0.3	0.0	0.8
	FY01-FY10	5.1	9.66	4.1	1.0	0.2	0.7	0.0	0.1
	FY81-FY11	5.4	9.94	3.5	1.8	0.3	0.5	0.0	0.9

Source: Lopez-Calix et al. (2013).

The main empirical findings of this study and its major conclusions are as follows:

- To a large extent, Pakistan's growth is still driven by agriculture with a high correlation between real GDP and real agricultural growth. With the economy slowing down, this role has, since the 2000s, shifted to services.
- The last 30 years' growth in Pakistan has been driven mainly by labour and capital accumulation rather than by productivity gains as measured by TFP; this has declined in the 2000s to a quarter of its level in the 1980s.
- The contribution of TFP to economic growth has declined in all sectors since the 1980s, including in industry where it was particularly strong in the earlier period.
- The main reason for the decline in TFP is that structural reforms have been growth-reducing rather than growth-enhancing. Since the 1990s and 2000s also witnessed considerable efforts at economic reforms, these did not have the desired results because "structural reforms were fragmented, badly sequenced or truncated.

***Job generation and growth decomposition: Understanding the sectoral pattern of growth and its employment and productivity intensity in Pakistan***

We have carried out a broadly similar exercise using a World Bank-developed model to generate results, but one that has the advantage of bringing out somewhat more sharply the sectoral contributions to employment and productivity growth in the economy. However, we concentrate on the last period, i.e., 2000–10, so as to highlight what has happened more recently and to bring out the differences in the two sets of results and their policy implications.

Using the World Bank's Job Generation and Growth Decomposition (JoGGs) tool, we draw attention to Pakistan's growth decomposition over the period of analysis and its two subperiods: period 1 (2000/01 to 2006/07) and period 2 (2005/06 to 2010/11). Period 3 defines the overall ten-year period from 2000/01 to 2010/11. The Shapely decomposition methodology is used to gauge the importance of each component of the decomposition exercise.

Pakistan registered a growth rate of 27.6 percent in per capita GDP (value-added) during the overall period 2000/01 to 2010/11. Table 7 gives the results of the decomposition of aggregate per capita growth into its main components.

**Table 7: Decomposition of growth in per capita value-added, 2000/01 to 2010/11**

Growth component	Percent of total change in per capita value-added growth					
	1999 (PRs)			Period 1	Period 2	Period 3
	Period 1	Period 2	Period 3			
Total growth in per capita GDP (value-added)	6,522.8	2,359.7	7,181.0	100.0	100.0	100.0
Growth linked to output per worker	3,614.6	65.3	3,255.0	55.4	2.8	45.3
Growth linked to changes in employment rate	2,487.5	2,254.8	2,638.9	38.1	95.6	36.8
Growth linked to changes in the share of the working-age population	420.7	39.6	1,287.1	6.5	1.7	17.9

*Source:* World Bank JoGGs tool with data from Pakistan Economic Survey for 2006/07 and 2011/12 and World Bank growth calculations for Pakistan.

Of the actual growth in GDP per capita between FY2001 and FY2007 (25.1 percent), 55.4 percent is linked to growth in output per worker. In other words, more than half the growth in per capita GDP value-added (13.9 percent of the actual growth of 25.1 percent) is linked to this component. The employment rate contributes to 38.1 percent of the actual growth in per capita GDP value-added (9.5 percent). Moreover, the growth linked to changes in the share of the working-age population is calculated to be 6.5 percent—1.6 percent of the actual growth of 25.1 percent.

In the period of economic slowdown (FY2006–FY2011), growth linked to productivity (output per worker) experienced a sharp decline to 2.8 percent. The change in the employment rate had a much larger impact: 95.6 percent. The demographic component (as reflected in the change in the share of the working-age population) also registered a weak link with growth. For the overall period FY2001–FY2011, the growth components linked to output per worker, changes in the employment rate, and the population of working age were fairly moderate but still significant.

Table 8 presents data on employment by sector. During FY2001–FY2007, the aggregate increase in total employment was 27.5 percent. The high employment growth in the industrial sector contributed 47.5 percent to the increase in total employment. Overall, the employment rate increased by 8.9 percent as a consequence of the simultaneous growth in the working-age population. Industry contributed 26.1 percent—the highest share in the total percentage increase.

**Table 8: Employment by sectors of economic activity, 2000/01 to 2010/11**

	Total employment			Employment/working-age population		
	Percent change			Percent change		
	Period 1	Period 2	Period 3	Period 1	Period 2	Period 3
	1					
Agriculture	14.5	24.4	33.3	-2.2	11.8	1.7
Industry	47.5	22.5	67.4	26.1	10.1	27.8
Services	35.4	11.7	44.9	15.7	0.4	10.6
Total	27.5	19.4	43.3	8.9	7.3	9.4

*Source:* World Bank JoGGs tool with data from Pakistan Economic Survey for 2006/07 and 2011/12 and World Bank growth calculations for Pakistan.

During FY2006–FY2011, total employment by sectors of economic activity declined from 27.5 percent to 19.4 percent. Employment as a percentage of the population of working age remained relatively stable, with the share of industry falling by more than half compared to the previous period. Overall, during the ten years, we see that industry absorbed most of the labour force.

Table 9 shows the decomposition of output per worker, capital stock, the capital-labour ratio, and the change in the share of capital in total income. Here, we have used data compiled by Lopez-Calix et al. (2013), who have constructed a capital series for Pakistan giving us capital stock figures for the periods under consideration. We report the results for a constant share of capital in total income of 30 percent. The table shows the role of capital and TFP as well as inter-sectoral shifts. Between FY2001 and FY2007, total output per worker increased by 13.2 percent. Of this increase, inter-sectoral employment shifts had a positive effect on total output per worker, contributing PRs4,451 to total productivity growth in absolute terms. The capital-labour ratio fell slightly by 0.2 percent. Period 2 was marked by extremely low productivity growth: capital stock experienced a relative decline while the capital-labour ratio increased. Overall, the decade saw a rise in capital stock, the capital-labour ratio, and TFP net of inter-sectoral shifts.

**Table 9: Decomposition of output per worker, capital stock, capital-labour ratio, and share of capital in total income, 2000/01 to 2010/11**

	Percent change		
	Period 1	Period 2	Period 3
Share of capital in total income (%)	0.0	0.0	0.0
Capital	27.2	22.9	47.7
Total output per worker	13.2	0.2	11.7
Output per worker net of inter-sectoral shifts	8.6	2.2	8.8
Capital-labour ratio	-0.2	2.9	3.1
TFP residual net of inter-sectoral shifts	8.7	1.3	7.8

*Source:* World Bank JoGGs tool with data from Pakistan Economic Survey for 2006/07 and 2011/12 and World Bank growth and capital stock calculations for Pakistan (2012).

Table 10 gives the results for growth decomposition in terms of the percent contribution to total growth in GDP value-added per capita during FY2001–FY2011. In period 1, between FY2001 and FY2007, the total percentage change in value-added per capita of 25.1 is attributed to the following sectoral contribution aggregates: the contribution of within-sector changes in output per worker (36 percent), the contribution of changes in employment (38.1 percent), and the contribution of inter-sectoral shifts (19.4 percent). Overall, services contributed the most towards total growth in per capita value-added, followed closely by industry during the period. The population of working age added 6.5 percent to total growth per capita within the period, owing to the youth bulge that Pakistan currently faces.

**Table 10: Contribution to total growth in GDP (value-added) per capita, 2000/01 to 2010/11**

	Percent contribution of											
	Within-sector changes in output per worker			Changes in employment			Inter-sectoral shifts			Total		
	Period	Period	Period	Period	Period	Period	Period	Period	Period	Period	Period	Period
	1	2	3	1	2	3	1	2	3	1	2	3
<b>Sectoral contributions</b>												
Agriculture	5.9	-29.2	2.1	-4.5	66.7	3.2	11.1	-12.4	7.1	12.5	25.1	12.4
Industry	6.5	-13.5	2.2	20.1	27.1	19.6	3.5	1.7	3.3	30.1	15.2	25.1
Services	23.6	72.0	29.8	22.5	1.8	14.0	4.8	-15.8	0.9	50.9	58.0	44.6
Subtotal	36.0	29.3	34.1	38.1	95.6	36.8	19.4	-26.5	11.2	93.6	98.3	82.8
Demographic component										6.5	1.7	17.9
Total										100.0	100.0	100.0
Total percent change in value-added per capita										25.1	7.7	27.6

*Source:* World Bank JoGGs tool with data from Pakistan Economic Survey for 2006/07 and 2011/12 and World Bank growth calculations for Pakistan.

Period 2, depicting low growth in Pakistan, contributed the least to total growth in GDP value-added per capita. Overall, during the ten years, industry was still one of the major driving forces in terms of its contribution to changes in employment—including inter-sectoral employment shifts—even though the sector’s productivity declined over time. The services sector did well on all three decomposed sectoral contribution indicators over the decade.

Some other results of the exercise are consolidated in Appendix A. We have also carried out growth decompositions using the same tool for the three periods in our analysis above, this time presenting data on the industry sector subdivided into manufacturing and nonmanufacturing. The results are broadly similar for the industry sector either way.

Our analysis suggests that the labour absorption capacity of industry and services increased during the ten-year period: the greatest employment was generated by the industry and services sectors, even after taking into account the simultaneous increase in the population of working age. Inter-sectoral shifts in employment also contributed to the overall growth of the economy but not to a large extent. TFP figures for the different periods were crucial in determining the behaviour of individual sectors. The services sector played a more important role than industry and agriculture in the overall growth of GDP value-added. Even though agriculture recorded growth in output, services took the lead during the decade.

### *Some important conclusions*

We have analysed in considerable detail the contribution of industry, services, and agriculture to productivity, employment, and TFP over the period FY2001–FY2010 to show not only the contributing role of the industry sector but also to bring out also some fundamental differences in our analysis compared to Lopez-Calix et al. (2013). The two analyses differ in terms of results and main policy conclusions. Moreover, substituting manufacturing for industry does not make any real difference to the findings. These are spelled out as follows:

- (i) It is misleading to treat the overall period FY2001–FY2011 as a whole and draw from it analytical findings on key variables and policy conclusions.
- (ii) The main message that emerges from our analysis by breaking down this period into a high-growth phase and a low-growth phase is that it is primarily economic growth that drives productivity, employment, and TFP growth. This is as true for the 2000s as it is for the 1980s and 1990s.

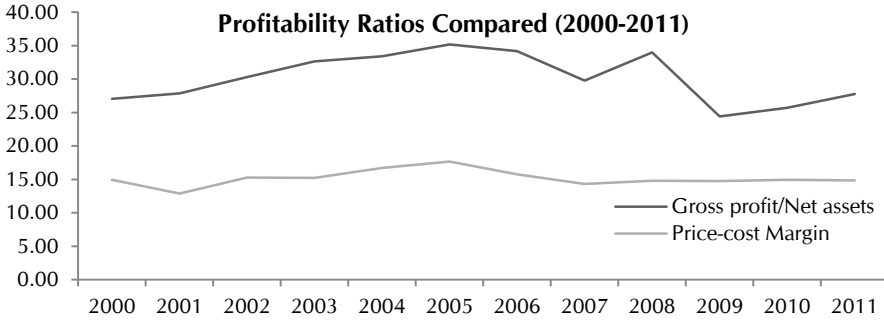
- (iii) An important conclusion that emerges from our analysis is that, while undertaking economic reforms is important and they can facilitate growth, they are not in themselves the major driver of economic growth. The major driver is investment, primarily in response to the growth of demand and profitability. During a period of high investment and the resulting high growth, both labour productivity and TFP rise because investment embodies the latest knowledge and new technology as postulated by Kaldor (1966) and more recently by Ocampo (2005). Pakistan's problem stems from very low investment in both physical and human capital.
- (iv) The policy focus, therefore, must shift from an emphasis solely on economic reforms, which are primarily structural and have a medium- to long-term impact on reviving investment and growth. Pakistan's current downturn reflects primarily a lack of business confidence due to the security situation arising from the conflict on its western borders.
- (v) Besides the security situation, reforms are needed immediately in two key areas. The first relates to overcoming the country's severe energy shortages, which are a major hindrance to new investment and higher capacity utilisation of the current capital stock. The second relates to macroeconomic measures to restore macroeconomic stability, primarily by raising the tax-to-GDP ratio, which remains abysmally low at less than 9 percent.

### *The profitability of manufacturing firms quoted on the Karachi Stock Exchange*

To further build up the argument that the economy was not demand-constrained in the 2000s, we examine the movement in profitability as represented by the rate of return on net assets and price-cost margins for nonfinancial, mainly manufacturing, companies quoted on the Karachi Stock Exchange over this period.

As Figure 3 shows, both profitability and price-cost margins increased during the period of high growth FY2001–FY2007. The global slowdown and compression of domestic demand to restore macroeconomic stability under an IMF programme led to a sharp decline in the next two years. Subsequently, profitability picked up again and rose gradually over the next two years.

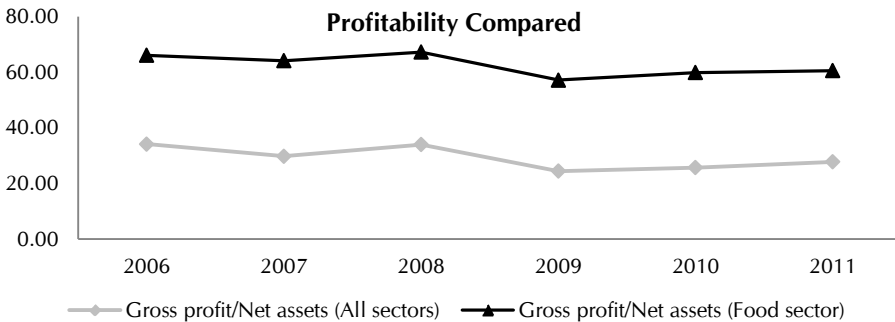
**Figure 3**



*Source:* Authors’ calculations based on consolidated balance sheet data from the State Bank of Pakistan for nonfinancial companies.

The behaviour of profitability in the foods sector (Figure 4) also brings out rising consumption demand during FY2006–FY2011. The sector’s consistent and much higher profitability testifies that consumption demand kept increasing throughout this period.

**Figure 4**



*Source:* Authors’ calculations based on consolidated balance sheet data from the State Bank of Pakistan for nonfinancial companies.

## Part IV

### Can Manufacturing Serve as an Engine of Economic Growth and Create More and Better Jobs?

Keeping in mind the main results that emerged from the growth accounting exercises in Part III, we now carry out a more in-depth analysis of the manufacturing sector to determine the extent to which the main findings are substantiated and the important qualifications and modifications that need to be



made when interpreting these results. We start by breaking down the manufacturing sector into its two major components: the large-scale sector and the small-scale and household sector.

### *Large-scale manufacturing*

The high capital intensity of large-scale manufacturing, as reflected in the sector's high capital-output ratio and lack of employment generation, has been an area of considerable concern since the 1960s. An important study by Khan (1970) found that, not only was capital intensity extremely high compared to that of small-scale manufacturing and other sectors, but also that the capital intensity of a number of Pakistani industries was higher than that of Japan. A major reason for this high capital intensity was the prevalence of price distortions in the economy, including an overvalued exchange rate (which, since most industrial machinery had to be imported, grossly underestimated the scarcity price of capital), subsidised financial costs, accelerated depreciation, and tax holidays (see Guisinger, 1981).

It was hoped that the devaluation of the Pakistani rupee in 1972 to a more realistic exchange rate would help reduce this distortion and thus lead to a more optimal choice of technology in the import of industrial machinery and, in turn, generate more jobs. This immediate expected impact was considered to have been compromised considerably by the significant decline in private investment in large-scale manufacturing due to the government's earlier nationalisation policies. Most public investment in this sector was in heavy industries, namely steel and heavy engineering, and in the manufacture of machinery and machine tools, which, again generated fewer jobs.

The ILO-ARTEP (1983) study, which reviews data for the 1960s and 1970s, concludes the following:

- In Pakistan, the process of structural transformation from a predominantly agrarian economy to one with a significant manufacturing sector began soon after independence. Despite the slowdown in the 1970s, the share of manufacturing output in GDP increased from 8 percent of GDP in 1949/50 to 17 percent in 1981/82 (see Table Annexe 1).
- Within manufacturing, the share of large-scale manufacturing in GDP increased from 2.2 percent in 1949/50 to 12.5 percent in 1969/70. Due to the slowdown in the 1970s, it was still at this level in 1981/82 (see Table Annexe 2).

- The process of structural change in the economy in the 1960s and 1970s was not proportionally reflected in the share of employment in the manufacturing sector in total employment. Its share reached 13.4 percent of the labour force in 1960 and was at the same level of 13.4 percent in 1982/83.
- The share of large-scale manufacturing employment in the total labour force was 2.5 percent in 1960/61 and increased only marginally to 2.7 percent in 1982/83.
- Of the total employment in manufacturing, the relative share of large-scale manufacturing was 18.3 percent in 1960/61, which increased only marginally to 21 percent in 1971/72 and remained at this level till 1977/78. In contrast, the share of large-scale manufacturing in total manufacturing was 30 percent in 1949/50; it increased to almost 80 percent in 1969/70 but declined to 73 percent in 1981/82.
- The study also revealed the fragility of using employment elasticity as an indicator of the labour absorption capacity of the large-scale manufacturing sector, which increased almost threefold in the 1970s compared to the 1960s from around 0.27 to 0.75. This reflected more the drastic slowdown in growth (from over 10 percent to around 5 percent) than a capacity to generate greater employment (which increased only marginally from 3.1 to 3.3 percent).

There was little change in the low employment-generating capacity of the large-scale manufacturing sector in the next two decades, as a detailed ILO (2000) study on employment, output, and productivity shows. In response to the question why the sector's employment absorptive capacity had continued to decline in the 1980s and 1990s, the study argued that, in the 1980s, large-scale manufacturing had followed an "internationally established pattern of capital-augmenting, labour-substituting growth, increasing profit shares and reducing the wage share" (p. 6). For the 1990s, it added deflationary policies as a result of the structural adjustment programmes entered into by the government, which dampened recovery in manufacturing and further constrained capacity utilisation and employment.

For the decade 2000–10, any analysis of the large-scale manufacturing sector is constrained by the fact that the last CMI for which data are available was carried out in 2005/06. However, there was no major change even in the first half of this decade in terms of the sector's employment-generating capacity.

To try to adjust for non-responding firms as well as the fact that the CMI's overall frame does not cover all large-scale manufacturing firms, we have

tried to give a rough estimate of the possible employment in the large-scale manufacturing sector. This works out at around 1.5 million employed in large-scale manufacturing (Table 11) and increases its share to about 25 percent of total employment in the manufacturing sector. However, only the results of the 2011/12 census will give us a better idea of the actual numbers.

**Table 11: Employment in the manufacturing sector**

	1960/61	1971/72	1977/78	1982/83	2001/02	2005/06	2011/12
Large-scale manufacturing	337,000	480,000	580,000	690,000	690,122	941,283	1,500,000
Small-scale <sup>a</sup> manufacturing	1,501,000	1,806,150	2,398,928	2,699,044	4,264,878	5,738,717	4,632,090
Total manufacturing	1,838,000	2,228,615	2,978,928	3,389,044	4,955,000	5,780,000	6,132,090
Total labour force <sup>b</sup>	13,517,000	18,270,000	21,840,000	25,220,000	40,865,000	50,640,000	59,740,000

Note: a = residual of total and large-scale manufacturing sector, b = derived from Labour Force Survey, c = estimate (corrected for underestimation).

Source: ILO/ARTEP (1983) and Labour Force Survey (various issues).

### *Small-Scale and Household Manufacturing*

It is best not to get into any precise definition of the small-scale manufacturing sector as these vary widely. In the national accounts, the small-scale sector is the residual of what is not covered by formal, organised large-scale manufacturing, i.e., it consists of firms that employ fewer than ten workers. The detailed census periodically conducted by the statistical authorities covers firms employing more than ten workers, but these represent only a small portion of the total sample. The small-scale sector also includes households—mostly rural—that engage in manufacturing activities and comprise mainly self-employed artisans, although they may employ more than one person. These are around 20 percent of the total firms covered.

It is also important to note that the official estimates of this sector's growth are calculated using an indirect method. In the 1950s and 1960s, these estimates were taken as equal to the growth rate of population. Subsequently, they were derived from the Census of Small-Scale Manufacturing Industries in terms of the recorded growth in the inter-censal period. When the census does not take place, the previous inter-censal estimates are used (which can be misleading) and then subsequently revised—this can create havoc with the national income accounts! Estimates of investment in small-scale manufacturing are derived indirectly and related to the growth of output, assuming a constant capital-output ratio.

Keeping these statistical anomalies in mind, we now try to decipher the growth and structural change that has taken place in the sector, which is believed in recent years to drive economic growth and account for the economy's so-called resilience.

It is now generally accepted that the growth of small-scale manufacturing was low in the 1950s and 1960s mainly because the incentive structure, i.e., the trade and exchange rate regime and credit, favoured large-scale manufacturing. The devaluation in 1972 that did away with the overvalued exchange rate, de-controls on imports, and the nationalisation of the banking sector all made the environment more conducive to the small-scale sector. What really spurred growth, however, was the increase in agricultural incomes and the inflow of large remittances, especially into small towns and rural areas (see Hamid, 1984). This boom continued in the 1980s as remittances rose further in the earlier years and the overall economy was driven by increases in foreign inflows (resulting from the Afghan war). This, in turn, led to overall high economic growth and growth in manufacturing.

It is also important to keep in mind the strong links for many industries—e.g., light engineering (tubewells) and, later, automotive industries (cars, tractors, motorcycles)—that have developed between the large- and small-scale sectors. In addition, there are major sectors, e.g., sports goods and surgical instruments, which cater mainly for the export market and often operate in the small-scale sector.

The best example of their vibrant growth is the so-called “Golden Triangle” in central Punjab, linking Sialkot, Gujranwala, and Gujrat as the hub of light engineering fans and some specialised exports. The triangle extends southwards and is estimated to cover around 75 percent of the country's engineering sector (with the rest located in and around Karachi).

Unfortunately, earlier studies that analysed in detail the sector's growth and structural change (e.g., ILO-ARTEP, 1983; Nadvi, 1990) have not been replicated for the recent period. Most of these focused on individual industries (e.g., fans, garments, automotive goods), but a number of their conclusions remain valid today. These include:

- (i) The very low cost of job creation and economically efficient use of capital and labour resources.
- (ii) Large divergence in economic efficiency, productivity, and technology use by firms in this sector, which represent a continuum from the

lowest to the highest in terms of productivity. Hence, average estimates may be misleading.

- (iii) The low level of skills and skill shortages, which all studies identify as major constraints to growth.
- (iv) Lack of credit availability and poor marketing responsible for the slow growth of most firms.
- (v) Rampant consumption and high-handedness of officials, especially tax authorities and labour inspectors.
- (vi) In recent years, the lack of energy is identified as a binding constraint to output and new investment.

The question that needs to be addressed is why many of the firms in this sector continue to remain informal and unregistered. Some surveys have come up with the following reasons:

- (i) Firms avoid labour laws, including the minimum wage.
- (ii) Firms avoid harassment by government/local body officials.
- (iii) Firms avoid paying taxes and, in some cases, electricity, gas, and other charges.

It is difficult to give weight to these reasons but what is clear is that a large part of the small-scale sector remains unregistered and undocumented.

### ***Manufacturing: Strengths and weaknesses***

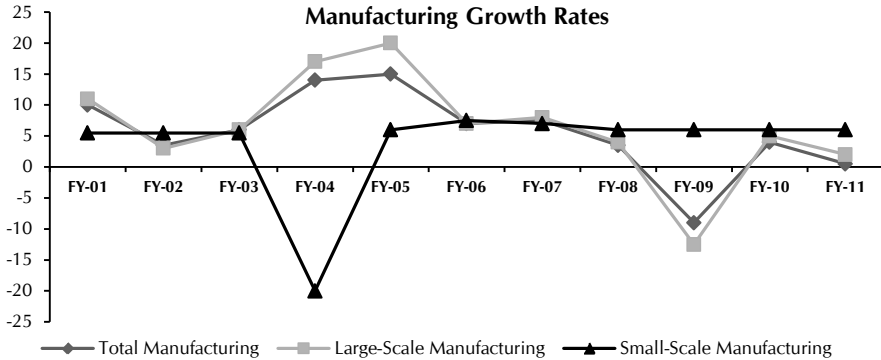
Figures 5 and 6 show growth and investment in manufacturing overall as well as separately for the large-scale and small-scale sectors. Since growth and investment in small-scale manufacturing is worked out indirectly based on inter-censal estimates and constant capital-output ratios, the figures do not reflect year-to-year fluctuations or overall trends accurately.

Even though the size of the sector may have been considerably underestimated, large-scale manufacturing clearly shows growth in output and investment in the boom years FY2000–FY2007, with a collapse in the subsequent period. Trends in private investment in large-scale manufacturing follow the same movements as the total and account for most of the investment in this sector.

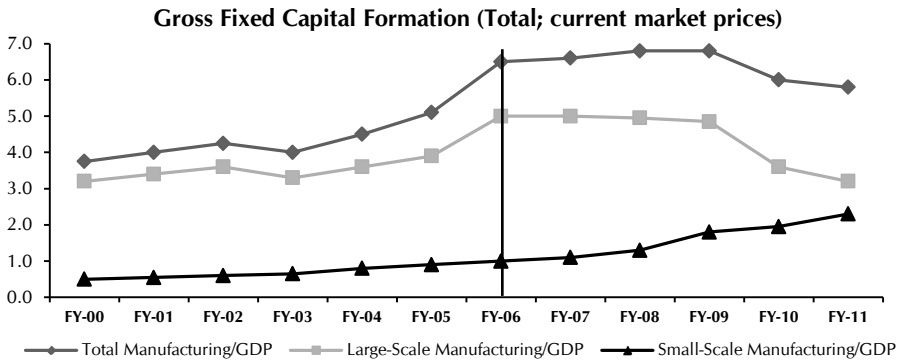
These movements reinforce our earlier argument that the manufacturing sector did not run out of steam, even during 2000–10, as the earlier World

Bank study seemed to suggest. It is also important to keep in mind that the slowdown in manufacturing was not across industries. Those that were mainly export-oriented, especially textiles, were badly hit by the financial crisis and global recession that followed post-2008, but other subsectors, especially food products and consumer durables (e.g., motor cycles), showed high growth and high profitability (Figures 4 and 5).

**Figure 5**



**Figure 6**



*Source:* Authors’ calculations based on data from Pakistan Economic Survey (various issues).

The real weakness of the manufacturing sector lies in its failure to move to higher value-added products (Table 12) and diversify exports into more technologically advanced sectors (Table 13). This has meant that it has not been able to take advantage of the growing sectors in world trade and, hence, not benefited as it certainly could have during the period of rapid growth in global trade.

**Table 12: Average product shares in manufacturing, 1970–99  
(percent)**

Product	1970–79	1980–89	1990–99
Food and beverages	30.45	30.94	22.89
Textiles	27.78	18.14	25.06
Industrial chemicals	11.20	14.29	15.50
Metals and nonmetals	9.10	14.20	13.20
Petroleum and coal	5.27	6.01	3.26
Electrical machinery	3.31	3.26	5.43
Transport equipment	2.99	2.89	3.05
Apparel, leather, and textiles	2.04	2.37	2.80
Nonelectrical machinery	1.84	2.14	2.09
Rubber and plastic	1.80	1.80	1.42

Source: World Bank (2013).

**Table 13: Technological level of exports, Pakistan and the world,  
1998–2008 (percent)**

Sector	Growth	Share	Share	Growth	Share
	1998–2008	1998–2000	2006–08	1998–2008	2008
Primary	0.1	12.3	12.7	11.2	11.4
Resource-based	23.9	3.5	10.9	10.5	14.8
Low-technology	8.2	74.7	66.7	9.2	16.2
Medium-technology	8.7	8.6	8.1	10.1	35.5
High-technology	17.5	0.8	1.4	9.3	22.1
Total	9.6			10.1	

Source: World Bank (2013).

## Part V

### Major Conclusions and Policy Recommendations

The major conclusions and policy recommendations that emerge from this study are put together under the following headings.

#### *Reigniting economic growth under an IMF programme*

More, and especially better, jobs can only be generated in a growing economy. Sustained economic growth has, however, remained elusive due to recurring foreign exchange crises resulting from unsustainable fiscal and

balance-of-trade deficits. Pakistan has had to resort to IMF support to avoid default and has been under 11 different IMF programmes for more than 12 years. The present Sharif government entered into an Extended Fund Facility programme soon after coming into power in September 2013. Before that, the PPP government had entered into a Standby Agreement with the IMF in October 2008, which it then abandoned in June 2011.

Two key questions are, first, whether economic growth can be ignited under a strong stabilisation programme that the IMF conditionalities as well as current macroeconomic imbalances dictate; and second, if the economic reforms under this programme will succeed in leading to higher and sustainable growth.

At least on the performance of the economy in the last 25 years, the answer to both questions appears on balance to be negative. Except for a short-lived spurt during FY2003–FY2007, economic growth has failed to pick up. Even this spurt can be traced largely to increases in foreign aid inflows post-9/11, manifold increases in remittances, and the global trade boom rather than to the reforms undertaken in the preceding three years as part of an IMF programme, as some economists have argued (Husain, 2003). In fact, the series of reforms undertaken in the last two decades as part of different agreements entered into with the IMF have not resulted in generating sustainable growth. Nor have they resulted in bringing about the needed structural changes, which, among others, would have made the economy less vulnerable to external shocks. Pakistan's economy faltered in the face of the rising global price of oil and foodgrains in 2007 even before the financial crisis unfolded in 2008. India and other South Asian economies were able to better deflect the global financial crisis, even if the Indian economy has slowed down more recently (see Amjad & Din, 2010).

The international financial institutions' (IFIs) (see World Bank, 2013) view is that reforms were not fully implemented and, when undertaken, were wrongly sequenced. This criticism is partly justified: except for the one instance in the early years of the Musharraf government, Pakistan has never fully gone through the cycle and completed any of the other ten IMF programmes. However, many economic reforms were initiated as part of these programmes.

Our view takes a somewhat different approach. We do not argue against economic reforms that will make the economy more efficient—by relying more on market-driven forces—and more globally competitive. Indeed, we support many of the suggested reforms. However, we argue that economic reforms per se are not sufficient to ignite growth in the economy. The



binding constraint to Pakistan's growth is the collapse in investment and policymakers need to concentrate on reviving investment that could then be the basis for reigniting growth and leading to sustainable and higher economic growth.

This would require:

- (i) Giving the highest priority to attaining peace on the country's western borders and, through this, improving the security and law and order situation, which has been adversely affected in turn
- (ii) Restoring domestic and foreign investors' confidence as a result of the above; fully opening up trade and investment flows with India by granting it MFN status while putting in place safeguards to allay fears that it will not use non-tariff barriers against Pakistan's major competitive exports
- (iii) Maintaining a high level of public sector investment, primarily the Public Sector Development Programme (PSDP), rather than reducing it drastically as stipulated in the IMF programme (given the high PSDP multiplier impact on the economy<sup>8</sup>) through cuts in nondevelopment expenditure, including subsidies on fuel and support for highly loss making state-owned enterprises
- (iv) Reducing interest rates from the current double-digit level (10 percent) rather than increasing them as recently done in November 2013 under the current IMF programme; it is worth keeping in mind that monetary policy has proved ineffective in containing inflation in the face of unsustainable and extremely high fiscal deficits being financed by State Bank borrowing (i.e., printing money)
- (v) Overcoming the energy gap by adjusting prices and reducing theft and other leakages
- (vi) Providing better economic management and reducing corruption, which has become rampant in recent years.

### ***Resurrecting the manufacturing sector***

The emphasis in this paper is on the manufacturing sector and we have clearly shown that it has the potential to serve as a major driver of economic growth and create more and better jobs. However, this will require concerted action in a number of areas as outlines below.

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<sup>8</sup> The fiscal multiplier of a cut in the national PSDP equivalent to 1 percent of GDP leads to a 2 percent decline in GDP in the same year (Pakistan, Planning Commission, 2011).

*Tapping the growing forces of demand for manufacturers*

The domestic market is growing, driven by rapid urbanisation, remittances, an emerging middle class—estimated in 2010 at around 25–30 percent of the population (Nayab, 2011)—and growing rural incomes. Pakistan’s GSP-plus status granted recently by the EU (effective from January 2014) and new export market opportunities, especially in garments as China moves into higher-value added goods, will further boost demand in the manufacturing sector. There is also considerable potential in exploiting economies of agglomeration and connectivity through the spread and better use of information and communication technology, which has been relatively neglected in the past.

*Overcoming the skills constraint*

Investing in education and skills remain the two most neglected areas of Pakistan’s economic development. The only improvements are in higher education: enrolment has increased almost fivefold in the last ten years, especially female enrolment, which is now almost half of the total 1.4 million enrolled. Additionally, the Punjab government has taken a number of recent initiatives for skills development, though their overall coverage of the total labour force is still limited.

Our analysis of the market for skills and the factors leading to skill mismatch in the labour market leads us to conclude that the problem emanates not just from the supply side as is normally diagnosed. The demand for skills is considerably constrained by both the low returns on investment in skills and the current widespread labour hiring arrangements (covering almost 70 percent of organised manufacturing), which encourage the use of contract workers, especially in the organised large-scale manufacturing sector. Employers are reluctant to pay for higher skills or to invest in skills development, given that a large part of their labour force consists of contract workers hired through contractors.

*Tariff reforms*

Will increased foreign competition in the domestic market and the search for new higher value-added products in the export market help increase investment in skills by employers and encourage them to move away from contract labour to hiring permanent employees? Theoretically, this should happen. Unfortunately, despite considerable tariff reforms, progress remains slow and disappointing. The structure of Pakistan’s manufacturing sector is still heavily biased towards lower value-added, mainly consumer goods and exports in low-technology products.

It is true that the far-reaching tariff reforms introduced post-1997 have, to some extent, been reversed post-2008 in the face of an unsustainable balance-of-payments situation. Under the current IMF programme, some of these measures are to be rolled back and the government has committed to reducing and rationalising the revised tariffs as well as removing SROs that act as a major restriction on imports and favour specific importers-cum-producers.

The results are yet to be seen, but the fact remains that there is little agreement among policymakers on the adoption of a suitable tariff and exchange rate regime that would foster a “desirable” structure of industrial growth. A powerful lobby believes that such a desirable structure means giving preference to the growth of industries that produce high value-added engineering and related machinery through high tariff barriers and cloaked quantitative restrictions (under SROs). This is in sharp contrast to what we can broadly term “free trade” advocates (which includes the IFIs) who believe that “uniform and low tariffs” will result in an efficient and competitive industrial structure.

Given the strong vested interests that have built up, an easy solution to this conundrum may not be possible, at least not in the foreseeable future. In these circumstances, we recommend a second-best solution on the lines suggested by Pursell, Khan, and Gulzar (2011) in their study on tariff policy for the Planning Commission.

These measures include:

- Where SROs are becoming permanent, they should replace the statutory tariffs.
- Tariffs in the 0 to 10 percent range should be unified; where customs duties concessions are given, they should be available to everyone, including traders and importers.
- Tariffs in the 10 to 20 percent range should be reduced so that most raw materials are available in the 10 percent range.

In addition, the following guidelines should be agreed on:

- When targeting the growth of higher value-added sectors (e.g., engineering, including automotives) and affording them protection, this should be done through tariff adjustments and not SROs. This protection should be time-bound and the set target dates strictly enforced.
- Government organisations or bodies set up to foster the growth of specific industries, e.g., the EDB, should be gradually wound up. The chambers

and associations of producers in these sectors are now very well developed and can directly deal with the Ministries of Industries and Commerce. This will help reduce corruption and micromanagement, which results from the current arrangements.

- Eventually, government policies should concentrate on the development of human capital rather than on targeting specific industries. This should take the form of giving much higher priority to education and skills development in terms of investment and supporting services.
- It is extremely important to include workers' representatives in skills development bodies at the federal and provincial level as well as at the local or district level. Most of the current bodies (e.g., NAVTEC at the federal level or TESDA in the Punjab) have no formal representation of workers.

#### *Raising productivity in small-scale manufacturing*

There are currently around 4.5 million workers in small-scale and household manufacturing, that is, around 75 percent of the labour force in manufacturing produces less than 20 percent of the sector's value-added. For many of the enterprises operating in the small-scale and informal economy, this is reflected in the very low productivity per worker. In many cases, it is well below the minimum wage and indeed many of the workers employed live below the poverty line.

In no other sector of the economy will investment in building an educated and skilled workforce have a higher return. The resulting growth in output and productivity—the latter boosted through concerted efforts and incentives to upgrade skills—will create jobs and as productivity increases better jobs in this sector. This sector can then serve as a major driver of economic growth and manufactured exports by producing and exporting new products to new global markets.

But how is this to be achieved? The major thrust must be on increasing primary and secondary enrolment and improving the quality of the education imparted. The second area is skills development as proposed earlier but with a specific focus on small-scale and unorganised enterprises. The focus of government support for this sector—including that of government-supported organisations such as the Small and Medium Enterprises Development Authority (SMEDA) and other provincial bodies—needs to change. There is far too much emphasis on targeting particular industries, including for exports, where the focus is also mainly on large enterprises.

There is clearly a justification for such interventions, and these have helped encourage growth and productivity in particular industries and specialised products. The focus needs to shift to creating a better and more conducive environment for this sector and removing obstacles to the growth of all enterprises, i.e., relatively large as well as small and microenterprises in this sector.

Specifically, this means reducing the anti-small-scale bias in tariff policy (which results in the high cost of raw materials); providing infrastructure facilities, including space, for firms to operate; providing transportation and connectivity services; and, most important, providing access to finance, which, for most small firms, is a binding constraint to their expansion. From just a micro-interventionist vision, policies in favour of this sector should analyse the macro-environment in which they operate and then suggest, support, and help implement specific policy changes and interventions that would support the growth of the small-scale sector.

### *Creating more and better jobs*

The creation of more jobs in manufacturing needs a two-pronged strategy (“walking on two legs”): encouraging the growth of labour-intensive manufacturing as well as moving up the value-added ladder. We have spelled out a number of measures for achieving this, including specifically for two subsectors—garments and automotives.

The aim, however, is not just to create any jobs but more productive, remunerative, and decent employment that results in an adequate income to cover basic needs, a degree of social protection, a voice at work through democratically elected representatives, and respect for workers’ fundamental rights. Even though this may not be immediately possible for the vast majority of the workforce, the real challenge lies in determining how to move in this direction.

First and foremost is the revival of economic growth, including in the manufacturing sector, which, as our study shows, still has considerable potential for higher growth and job creation. With the labour force growing at 3–3.5 percent, the economy must grow at around 8 percent to productively absorb new entrants into the labour force, and even higher to increase the incomes and living conditions of the unemployed and of those living just above or below the poverty line.

Second, a concerted effort must be made to reduce the high growth rate of population. At around 2.1 percent, it remains among the highest in the

region and could turn out to be even higher once the Population Census is held, which has not been done since 1998.

Third, as distinct from other studies (e.g., World Bank, 2013), which hold that higher economic growth will result in jobs, we have argued that, while economic growth is a necessary condition, it is by no means a sufficient one. For productivity growth to translate into higher wages and incomes and improved living conditions, it is necessary to build strong and well functioning labour market institutions, and for elected governments to overtly protect workers' rights and make good on their commitment to social justice by providing basic education, health, and adequate and affordable social protection to workers. In this context, some of the specific measures that this paper supports include:

- (i) Strengthening workers' organisations that allow workers to effectively bargain with their employers through democratically elected representatives to ensure fair and liveable wages and better and safer working conditions
- (ii) Reintroducing labour inspection to ensure safe conditions of work while putting in place measures that prevent factory inspectors from unduly harassing employers
- (iii) Fixing minimum wages through a tripartite dialogue and agreement, and strictly enforcing minimum wages in the organised sector—this could gradually be extended to the small-scale and, eventually, the informal economy
- (iv) Extending social protection to all workers in large-scale manufacturing, finding ways to cover contract workers, and extending this gradually to firms in the small-scale sector
- (v) Inducing informal sector firms to register and enter the formal/documentated economy.

This paper also shows that, if Pakistan is to be an effective player in the global market for manufactured goods, it should carry the credentials that its goods are produced in an environment that respects human rights and protects basic workers' rights. On a positive note, there are already signs that employers are becoming much more conscious and actively working towards creating such an environment. A case in point is the setting up of the garments city near Lahore to attract buyers and investors who are moving away from destinations where cheaper goods are produced at very low wages and in very poor and hazardous working conditions. This move by employers also reflects

the importance they are giving to taking full advantage of the GSP-plus status granted by the EU to Pakistani imports; they are fully aware of the conditions related to respect for human rights and workers' basic rights that need to be met to ensure this status is regularly extended.

This may well be, therefore, an opportune time in Pakistan to raise the pillar of "more and better jobs" as an integral part of national economic policy.

## Appendix A

Some other consolidated results of the World Bank growth decomposition exercise are given below.

**Table A1: Contribution of employment changes to overall change in employment rate, 2000/01 to 2010/11**

	Contribution to change in total employment rate (percent points)			Percent contribution of sector to total employment rate growth		
	Period 1	Period 2	Period 3	Period 1	Period 2	Period 3
	Agriculture	-0.4	2.1	0.3	-11.8	69.8
Industry	1.9	0.8	2.0	52.7	28.3	53.4
Services	2.1	0.1	1.4	59.1	1.9	38.0
Total employment rate	3.5	2.9	3.7	100.0	100.0	100.0

**Table A2: Contribution of employment changes to overall change in per capita GDP (value-added), 2000/01 to 2010/11**

	Contribution to change in per capita GDP (value-added)			Percent of total change in per capita GDP (value-added)		
	Period 1	Period 2	Period 3	Period 1	Period 2	Period 3
	Agriculture	-293.3	1,573.9	229.5	-4.5	66.7
Industry	1,310.5	638.6	1,407.9	20.1	27.1	19.6
Services	1,470.3	42.3	1,001.5	22.5	1.8	13.9
Total contribution	2,487.5	2,254.8	2,638.9	38.1	95.6	36.7

**Table A3: Changes in output per worker by sectors, 2000/01 to 2010/11**

	Percent change in output per worker by sectors			Contribution to change in total output per worker		
	Period 1	Period 2	Period 3	Period 1	Period 2	Period 3
	Agriculture	5.9	-9.4	2.3	10.6	-1,054.1
Industry	6.1	-3.8	2.2	11.8	-488.4	4.9
Services	10.7	10.6	14.9	42.6	2,601.4	65.7
Inter-sectoral shift				35.0	-958.9	24.8
Total	13.2	0.2	11.7	100.0	100.0	100.0



**Table A4: Contribution of within-sector changes in output per worker and inter-sectoral shifts to change in GDP (value-added) per capita, 2000/01 to 2010/11**

	Contribution to change in GDP (value-added) per capita			Percent of total change in GDP (value-added) per capita		
	Period 1	Period 2	Period 3	Period 1	Period 2	Period 3
Agriculture	383.1	-688.5	150.1	5.9	-29.2	2.1
Industry	426.1	-318.9	159.7	6.5	-13.5	2.2
Services	1,540.9	1,699.0	2,138.8	23.6	72.0	29.8
Inter-sectoral shift	1,264.4	-626.3	806.4	19.4	-26.5	11.2
Total contribution to change in per capita GDP (value-added)	3,614.6	65.3	3,255.0	55.4	2.8	45.3

*Source for all tables:* World Bank JoGGs tool with data from Pakistan Economic Survey for 2006/07 and 2011/12 and World Bank growth calculations for Pakistan.

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