Economic Prospects of Pakistani Punjab: Historic Heritage, Institutions and the Regional Dimension of Growth

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During the last decades, the Pakistani economy has experienced dramatic ups and downs with the Punjab historically playing a key role in the country's development. In analyzing its longer-term growth prospects three aspects have to be emphasised: First, history matters. This draws the attention to factors such as the region's ancient role as hub between Central Asia and the Ganges valley, the influences of Islam and the colonial inheritance. Second, institutions matter as they set the frame for private economic activity. A third aspect is the regional dimension of growth. While the European experience has demonstrated the benefits of regional economic collaboration in particular in the early stages of development, in South Asian approaches Pakistan's neighbourly relations pose a challenge to multilateral cooperation. The Punjab's historic legacy offers several promising perspectives to overcome existing barriers and exploit the benefits of a shared cultural and institutional heritage.

I. Introduction

In autumn 2008, as this paper is written, news on the Pakistan economy worsen from month to month. There are industrial lay-offs and strikes, food riots, daily 12-hour nationwide power cuts, and a rapidly declining internal and external value of the Pakistan Rupee. With rising costs of imports of food, fertiliser and fuel for the fiscal year 2008 which ended June 30th the country's current-account deficit was reaching a record high of an estimated 7.8 per cent of GDP. Growth is slowing, inflation accelerating to over 30 per cent and, at the same time, the government deficit is constantly widening. Unemployment is about 20 per cent. Farmers can no longer afford to buy fertilizer, wheat production is in decline and Pakistan, the world's sixth-largest grain exporter is facing the need to import grain to feed the people. Threatened by economic and political instability with a rising danger of terrorist attacks Pakistani are fleeing the country in increasing numbers with refugees allegedly paying up to 5,000 euros to get out – to Europe or elsewhere (The Economist 2008, Hamburger Abendblatt 2008). Capital, too, is fleeing the country. Dwindling foreign exchange reserves force Pakistan's authorities into IMF negotiations about a several-billion dollar loan in order to avoid default on its foreign debt.

Economic decline came rapidly and largely unforeseen. In January 2008, an IMF report still conceded a positive transformation after a decade of corruption and mismanagement (International Monetary Fund 2008). In the fiscal year 2006-07, Pakistan had attracted over five billion dollars of foreign direct investment, ten times the figure of 2000-01. Government debt had fallen from 68 per cent of GDP in 2003-04 to under 55 per cent, and foreign exchange reserves were rising.

The current bleak picture of the Pakistan economy hides an underlying strength. It is also in stark contrast to the optimistic assessment observers made in the nation's early beginnings. In 1950, summarizing the first two years of Pakistan's existence one observer stressed the country's balanced budget, a favourable balance of trade, a stable government, an independent foreign policy, and a standard of living at least as high as that of her neighbours, adding:

Two years is an early stage at which to assess the prospects of a nation, but from the rough sketch which has been given it seems that Pakistan's economy is soundly based on an agricultural surplus and on cash crops which have at present a ready market. Her budgets have been balanced and her balance of trade favourable. Though her industries are scanty, her potential resources of power are considerable, and she welcomes foreign investment. (Symonds 1950: 15, 193)

There are many debates of what has gone wrong. Seeing no benefit in repeating old and worn out arguments this paper intends to draw the attention to longer-term prospects and developments and to fundamental needs and potentials with a focus on the Punjab – Pakistan's most prosperous and most populous region which holds the key to the country's long-term recovery and sustainable economic development.

II. The Punjab economy – some facts and figures[1]

In the opening chapter of his book *The Elusive Quest for Growth* William Easterly gives an account of a visit to rural Punjab where people lead a life in extreme poverty - in malnutrition and poor sanitary conditions, without roads, schools, electricity, running water and telephone. Easterly comes back to the Punjab example several times in his book, not only to its dark sides, but also to the vitality, for instance, of its capital, Lahore. He vividly describes the traffic, the people buying and selling, at "every street, every lane crammed with shops, each shop crammed with people" (Easterly 2001: 285) drawing a picture of a private economy with a lot of dynamism.

Table 1: Pakistan and Punjab – Annual Growth of Real GDP

Year	Punjab	Pakistan without Punjab	Pakistan
1991/92	9.2	5.6	7.6
1992/93	1.4	2.9	2.1
1993/94	4.2	4.5	4.4
1994/95	6.4	3.3	5.1
1995/96	6.3	7.0	6.6
1996/97	1.8	1.6	1.7
1997/98	4.3	2.5	3.5
1998/99	4.2	4.2	4.2
1999/00	5.0	2.5	3.9
2000/01	2.2	2.2	2.2
2001/02	4.3	2.2	3.4
2002/03	4.7	5.6	5.1
Average			

(1991-2002)	4.5	3.7	4.1

Source: Government of Punjab et als (2005), Table 1.1.

The question immediately coming to mind reading this is: How can this dynamism of the Punjabi people be transformed into higher economic growth and improved living standards? A brief glance at facts and figures gives a first impression of where the chances and challenges lie.

The name Punjab is of Persian origin, literally meaning “five waters”. This refers to the five rivers crossing the province. The climate is dry, but a system of extensive irrigation – a heritage from the British - is making it the country’s richest and most fertile region. Table 1 demonstrates the role the region is playing for Pakistan’s economy. On average, rates of real GDP have been markedly higher in Punjab than in the rest of Pakistan.

The data also show large variations in real growth which in part is explained by fluctuations in agricultural sector development. As a rule, ***agriculture*** is more vulnerable to external shocks than other parts of the economy and this holds in particular in a region frequently exposed to weather calamities, pest attacks and natural desasters.

Table 2: Pakistan - Selected Sector Growth Rates and Shares 2007

Sector	Growth rate	Percentage share of GDP
Commoditiy producing sector	*6.0*	*46.7*
Agriculture	5.0	20.9
Industry	6.8	25.8
Manufacturing	8.4	19.1
Construction	17.2	2.3
Services	*8.0*	*53.3*
Wholesale & retail trade	7.1	19.1
Transport, storage and communication	5.8	10.3
Finance & insurance	18.2	5.6

Community, social & personal services	8.5	9.6
GDP	*7.0*	*100*

Source: State Bank of Pakistan (2008)

Traditionally, agriculture makes the Punjab the "***breadbasket of Pakistan***". This explains in parts why the province is so important for the Pakistan economy. As indicated in Table 2, in Pakistan, with more than 20 per cent of GDP agriculture is the single largest sector of the economy and, as the Government of Pakistan stresses in its latest economic report, an overwhelming majority of the population depends directly or indirectly on income streams generated in this sector. Agriculture is a major source of foreign exchange earnings and provides employment to 44 per cent of the country's labour force (Government of Pakistan 2008: 4). The sector has always been an important growth factor for the country: Since the mid-1980s it has grown at around four to five per cent per annum which was higher than the average for Pakistan, South Asia and low-income countries in general (Government of Punjab et als 2005: 43). Four crops – wheat, cotton, sugarcane and rice – account for approximately 80 per cent of the cultivated area (State Bank of Pakistan 2008). Before the recent crisis, self-sufficiency had been reached in wheat and sugar with the attention gradually shifting more to high-value and value-added products such as fruits and vegetables for export.

Agriculture has long benefitted from the Green Revolution strategy of adopting inputs of high yielding fertilizers and pesticides, combined with an expansion of irrigated water supplies. But, for several reasons past development will not be sustainable in the future. In recent years, the share of agriculture has already fallen persistently, from 24.1 per cent of GDP in 2001-02 to 20.9 percent in 2007-08 (Government of Pakistan 2008). Prospects to increase land area and water supplies are limited, returns are rapidly diminishing, productivity is low in terms of the efficient use of resources and inputs compared to countries and regions with rapid technological transformation such as India, China and Brazil, and the use of pesticides and other inputs has turned out to have serious environment and health implications. Thus, higher growth rates will be hard to achieve and the sector is more and more outperformed by others.

The data in Table 2 show that in 2007 both the commodity producing and the services sectors were faring much better than agriculture with construction and finance and insurance taking the lead with rates of annual growth of 17.2 and 18.2 per cent respectively.

In Pakistan, ***construction*** is generally considered a sector with a high, but still widely untapped growth potential. This holds in particular for the Punjab. At the beginning of this century, about 56 per cent of the entire urban population of Pakistan was living in the Punjab (Zaidi 2005: 401). In the recent past, the region had seen several massive waves of refugees. The first came with the two-way mass migration accompanying partition in 1947. The overwhelming majority of migrants from India (73 per cent) came to the Pakistan Punjab. The province accomodated 5.3 million refugees – accounting for 25.6 per cent of its population – who were dispersed in cities, towns and villages (Waseem 2000: 211). Other successive waves occurred after the Soviet invasion of Afghanistan in 1979. In 1999, there were more than 1.2 million registered Afghan refugees in Pakistan.

Beside, there were other social changes affecting the construction sector, in particular the growth of middle classes with the rise of the economy’s industrial and service sectors (Talbot 2005: 46 ff.). At present, beside growth in urban families, population increase in cities results from two factors, (1) from previous rural areas adjacent to urban centers being transformed to urban areas in course of development and the overspill of urban activities, and (2) from rural to urban migration. The latter has dramatically increased over time as data for overall Pakistan indicate. From 1951 to the time of a Census in 1981, the number of urban dwellers rose from 17.8 per cent of the population to 28.3 per cent (Talbot 2005: 43). Growth is not limited to the largest cities. On the contrary: Intermediate cities have been the most dynamic. For instance, according to a 1941 Census the then small Punjabi towns of Sargodhad and Gujranwala had populations of 36,000 and 85,000 respectively. By 1978, these numbers had already risen to 252,000 and 486,000 (Talbot 2005: 44).

These days, cities such as Gujranwala, Multan and Rawalpindi have joined Lahore and Faisalabad in the group with more than one million inhabitants making observers think about the prospects for promoting the development of cities as growth engines (Government of Punjab et als 2005). With respect to the construction sector, demand is by far exceeding supply. Like the rest of Pakistan, the Punjab faces a huge shortage of housing units, but the number of new housing units there has even been lower than elsewhere. The result is a crowding of houses, while in other provinces the number of persons per housing units is in decline (*Government of Punjab et* als 2005: 35).

Growth of the construction sector is particularly important for the Pakistani economy because of its linkages to other industries and because of its employment creating capacities. With rising construction activities the demand for cement, iron, electric fittings, timber and wood, color and chemical, marble, sanitary tiles and many more products rises as well as the demand for employment in the whole range from unskilled workers to architects (*State Bank of Pakistan* 2008: 24).

However, there are many obstacles to growth in the construction sector, too. The 2005 Punjab Economic Report jointly presented by the Government of the Punjab, the World Bank, the Asian Development Bank and the DFID (*Government of Punjab et* als 2005) names legislatory and regulatory barriers such as building and zoning laws, unclear land titles, stamp duties and other levies. On the other hand, Zaidi (2005) cites a study by Arif Hasan from 1992 examining the failure of government housing policies with special reference to the example of Karachi which bears lessons for development elsewhere in Pakistan. That study stresses factors such as investments in land by an affluent middle class for speculative purposes, development on too small a scale or taking too many years to materialize, political pressures and a developers' lobby setting the wrong priorities, a "cultural gap" between the government and the poor resulting in an emphasis of the needs of the middle and upper classes, and high development costs.

Largely as the result of government failure an informal sector has emerged in construction which "does everything that the formal and government sectors do not" (Zaidi 2005: 403). The informal sector provides land for those with an urgent and desperate need who cannot wait for a development process to be completed. Prices in the informal sector are more affordable, there is no red tape, arrangements for water supply and electricity are made by the providers. Locations are often selected close to the workplaces of the urban poor or with adequate access through roads and transports.

The ***informal sector*** is not limited to construction, but stretches into all parts of the Pakistani economy. To cite the above mentioned Report once again:

"There exists a marked dichotomy between economic participants in Pakistan's private sector. On one end of the spectrum, formal large enterprises enjoy a high degree of protection, get virtually all the institutional private credit, use relatively modern technologies and management, make most of the country's private investment, deliver most of its private exports, and pay higher salaries. On the other end, there exist the small, micro, and medium industries ... that in many cases are informal units, are financially constrained, turn out much of the country's private output, and account for most of its private jobs. Yet the country's policies – for import protection, for taxation, for technology transfer, for access to finance, for infrastructure ... – are all devised with the larger enterprises in mind." (Government of Punjab et als 2005: 25)

The latter is the more disturbing as in Pakistani politics the Punjab is said to often hold the key to power with the support (or loss of) small traders, merchants and shopkeepers being crucial (Talbot 2005: 244).

The informal sector which according to cautious estimates accounts for 30 to 40 per cent of the Pakistani economy (*Dawn* 2008a) deserves a closer look. Definitions differ. Some authors use the informal sector and the small-scale sector as synonyms although they are not the same. The above-mentioned Report regards firms with less than 10 employees as part of the informal sector. In Punjab, this would include over 80 per cent of employees in the private sector.

Economic activities in the informal sector are largely undocumented. This "black economy" poses big problems to policy making. One is public finance. The parallel informal economy could yield the national exchequer the equivalent of several billion dollars if taxed even at the minimum rate of 10 per cent. Another is the damage done by speculation. Every economic crisis offers hoarders and blackmarketeers the opportunity to earn billions in wheat and flour trading but no record is available to pin them down (*The Khaleej Times* Online 2008). Money laundering, smuggling, drug traffic and other illegal activities are favoured by the scale of this sector.

The views how to cope with the phenomenon are divided. While some observers call for punitive measures others are warning that sending wrong signals to the markets would be counterproductive. Instead they plea for offering incentives that would gradually merge the informal sector into the formal economy thereby paving the way to higher overall efficiency and the mobilisation of new resources.

Table 3: Punjab's Non-Farm Sectors 2001/02

Category	Percentage share of the total of non-farm sectors
Manufacturing	22.1
Housing and Construction	12.9
Wholesale and Retail Trade	21.8
Transport, Storage and Communication	12.8
Public Administration and Defense	8.4
Other	21.9

Source: Government of Punjab et als (2005).

Solving this problem could improve the country's growth prospects considerably. The literature on economic growth emphasises the vital role of small and medium-size enterprises (SMEs) in providing employment and output in particular in the early stages of structural transformation. However, in Pakistan, the overall impression is that the SME sector so far "has acted neither as a significant engine of growth, nor as an important conduit for structural change." (*Government of Punjab et* als 2005: 25)

This poses particular challenges to the Punjab authorities. The province is not only the breadbasket of Pakistan but also the country's ***most industrialized province***. Beside manufacturing important sectors are wholesale and retail trade, housing and construction and transport, storage and communication (Table 3). The major industrial locations are Lahore and Faisalabad. There is cotton ginning in Multan, metal engineering, electrical goods and textiles are made in Gujranwala and Sialkot is known for its sports goods industry. In addition, there are a large number of bazaar workshops, but the size of units is increasing (*Talbot* 205: 98).

Table 4: Comparative Real GDP-Growth 2007-08

Country	Growth rate
World	4.8
India	9.2
Bangladesh	5.6
Sri Lanka	6.3
Pakistan	5.8
China	11.4
Euro Area	2.6
United States	2.2
Japan	2.1
Korea	5.0

Source: Government of Pakistan 2008, Table 1.1.

Manufacturing had fared extraordinary well for several years. However, recently, its performance worsened due to heightened political tension, a deteriorating law and order situation, growing power shortages, monetary tightening and rising overall cost of doing business. In overall Pakistan, the current main contributors to economic growth are pharmaceuticals which grew with a rate of 30.7 per cent from July 2007 to March 2008, wood products (21.9 per cent), engineering products (19.5 per cent), food & beverages (11.1 per cent), petroleum products (6.03 per cent) and chemicals (3.1 per cent) (*Government of Pakistan* 2008: 38).

The strong performance of individual sectors cannot hide the fact that the Pakistan economy still has a long way to go. In international comparison, its real growth, although impressive when contrasted to the growth rates of the Euro Area or the United States, for example, is far behind that of China and India (Table 4). According to a report by the Commission on Growth and Development published in 2008, under given circumstances Pakistan would need 159 years to catch up with industrialised nations. By comparison: China would reach the same target in 23 years, India would need 50 years and among the Muslim nations Malaysia would perform best needing only 35 years (*Dawn* 2008b).

III. History, institutions and growth

Although often containing a grain of truth scenarios such as the one cited above should not be taken too seriously. One fundamental error in analyses like these is the assumption that circumstances never change and that comparisons across countries can be made without reference to the historic layers of social, political, cultural and economic evolution in which current developments and future prospects are rooted. Economists tend to regard the economy as sort of isolated mechanical system, a machine, which leaving undisturbed would settle in a standstill called long-run equilibrium or work growing along a steady path by a rate determined by the endowment with capital, natural resources and technology.[2] Undesirable deviations from this state or long-term path could be cured by pulling a lever here and pressing a button there, with the levers and buttons being the instruments of macroeconomic policy available to governments. Countries with same endowments and same policies applied would show the same economic performance, regardless of where they came from. Shocks such as bad harvests or other man-made or natural desasters would occur, but be absorbed by the system without leaving traces.

In history, numberless counterexamples can be found. Economic powers come and vanish, a lake falls dry, a river changes its course, an oil field is newly discovered, a seemingly minor invention is made in some distant part of the world – and generations later nothing in the economy is like it was before. At times it is the combination of seemingly unrelated events – a political crisis in one part of the world, an economic boom in another, a regionally limited financial crisis freeing international capital in search of new investments –that triggers a change.

The Pakistani economy in the 1980s is the best example of how external stimuli may affect growth. Noman (2001) lists three developments which occurred almost simultaneously and independent of each other. One is the wave of migration of Pakistani overseas labourers during the construction boom in the Middle East. At the height of this wave in the mid-1980s there were an estimated 2 million Pakistanis in the Gulf region remitting more than US$3 billion every year to their homeland which accounted for almost half of Pakistan's foreign-exchange earnings at that time.[3] In those years, around one in ten Pakistan's adult male workforce was employed overseas.[4] The second influence is the Afghan war and related aid inflows which stimulated demand, and the third is the boom in East Asia which created new markets through expanding regional incomes. None of these lasted very long, but they lasted long enough to make the Pakistani economy shift to a path of modestly higher growth.

Beside recent history, ancient roots matter. This, again, holds in particular for the country studied here. In contrast to the impression given in many analyses Pakistan's history does not begin with the partition of the subcontinent. Political scientists and economists tend to neglect 10,000 years of human development, of settlement, culture, wars and trade that left their mark and still have a profound impact on the Pakistani society as well as on future economic prospects.[5]

Pakistan is often called ***the cradle of civilisation***. About 10,000 years ago, the first nomads began to settle down in the Indus Valley. The settlement of Harappa in the Punjab which existed from about 3300 BCE had an estimated 40,000 residents. It was one of the 400 sites of the Harappa Culture which extended well beyond the boundaries of present day Pakistan establishing industries and even carrying trade over long distances.

Other great civilisations followed. The Punjab was invaded by the Aryans from Central Asia establishing the Vedic civilisation. The region became part of the ancient empires of

Gandhara, of the Mauryas, Kushans, Guptas and Shahi and was conquered by a succession of Persians, Greeks, Scythians, Turks, and Afghans. The Mughals did not only create magnificient works of art but were also excellent administrators with a sophisticated bureaucratic system. The region's legacy combines Hindu, Buddhist, Persian and Central Asian as well as Islamic, Sikh and British elements. It is this palimpsest of cultures and traditions which offers explanations for persisting conflicts but also for much of the economic dynamism.

A related aspect which is often neglected in economic analyses is the role of ***institutions***. One example of their importance is the development of agriculture in the Punjab in Pakistan and India after partition. To cite Thandi (2000):

"The two Punjabs have pretty much the same climate, both started off with similar agro-ecological and land tenure systems and both share a common culture, language, historical tradition and institutional arrangements. ... both regions have since the mid-1960s experienced rapid technological change associated with the so-called green revolution. Yet, in terms of agricultural and rural development, the Indian Punjab has shown superior performance ..." (Thandi 2000: 299).

Thandi finds three main reasons for this development: Differences in the agrarian structure and land ownership, national and regional state policies (relative autonomy of the regional states to tax and regulate agriculture in India) and the development and quality of human resources as reflected, for instance, in medical institutions and literacy rates. The author also briefly touches the relation between culture and economic development, an aspect found, for example, in Weber's idea of 'Protestant' ethic, speculating about the role of the Sikh value system.

There is a conceptual ambiguity surrounding the term 'institution'. In the literature on evolutionary economic growth, it is mainly used in two senses (*Edquist* 1997: 26). One can be called 'things that pattern behaviour'. This includes norms, rules and laws. The other is 'formal structures with an explicit purpose', a definition some authors would rather relate to organisations. In this paper, a pragmatic approach is chosen including all kinds of regimes and arrangements which, directly or indirectly, support or hamper, stimulate or discourage, regulate and organise social interactions and transactions related to the growth process. This definition includes the political system, the educational system, patent legislation, labour relations, but also social and cultural factors influencing development. Is cricket an institution in this sense? Perhaps not in Germany or Spain, but certainly in Pakistan, where it is a driving passion Pakistanis are proud of. Inherited from the British, it has acquired a unique Pakistani distinctiveness and the successes and failures of national cricketers considerably influence people's overall sentiment with a feedback on the economic spirit of enterprise prevailing in society.[6]

Recent economic research on the influence of institutions on economic development and growth bears valuable insights for the study of the long-term prospects of the Pakistan Punjab.[7] Here, the focus will be on three aspects: On legal systems, on the role of governments in the provision of public services and a business-friendly environment, and on financial systems.

Even in the most liberal economies, the influence of government is felt everywhere. Governments make laws and seek to enforce them. Key industries are often state enterprises or monopolies closely related to state agencies. Governments raise taxes and act as powerful investors and consumers. Some of them run huge fiscal deficits. Governments influence financial markets as both debtors and regulators, bail out big firms in financial difficulties, lure or hinder foreign investors to buy domestic enterprises, and in these and many other ways contribute to the determination of economic and financial conditions for private households and business firms alike.

Government influence is most manifest in the ***legal system***, setting the frame in which contracts are written and rights enforced thereby laying the foundations for all kinds of economic activity. These days most legal systems in the world are rooted in one of two groups of legal traditions. A distinction is made between common-law countries like the United Kingdom and code-law countries such as Germany and France. Many nations with a colonial history have inherited one system or the other. Pakistan is no exception. The country's common-law system developed from the one used in British India.[8]

In principle, laws in code-law countries set a minimum standard of behaviour expected with citizens obligated to comply with the letter of the law. This is in stark contrast to the "non-legalistic" orientation of common-law countries where the laws only establish the limits beyond which it is illegal to venture and within which latitude and judgment are permitted and encouraged. Code-law and common-law countries differ, among other things, in their approaches to investor protection and accounting. There is a wide variety of prevailing rules and practices, but, normally common-law countries are regarded as more capital-market friendly and more likely to protect investors' rights than code-law countries. At the same time, accounting practices in those countries are said to be more adaptive and innovative. Code-law countries focus less on investors' needs but are rather designed to satisfy government-imposed requirements in computing income taxes or to demonstrate compliance with overall macroeconomic principles.

In international economic relations there is a clear advantage in sharing a common legal tradition which facilitates trade and investment. However, Pakistan appears not able to fully exploit the advantages of common-law tradition. The problem is law implementation. The country's judicial system does not protect property rights effectively. Security for judges and witnesses is poor, facilities are understaffed and corruption among executive and legislative branch officials is widespread[9]. In addition, there is a huge backlog of civil and criminal cases at the level of subordinate judiciary: On 1st January 2007, in the Punjab the number of cases pending was 110,546, in the Lahore High Court it was 75,195 (Hussain, Faqir 2008).

Beside Supreme Court and provincial High Courts a third pillar of the judicial system is grounded in the Islamic legal code. Established in 1980, the Federal Shariat Court has the power to nullify any law it finds repugnant to Islam. The Court consists of eight Muslim judges appointed by the President from amongst serving or retired Judges of the Supreme Court or a provincial High Court. Three of them are required to be *Ulema* well versed in Islamic law. The Court acts on its own motion or through petition by a citizen or a (Federal or provincial) government. On 1st January 2007, a total of 3316 cases were pending there. [10]

Table 5: Governance Indicators 2004*

Country	Political stability	Government effectiveness	Regulatory quality	Rule of law	Control of corruption
Pakistan	6.3	32.7	15.8	26.1	20.2
Bangladesh	11.7	26.4	13.3	22.2	10.3
Sri Lanka	14.1	45.7	59.6	53.1	52.2
Malaysia	58.7	81.3	64.5	64.7	64.5
China	46.6	60.1	35.0	40.6	39.9
Turkey	30.6	57.2	48.8	54.6	50.7
India	24.3	55.8	26.6	50.7	47.3
in comparison:					
Singapore	96.6	99.5	99.0	95.7	99.5

* Percentile.
Source: World Bank 2006, Table 6.1.

The co-existence of Islamic and non-Islamic law poses a constant challenge to economic policy. For instance, Federal Shariat Court decisions risk detering foreign investors as was the case when in November 1991 twenty federal and provincial laws dealing with *riba* (usury) were declared to be repugnant to Islam and at the same time non-islamic foreign investment was sought in an ambitious $1.3 billion power generation project (*Talbot* 2005: 317 f.). On the other hand, Islamisation in this and other parts of society helps to attract foreign capital from Islamic countries, in particular from Middle Eastern oil-surplus countries.

Table 6: Literacy Rates in the Punjab and Pakistan 2001/02*

	Pakistan	Punjab		
	Overall	Overall	Rural	Urban
Male	58	57	51	71
Female	32	36	26	60
Overall	45	47	38	66

* Per cent of population 10 years and above.
Source: Government of Punjab et als (2005) : Table 4.1.

Poorly protected property rights, corruption and insufficient law enforcement severely hamper economic development. They are one explanation for Pakistan's low score in international governance comparisons (Table 5). Among the countries listed here for comparison, for instance, control of corruption is only lower in Bangladesh, and the rule of law, too, is regarded by far less worth in these two countries than elsewhere. Other criteria are political stability, regulatory quality and overall government effectiveness, and again, the picture for Pakistan is rather bleak.

Table 7: Housing Accessability to Municipal Services 1973, 1989

	Pakistan		Punjab	
	1973	1989	1973	1989
Electricity	18	59	16	58
urban	54	93	58	92
Inside piped water	8	18	7	16
urban	28	60	27	55
Gas piped	2	9	1	7
urban	7	41	6	34
Kitchen	20	38	20	34
urban	30	63	32	51
Latrine	29	35	19	25
urban	55	84	68	78

Source: Zaidi (2005), Table 17.18.

One of the biggest challenges of the Pakistani Government is the provision of ***public services***. In particular with respect to primary education, in international comparison Pakistan fares bad. In 2000, Pakistani on average had 3.88 years of schooling which was extremely low compared to India (5.06), China (6.35), Malaysia (6.80), Sri Lanka (6.87) or the Philippines

(8.21) – to name only a few Asian examples (World Bank 2006: Table 6.5). In the Punjab, the situation looks slightly better. The province has higher literacy and enrollment rates than the rest of Pakistan.[11] In addition, the differential between male and female literacy is lower than elsewhere, although it is still worringly high (Table 6).

Table 8: Infrastructure Indicators 2002 in International Comparison

	Per cent of losses in electricity generation and transmission*		Paved roads as per cent of total	Per cent of population with access to sanitation	Per cent of population with access to water	Telephone per 1000	Mobile phones per 1000
	1995	2002	1999	2002	2002	2002	2002
Pakistan	22.8	26.5	55.0	54.0	90.0	25.0	8.5
Bangladesh	16.6	20.6	9.5	48.0	75.0	5.1	8.1
Sri Lanka	18.0	18.1	95.0	91.0	78.0	46.6	49.2
Malaysia	9.0	5.6	75.3	-	95.0	190.4	376.8
China	7.4	7.1	22.4	44.0	77.0	166.9	160.9
Turkey	16.0	18.5	34.0	83.0	93.0	281.2	347.5
India	19.1	26.2	57.4	30.0	86.0	39.8	12.2
in comparison:							
Singapore	3.8	8.5	100.0	-	-	462.9	795.6

Source: World Bank (2006), Table 6.6.

Another challenge is ***municipal services***. Comparing again the Punjab with overall Pakistan, Table 7 gives an impression of how much the provision with electricity, water and gas has improved during the 1970s and 1980s and to which extent living conditions have changed or remained largely unaltered. The biggest progress is found in urban environments. But, remarkably, this time the Punjab is not faring better than the rest of the country.

The indicators listed in Table 8 give a more recent impression of the supply of services in overall Pakistan allowing for an international comparison of infrastructure. Provision of electricity still appears a much bigger problem than in other countries – and even seems to have become worse over the years – and Pakistan’s backwardness also shows in the numbers of telephones and mobiles, but for other criteria, the impression is rather mixed. The percentage of Pakistani with access to water is comparably high, in India, Bangladesh and China fewer citizens have access to sanitation than in Pakistan, and in 1999 half of Pakistan's roads were paved – more than in China or Turkey.

The picture is also modestly promising with respect to ***business conditions*** in international comparison (Table 9). Managers in Pakistan spend less time on government regulation than in India, China or the global average – although far more than in Sri Lanka, Bangladesh or Turkey – , starting a business requires much less time and costs less than in most other countries listed in the table, and the time needed to register property is shorter than on average. If improving the business environment is one way of meeting the described challenges – of promoting growth of small and medium-size enterprises, attracting both domestic and foreign investors and offering incentives that would gradually merge the informal sector into the formal economy – apparently Pakistan has some comparative advantages.

Table 9: Doing Business in International Comparison

Country	Managers' time spent on govt. regulation*	Starting a business: Number of days	Starting a business: Cost**	Registering property: Days needed
Pakistan	10.1	24	24.4	49
Bangladesh	4.2	35	81.4	36
Sri Lanka	3.8	50	10.4	63
Malaysia	-	30	20.9	143
China	19.6	48	13.6	32
Turkey	4.6	9	27.7	9
India	14.4	71	61.7	67
Global average	12.2	48	77.7	85.6

* In per cent ot total.

** As per cent of GNP per capita.

*** As of 2005, in per cent of loan contract.
Source: World Bank (2006), Tables 6.2-6.4.

Again, this positive impression cannot hide the fact that in business environments many obstacles still exist. In the Punjab as in the rest of Pakistan tax enforcement and tax levels, corruption, the cost of finance, and electricity are still named as main barriers to investment. One constraint where the Punjab scores substantially worse than the rest of the country is anticompetitive and informal practices (*Government of Punjab et* als 2005: 35).

Respective answers differ in the formal and informal sectors: Informal enterprises name access to finance, electricity, and the non-availability of skilled and educated workers as main constraints to investment. One explanation for these differences is the underlying nature of the two sectors:

"Since electricity, telecommunications, and transportation tend to be more formal than other sectors of the economy and have denser networks in the more developed regions of any locality, a firm's informality typically makes it more difficult to access these services, especially electricity. Corruption is a significantly less severe constraint for informal firms because informality helps them avoid taxes and other regulations that tend to be associated with more corruption." (Government of Punjab et als 2005: 29)

One of the biggest obstacles to growth in both the formal and informal sector is access to, and cost of, ***finance***. In general, without functioning credit and capital markets economic agents may not be able to finance production or consumption or take advantage of investment opportunities. In addition, nonexistence of derivatives markets unnecessarily exposes producers, savers and investors to market volatility and unforseen risks. The phenomenon of "missing" or inefficient markets is particularly damaging for poor countries where it adds to, and reinforces, other obstacles to development.[12]

Traditionally, the Pakistan economy is especially dependent on foreign resources for capital formation and therefore highly vulnerable to shocks in international markets. National savings are low and there are few incentives for savers. Pakistan's financial system was long characterised by few underdeveloped markets and inefficient structures (Schweickert 1998). Up to the early 1990s credit availability was controlled by nationalised commercial banks and public development finance institutions. There were government bonds, but no market for corporate debt. The stock market was lacking depth and was dominated by insider trading. Short-selling and derivatives were not allowed.

With economic liberalisation financial reform was initiated in 1991. Branches of nationalised banks were privatised, new private banks became allowed and the market shares of foreign banks increased (Table 10). But, inefficiency still prevails. Market concentration is high and there is still a strong overall presence of government influence. In particular for small firms – the pillars of economic development in an early stage – cost of finance remains a critical issue. This and high collateral requirements and cumbersome procedures make small businesses rely less on bank finance than larger firms. In the Punjab, loan approval can take from two to ten months often requiring the payment of bribes to proceed. Another problem is collateral: Financial institutions frequently ask for even higher collateral than required by the State Bank of Pakistan - amounting to up to 120 to 130 per cent of the loan value (*Government of Punjab et* als 2005: 26 f.).

Table 10: Market Shares in the Banking Sector*

	Nationalized commercial banks	Private commercial banks	Branches of foreign banks
Deposit market shares			
1992/93	58.3	25.1	16.6
1996/97	45.6	32.1	22.3
Credit market shares			
1992/93	49.4	36.8	13.8
1996/97	39.0	42.3	18.7
Foreign currency deposit shares			

1997	21.2	26.1	52.7

* In per cent.
Source: Schweickert (1998), Table 1.

Contrary to the credit market, Pakistan’s capital market has benefitted strongly from liberalisation. Since 1991, the government allowed foreign investment and lifted limits on shareholdings, taxes on capital gains, and restrictions on the repatriation of capital and profits.

There are three stock exchanges, in Karachi, Lahore and Islamabad. Founded in 1947, the Karachi Stock Exchange (KSE) is Pakistan's largest and oldest stock exchange, with Pakistani as well as overseas listings. As on December 31 2007, 654 companies had listed on the exchange, with market capitalisation totaling US$70.2 billion. [13]

The KSE was repeatedly voted by Business Week one of the world’s best performing bourses thereby fuelling international investors’ interest. In April 2008, the exchange achieved a major milestone when the KSE-100 Index for the first time crossed the psychological level of 15,000. Moreover, its increase of 7.4 per cent in the first months of the year made it the best performer among major emerging market indexes. However, the picture changed dramatically during the recent crisis. End of August 2008, the plunge in stock prices at the KSE had wiped out the equivalent of $36.9 billion of April’s market value. [14]

This was not the first time that crisis struck in Pakistan’s largest financial and commercial centre. One consequence is that, while international capital is fleeing the country domestic capital is wandering to Lahore and other places thereby further reducing the national competitiveness of the KSE and reinforcing an observed overall tendency of financial activities in Pakistan to move away from their traditional base in Karachi to Lahore and other urban areas in the Punjab (Talbot 2005: 343, *Government of Punjab et* als 2005).

The recent crisis demonstrates the need for further reform. Suddenly, the potential benefits of a well-structured, well-regulated, transparent and (almost) complete and diversified financial system become only too apparent as well as the dangers of relying too much on the necessarily temporary and highly volatile success of equities markets. In addition, in particular for a nation in an early stage of development which is as dependent on foreign resources for capital formation as Pakistan, and as vulnerable to shocks from outside, one urgent requirement is to think about measures to decouple national markets from international financial turmoil.[15] This is not necessarily a plea for returning to the old system of closedness and inconvertibility, but rather a request to redefine the "rules of the game" for some dominant players – if possible in close regional or international cooperation.[16]

Pakistan's financial landscape mirrors the complexity of the Pakistani economy. As one author puts it:

" At one end of the spectrum there is the corporate culture of Karachi, at the other the brutal feudal society of bonded labour ... in the interior of Sindh. In between there are prosperous Punjabi industrialists and capitalist farmers, small scale traders, artisans, labourers and peasants." (Talbot 2005: 51)

Two examples of the many facets of the country's financial system are Islamic finance and the large informal financial sector. Both belong to a number of key characteristics that in one way or the other influence Pakistan's development prospects and, at the same time, draw the attention to the country's regional linkages and the resulting growth impulses.

IV. Regional challenges

In the rest of the world Pakistan is widely perceived as a poor country with deep-seated governance problems, high security risks and an unhealthy involvement in the Afghan conflict and international terrorism, always on the brink to bankruptcy and unable to survive without massive international aid and the assistance of IMF and World Bank. This view does not only ignore the impressive economic progress the country made under most difficult circumstances, it also neglects the longer-term international comparative advantages rooted in its historic and institutional record. In this context three aspects deserve a closer look: (1) the region's role as a hub between Central Asia and the Ganges valley along ancient trade routes, (2) the long-term economic prospects of its relations with its direct neighbours India and Afghanistan and (3) its role in the growing importance of Islam in the world economy.

Routes

Trade routes have always inspired men's imagination. They are the subject of countless myths and since ancient times have become deeply anchored in the collective memory of people – of those making a living along and from the routes and of others far away who were told about them. Trade routes have become part of the grand narratives of the world community. As a consequence, these days, their economic importance reaches far beyond their initial function and they become increasingly attractive for tourism and the culture industry.

Some of the most ancient routes of the continent run through Pakistan Punjab. One is the **Grand Trunk Road**. Covering a distance of more than 2,500 kilometres from Kabul to Kolkata this route links Pakistan, India and Bangladesh. In Pakistan, the Grand Trunk Road is leading from Peshawar over Rawalpindi and Lahore to Wagah in India. Widely attributed to Sher Shah Suri in the 16th century, the Sarak-e-Azam, or Rajapatha (Royal Highway) as it was called initially, had been in continuous use for three millenia. Chandraguptra Maurya, who reigned from 322 to 298 BC, is known to have maintained "regiments of road engineers" (Halliday 2007: 192) for what was the connection between his capital Patliputra (Patna) with Kabul. Over the centuries, the road facilitated travel and communication but also the movement of troops: The Khyber Pass was the gateway to the Ganges valley for all invaders - except for the British who came by sea. The route stimulated growth and innovation. Cities were built and industries established alongside. The exchange of cultures was a constant source of inspiration for science and the arts. As early as in the 6th century BC, Taxila, today one of Asia's richest archaeological sites, rose to international fame as university town.

Taxila is strategically situated at the crossroads of the second ancient route running through the Punjab, the **Silk Road** linking China with the Western regions. The term is misleading: Rather a network of roads than a single route it served to transport not only silk and other luxury goods such as satins, musk, rubies, diamonds, pearls and rhubarb (for medical treatments) but also more worldly goods. Most maps show the Silk Road departing from Xi'an in China westwards through Lanzhou and Dunhuang where it split for the first time into a northern route running along the north of the Taklamakan desert to Kashgar and a southern route with the same destination. From Kashgar onwards, there were a variety of routes westwards and southwards. Travellers included traders and merchants, mercenaries and monks. Goods were transported by a series of agents on different parts of the roads. Their full length was travelled by few people, above all, missionaries, explorers, geographers and archaeologists (Whitfield 2000, Wood 2002).

The third ancient route crossing the region is the **Karakoram Highway**. Departing at Hasan Abdal 45 kilometres northwest of Rawalpindi it is linking Pakistan's Northern Areas to the Silk Road. The Karakoram Highway is the highest paved international road in the world, passing the Khunjerab Pass at an altitude of 4,877 metres. It covers a distance of about 1,300 kilometres. The highway cuts through a politically highly sensitive region where China, Tajikistan, Afghanistan, Pakistan and India come within 250 kilometres of one another. There are plans to rebuild and upgrade the Karakoram Highway with Chinese help in order to increase its transport capacities and to link it to the southern port of Gwadar in Balochistan.[17] Gwadar port is a deep-sea warm water port, located at the entrance of the Persian Gulf to the Arabian Sea, about 460 km west of Karachi, near the Iranian frontier. The port, which during construction triggered a lot of controversy and opposition from in- and outside the country, is an example of regional economic cooperation: Financed with heavy funding from China and managed by the Port of Singapore Authority it started operating in 2008. There are high ambitions to develop the Gwadar region to a business model such as Dubai or Singapore making it a regional hub for industry, tourism and trade.[18]

Along with trade along the great routes institutions developed in order to facilitate travel, communication and economic activity over long distances. One of the oldest is an informal payment transfer system known as ***hawala***. In South Asia, *hawala* has been a traditional method of moving money long before Western banking became established in the region.

In ancient China it was known as "fei qian" or "flying coins". The system spread throughout the world - to Europe, the Middle East, eastern and southern Africa, North and South America, and other Asian regions – following immigration patterns. Based on a man's word there is a strong market segmentation in that, for example, a *Pashtun* is trusting only a *Pashtun hawaladar*, a *Sikh* only a *Sikh* one, and so on.

Hawala is a reliable, convenient, safe and inexpensive means which enables workers to send money from abroad circumventing the high cost charged by formal banks. It connects remote areas with the international flows of goods and money, allows non-governmental organisations (NGOs) to operate and manage their operational expenses in regions without functioning formal financial system, but also helps evading taxes, laundering money and financing illegal activities.

Hawala allows the transfer of funds without actual physical move. For example, an expatriate working in Kuwait who wants to send money to his family in Pakistan turns to a moneylender or trader with contacts in both countries giving him the money. The trader calls a trusted partner in the home country who delivers the amount to the family, minus a commission. For identification and the details of the trade often a code is used. The two traders settle accounts either through reciprocal remittances, trade invoice manipulations, gold and precious gem smuggling, the conventional banking system, or by physical movement of currency. Usually, *hawaladars* operate independently of each other rather than as part of a larger organisation. In general, they are merchants or small business owners. There are no limits to the volume of transfers. For example, in Afghanistan financial flows have grown significantly since the fall of the Taliban regime and the advent of large numbers of NGOs[19], and “single transactions in excess of US$500,000, especially between Peshawar in Pakistan and Kabul, are not uncommon.” (*Maimbo* 2003: 4).

These days, the *hawala* business it truly globalised. Allegedly it is monopolised by migrants from India who mostly operate from countries in the Gulf and South East Asia. Many *hawaladars* offer a range of financial services. Many are instrumental in providing financial services for the delivery of emergency relief and humanitarian and developmental aid for

NGOs, donor organisations and development aid agencies (*Maimbo* 2003). Networks include trading points in the financial centres of Singapore and Hong Kong, and some of the biggest family-based money-dealers are based in London. Banks all over the world, in particular Islamic banks in Muslim states, and even central banks, are collaborating with the system: For instance, in May and June 2001 the State Bank of Pakistan, was said to have turned to *hawala* shops in Islamabad to buy dollars in order to support the own currency (*Reszat* 2001).

In countries with large informal economic sectors such as Pakistan where *hawala* is in wide use, there are considerations to encourage *hawaladars* to convert their businesses into formal entreprises. For Pakistan, a conversion would have many advantages:

Hawaladars enjoy long-lasting stable customer relations and high public confidence and act largely independent of formal credit and capital markets. This would shield them to a certain extent from the shock waves of financial crises making the formal system incorporating them more stable. Many of them already operate as miniature banks offering a wide range of financial services including money exchange transactions, funds transfers, micro-finance to small farmers and informal entrepreneurs, trade finance and deposit taking. Given the convenience, cost-effectiveness and speed of *hawala* transactions, as well as the width of their networks, in competing with traditional formal institutions their incorporation could strengthen the overall efficiency of the financial sector and financial institutions' national and international competitiveness. In addition, formalised *hawala* structures could serve as financial backbone in developing industry, trade and tourism beyond national boundaries along the ancient routes and contribute to stimulating economic growth through regional cooperation. This, however, would require to improve neighbour relations in many fields.

Neighbours

Ancient trade routes are crossing many regions and countries thereby spinning a thread connecting people's lives. As a consequence, despite their diversity those living and working along the routes share a historically grown subjective experience establishing a sort of common cultural identity. In principle, this common heritage would make them ideal candidates for economic and monetary collaboration. The experience of EU enlargement demonstrates the benefits of cooperating with strong neighbours. However, reality in South Asia looks different: Few multilateral links exist and Pakistan’s neighbour relations are one reason why even existing ones are weak.

The best example is the South Asian Association for Regional Cooperation (SAARC). Founded in 1985 in Dhaka, SAARC consists of eight members: Pakistan, India, Bangladesh, Sri Lanka, Nepal, Maldives, Bhutan and, since April 2007, Afghanistan. The United States, China, Japan, South Korea, Iran and the European Union are granted observer status. Progress is slow. In 1993, SAARC countries agreed to gradually lower tariffs within the region and only eleven years later, the Agreement on South Asian Free Trade Area (SAFTA) was signed, which created a framework for the establishment of a free trade area covering 1.4 billion people. Major impediments to greater cooperation were repeated tensions between India and Pakistan which prevented the association to fully exploit its economic potential so far, although prospects improved with the first signs of relief when in autumn 2008 both countries opened a historic trade link across divided Kashmir – the first one after sixty years.

The history of India and Pakistan is one of constant hostility, rivalry and distrust which, economically regarded, appears a great waste of resources and opportunities. This holds in particular for the two Punjabs. Shared culture, language and traditions, in parts similar institutions, an international Punjabi diaspora from both countries promoting cultural and economic ties, and a most favourable strategic location of the two in terms of markets in South and Central Asia all call for greater economic cooperation.[20] Pakistan Punjab covers an area of 205,344 square kilometers, the Indian State of Punjab 50,362 square kilometers. Punjabi is spoken by approximately 65 per cent of the population in Pakistan Punjab, with another 25 per cent speaking Punjabi variants, and 92.2 per cent in Indian Punjab.

Before partition, there had been railway links between Hindukot and Samasata, Ferozepur and Kasur, Amritsar and Narowal and Jammu and Sialkot. The Dehli-Amritsar route was connected with Peshawar via Lahore. These days, only one railway line exists between Wagah and Atari. Before, there had been much commercial activity between Lahore and Amritsar and between Kasur and Ferozepur. The Karachi sea port served goods and people on their way to and from East Punjab.

One potential growth factor is tourism, another is religion. Just as Punjabis have bought residential properties in Sindh where they only live during religious festivities generating business and revenue for the local community, Sikhs from Canada, the United States, Europe and India could become attracted to invest in their holy places in Pakistan in the course of intra-Punjab cooperation (Shah 2007).

In recent years, there have been a number of initiatives which started with establishing people-to-people relations in the areas of culture and sport, gradually moving into other fields as well. Examples are the holding of the Punjab Games at Patiala in December 2004, the World Punjabi Congress, the establishment of a bus service between Amritsar and Lahore in January 2006, and between Amritsar and Nankana Sahib in May 2006, as well as the opening of the Wagah road border for trade in certain commodities. Suggestions for further development include easing of visa procedures and the free movement of people, opening up trade along old and new routes, improving communication facilities, and establishing a joint trade office at Wagah and setting up a Joint Punjab Chamber of Commerce. There are even visions of the role the dynamism of future Punjab-Punjab cooperation could play in South Asia (Sahai 2008).

Further rapprochement would clearly benefit both sides. It would allow them to exploit mutual advantages in agriculture, industry, trade and tourism, open up new regional and international markets and improve the general conditions for economic cooperation in South Asia.

In parts, similar arguments hold for Pakistan's relations with Afghanistan. There, too, is a shared cultural heritage along ancient trade routes, and economic ties have been traditionally strong – albeit not necessarily beneficial for both countries:

Current problems began in 1950 with international agreements allowing Afghanistan to import duty-free goods through the port of Karachi. The result was a first wave of illegal cross-border transactions giving Pakistanis access to cheap foreign consumer goods, in particular Japanese electronics. [21] A second wave was triggered after the collapse of the Sovjet Union in 1991. Successive Pakistani governments then sought to open direct routes for trade with the new Central Asian Republics via Afghanistan, but their efforts were hindered by the Afghan civil war. In the end, as usual, the informal sector took over. A transport mafia made an agreement with the Taliban that cleared the way for trucks from Pakistan via Spin Baldak into Afghanistan and farther to Central Asia, Iran and the Persian Gulf.

For Pakistan, the resulting smuggling trade proved disastrous. It not only meant a constant huge loss of revenue but also a weakening of local industry by cheap foreign imports. Ahmed Rashid gives a vivid description of the daily routine of the modern form of the "Afghan Transit Trade":

"The border post between Chaman and Baluchistan province and Spin Baldak in Afghanistan is a prime location for watching the racket at work. On a good day 300 trucks pass through ... Many of the huge Mercedes and Belford trucks are stolen and have false number plates. The goods they carry have no invoices. The drivers may cross up to six international frontiers on false driving licences and without route permits of passports. The consignments range from Japanese camcorders to English underwear and Earl Grey tea, Chinese silk to American computer parts, Afghan heroin to Pakistani wheat and sugar, East European kalashnikovs to Iranian petroleum – and nobody pays custom duties or sales tax." (Rashid 2000: 189).

Rashid further speculates that the Silk Route which linked China to Europe in the Middle Ages passing through Central Asia and Afghanistan was run by the same tribesmen and nomads who are the truck-drivers of today. Just as the caravans in the middle ages, they travel like armies, with a leader and general staff, strict rules, compulsory staging posts, and routine precautions against marauding nomads. At this point, focusing on the dynamism behind those activities, one might wish to add that under changed circumstances likewise those truckers might be conceived as the entrepreneurs of tomorrow of a pulsating free trade zone in South Asia.

Growth prospects would not only arise from the re-establishment of law and order in cross-border trade, they already exist from Afghan reconstruction. Among South Asian countries Pakistan has a unique role in contributing to reconstruction in Afghanistan and to the rebuilding of the Afghan economy and banking sector. One example is the National Bank of Pakistan (NBP) which in quick succession has opened several branches all over the country. The NBP had been the first foreign commercial bank in Afghanistan when it started operations in Kabul in October 2003 (*Dawn* 30.06. 2008).

Faith

Pakistan and Afghanistan share a special common factor: Both are Islamic Republics. For Pakistan this contains several promising growth perspectives.

In economic relations, Islamisation includes the prohibition of paying and receiving interest (*riba*) and the introduction of charity taxes (*zakat*, *ushr*). Although prohibiting interest, Islam recognises the productivity of capital. As a consequence, capital provision on the basis of profit and loss sharing (*modaraba*) and mark-up (*murahaba*) is permitted. In principle, this opens the way to two concepts, (1) profit and loss sharing schemes and (2) financing techniques based on permissible profits from trade. In the latter case, the most straightforward way is that the bank itself is becoming a trader buying goods on behalf of a client and selling them to him at a predetermined price in the future which contains a fixed profit margin or mark-up.

More sophisticated forms of finance can be derived from this practice as soon as it is recognised that rights resulting from a profit and loss sharing scheme, or from mark-up trade, can be transferred to third parties at par-value or even traded at a premium or discount. This paves the way for asset-backed securities and Islamic securities markets. But, there is an ongoing controversy among Islamic scholars whether trade in equity or debt-based securities is still compatible with Islamic law. [22]

In Pakistan, the abolition of interest on domestic transactions (but not on Pakistan's foreign debts) was established in 1979 with three government financial institutions, the National Investment Trust, the Investment Corporation of Pakistan and the Small Business Finance Corporation, starting interest-free operations. In 1981, savings banks began offering profit and loss sharing accounts alongside interest-bearing accounts which within three years made up for almost a quarter of all deposits. [23] In addition, the Government of Pakistan successfully started to launch dollar-denominated Islamic bonds.

With an expanding economy fuelling demand for Islamic loans, credit cards and investment in recent years Pakistan has a strong interest in widening the role for Islamic finance. The demand for Islamic banking assets is constantly rising. Islamic financial services include home loans, car financing and investment. Foreign banks are pushing into the market. In September 2005 the State Bank of Pakistan announced to license the first two overseas banks to offer services in compliance with Islamic principles, Dubai Islamic Bank and Emirates Global International Islamic Bank, representing a group of investors from the Middle East and Malaysia (Zamir and Nambiar 2005). Dubai Islamic Bank also acquired an 18.5 per cent stake in Bank Islami Pakistan. Currently, there are five Islamic banks and another 21 operating with an Islamic window, including ABN Amro, Barclays and Citigroup (AME Info 2008).

The interest in Islamic finance is increasing worldwide. Relative to the global financial system the size of this market segment is still small, but growth rates are impressive. Its main target is the accumulated wealth of oil exporting Middle Eastern countries, including the Gulf Cooperation Council (GCC). From 2002 to 2006, GCC capital outflows rose to $530 billion. The bulk of these flows, however, are still invested in the United States and Europe (Akhtar 2008).

With the economy's constant need to attract foreign capital, Pakistan seeks to become a global player in the market. This is a strong challenge, not only for the country's commercial and financial centre Karachi, but also for Lahore, the Number Two. Big financial institutions worldwide are interested and instrumental in fostering linkages and product innovation. Foreign direct investment statistics, too, indicate that there is a demand: Beside the United States, the United Kingdom, the Netherlands and China, the list of foreign direct investors includes the UAE and Saudi Arabia.[24] Pakistan's biggest competitor in the global market for Islamic finance is Malaysia. The country has a first-mover advantage. It started very early to develop innovative Islamic products and, in 2002, for example, became the first country to sell overseas dollar-denominated Islamic bonds.[25]

The global market for Islamic finance is still fraught with diversity, fragmentation and heterogeneity lacking coherent standards. Problems of legal standardisation of contracts, prudential regulation, accounting and supervision are largely unsolved. Religious views and interpretations differ bearing a high Shariah risk – the risk of one institution's instruments and practices being eroded by another institution's *Shariah* board questioning their compatibility with Islamic rules – and call for *Shariah* compliant mechanisms and a mutual acceptability across products and countries (Akhtar 2008: 4). This is necessarily slowing down market growth but not preventing it. Apparently, Islamic investors feel confident to cope with these risks, and financial instability and crises in traditional global markets are strong arguments to search for alternatives.

V. Conclusion

Pakistan Punjab can best be typified as the industrial heartland of a populous, rapidly growing middle-income country with a strong dependence on foreign capital and high vulnerability to internal and external shocks. The province is still the "breadbasket of Pakistan", but agriculture has lost its predominance. Manufacturing, housing and construction as well as wholesale and retail trade show impressive growth rates. Another sector with a high growth potential is finance and insurance. Here, a big question mark is hanging over the relation between Karachi and Lahore and the competition between the two.

One of the major challenges for economic policy in Punjab is to strengthen institutions and improve the business environment in particular for small and medium-size enterprises which are generally considered as the pillars of economic growth in the early stage of development. Another challenge is the large informal sector which is stretching into all areas of the economy. In parts, this has become a global challenge which is calling for regional bilateral or multilateral cooperative solutions.

As a consequence of long-lasting Communist closedness, war and hostiliy in the neighbourhood, the regional aspect of economic growth which has played such a dominant role in Europe and other parts of the world has long been neglected for Pakistan. A closer look at Punjab's history indicates a widely untapped growth potential in neighbour relations resulting from a common cultural and economic heritage. In the Punjab, to refer to Rudyard Kipling's words, East and West, the Twain have met more than once, and many strong men have stood face to face to do business and trade. This historic legacy is an invaluable asset in today's globalised world only waiting to be fully exploited.

Notes and References

1. See for a detailed overview of the economy of Punjab *Government of Punjab et als (2005)*.

2. A discussion of theoretical and empirical aspects of economic growth in defense of the neoclassical approach in economics briefly touched here is provided by Mankiw (1995).

3. These numbers are from: http://www.yespakistan.com/people/migration_pak.asp.

4. Pakistanis also went to other countries and regions, above all to Britain and North America, where many settled more permanently (Talbot 2005: 42).

5. Ian Talbot draws the attention to an existing gulf between historians of the Pakistan region and political scientists. While to the former historical narratives abruptly terminate in 1947, the latter write as if Pakistan politics were constructed on a *tabula rasa,* rather than

being influenced values, ideas and events from earlier times (Talbot 2005: 12)

6. There are many examples of how sporting events affect a country's overall political and economic spirit. One is the strong unity and national pride South Koreans displayed during the 2002 FIFA World Cup which was not limited to South Korea alone but included ethnic Koreans all over the world. South Korea had participated in seven World Cup final tournaments, and in the 2002 tournament became the first Asian nation to reach the semi-finals. As a result, football became hugely popular in the country, where the game had traditionally attracted less followers than other games such as baseball. The World Cup translated into an economic euphoria enormously lifting people's spirit which had been highly depressed after the national "shame" of the 1997 Asian crisis. See for a chronology of the latter the contribution of Ralf Müller in Menkhoff and Reszat (1998) and for the economic effects of the World Cup Asia Times Online (2002). A lucid record of fifty years of cricket in Pakistan is given by Noman (1998).

7. See for the following in greater detail, although in another context Reszat (2005), Chapter 6.

8. Beside these two types, some Asian countries seem to have found a sort of "Third Way": The economic success of nations following the principles of informal policy influence and "administrative guidance" demonstrates that although legal systems matter for economic growth their influence must not be overrated. Administrative guidance is applied both in civil-law countries like Korea and Japan and in countries with a common-law tradition such as Malaysia.

9. In Transparency International's Corruption Perceptions Index of 2006 Pakistan ranked 142nd out of 163 countries making the country one of the most corrupt nations in the world (Index of Economic Freedom 2008).

10. From the beginnings, the Federal Shariat Court has been the subject of criticism and controversy. See for the details Hussain, Faqir (2008).

11. But, those are still low in international comparison: For example, the 2005 Report mentions even a twenty percentage points higher enrollment in Bangladesh. See Government of Punjab et als (2005): 64.

12. The problem is still aggravated if markets such as bond markets that serve as a benchmark function are non-existent (Herring and Chatusripitak 2001).

13. http://www.oracle.com/customers/snapshots/karachi-stock-exchange-snapshot.pdf

14. http://en.wikipedia.org/wiki/Karachi_Stock_Exchange, 22.10. 2008.

15. Admittedly, the call for rethinking liberalizsation is in contrast to the current mainstream, but it is strongly supported by evidence from the 1997 Asian crisis as the example of India and China demonstrates: In 1997, both countries were relatively closed economies with limited degree of capital account convertibility which helped shielding them to a large extent from financial contagion from outside (Reszat 1998). See for a general comprehensive overview of the current state of discussion on monetary and financial integration in East Asia the contributions in Hamada et als (2009).

16. Ideally, this would include restricting transactions of *foreign banks* in domestic currency since, in contrast to a widely held view, they, and not domestic investors, international hedge funds or whosoever, have the potential to drive the value of the currency into a free fall at the first signs of crisis – or to halt or at least slow down the decline at an early stage. See for this argument in detail Reszat (1999).

17. http://en.wikipedia.org/wiki/Karakoram_Highway.

18. An impression of these ambitions gives the website http://www.visiongwadar.com.

19. In 2003, there were approximately 127 international and 467 local NGOs operating in Afghanistan which channeled at least an estimted US$200 million through the hawala system. For many of them a foreign bank in Peshawar in Pakistan is “the bank of choice” (Maimbo 2003: 13).

20. See for example the reviews by Andley (2008), Sahai (2008) and Shah (2007) of a book by Tridivesh Singh Maini on South Asian Cooperation and the Role of the Punjabs.

21. "Truckers would drive their sealed containers from Karachi, cross into Afghanistan, sell some goods in Kabul and then turn around to resell the rest in Pakistani markets." (Rashid 2001: 191).

22. Other debates focus on the economic functions and risk-reduction capacities of Islamic instruments. See, for example, Honohan (2001).

23. This initial success is partly explained by restricting the use of funds to safe public-sector projects, in particular export and import operations (Talbot 2005: 277).

24. Other countries contributing to the boom of FDI in recent years included Australia, Canada, Germany, Hong Kong, Japan, Koreas, Luxembourg, Singapore and Switzerland.

25. Beside Pakistan, Bahrain, Qatar, and the German state of Saxony-Anhalt followed. See Nambiar (2005).

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