Insights for Change

How Pakistan Fell Behind?

Dr. Aasim Husain | January 2022
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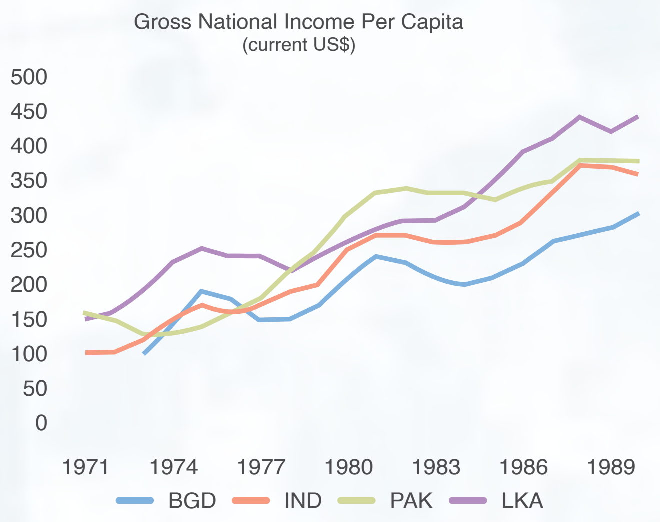
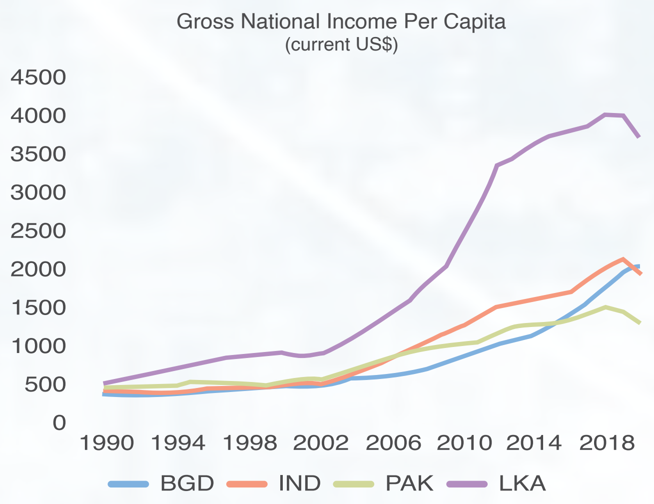
Pakistan used to have the highest per capita income in South Asia. Now we have the lowest. What went wrong?

Just fifty years ago, Pakistanis earned just as much or even slightly more than Sri Lankans on average, and around one and a half times as much as Indians and Bangladeshis. Today, we earn two thirds as much as Indians and Bangladeshis, and only one third as much as Sri Lankans.



Source:
World Bank, World Development Indicators Database.



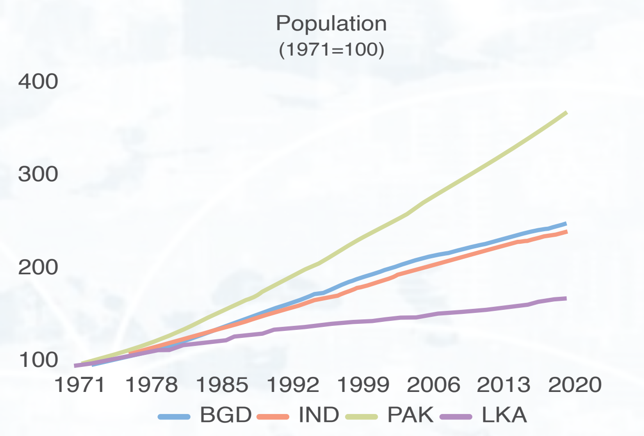
Source:
World Bank, World Development Indicators Database.

What caused Pakistan to fall so far behind?

No single reason can fully explain this unfortunate performance, but population growth was certainly a major element. Pakistan's population has quadrupled over the last five decades. By contrast, Sri Lanka's has less than doubled, while India and Bangladesh have increased their populations by about two and a half times.

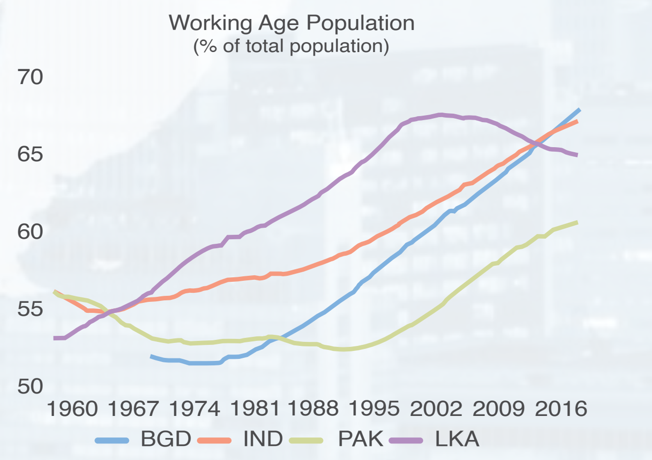
But the real explanation is not quite as simple as that. True, dividing national income over more people certainly reduces income per capita. But having more people also results in more income as they engage in productive activity. So simply having a larger population doesn't necessarily mean lower per capita income.

Instead, what really matters is the share of the population that is able to work. If a large share of the populace is not of working age (is either too young or too old to work), domestic saving will be low. To see why, consider two families that have the same income and are otherwise similar except that one has six family members and the other has eight. Clearly, the larger family will not be able to save as much as the smaller one. This translates into a lower saving rate in countries where the share of working age to total population is relatively low, such as Pakistan.



Source:
World Bank, Health Nutrition and Population Statistics Database.

At 60 percent, Pakistan's working age population share is much lower than that of our neighbors (65-68 percent). Moreover, the increase in Pakistan's working age share over the past fifty years has been much slower, mainly because we have continued to have more children. Fifty years ago, the share of the young—those under 15—was 40 percent in Pakistan, India, and Sri Lanka, and 45 percent in Bangladesh. Today, that share in Pakistan is still 35 percent, while it has fallen to 24-27 percent in the other countries.



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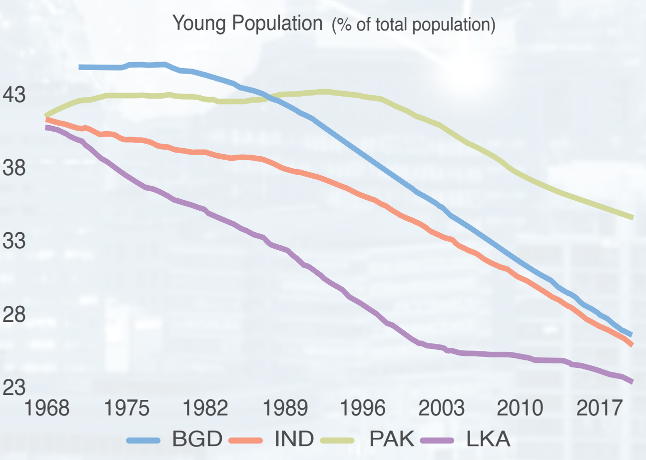

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World Bank, Health Nutrition and Population Statistics Database.

That is why Pakistanis save so much less than Indians, Bangladeshis, and Sri Lankans. Over the past decade, Pakistan's gross domestic saving rate has remained below 10 percent of GDP. In Bangladesh and Sri Lanka, it varied between 20-25 percent, while in India domestic saving consistently exceeded 30 percent of GDP. Around one half to two thirds of this difference can be attributed to the difference in the working age population ratio. Indeed, using the estimated relationship between private saving and the working age population ratio in Southeast Asian countries during the 1980s and 90s (See Hamid Faruqee and Aasim M. Husain, "Saving Trends in Southeast Asia: A Cross-Country Analysis," Asian Economic Journal, September 1998), simple calculation suggests that if the age structure of Pakistan's population had been similar to that of our neighbors, our saving rate would have been 6-10 percentage points higher.

When the domestic saving rate is low, banks will have less funds to lend. That translates to less financing available for investment, and lower investment in turn holds back economic growth. Had saving been 6-10 points higher, investment would have been higher by at least 6-10 points too, and possibly by even more on account of "multiplier" effects (because higher saving and investment raise income which, in turn, yields more saving and, as a result, higher investment). Assuming an average capital stock to output ratio of 3, a higher investment rate of 9 percentage points of output (GDP) translates to a faster growth rate of capital by 3 percentage points. So with that much more investment, the economy would have grown at a 2½ -3 percentage point faster clip than what actually took place. Over five decades, the cumulative impact of even 2½ percent more rapid annual growth would have been immense. Pakistan's per capita income today would have been around $3,600, much as Sri Lanka's and twice the level in India and Bangladesh!

How can Pakistan catch up?

Reducing population growth is critical. Improving access to education will be immensely important to curbing fertility. Only by enhancing its quality can the return to education be improved, thereby inducing today's youth to pursue an education that allows them to earn adequate income when they reach working age. But even with success on this front, a meaningful change in the age structure of Pakistan's population will take a decade or two.

Until then, because of the low saving and investment that our population's age structure confers, Pakistan will have to do much better in other areas that enhance economic growth just to keep pace with our neighbors. And to catch up with them, we will have to do better still. In other words, it will not be enough to improve our business environment, competitiveness, and economic governance just to the best in South Asia. We will have to be much, much better than our neighbors on these dimensions to close the gap with them.

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Dr. Aasim M. Husain

About the Author

The author was formerly with the International Monetary Fund, where he served as Deputy Director of the European, Middle East & Central Asia, Western Hemisphere, and Strategy, Policy & Review departments. While on leave from the IMF in 1995-96, he founded the Economics Department at ABN-AMRO Bank Pakistan and its Economic Bulletin and Economy Watch publications.

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