

## Creating a Place for the Future Strategies for Entrepreneurship-Led Development in Pakistan

For six decades, Pakistan has faced, and overcome, conflict and calamity. Despite many obstacles, the country's economy has grown steadily. At critical junctures, successive governments have adopted strategies suited to the circumstances of the day, and the nation has developed steadily due to these particular well-conceived initiatives. Yet, as a consequence of the reactive nature of policy formulation and implementation, the institutions of government are conditioned to think in terms of projects rather than strategies to support growth.

Today Pakistan confronts a new round of immediate challenges and urgent demands. Yet, it is precisely at this moment of apparent crisis—in the aftermath of the devastating flood of 2010 and with security concerns continuing to dominate the national agenda—that the need to change the discourse about the country's development has become most apparent. Reactive tactics and dependence on external aid have not helped Pakistan to develop or to realize its potential. Sustained and sustainable development cannot come from a collection of projects, no matter how well intended. A new development approach is needed: Building markets. Building opportunity. Building cities. Building good governance. Including youth.

To realize Pakistan's 21st-century potential, the nation's political and business leaders must not only meet the demands of the present, but also—and perhaps more importantly—create a space for the future.

---

*Philip Auerswald is the Cofounder and Coeditor of Innovations. He is also an associate professor of public policy at George Mason University and an adviser to the Clinton Global Initiative.*

*Elmira Bayrasli writes and work on economic development issues. She blogs for Forbes and is a project leader for World Policy Journal.*

*Sara Shroff is Senior Consultant and Strategist at Bob Carter Companies and the Founder and Managing Partner at Tessera Global.*

*This paper was written in support of work undertaken by the Planning Commission in Pakistan under the direction of Dr. Nadeem Ul Haque. That work resulted in an economic strategy document adopted by the government of Pakistan in Spring 2011.*

For the government, creating a space for the future means removing obstacles to innovation and entrepreneurship—that is, long-term investments that have potential to provide needed services to a youthful and growing population. It means supporting entrepreneurs as they seek to build innovative high-growth companies—even when those new businesses challenge the dominance of existing firms. It means radically remaking the nation's cities so they are focal points for creativity, not flashpoints for conflict. It means creating mechanisms to support and empower public servants who push back against powerful interests and overcome institutional inertia.

For business, creating a space for the future means seeking advantage not in regulatory protections that stifle social development but in market innovations that accelerate it. It means developing new products for the global marketplace, in which branded Pakistani producers are underrepresented, and for the domestic marketplace, which underserves Pakistani consumers. It means looking beyond short-term interest and local advantage, and instead building foundations for organizations with the potential to compete over the long term anywhere in the world.

Conditions that allow markets to function normally—that is, economic agents being enabled to operate, compete, and interact with each other on a level playing field<sup>1</sup>—create the environment essential for private initiative to thrive and business enterprises to realize optimum productive efficiency. This contributes substantively to economic growth and development. A functioning market without government intervention (albeit with competent regulation as needed) and protected from anticompetitive practices is fundamental to achieving productive efficiency, innovation, and entrepreneurship.

Cognizant of today's demands as well as those of the future, this paper argues that developing a culture of productive entrepreneurship in Pakistan requires immediate action by the government of Pakistan:

- **Enhance Competition**—Despite serious but sporadic initiatives aimed at market liberalization, Pakistan's economy remains dominated by the government. It is important that all government ministries carefully examine the rationale behind and consequences of direct involvement in the economy, and act assertively to eliminate programs and policies that crowd out private business initiatives. The government should (a) map out, with respect to goods and services, the economic subsidies and protections that are currently operative; and (b) implement a plan to gradually eliminate laws and policies that have the unintended consequence of promoting unproductive entrepreneurship. While the pushback from incumbent firms against a comprehensive competition strategy is likely to be intensive, the alternative to the implementation of such a plan is economic stagnation—an outcome ultimately detrimental and unacceptable to all.
- **Encourage Entrepreneurship**—Pakistan has many entrepreneurs. However, the state of competition in many Pakistani industries is such that too many entrepreneurs direct their energies toward rent-seeking rather than productive entrepreneurship. A key objective of a New Development Approach should be to create

an economic environment conducive to entrepreneurship in general, and specifically to the formation and development of both small-scale entrepreneurial ventures and innovative high-growth firms.

- **Minimize Transactions Costs**—Entrepreneurship doesn't happen without deal-making in circumstances of uncertainty, which depends to a great extent on trust. While Pakistan is rich in talent and has ample capital resources (particularly when the economic assets of the Pakistani Diaspora are taken into consideration), it suffers from a significant trust deficit that not only undermines the relationship between citizens and government but also, and significantly, impedes the conduct of business by increasing the cost of business transactions. Rebuilding trust will take time. Consequently, the government should undertake to mitigate adverse consequences of the trust deficit by decreasing transaction costs in its dealings with citizens at the same time that it increases the transparency of government decisionmaking. In practical terms, this means seizing every available opportunity—in particular, opportunities created by the widespread availability of information and communications technologies—to improve the efficiency of government service delivery and to make government information easily available to citizens.

By acting simultaneously to enhance competition, encourage entrepreneurship, and minimize transactions costs, the government can promote the business innovation necessary to provide essential goods and services to its citizens, encourage the development of domestic markets, and drive sustained economic growth. In doing so, it will achieve broad-based societal development and realize national potential in the long term.

#### PREREQUISITE TO PROSPERITY

Pakistan is a nation whose promise has yet to be fulfilled. Finding evidence of this is as inexpensive as a one-way ticket from Karachi to Istanbul, Seoul, or Bangkok. Turkey, South Korea, and Thailand were all roughly on a par with Pakistan until the 1970s. Pakistan has progressed substantially in the four decades since then, yet these three countries—and others similarly endowed—have surged even farther ahead in terms of human and economic development.

Unfortunately, recent trends have not been any more favorable to Pakistan. In the past two years, as entrepreneurship and innovation have driven an upsurge in prosperity in many parts of the developing world, the Pakistani economy has been stuck in low gear. With turnover and external competitive threats suppressed by government action (and inaction), key industries serving the domestic market have failed to seize new market opportunities both inside and outside the country. Intensified flows of overseas direct assistance have deepened a reliance on government, rather than on markets, as a source of opportunity. Longstanding shortcomings in the country's physical and educational infrastructure have remained far from a solution. The result is a society in which present interests have been protected to such an extent that the future has been obstructed.

## Strategies for National Transformation—The Turkish Example

By 1980, Turkey's state-planned economy had come to a halt. Inflation was in the triple digits, unemployment was rampant, and debt was through the roof. Turgut Ozal, a World Bank economist, took the reins of power and made radical changes that led to Turkey's development and enabled entrepreneurial growth. They are seen as radical, which they were, but they were also simple. Ozal's reforms were intended to bring legal order to what was being done on the black market. He didn't have a grand scheme for turning the country into a second Sweden; he instead changed the rules so that everyone would have the incentive to participate in the formal economy.

**Export-led growth:** Ozal's signature reform was redirecting government support to those (businesses) that could export and generate badly needed foreign revenue. Tariff rules, exchange rates, and subsidies were all changed to promote exports. Among those who thrived especially well were makers of textiles and furniture, which were clustered mostly in industrial zones in the Anatolian heartland, far from Istanbul. By 1990, Turkish designers and engineers had started to create their own products rather than simply filling orders for foreign firms. Others started investing in factories and franchises in various communities.

**Capital:** Ozal made it a priority to allow capital to move freely in and out of the country. One way he did that was to bring into circulation unused capital help from those opposed to interest-bearing banking. He also developed economic ties with wealthy Gulf states and encouraged them to invest in Turkey.

**Bureaucracy:** Ozal cut through red tape. There were 35,000 categories of civil servants in Turkey in 1983; he reduced the number to 150. Bureaucrats were forced to come back to him five times before they had succeeded in simplifying

---

A recent "growth diagnostics" analysis of the Pakistani economy undertaken by a team at the Pakistan Institute of Development Economics and NUST confirms this assessment. This analysis finds "the failure of governance and that of institutions to be the binding constraint to growth" in Pakistan. Furthermore, "rent seeking in the shape of licenses, subsidies, and tariff protection has not allowed the development of a competitive environment which is essential for innovation to occur."<sup>2</sup>

With these and similar findings in mind, this paper, which offers an assessment of the state of entrepreneurship and markets in Pakistan, is intended to inform government policy and planning. It is based on three tightly linked premises:

- Entrepreneurial talent exists everywhere. The objective of policy is not to create entrepreneurs where they don't exist but to ensure that those (many) individu-

the country's foreign currency regulations from 75 pages of instructions to 15. (Of course, this is not a realistic comparison to Pakistan, which is grappling with an insurgency problem. Cutting government positions seriously increases the risk of political destabilization. The point is that Ozal sought to change, above all, mentality and habit.)

**Talent:** “The best people,” Ozal once said, “work as inspectors, the middling ones in the executive. The state trusts neither its own officials, nor its own citizens. Everybody is frightened of making a mistake or taking responsibility.” He approached Turkish governance in the same way Washington, D.C.’s school commissioner Michelle Rhee did—by cutting out the dead wood and replacing it with talented individuals who can deliver results.

**Communication:** Ozal liked to visit countries and see what was new in stores and shopping malls. He worked to communicate his consumer hunger to his people. As a result, he made it a priority to bolster Turkey’s statistics office. He made statistics available on a large scale. This transparency and access boosted public confidence.

**Imports:** Ozal lifted quotes on imports. Free trade, he believed, would force Turkish businesses to improve their products. The sight of fancy foreign goods on previously monotonous shop shelves would encourage the Turkish people to work harder to earn more money to buy them.

**Infrastructure:** The biggest change Ozal made was to shift resources from supporting state industries to infrastructure projects. He spent huge amounts on new motorways, bridges, dams, and airports. He was famous for his BOT (Build, Operate and Transfer) effort, which called on foreign companies to undertake infrastructure projects at their own expense, turn a profit, and then hand operation over to the Turkish state.

---

als in the society who have a predisposition for entrepreneurship are adequately supported.

- The outcomes for any given society depend significantly on whether potential entrepreneurs direct themselves to productive, unproductive, or destructive entrepreneurship. Not all entrepreneurship is positive. The same energy that goes into building a globally competitive company can, if social incentives and individual motivations are so aligned, go into chasing business advantage through government protections or organizing criminal activity. Support for productive entrepreneurship directs talent toward social development and away from both unproductive (rent-seeking) and destructive (criminal) entrepreneurship.

- Small-scale entrepreneurs can play a vital role in providing needed goods and services. Entrepreneurs who work on a small scale—for example, operators of rural, craft-based enterprises or urban *khokhas* (kiosks) and *rehris* (carts)—are essential to the functioning of any dynamic economy. Government policy must

enable small-scale entrepreneurs to establish, formalize, and grow their operations with minimal difficulty.

- A subset of productive entrepreneurs—those who create high-growth firms—make a significant and critical contribution to development. Most entrepreneurs start small and stay that way. The small share of productive, opportunity entrepreneurs who create rapidly growing companies (sometimes called “gazelle” firms) play a particularly significant role in social development through job creation, industry revitalization, and philanthropic giving.<sup>3</sup> As a result, ensuring that high-growth firms have the space to form (in both urban and rural areas) and the resources to develop is an important social priority.

Putting Pakistan’s economy back in a position to reap the dividends of global growth in the 21st century will require nothing short of a fundamental shift in the discourse about the country’s development. Projects focused narrowly on the demands of the moment will be no more effective in reinvigorating Pakistan’s economy than will recipes from the past—from 1960s-style large infrastructure projects to 1990s-style liberalization. What is needed is a redirection from the hardware of development to the software; from external aid to internal enterprise; and from implementing projects to investing in people.<sup>4</sup>

Planning for the future in Pakistan will have succeeded not when donor organizations have disbursed funds or government agencies have expended their budgets, but when more people believe that they have a stake in a shared future that is as valuable as dividends derived from protecting the present. Such a belief, when translated to action, is an absolutely prerequisite to prosperity—for Pakistan, just as for any other country.

### **Why Does Pakistan Need Innovation and Entrepreneurship?**

Today’s dynamic global economy is driven by innovation and entrepreneurship.

Both high-growth, disruptive entrepreneurship and small-scale, opportunity entrepreneurship are vital to national development global competitiveness.

Turkey, Brazil, and China are recent examples of countries that have consciously emphasized entrepreneurship and innovation as core elements of their growth and development strategies.

This new economic order is an opportunity for Pakistan to realize its potential in the 21st century by enhancing competition, nurturing entrepreneurial talent, and building a high-trust, low-transactions-cost society.

### **ENHANCING COMPETITION**

Markets are the part of the economy in which forces of demand and supply, and the resulting prices, determine the allocation of goods. The internal operations of government, the military, and large companies lie outside markets. Within those domains, resources are allocated by an administrative mechanism—for example, via the Public Sector Development Program—not by a market mechanism. For markets to serve the interests of the public, they must be accountable to consumer

demand and subject to competitive pressure, in particular from new firms entering the market.

Ensuring that competition occurs in markets must be an urgent government priority because markets that function effectively can meet Pakistan's critical need for economic opportunity and vital goods and services, such as reliable energy, accessible financial products, and affordable housing. Currently, markets in Pakistan are not adequately competitive and are not providing economic opportunity and vital goods and services efficiently. The primary reason for this is that entrenched business practices and government policies have stifled competition and innovation in relevant industries—notably banking, cement and construction, and power generation and transmission. With the notable exception of mobile communications (an industry we address in detail later in this paper), nearly every market in Pakistan is structured to disadvantage entrepreneurs and discourage innovation.

Obstacles to competition act like a brake on progress throughout a society; until that brake is released, it should come as no surprise that outside aid causes increased friction rather than forward movement. The Competition Commission (2009b, 2010a, 2010b, 2010c), and Ghazanfar and Kazmi (2009) profile competition in five critical markets—the three just mentioned, as well as sugar, automobiles, and fertilizer.<sup>5</sup>

### **The Nature and Consequences of Market Distortions**

While the state of competition varies significantly among industries, certain generic distortions are present in most markets in Pakistan.

#### *Distortion 1. Excessive government engagement in the economy*

The Pakistani government needs to shift its role in the development process from hands-on engagement to a facilitator of private action. In response to inflows of donor funds sustained over decades, the very functions of government in Pakistan have evolved toward direct engagement in development and away from the essential magisterial functions of government, including maintenance of law and order, enforcement of property rights, and application of judicial procedures. This “big-push” approach to development worked for a time (nearly 40 years), but it is not working today. As a consequence, the quality of governance in the country—notably, professional standards in the civil service—has declined. Rent-seeking and corruption have been reinforced.

#### *Distortion 2. Ubiquitous “rent-seeking”*

Business leaders have become conditioned to an environment in which the short-term gains from seeking advantage from the government are systematically greater than longer-term gains from the identification and exploitation of genuine economic opportunity. As Haque (2007) observes:

When wealth transfers can be achieved through government licenses, policies and directives, entrepreneurial efforts will be directed toward gaining such transfers. Economic agents will expend efforts toward attempting to influence government actions in their favor in order to accumulate wealth. Examples of such government provided wealth transfers are conferring of a monopoly through a license, obtaining resources at below the market prices (e.g., publicly provided land at cheaper rates than market to influential groups), protection from competition (e.g., restriction of number of players in a market) and the manipulation of government subsidies, tariffs and tax policies. In all such cases, the government directive or policy confers wealth on an individual often at the expense of the rest of society. (p. 5)

In this way, government policies that encourage rent-seeking and short-term gain act as a reverse tax of sorts that is imposed by a favored group on the rest of society. Once in place, the favored group will be willing to expend real resources—including creative business practices that we have termed “unproductive entrepreneurship.” When the returns to rent-seeking are sufficiently large, potentially productive entrepreneurs will be drawn away from entrepreneurship and toward government patronage.

### *Distortion 3. Inadequate incentives to innovate*

The most severely negative consequence for the economy of rent-seeking behavior is that it undermines the incumbent firm’s incentives to innovate and the willingness of investors to take risks. The banking industry in Pakistan offers a prime illustration of this phenomenon. Pakistan is the world’s least banked nation. Depending on the measures used, only between 4 percent and 15 percent of the population of Pakistan has access to financial services.<sup>6</sup> At the same time, the Pakistani banking industry is among the region’s most stable and profitable as a result of spreads that are 2-3 times those sustainable in the U.S. and other advanced industrialized countries.<sup>7</sup> Financial service innovation is possible, of course. Leading banking firms are undoubtedly capable of developing the new products that could lead to greater financial inclusion and overcome historical neglect of agricultural credit, small- and medium-enterprise (SME) financing, and housing finance in particular. However, as the Competition Commission noted in a 2009 report,

The solution to the chronic problems of policy neglect and bank complacency...must be sought outside the banking industry. No amount of exhortation or incentives to commercial banks has worked in the past 60 years because...the opportunity costs of entering [the agricultural credit, SME financing, and housing finance] markets are clearly much too high [due to] the existence of “monopoly rents” in the shape of high spreads between deposit and lending rates accruing elsewhere in more lucrative



markets from which there is no competitive compulsion to diversify. (p. 20)

The government's direct engagement in financial markets has the effect of further distorting the environment for competition. In particular, the "success" of the National Savings Schemes has the unintended consequence of drawing capital away from the private sector.<sup>8</sup>

Although each industry has its own particular competitive dynamics, innovation is similarly hindered in many other sectors of the economy by the absence of competition and the "monopoly rents" that such an absence permits.

### **Actions by Government That Affect the Attainment of a Level Playing Field**

Like entrepreneurs, not all market institutions are created equal. As a consequence, the mere existence of a market does not, in itself, indicate the presence of economic dynamism. In societies where the extensive involvement of the government distorts market signals, competition is dulled and markets stagnate.

In the long term, societies with adaptable market institutions tend to edge out those with rigid market institutions.<sup>9</sup> For this reason, improving the environment for competition is not a matter of policy aesthetics or whim—it is an absolutely essential element of adaptability and effective competition for Pakistan, as it is for any country in the 21st century.

That said, while acting to ensure that markets are competitive sounds simple in theory, it is not so in practice. The key to competition policy, as described by the Competition Commission in its 2009 report on the state of competition in Pakistan, is the notion of a "level playing field" for market participants:

A "level playing field" in the market is one in which companies (and countries, for example, in the realm of international trade) can compete fairly with each other in a rule-based environment because no one enjoys, or is given, any special advantages. All competition agencies regard the attainment of such a level playing field in individual sectors of the economy and, indeed, in the economy as a whole, as their primary responsibility. (p. 10)

The Competition Commission details four mechanisms by which government actions impede the attainment of a level playing field:

First, the overall duty structure on imports varies enormously between raw materials, intermediate inputs, and no clear rationale is discernable in terms of the objectives that are being pursued...The actual result of the high tariffs has been widespread abuse in the form of smuggling or informal imports. The government in the meantime has become dependent on the duties as a vital source of revenue and is reluctant to rationalize them...

Second, in order to attract foreign direct investment (FDI), tax holidays and tax-free zones have been the modus operandi in Pakistan as elsewhere. But tax concessions for FDI, aside from leading to significant revenue losses, also lead to unevenness in the domestic playing field...

Third, the government is often forced to subsidize the production and sale of staples in the household budgets, wheat flour and sugar being particularly apt cases in point in Pakistan today. However, the actual impact of subsidies on production and prices is often unpredictable and the situation is rendered even more complicated in an inflationary environment...

Finally, public procurement procedures have a major impact on competition in the country. The prime examples are the Frontier Works Organization (FWO) and the National Logistics Cell (NLC), two entities dominant in road building and road haulage and indirectly controlled by the state. Over time, their dominance has tended to increase rather than diminish leaving only a small area of activity in their respective sectors where competition exists. (p. 13)

To revitalize competition in Pakistan will require a determined and comprehensive effort to simplify and rationalize, inter alia, the duty structure on imports, the tax code, the government's direct involvement in commodities markets, and the government's approach to procurement.

### **Competitive Cities as Drivers of Growth**

Competition is not only vital on the national level, it is also vital to the functioning of cities. Pakistan's cities, like its markets, have not yet had the opportunity to develop in an organic manner.

In Pakistan, as elsewhere in the world, cities are key drivers of growth. Innovative entrepreneurs live in cities, and development policy must meet innovative entrepreneurs where they live. This is not to say that rural entrepreneurs are not innovative or not vitally important to a New Development Approach for Pakistan. They are, most emphatically, as Pakistan remains a substantially agrarian society. However, experience over decades shows that (1) rural entrepreneurship thrives where there are urban markets for rural output, and (2) innovation thrives where populations are sizable and diverse. Cities are what will dominate Pakistan's development. The most effective way to induce rural entrepreneurship and innovation is to improve conditions for entrepreneurship and innovation in markets generally, and in cities in particular.

For the success of cities, investment is needed in "relational assets" and local collective goods. These include transportation, affordable housing, and other public infrastructure. But they also include building links between universities and science-based industries and strengthening relationships between firms and suppliers, including small businesses. Indeed, the entire range of creative capabilities in the arts, education, and the broad range of service industries must be tapped, thus paving the way for vibrant cities across Pakistan.

### **ENCOURAGING ENTREPRENEURSHIP**

Economic growth is impossible without, and to a significant extent synonymous with, the creation and growth of business. Businesses are created and grow when they provide needed services and introduce innovations into the marketplace.

Successful firms return revenue into the economy through wages, procurement, capital investments, returns to investors, and the payment of taxes. When the state (and, potentially, foundations funded via philanthropic giving) provides the infrastructure required for business creation and growth to be an ongoing process, a virtuous cycle ensues.<sup>10</sup>

### **Supporting New and Rapidly Growing Companies**

Nearly 20 years ago, A. R. Kemal, then the joint director of the Pakistan Institute of Development Economics, published a paper titled, “Why Do Small Firms Fail to Graduate to Medium and Large Firms in Pakistan?” The question posed in his paper still holds. While small firms, in the aggregate, continue to grow in Pakistan, instances of small firms becoming midsize and large firms remain relatively rare.

A sequence of studies over the past two decades has identified a consistent set of challenges that impede the growth of small firms. Foremost among these are the following:

- Government regulation of trade (both internally and with respect to exports) in a manner unfavorable to small firms
- Financial-sector business practices and government interventions that have failed to reach to small firms
- Relative difficulty coping with high fixed costs of licensing requirements, the lack of clarity with regard to taxation, and the development of alternatives to poorly performing infrastructure (energy in particular)

Additional impediments include cultural barriers, such as social sanctions in the face of failure, lack of peer experience to enable realistic assessment of risk, a paucity of mentors and entrepreneurial role models, and inadequate understanding of markets and global business practices.<sup>11</sup>

It is important to note that these obstacles do not prevent entrepreneurship; they inhibit it. Entrepreneurs never scale-up beyond a certain point. Without scale, entrepreneurship cannot contribute fully to a country’s growth, and thereby its development. It is only when an enterprise is expanding the number of jobs in a community, increasing its profits, and investing those profits that it contributes to GDP growth.

### **Facilitating the Transition of Family Businesses to Business Families**

Globally, a natural path of development has led from family businesses with a tradition of moral reciprocity to the modern, professionally managed corporation. Where this transition has occurred it has been based upon faith in the legal and judicial system, including respect for contracts and property rights.

In Pakistan this transition has come slowly. Mistrust of professional managers stems not only from inadequacy of the legal and judicial systems but also from the limited ability of existing institutional structures to prevent fraud, theft, and misuse of business information. This is where the government can play a critical role in helping to nurture an environment of trust. In order for Pakistan’s family busi-

nesses to capture national and international growth in their sectors, they must transition into business families that are focused on growth through leadership development, succession planning, operational effectiveness, management, and transition of ownership.

Large professionally managed businesses, particularly in high-trust societies such as the U.S., Japan, and Germany, emerged due to a host of technological, financial, and market factors, but also because of an evolution in corporate management. U.S. corporations such as Du Pont, Eastman Kodak, Sears Roebuck, Tyson, Pitney-Bowes, and Kellogg all started out as small family businesses in the 19th century. Today they are large conglomerates and strong brands that rely heavily on professional management; current generations of the founding families are often majority stockholders with little exposure to business operations.

Many low-trust societies, such as China and Italy, went through a period of strong political centralization, as did Pakistan. In the absence of high trust, a society has three options for building large-scale organizations, each of which is amply in evidence in Pakistan:

- Evolutionary growth of family businesses with only family members in decision-making positions
- Formation and subsidization of state-owned and state-managed enterprises
- Foreign direct investment or joint ventures with large foreign partners

In general, the challenges faced by family businesses vary according to the size of the company and its level of development, and in Pakistan this is no different. The good news is that some large family owned and operated companies in Pakistan do have global operations. These companies have made the transition from family business to business or corporate families. They have professionalized their management, developed professional boards, diversified their ownership, and issued shares in the stock market.

Ironically, many professionally owned and managed companies seek to promote family-type values in their businesses in order to engender the commitment and trust that are hallmarks of family companies. They do this so the essence of family businesses and the social capital they have built are not lost. So, as family businesses decline, businesses seek to replicate the strong social ties that bind families.

The real issue, then, is not the preponderance of family businesses themselves, but rather how effectively family businesses manage and adapt to change. For family businesses to transition into becoming professionally managed business families, they may continue to have a say in the vision of the business but also to capture creativity and entrepreneurial spirit within the spheres of their businesses through a focus on professional management driven by efficiency and growth.

### **Encouraging Rural Entrepreneurship**

Agriculture accounts for 25 percent of GDP in Pakistan. That figure alone, however, underestimates the opportunity for rural entrepreneurship; non-agricultural entrepreneurship in rural areas generates substantial income and employment

within non-farming communities. Policies and strategies to support rural entrepreneurship must therefore focus as much on non-farming communities as on small farmers.

Rural entrepreneurship already contributes to increased economic opportunities, workforce development, income generation, and food security in rural areas of Pakistan, but there is still a critical need for training and assistance to both enhance the skills of small entrepreneurs and improve their connections to market opportunities—throughout Pakistan, but notably in Balochistan and North-West Frontier Province. The long-run solution for sustainable agricultural development is competitive agriculture.

Entrepreneurship in rural areas can benefit from public-private partnerships among governments, NGOs, universities, and the private sector to build capacity and the entrepreneurship ecosystem in rural Pakistan. A number of research universities in Pakistan are producing technologies that have significant potential to boost rural entrepreneurship. However, due to the inadequate development of the institutional infrastructure to support the transition from invention to market-ready innovation, the market potential of many of those university-generated concepts remains underdeveloped.

### **Creating Space for Urban Micro-Enterprise**

The urban population in Pakistan is likely to increase threefold over the next 25 years to 130 million. In 2030, the urban population in Pakistan will constitute 50 percent of the total population, making it among the largest urban centers in the world. The urban development in Pakistan is likely to pose new challenges in governance, development of micro-enterprises, and urban service delivery; these challenges must be addressed to allow urbanization to fuel growth. While urbanization does pose challenges, it will also create new opportunities for growth and prosperity. The emergence of a middle class will create a domestic market for goods and services and provide a skilled workforce that can become the engine of growth. This dividend can only be leveraged if government creates a “formal” and “affordable” space for urban micro-enterprise to prosper.

Supporting micro- and small business is most effective where the legal and regulatory environment provides both security and opportunity while creating an effective balance of incentives and disincentives. A policy and legal environment that lowers the costs of establishing and operating a business, including simplified registration and licensing procedures, appropriate rules and regulations, and reasonable and fair taxation, will help new entrepreneurs to get a start in the formal economy and existing informal businesses to enter the formal sector. Furthermore, the security that formality provides will facilitate access to formal markets, favorable credit terms, legal protection, contract enforcement, foreign exchange, and local and international markets. A coherent legal, judicial, and financial framework for securing property rights and utilization of productive capital through sale, lease, or use as collateral should be a high priority.

## MINIMIZING TRANSACTIONS COSTS

Entrepreneurship doesn't happen without deal-making in circumstances of uncertainty, which depends to a great extent on trust. While Pakistan is rich in talent and has ample capital resources (particularly when the economic assets of the Pakistani Diaspora are taken into consideration),<sup>12</sup> it suffers from a significant trust deficit that not only undermines the relationship between citizens and government but also, and significantly, impedes the conduct of business by increasing the cost of business transactions. Building trust takes time. Consequently, the government should undertake to mitigate adverse consequences of the trust deficit by decreasing transaction costs in its dealings with citizens and increasing the transparency of government decisionmaking. In practical terms, this means seizing every available opportunity—in particular, opportunities created by the widespread availability of information and communications technologies—to make government information easily available to citizens and to improve the efficiency of government service delivery.

The economic structure of an economy, and its competitive potential, is determined not only by the nature of competition in core industries and the latitude that exists for entrepreneurial entry: underlying both entrepreneurship and competition is the need for trust. As Frank Fukuyama has observed:

Although there are other factors accounting for firm size, including tax policy, antitrust, and other forms of regulatory law, there is a relationship between high-trust societies with plentiful social capital—Germany, Japan, and the United States—and the ability to create large, private business organizations. These three societies were the first—both on an absolute time scale and relative to their own development histories—to develop large, modern, professionally managed hierarchical corporations...In [low-trust] societies the reluctance of nonkin to trust one another delayed, and in some cases prevented the emergence of modern, professionally managed corporations.

If a low-trust, familistic society wants to have large-scale businesses, the state must step in to help create them through subsidies, guidance, or even outright ownership. The result will be a saddle-shaped distribution of enterprises, with a large number of relatively small family firms at one end of the scale, a small number of large state-owned enterprises at the other, and relatively little in between.<sup>13</sup>

It is clear from the foregoing that Pakistan conforms to the profile of a low-trust society. Furthermore, as Fukuyama's analysis further indicates, the low level of trust in Pakistan is as much the cause as it is the result of the country's economic stasis. To be sure, government actions that intervene in favor of powerful incumbents undermine trust within the society but, as Fukuyama notes, such interventions may, at the outset, themselves be induced by low levels of trust within the society. Low levels of trust translate into the high cost of business transactions.

A key element of the New Development Approach, then, is to implement strategies that minimize transactions costs and build trust by focusing on the interaction between the government and the citizens of Pakistan along three dimensions:

- **Information**—Timely, consistent, and easily accessible information is critical to building trust. Where citizens can access information about laws and government processes—including hours of operation and the documentation required to complete a process—trust increases. Where the media provides accurate reporting with verified sources, trust is increased. The Pakistani government has put some of its processes online. The 2008 Securities and Exchange Commission's e-Services are an example. E-Services have enabled online company registration, which has resulted in an increase in the number of companies registered in Pakistan.
- **Transparency**—The ease with which citizens can access information is as critical as the accuracy of the information itself. Trust is increased whenever a citizen can easily identify operative laws, rules, and procedures, and otherwise access information vital to business and personal functioning in society.
- **Connections**—Networks are well known to be critical to an entrepreneur's success. People trust one another when they interact with and know one another. Bringing people together is another way to enhance trust. Societies in which officials seek votes, reach out to the community, and hold town hall meetings have an increased level of trust. The government can increase the connectivity of the society by making the most of its potential role as a neutral convener.

#### ACCOMPLISHING THE TRANSITION TO AN ENTREPRENEURIAL ECONOMY

Little, if anything, in this report is new. Indeed, some of the analyses and proposed initiatives are over two decades old. This prompts one to ask why a new round of initiatives to enable firm growth would be likely to succeed when previous efforts have not been successful. There are at least three reasons:

1. Previous initiatives to support entrepreneurs were sporadic and contradicted by other aspects of economic policy. The opportunity exists today for the government to deploy a coherent and consistent entrepreneurship-led growth strategy.
2. Competitive and demographic challenges facing Pakistan have only intensified in the past two decades, making support for entrepreneurship and innovation an even more urgent national priority now than before. This increases the likelihood that interests that otherwise might be opposed to market reform might align in favor of policies to support entrepreneurs.
3. Perhaps most significantly, the dramatic diffusion of information and communications technologies and other distributed technologies creates new pathways to address longstanding disadvantages to entrepreneurship and innovation.

Accomplishing the transition to an entrepreneurial and innovative economy will require directly addressing fundamental and longstanding issues, but at the same time it will require making the most of particular opportunities inherent in the historical moment. This section focuses on four such opportunities:

- Acting assertively to capture the “demographic dividend”
- Engaging Diaspora talents and resources
- Accelerating the mobile revolution
- Supporting the deployment of distributed energy technologies

### **Acting Assertively to Capture the “Demographic Dividend”**

Pakistan’s population has tripled in less than 5- years, and it will increase by an additional 85 million by 2030. Half of Pakistan’s citizens are under age twenty; two-thirds have yet to reach their 30th birthday. To meet the needs of its growing population, Pakistan’s economy must grow by 6 percent each year; that means it must add 36 million new jobs in the next ten years.

The education and social systems do not encourage or facilitate entrepreneurship as a preferred career option among the youth. High-growth, opportunity entrepreneurship is excessively restricted to those belonging to existing business families or by students at premier business schools. As a result, the economy witnesses the creation of too few new enterprises; those that are created are disproportionately in traditional areas of business, creating congestion in a few markets while other markets are dramatically underserved.

Yet, with the proper institutional context in place, experience elsewhere (as well as from the Pakistani Diaspora) suggests that that the entrepreneurial capabilities of the Pakistani people remain a significant and untapped resource for development. If this entrepreneurial potential can be unleashed by providing a level playing field, information, awareness, and support in establishing enterprises, Pakistan can witness fast-paced growth as new enterprises create new employment opportunities, thereby improving the distribution of wealth and exploiting the opportunities offered by international markets.

There is a need to promote entrepreneurship actively (1) by implementing curricular enhancements pertaining to entrepreneurship (for example, modeled after Jordan’s successful Injaz al-Arab program); (2) by creating awareness among youth; and, more importantly, (3) by providing effective support mechanisms, including access to capital, mentoring, and skill-building, to those who want to establish new enterprises. The ultimate objective of entrepreneurship education policies should be to facilitate the creation of an entrepreneurial culture, which in turn will help potential entrepreneurs to identify and pursue opportunities. Government policies on entrepreneurship education are critical to ensure that entrepreneurship is embedded in the formal education system and offered through partnerships with the private sector, with the informal community, and with apprentice training programs in rural areas.<sup>14</sup>



Pakistan currently is experiencing an unprecedented “demographic dividend” as the working-age population bulges and the dependency ratio declines. This shift is as much an opportunity as it is a challenge. The demographic dividend available to Pakistan and its implications for the country mainly reflect three key issues: labor supply, savings, and human capital. For economic benefits to materialize, there is a need for policies dealing with education, public health, and those that promote labor market flexibility and provide incentives for investment and savings. In contrast, if appropriate policies are not formulated, the demographic dividend might in fact be a cost that leads to unemployment and puts an unbearable strain on education, health, and old age security.<sup>15</sup>

If young Pakistanis can be properly educated and successfully absorbed into the labor force, the country’s demographic dividend could boost social well-being and spark economic growth.<sup>16</sup>

### **Engaging Diaspora Talents and Resources**

The Pakistani Diaspora community could be an invaluable resource for the national development of Pakistan. Their contributions to economic development could be substantial through platforms of the knowledge economy and via knowledge networks if leveraged strategically and diligently.

The Pakistani Diaspora is significant, numbering roughly ten million people around the world. Formal remittances to Pakistan were \$8 billion in 2008. This was nearly same level as foreign direct investment, which was only \$500 million per year in the 1990s and more than \$8 billion in 2008—an increase by a factor of 16 for Pakistan, compared to a factor of 10 increase for emerging markets as a whole.<sup>17</sup>

The “brain gain” from this group could indirectly improve overall governance in aspects of social, economic, and political life by further activating the entrepreneurial space. Clear examples of this include the following:

- Lahore University of Management Sciences (LUMS) and the Organization of Pakistani Entrepreneurs (OPEN) signed a memorandum of understanding for cooperation to establish the OPEN Centre @ LUMS for Innovation and Entrepreneurship on July 29, 2010, for a period of five years. The center aims to create an entrepreneurship network that sustains entrepreneurs and promotes the creation of new ventures to foster economic growth in Pakistan.
- The Indus Entrepreneurs (TiE) has three chapters in Pakistan: Karachi, Lahore, and Islamabad. It provides a platform for business plan competitions, networking forums, start-ups, mentorships, entrepreneurial summits, and much more. All these local chapters are operated by well-known Pakistani entrepreneurs.

Done on a larger scale, this could also pave the way for direct links between entrepreneurs in Pakistan and entrepreneurs of Pakistani origin that would enable them to invest in high-impact entrepreneurial ventures. The Pakistani government should seek to encourage such exchanges by improving the business environment and offering incentives, as has been demonstrated successfully in South Korea, India, and China.

There are signs that Diaspora entrepreneurship of this kind might be growing, albeit in different shapes and forms. The key Diaspora-driven entrepreneurship showcases a safer way to enter a new market like Pakistan and minimizes risks for foreign companies seeking to operate there. It ties a lot of the reputation and network capital of these Diaspora founders to the venture capital of U.S. investors, thus considerably enhancing the chances of success. One model of Diaspora entrepreneurship is the “straddling expatriate,” who lives in the United States or Europe (the developed “market”) but operates a company whose development hub is in a developing country—in this case, Pakistan. The second model of Diaspora entrepreneurship is the “returning expatriate” who, after spending several years abroad, has now returned to his native country—at least partially—and now helps to develop a foundation for innovation and employment in his native country.

### **Accelerating the Mobile Revolution**

Pakistan represents a growth market for mobile communications and applications that can provide a significant impetus for the development of an enterprise economy.

The widespread use of mobile phones creates a particular opportunity in the financial services industry to increase competition and thus extend financial inclusion through branchless banking. Through the Branchless Banking regulation issued by the State Bank of Pakistan in March 2008 and the Branchless Banking guidelines issued by the Pakistan Telecom Authority in June 2008, the government has set the stage for the widespread deployment of branchless banking services. However, in part for the reasons outlined at the outset—excessive monopoly rents derived from core lines of business—as well as the fragmented (and highly competitive) nature of the Pakistani mobile phone industry, branchless banking services have been slow to develop in Pakistan. To date, only one consumer offering exists—Telenor’s “easypaisa”—and that service has limited functionality and reach when compared to mobile-enabled branchless banking services elsewhere in the world. Accelerating the deployment of branchless banking could be a key driver of competition in the financial services industry, and potentially also a facilitator of entrepreneurship in Pakistan.<sup>18</sup>

The government of Pakistan can act in other ways to accelerate the beneficial impact of the mobile revolution, potentially including:

- Accelerating the adoption of leading mobile services, such as mobile payments
- Developing shared standards for data exchange, facilitating interoperability (including via “cloud computing”)
- Encouraging flexible regulation that does not impede innovations that could transform the delivery of essential products and services to the poor
- Easing the process by which remittances can be transferred via mobile phones
- Actively supporting the development and deployment of open-source, interoperable mobile applications (in particular SMS) in a range of areas, including health

and financial services, through direct funding, prizes, and the facilitation of advance-usage commitments

- Nurturing entrepreneurship in the development of mobile applications among youth with programming skills

### **Supporting the Deployment of Distributed Energy Technologies**

Two-way metering, dynamic pricing, and other market-based policy initiatives can open the door to market entry by a variety of new ventures in electric power generation and transmission.

Distributed solar-, wind-, and hydropower are all well adapted to different parts of Pakistan. With the right government policies in place to support their exploitation, each has the potential to positively disrupt the electric power industry in Pakistan—which today is needlessly dependent on oil, an inefficient and volatile energy source for electric power generation.

Consider, for example, hydropower. Hydroelectric generation is one of the oldest forms of electricity production, but in the 20th century, hydroelectric development focused on ever-increasing generation capacity. Large, capital-intensive hydro efforts, such as the Hoover Dam and Tennessee Valley Authority in the U.S., led to similar projects throughout the world, such as the Aswan Dam in Egypt.

More recently, however, research and entrepreneurial activity have spurred renewed interest in smaller hydroelectric generation facilities, especially for international development. The term “micro-hydro” commonly refers to facilities with generation capacities generally less than 100 kW, which do not significantly alter local environmental conditions or river flows.<sup>19</sup> One relatively new subset of micro-hydro is pico-hydro, which includes very small systems that generate less than 5 kW of capacity. These concepts are especially relevant for communities in rural and developing areas as a way to generate cost-effective, low-impact electricity.<sup>20</sup>

Pakistan is ideally situated geographically for implementing micro-hydro facilities. Micro-hydro generates electricity by diverting upstream river water through a side chute to a set of turbines downstream. Micro-hydro facilities operate in “low-head” environments, where the difference between the upstream intake and downstream outlet is at least 30 meters. Depending on energy usage, infrastructure, and geographical distribution, a micro-hydro facility can provide electricity for about 100 households. Chattha, Khan, and Haque (2009) estimated the total potential hydro resources of Pakistan to be 41 GW, with 1290 MW suited to micro-hydro development. They estimate that the “off grid micro-hydro systems are very essential for the consumers living in the remote areas of Pakistan and may be installed on canals and water falls which are abundant in the remote areas.” Indeed, development programs in Pakistan and neighboring Afghanistan have broadened rural access to electricity through innovative micro-hydro systems. They not only built the facilities, they also developed the community-based governance mechanisms that regulate output and pricing.<sup>21</sup>

Given the favorable geographical characteristics in Pakistan for micro-hydro, an equally favorable environment for entrepreneurship could induce the development of a regional entrepreneurial cluster related to micro-hydro installation. Novel micro-hydro designs could also integrate other services needed by rural populations, such as drinking-water filtration, making Pakistan an entrepreneurial laboratory within the hydroelectricity sector.

To enable the entry of new firms into distributed solar-, wind-, and hydropower generation and transmission, the government of Pakistan should

- fully implement two-way metering and dynamic pricing in energy markets;
- institute lower-bounds for regulatory oversight in energy markets and otherwise lower barriers to meso-scale energy generation.

## CONCLUSION

Conventional wisdom holds that a country can transition from a 20th-century industrial economy to a 21st-century entrepreneurial economy only after its political institutions have fully matured. That is backwards: a country's political institutions mature only as its economy produces broad-based opportunities on a sustainable basis. Similarly, internal security and political stability are not prerequisites for, but the consequence of, broad-based social development that is driven by competition and entrepreneurship and supported by increasing levels of social trust. Actions taken in the name of near-term stability that undermine competition and economic dynamism not only make a country less prosperous—they also make it less secure and less stable.

In any country—Pakistan is no exception—the real cost of an excessive preoccupation with the “hardware” of both national security and development is that it draws attention and resources away from the “software”—competition, entrepreneurship, and trust. Indeed, crises of any type have the same effect: they divert resources from the future and toward the present.

International perceptions to the contrary, Pakistan is a no more violent or dangerous place than many other countries in the vicinity. India (Naxalite rebels, Hundi extremists, sectarian violence), Sri Lanka (Tamil Tigers), and Turkey (Kurdish nationalists) are all places where indigenous and imported terrorists have been active; that fact has not prevented those countries from developing rapidly. Taking the comparison farther afield, gang and politically related deaths in Mexico during the past three years have been nearly four times more numerous than in Pakistan. The difference is that Pakistan's security challenges have an international profile, and thus they attract greater attention than would otherwise be the case.

As a consequence of diverse pressures, then, the demands of the present have been so great for the past 20 years in Pakistan that the future has persistently been put on hold. Now the time has run out on that approach. Yes, there will be new exigencies of the moment. The impetus will be great to revert to familiar modes of argumentation and action: crisis, assistance, projects. What is needed, however, is a decisive break with the past. What is needed is a New Development Approach

that creates new modes of argumentation and action: competition, entrepreneurship, and trust.

In short, for Pakistan to be a place of the future, it must create a place for the future.

## ANNEX. THE PROCESS OF DEVELOPMENT

Decades of quantitative, macro-level studies of development offer little, if any, evidence to support the claim that official development assistance—foreign aid—can accelerate development on a national scale. If anything, historical evidence suggests that aid has a corrosive effect on governance and distorts the evolution of markets. Countries heavily dependent on development assistance characteristically suffer from an “aid curse” that is functionally comparable to the “resource curse,” which is known to undermine the development of countries dependent on revenues from natural resources. In both settings, a similar irony is at work: greater revenue and diminished accountability to citizens in the short term lead to slower development in the long term.<sup>22</sup>

### Fundamentals

To be sure, the realities of research in development economics are such that even the most able scholars have difficulty establishing with confidence proof that any approach to accelerating development has been “successful” in one place or another. Yet while academics and policymakers are still searching for the best approaches to accelerate development, the process of development itself is actually fairly well understood. Ample historical evidence supports the following general assertions about the manner in which development occurs:

- Development is an ongoing process of social change—subject to regular disruption—that involves institutions, culture, and technology.
- While societies can advance for a short while through incremental adjustments to the status quo, long-term development requires entrepreneurship and innovation.
- Entrepreneurs and innovators exist in all societies, but not all societies are equally welcoming of the disruptive changes they provoke.
- Individual entrepreneurs and innovators thus face three options: seek economic rents within the status quo; challenge the status quo through disruptive innovation; leave the society altogether to seek an environment more welcoming of creativity.<sup>23</sup>
- When too large a fraction of potential innovators and entrepreneurs choose either to seek rents within the context of the status quo or to leave the society altogether, development slows or comes to a halt.

What this means is that creating a place for the future in any country means creating a space for entrepreneurship and innovation—and, in particular, encouraging the subset of potential entrepreneurs and innovators who choose neither to conform nor to depart, but rather to stay and build something new.

Entrepreneurship is present in all societies but manifests itself differently depending on the context.<sup>24</sup> While there is little evidence that government action can affect the overall supply of entrepreneurs in a given economy, there is strong evidence that it can influence the manner in which entrepreneurs—or entrepreneurially inclined individuals—direct their abilities. As William Baumol has noted, “Policy can influence the allocation of entrepreneurs more effectively than it can influence its supply.”<sup>25</sup> Strategies that support development at a national scale thus must consider not only the quality of the business climate in general, but also, and importantly, the way government actions affect the relative returns to entrepreneurship of different types.<sup>26</sup>

The challenge in designing and implementing policies to support entrepreneurship is that such policies are effective only if they shift existing incentives in a direction that leads to preferred social outcomes. In work spanning two decades, Baumol has explained that the objective of policies that support entrepreneurship is less to create entrepreneurial talent than it is to affect the allocation of that talent among productive, unproductive, and destructive options:

How an entrepreneur acts at any given time and place depends heavily on the “rules of the game”—an economy’s laws and regulations—that happen to prevail... An economy’s laws and regulations—not the total supply of entrepreneurs or the nature of their objectives—undergo significant changes from one period to another and, in doing so, help to dictate the allocation of entrepreneurial resources.<sup>27</sup>

This observation has important empirical implications. For example, while microfinance has, over the past three decades, proven to be an effective tool to allow people to gain control over their own income, it has not unleashed the innovation and capital flow required to help to stimulate growth. Indeed, microloans only rarely fuel the creation and growth of entrepreneurial ventures.<sup>28</sup> Though there is no doubt that the availability of finance does facilitate entrepreneurship, contrary to popular belief, financing is not the primary obstacle to entrepreneurship: the primary obstacle is action (or inaction) by government that has the unintended consequence of directing entrepreneurial talent—whether in rural areas or at the heart of major cities—from productive activities to unproductive or destructive activities.

As seen in the West and increasingly in emerging markets, such growth comes from high-growth businesses such as Walmart, Microsoft, and Infosys, which have created millions of jobs and generated billions in revenues.<sup>29</sup> A county’s success in supporting such “Schumpeterian entrepreneurship” is reflected directly in the number of new but rapidly growing companies it produces. In Pakistan, firms with fewer than ten employees employ nearly 80 percent of the non-agricultural workforce but contribute only 30 percent of GDP—figures that have remained largely unchanged for the past two decades.<sup>30</sup> In contrast, small firms in developed countries typically are less dominant in terms of employment, but they contribute a greater share of GDP; small and growing firms also contribute to economic growth to an extent disproportionate with their size.<sup>31</sup>

Furthermore, today as in the past, there is no viable bridge linking small and large firms. Small family businesses are essentially precluded from growing into large groups; large corporations rarely invest in, or develop, small enterprises. Even buyer-supplier relationships with subcontractors—key to the functioning of large firms in advanced industrialized countries—in most industries are either poorly developed or absent. The economic environment lacks—in addition to trust—an ecosystem that connects the various levels of the private sector: large corporations, innovative high-growth firms, and micro-enterprises. The challenge is how to bring all of those into an ecosystem where they're working and reinforcing one another.

### **Implications for Economic Strategy**

A strategic imperative for Pakistan, as for governments around the world, is in the design and implementation of policies and programs that encourage entrepreneurship in general, and the creation of high-growth firms in particular—rewarding rather than penalizing entrepreneurs who are successful in providing new and innovative goods and services.

Contrary to widespread belief, a national economic strategy emphasizing development led by entrepreneurship is not the same as a strategy emphasizing either support for small- and medium-enterprises (SMEs) or improvements in the “business climate.”

While all new and rapidly growing firms fall, at first, into the category of SMEs, it is important to note that implementing strategies to accelerate entrepreneurship is not the same as building institutions to support SMEs. SMEs are small, but they are not necessarily new or growing. Schumpeterian ventures are new and innovative, but when successful they do not remain small or midsize for long. Indeed, programs to support SMEs, if improperly conceived and implemented, may actually undermine entrepreneurship if they diminish incentives for entrepreneurial innovation and growth-directed strategies—for example, by creating a program of subsidies not available to firms that grow beyond a certain size.

Support for entrepreneurship and innovation is similarly often confused with generic strengthening of the “business climate.” What is the nature of the difference? The business climate pertains to all firms—both incumbents and new entrants. Some elements of the business climate (for example, the time required to register a new business or the difficulty of obtaining business licenses) are relevant to entrepreneurship. However, others (for example, the stability of the financial sector) may actually imply the concentration of market power.

Given that development depends on the decisions made by entrepreneurs to allocate their talent to productive activities rather than unproductive (rent-seeking) or destructive ones, effective development planning begins with consideration of two key questions:

- What actions does government take (or fail to take) that affect the incentives of entrepreneurs?

- How can government adjust its actions to increase the allocation of entrepreneurial talent to productive activities?

These two questions suggests a domain of inquiry that spans almost every dimension of government activity at the federal, provincial, and local level—from fiscal and monetary policy, to land use and urban planning, to legal protections and antitrust policies. Effective action must connect this broad domain of inquiry to specific areas of work.

## **Acknowledgments**

This study was prepared for the Planning Commission by Tagore LLC under contract with the Competitiveness Support Fund, a joint venture of USAID and the Pakistan Ministry of Finance. Khalid Mirza, former chair of the Competition Commission, acted as senior adviser to the study team. A full list of those consulted in the preparation of the study appears at the end of the report. The paper draws analysis and insights from Haque (2007, 2010), Planning Commission (2010a, 2010b), and Competition Commission (2009a), in addition to other works cited in the text.

The authors thank the following people who offered input into this study: Pakistan

### **Islamabad**

1. Mosharraf Zaidi, Advisor and Writer
2. Tariq Shafi Chack, Additional Secretary, Ministry of Industries and Production, Government of Pakistan

### **Karachi**

3. Firoz Shroff, Chairman, SASI Group of Companies
4. Muddassar M. Malik, Co-Founder, CEO & Executive Vice Chairman, BMA Capital
5. Sabeen Mahmud, President, The Indus Entrepreneurs (TiE) Group, Karachi Chapter and CEO of Peace Niche
6. Saqib Shirazi, CEO, Atlas Honda Limited
7. Shakir Husain, CEO, Creative Chaos
8. Shamoos Sultan, CEO, Khaadi
9. Sono Khangarani, CEO, Thardeep Rural Development Program (TRDP)
10. Zafar Siddiqui, Director, IBA Centre for Entrepreneurial Development

### **Lahore**

11. Dr. Ahmad Jan Durrani, Vice-Chancellor, Lahore University of Management Sciences
12. Anwar Khan, CEO, Small and Medium Enterprise Development Authority (SMEDA)
13. Fahd Bangash, CEO, Amaana
14. Dr. Ghazanfer Ali, Professor, Lahore School of Economics, Banking Expert



15. Monis Rahman, CEO, Naseeb Networks
16. Seema Aziz, CEO, Bareeze
17. Shahad Khawaja, Senior Advisor, Competitiveness Support Fund, Former Secretary, Ministry of Industries & Production, Government of Pakistan
18. Syed Babar Ali, CEO, Packages Limited and Chairman, Lahore University of Management Sciences

#### **United States and United Kingdom**

1. Asim Khwaja, Associate Professor of Public Policy, Kennedy School of Government, Harvard University
2. Awais Khan, CEO, American Pakistan Foundation
3. Kashif Zafar, Managing Director, Barclays Bank
4. Molly Kinder, Center for Global Development
5. Peter Mandeville, Associate Professor of Government & Islamic Studies, George Mason University
6. Eric Manes, World Bank
7. Rabia Nusrat, British Asian Trust

#### **Endnotes**

1. See Competition Commission (2009a).
2. Qayyum et al. (2008).
3. See Schumpeter (1911, 1942) and Auerswald and Acs (2009).
4. Haque (2010) and Planning Commission (2010a).
5. All are available at the website of the Competition Commission of Pakistan. Available at <http://www.cc.gov.pk>.
6. Competition Commission (2009a), Ghazanfar and Kazmi (2009).
7. Ibid.
8. In 2009 and 2010, respectively, the NSS attracted Rs224 billion and Rs267 billion, in contrast with Rs87 billion in 2008.
9. The paradigmatic example of this phenomenon was the collapse of the Soviet Union, which followed directly from the antipathy toward innovation and inherent informational challenges inherent to central planning. Olson (2000).
10. Auerswald and Acs (2009).
12. See, e.g., Qayyum et al. (2008), Legatum (2010), and Competition Commission (2009a, 2009b, 2010a, 2010b, 2010c)
12. Qayyuem (2008).
13. Fukuyama (1995, p. 30).
14. Volkmann et al. (2009).
15. Nayab (2008). Pakistan Institute of Development Economics, Islamabad. The Pakistan Development Review, 2008, vol. 47, issue 1, pages 1-26.
16. Bloom and Freeman, 1986.
17. Ref. Legatum (2010).
18. CGAP (2010).
19. See Moreire and Poole (1993).
20. See University of Nottingham (n.d.); The Ashden Awards for Sustainable Energy (2010).
21. See Aga Khan Rural Support Program (2004); DAI (2010).
22. Easterly (2002), Quadir (2009).
23. These three options (taken in reverse order) are analogous to the fundamental political options articulated by Albert Hirschman (1970) long ago: exit, voice, and loyalty. As Hirschman (1958, p.

- 5) noted, “Development depends not so much on finding optimal combinations for given resources and factors of production as on calling forth and enlisting for development purposes resources and abilities that are hidden, scattered, or poorly utilized.”
24. Baumol (1990). Productive entrepreneurship corresponds to the creation and expansion of new firms; unproductive entrepreneurship corresponds to rent-seeking activities; destructive entrepreneurship corresponds to trafficking in illicit goods. All these forms of entrepreneurship create economic activity. However, institutions advances and societies progress only when the returns to productive entrepreneurship exceed those to unproductive and destructive entrepreneurship. Within the category of “productive entrepreneurship,” it is possible to differentiate further between “opportunity entrepreneurship” and “necessity entrepreneurship.”
25. Baumol (1990, p. 893).
26. Auerswald (2008).
27. Baumol (2010, p. 153).
28. Microfinance institutions (MFIs) today provide services to over 150 million clients across the globe, with wide variation in models used and outcomes achieved. Assessments of micro-lending have tended to focus on high repayment rates rather than on promoting borrower welfare. See, e.g., Banerjee et al. (2009), and Zinman and Karlan (2009).
29. In low-income countries, the contributions to economic output and employment made by formally registered small and midsized enterprises (SMEs) are less than one-third those made by their counterparts in high-income countries. This disparity is evidence of impediments that exist in poor places to the development of high-growth enterprises.
30. Data available from the Statistics Division, Government of Pakistan. Available at <http://www.statpak.gov.pk/>. See also Asian Development Bank (2005) and Rauf (1994).
31. Stangler (2010).

## References

- Acs, Zoltan. (2006). “How Is Entrepreneurship Good for Economic Growth?” *Innovations: Technology, Governance, Globalization* 1, no. 1: 97-107.
- Aga Khan Rural Support Program. (2004). “Solar Power for Communities, Farmers and Market Traders across India.” Available at <http://www.ashdenawards.org/winners>.
- Ashden Awards for Sustainable Energy. (2010). “Micro-Hydro.” Available at <http://www.ashdenawards.org/micro-hydro>.
- Auerswald, Philip E. (2008, May). “Entrepreneurship, Opportunity, and Growth,” paper presented at the OECD Kansas City Workshop on High-Growth SMEs, Innovation, and Intellectual Assets. Available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1376427](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1376427)
- Auerswald, Philip E., and Zoltan Acs. (2009). “Defining Prosperity.” *The American Interest* May-June: 4-13.
- Baumol, William J. (1990). “Entrepreneurship: Productive, Unproductive, and Destructive.” *The Journal of Political Economy* 98, no. 5, part 1: 893-921.
- Baumol, William J. (2010). *A Microtheory of Innovative Entrepreneurship*. Princeton, NJ: Princeton University Press.
- Banerjee, A., E. Duflo, R. Glennerster, and C. Kinnan. (2009, May). *The Miracle of Microfinance?* Washington, DC: Consultative Group to Assist the Poor.
- Bloom, David E., and Richard B. Freeman. (1986). “Population Growth, Labor Supply, and Employment in Developing Countries,” NBER working papers 1937. Cambridge, MA: National Bureau of Economic Research.
- Chattha, Javed A., Mohammad S. Khan, and Anwar ul-Haque. (2009). “Micro-Hydro Power Systems: Current Status and Future Research in Pakistan.” In ASME 2009 Power Conference (pp. 629-636). Albuquerque, NM: Available at

## Creating a Place for the Future

- <http://link.aip.org/link/ASMECP/v2009/i43505/p629/s1&Agg=doi>.
- Competition Commission of Pakistan. (2009a). "State of Competition in Pakistan." Islamabad, Pakistan.
- Competition Commission of Pakistan. (2009b). "Competition Assessment Study of the Fertilizer Sector in Pakistan." Islamabad, Pakistan.
- Competition Commission of Pakistan. (2010a, July). "Analysis of Competition in the Automobile Sector" (draft). Islamabad, Pakistan.
- Competition Commission of Pakistan. (2010b, July). "Competition Assessment Study on the Sugar Sector in Pakistan" (draft). Islamabad, Pakistan.
- Competition Commission of Pakistan. (2010c, July). "The Analysis of Competition and Economic Development in the Power Sector" (draft). Islamabad, Pakistan.
- Development Alternatives Inc. (2010). "Afghan Villages Bolstered by Micro-Hydro Power Plant." Available at [http://www.dai.com/work/success\\_stories\\_detail.php?stid=60](http://www.dai.com/work/success_stories_detail.php?stid=60).
- Easterly, William E. (2002). *The Elusive Quest for Growth*. Cambridge, MA: MIT Press.
- Fukuyama, Francis (1995). *Trust: The Social Virtues and the Creation of Prosperity*. New York (USA): Free Press.
- Ghazanfar, Agha, and Nayyar Almas Kazmi. (2009b). "State of Competition in Pakistan." Islamabad: Competition Commission of Pakistan.
- Haque, Nadeem Ul. (2007). "Entrepreneurship in Pakistan," working paper 2007:29. Islamabad, Pakistan: Pakistan Institute of Development Economics.
- Haque, Nadeem Ul. (2010). "Towards a New Development Approach." Planning Commission blog. Available at <http://115.186.133.2/pcportal2.0/Blogs/tabid/56/EntryId/9/Towards-a-New-Development-Approach.aspx>.
- Hirschman, Albert O. (1958). *The Strategy of Economic Development*. New Haven, CT: Yale University Press.
- Hirschman, Albert O. (1970). *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*. Cambridge, MA: Harvard University Press.
- Klapper, Leora, Raphael Amit, and Mauro F. Guillén. (2008, February). "Entrepreneurship and Firm Formation across Countries," unpublished mimeograph.
- Moreire, J. R., and A. D. Poole. (1993). "Hydropower and Its Constraints." *In Renewable Energy: Sources for Fuels and Electricity*. London: Earthscan, and Washington, DC: Island Press.
- Murphy, Kevin, Andrei Shleifer, and Robert W. Vishny. (1991). "Allocation of Talent: Implications for Growth." *Quarterly Journal of Economics*: 503-530.
- Nayab, Durre. (2008). "Demographic Dividend or Demographic Threat in Pakistan?" *The Pakistan Development Review* 47, no. 1: 1-26.
- Newland, Kathleen and Hiroyuki Tanaka. (2010, October). "Mobilizing Diaspora Entrepreneurship for Development," report from USAID and the Migration Policy Institute.
- Olson, Mancus. (2000). *Power and Prosperity*. New York: Basic Books.
- Planning Commission. (2010a, September 29). "Productivity, Markets, & Communities: A New Development Approach," PowerPoint presentation.
- Planning Commission. (2010b, October 11). "New Development Approach: Springboards for Development," PowerPoint presentation.
- Qayyum, Abdul, Idrees Khawaja, and Asma Hyder. (2008). "Growth Diagnostics in Pakistan," working paper 2008:47. Islamabad, Pakistan: Pakistan Institute of Development Economics.
- Quadir, Iqbal. (2009, January 30). "Foreign Aid and Bad Government." *Wall Street Journal*.

Available at <http://online.wsj.com/article/SB123327734124831471.html>

- Schumpeter, Joseph A. (1911). *Theorie der wirtschaftlichen Entwicklung*. Leipzig, Germany: Duncker & Humblot. Revised English translation by Redvers Opie, *The Theory of Economic Development*. Oxford, England: Oxford University Press, 1934.
- Schumpeter, Joseph A. (1942). *Capitalism, Socialism and Democracy*. New York: Harper and Row.
- Shahbaz, Muhammad, Khalil Ahmad, and A. R. Chaudhary. (2008). "Economic Growth and Its Determinants in Pakistan." *The Pakistan Development Review* 47, no. 4: 471-486.
- Stangler, Dane. (2010, March). "High-Growth Firms and the Future of the American Economy." Kauffman Foundation Research Series: Firm Formation and Economic Growth.
- University of Nottingham. (n.d.). What Is Pico Hydro? Available at <http://www.picohydro.org.uk/>.
- Volkman, Christine, Karen E. Wilson, Steve Mariotti, Daniel Rabuzzi, Shailendra Vyakarnam, and Ana Sepulveda. (2009, April). "Educating the Next Wave of Entrepreneurs: Unlocking Entrepreneurial Capabilities to Meet the Global Challenges of the 21st Century," Geneva, Switzerland: World Economic Forum (Global Education Initiative).
- Zinman, J., and D. Karlan. (2009). "Expanding Microenterprise Credit Access: Using Randomized Supply Decisions to Estimate the Impacts in Manila," working paper.