

*The Quaid-i-Azam Lecture*

## **Towards Reorientating the Role of the Government in Pakistan**

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*The natural tendency is for government to gain ground and liberty to yield.*  
— Thomas Jefferson

I feel it a privilege to be asked to give the Quaid-i-Azam lecture on the occasion of the 22nd Annual Meeting of the Pakistan Society of Development Economists (PSDE). At a time when sustainability appears difficult and institutions are not finding it easy to take hold, it is a source of legitimate pride that the PSDE has been able to meet consecutively for 22 years and to bring economists together to discuss current ideas, present latest research, and to think about our country: its economy; its institutions and its future; and also to think about our profession, and the role it can play in our country, in understanding and interpreting its past and in shaping and influencing its future. And of course it is a good opportunity for us to have some fun and renew the bonds of friendship.

The theme for this year's meetings—governance—is both timely and important. And it is a tribute to the resourcefulness of the organisers, in particular the President of PSDE, Dr Nadeem Ul Haque that he has been able to attract high quality participation from the academic and policy circles of Pakistan.

The title of the paper “Reorientating government in Pakistan” is broad and multidimensional. I will therefore have to be general and selective. Nevertheless I will try to review what guidance economic theory, international development experience and our own checkered history can provide us in reorientating the role of government in our economy. The paper should be seen as a work-in-progress, which I hope to finalise after benefiting from the comments of this distinguished group.

The paper has been organised in the following way: I first look at the role of government from four different vantage points or from four sources, all of whom have shaped global thinking on the subject and in turn the thinking itself has been shaped by global events and international development experience. These four sources are:

- economic theory, and the thinking of theoretical economists;
- the changing paradigms of economic development and the evolution in the thinking of the development economists;
- the results of econometric analyses about growth and development based on large, cross-country data and the findings of the econometricians;

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- the experience of government ownership and management of commercial enterprises, i.e., the rise and decline of public enterprises.

I shall then look at the Pakistan experience. The country's economic performance under different periods, the "big facts" about the Pakistan economy which have stubbornly resisted change, the role of the government and its continuing onward march, the result of some efforts to reduce its size and the current state of affairs. I will highlight some of the consequences of the unreformed government and the necessity and urgency for reorientating it if we are to have a chance at becoming competitive and sustaining our latest growth spurt. Throughout I will attempt to draw guidelines that can help us in this reorientation.

### THEORETICAL PERSPECTIVES

Two hundred years back Adam Smith set the tone for the discussion on the role of the Government in the economy. According to him, individuals and firms motivated by a desire for the maximisation of their own welfare, working through the "invisible hand" of the market were to lead to outcomes that were best ("efficient") for society.

A major task of neo-classical economic theory and the work of some of the greatest economists have been to rigorously define the notions of efficiency ("Pareto efficiency") and postulate the conditions under which markets will lead to such efficient outcomes. The best amongst these economists have been rewarded with international acclaim and Nobel prizes for their contributions in developing these fundamental theorems of welfare economics.

At the same time, neo-classical theory concedes that certain kinds of "market failures" will not allow the markets—if left on their own—to reach these desirable outcomes. Government intervention to "correct" these market failures can therefore enhance welfare. Thus a theoretical case for government intervention in the economy is made.

These market failures are well known to economists and include:

The presence of *negative externalities*, where the welfare of one depends upon the actions of another, and these effects are not captured by the market. A common example of a negative externality is the pollution generated by the producer of some industrial product. In this case the social costs exceed the private costs and some form of government intervention, for example a tax or compensation scheme can enhance welfare.

*Public goods*: are goods which exhibit two characteristics. First, they are characterised by high costs of exclusion i.e. it is very hard to exclude anyone from their use. Secondly, there is non-rivalness in their consumption i.e. their consumption by one does not diminish their availability for others. Examples of public goods include national defense, functioning currency systems, national parks, scientific research, street lights etc. The high exclusion costs and non-rivalness in consumption create a "free-rider problem" as the people are unwilling to pay the price for the use of these public goods. Thus the market mechanism breaks down. The government then has to intervene and provide these public goods by raising funds for them, typically through the tax system.

New advances in welfare economics have added *imperfect information* and *incomplete markets* to the list which give rise to problems in a market economy.

For example *information asymmetries* (disparities in the availability of information) in the sale of certain items, requires government intervention to ensure full disclosure of product risks, and prevent the abuse of market power and insider trading.

Finally, the theoretical analyses of welfare economics are based upon a given distribution of income. If the given distribution of income is not considered desirable then also there is a case for government intervention. Thus in addition to the “efficiency” considerations listed above, the case for government intervention in the economy can also be made for reasons of “equity”.

Adam Smith in his *Wealth of Nations* states that the main tasks for the government are allocation of resources, redistribution of income, stabilisation of economic activity and promotion of growth and employment. In practice, this has meant the government’s pursuit of at least the following policies:

- (1) macroeconomic policies (or stabilisation policies), e.g., monetary and fiscal policies;
- (2) structural adjustment policies to address sources of economic rigidity and facilitate adaptability of business, government, and individuals to changing economic circumstances;
- (3) microeconomic policies to affect the decisions of investors, savers, workers, consumers and managers.

Even Milton Friedman, a leading critic of “big government” recognised in his classic “Capitalism and Freedom” that absolute freedom for the market was not possible. The existence of a free market does not eliminate the need for a government. Rather, governments become important in determining, interpreting and enforcing the “rules of the game”.

We can therefore say that economic theory assigns primacy to markets but accepts, rather requires intervention of the governments for attaining superior outcomes in the presence of market failures. However, while a theoretical rationale exists for government intervention, the issue of debate remains the magnitude, the means and the sequencing of these interventions.

Just because markets do not achieve efficient outcomes does not mean that government intervention can improve matters. This is so because any effort by the government to correct a market failure is met by “government failure”. Since governments (as principal) have to rely upon bureaucrats (agents) for correcting market failure, the principal-agent problems do not lead to desirable outcomes. Therefore, interventions have to be selective, judicious, and be based on a calculation—or at least an understanding—of the relative magnitudes of the market failure and the government failure.

### **DEVELOPMENT ECONOMICS PERSPECTIVES**

Development economists have also been trying to understand, explain, and sometimes influence the development of nations. The field has developed considerably in the post-war period and the emergence of new developing nations. These experts have been active in trying to draw the lessons of international experience and the implications for the appropriate role of the government.

As the process of development and the learning of the development economists has evolved the dominant economic paradigm has been changing and with it the assigned role for the government.

Some of the prominent post-war economic thinkers such as Arthur Lewis, Rosenstein Rodan, Nurkse, Prebisch, Hirshman and Leibenstien viewed economic development as a process that required the systematic reallocation of factors of production. This reallocation was from a low-productivity, traditional, decreasing returns, mostly primary to a high productivity, modern, increasing returns, mostly industrial sector. *The constraint was capital*. The reconstruction of war-destroyed Europe by the Marshall Plan and the advocacy by Rosenstein Rodan for the development of the underdeveloped Southern part of Italy through a series of government financed investments further influenced this thinking. Moreover, both physical and social infrastructure was lumpy and therefore, would not emerge spontaneously in response to uncoordinated market incentives. Thus government planners, foreign aid and government projects had to play a prominent role in this paradigm. The IBRD was created.

Soon development economists were convinced about the capacity constraints of the foreign assistance, and that government sponsored projects were not allowing sufficient rapid growth of privately managed and owned industry. There were just not enough industrialists available to carry the momentum forward and entrepreneurship emerged as they key missing element. However, this did not necessarily erode the government's role. In fact it created another basis for continuing with government projects. The "missing entrepreneurship school" led to the creation of the IFC.

An important observation of the development process was the fact that high rates of economic growth and industrialisation failed to reduce unemployment in many countries. Not only that but the income distribution worsened as owners of capital and skilled workers participated in the capital intensive projects and the unskilled, often jobless workers were left out. It was argued amongst others by Streeten that inappropriately high capital intensive technology was the culprit, while Harris and Todaro pointed to the rapid rate of rural-urban migration. In any case, the highly capital-intensive, large, government projects were contributing to this lopsided industrialisation and the slogan "getting prices right" became fashionable. A corollary of this thinking was to get the government's role curtailed in the industrial area.

Another source of criticism for the government's role in the economy came from trade theorists such as Krueger and Bhagwati. This group argued that government inevitably promoted a protection and subsidy driven industrialisation. This led to non-competitive and inefficient industry. Since governments found it hard to change their policies, their role needed to be curtailed. International trade could provide a substitute for low domestic aggregate demand, and if government's role could be confined to that of removing barriers to trade then export-led economic growth would result.

An alternate and more recent underdevelopment theory is associated with the Chicago School, in particular, Robert Lucas, which identifies the absence of human capital as the dominant reason for the LDC's inability to exploit the economies of scale associated with industrialisation. The role of the government is limited to providing investments in human capital and knowledge to propel developing countries from their low trajectory to a higher growth path.

Finally, the collapse of the socialist countries, the rise and subsequent problems of state-owned companies all over the world forced a rethink on the role of the government (this is a separate point to which I return later). The rise of the East Asian economies, the crisis, its aftermath and the subsequent recovery, has also allowed development economists to argue for selectivity in interventions and the importance of incentives for international competitiveness. (Of course, others such as Lall, and also Stiglitz pointed out the active support of some of the East Asian countries and argued for a more nuanced interpretation of the East Asian experience).

We can conclude this review with the following observations: that the development economists started the period after the WWII with expansive role for the government and the dominant thinking has evolved. Both economic theory and the experience of development ultimately limit the role of the government but allow for selective interventions. There is a place for governments but they must know their place. The issue ultimately is not one of the government's importance but that of its competence. Not of the quantity but the quality of its institutions. As Larry Summer's said, "*an overwhelming lesson.....we have learned in the 1990s, is .... the transcendent importance of the quality of institutions and ....the efficacy of political administration*".

### ECONOMETRICIAN'S PERSPECTIVES

Econometricians have been trying to understand, explain and forecast the growth of economies using large cross country regression analyses. These methods adopted primarily by Barro and Lee (1994) and Easterly, Loayza and Montiel (1997) consist of linking aggregate economic, political and social variables to growth rates in GDP per capita for a large sample of countries.

Five major classes of determinants have received particular attention in the academic literature and with policy-making circles, and some impact directly on the issue of the appropriate role of the government. These five determinants are:

- (1) *Transitional Convergence Variables*: i.e., countries tend to grow less rapidly as they become more developed and capital intensive due to diminishing returns.
- (2) *Cyclical Reversion Variables*: i.e., economies tend to recover from temporary recessions and slowdown from temporary booms.
- (3) *External Conditions*: that affect growth, i.e., changes in the global economy, terms of trade shocks, etc.
- (4) *Stabilisation Policies*: to achieve macroeconomic balance, raise productivity, check inflation and increase in real exchange rates, economic volatility etc.
- (5) *Structural Policies*: and changes to improve long-run productivity such as education, public infrastructure, government flexibility, trade openness, financial depth, etc.

There are important lessons for the role of the government particularly in looking at the last two groupings of indicators related to government policies: A recently concluded World Bank study [Growth and Competitiveness in Pakistan (2006)], uses data from 78 countries including Pakistan to draw the following lessons of relevance to our topic:

*Structural Policies*. The co-efficients of all variables have the expected signs and are statistically significant. Main finding: *Economic growth increases with improvements*

*in education, financial depth, trade openness and public infrastructure... it decreases when governments impose excessive burdens on the private sector.*

*Stabilisation Policies.* All estimated co-efficients carry the expected signs and statistically significance. Main finding: *Economic growth decreases when governments do not carry out policies conducive to macroeconomic stability.*

Another area of econometric analyses using large cross-country data is the study of the determinants of total factor productivity (TFP). It has long been established, at least since Solow's famous work, that in the long run growth will be sustained through factor accumulation and even more importantly, technological change i.e. TFP. These studies have been done at the level of the firm. The most recent study [Dollar, Hallward-Driemeier and Mengistae (2005)] which includes Pakistan—and is generally in conformity with other findings—shows that *improvements in the investment environment matter for firm level productivity.*

What these cross country analyses are highlighting is the Government's role as a *supplier of good policies* and as a *coordinator of policies* (because understanding policy complementarities is crucial for sustaining reforms and achieving best results. For example, there is a view that Pakistan has not been able to achieve the maximum impact from trade liberalisation because of the lagging reform in the regulatory environment and factor markets. These analyses also highlight the government's role as a *catalyst for structural change* (as a provider of education and public infrastructure) and as the *enable of the investment environment.*

#### **FOURTH PERSPECTIVE: THE RISE AND DECLINE OF PUBLIC ENTERPRISES**

Another important area of review for reorientating the role of the government is the experience with public ownership and management of commercial enterprises, i.e., public enterprises (sometimes also called state-owned enterprises).

In the brief review above, we have established that a market failure can be corrected through government intervention, but the method of intervention is left open. Consider a market failure to be present in the form of a natural monopoly. If left on its own it can exploit the consumers by overcharging them. However, the government can respond to this market failure in several ways. For example it can regulate the monopoly while it remains under private ownership. Or, it can take over the ownership itself and convert it into a public enterprise monopoly. In the face of several alternatives, we witnessed a tremendous growth in public enterprises. What explains their growth and the subsequent decline, leading to an expansion and then a reorientation in the role of the government in this important area of economic activity.

Public enterprises (PEs) are commercial entities owned and controlled by the government. They played an important role in the economies of socialist and even many mixed economies until the seventies. There were several reasons for the popularity of PEs with governments. PEs grew for reasons of ideology (as in the former Soviet Union and socialist countries); for reasons of history (the abandoned factories in some newly independent countries were taken over by their governments); for reasons of politics (to weaken opposition—or example the nationalisations of Egypt and Pakistan), and in some

cases, due to economic concerns when the domestic private sector was underdeveloped or the regulatory apparatus was not in place.

Unfortunately, but perhaps predictably, the PEs did not live up to their promise. The model of government-led import substitution policies in Latin America and India was discredited. The economies of the former Soviet Union, East Europe and Africa collapsed and with them went the ideological base for a dominant role of the state in production. In mixed economies, where the share of the PEs was in the range of 7 to 15 percent, their inefficiencies, poor quality of services, high costs and escalating fiscal burden forced governments to look for better alternatives.

The first impulse of governments in many countries was not to privatise but to reform these enterprises, while keeping them under continuing government ownership. Thus, all over the world, an industry developed under the title of public sector reform, restructuring, reinventing, turnaround etc. In our own country, different governments, often with help from donor agencies, attempted such reforms and restructurings. Everywhere, these reform efforts failed. Even when successful, the success proved short lived and could not be sustained. The failure of public sector reforms forced governments to turn towards privatisation as a last resort—and the only practical option.

Due to a combination of these reasons, privatisation, which had begun to gain momentum in the eighties, turned into a tide in the nineties. The average number of transactions per year reached 500 during the decade. Global proceeds in the same period amounted to US\$850 billion, up from US\$30 billion in 1990 to US\$145 billion in 1999, with large sales in EU countries contributing the most to these figures.

Developing countries' estimates for the decade were around \$250 billion with transactions in telecom, power, petroleum, mining, agriculture and forestry. Manufacturing contributed about 16 percent in developing countries, mainly from sales in Eastern and Central Europe and Latin America.

Out of the regions, Latin America has been very active with Argentina, Brazil, Chile, Bolivia, Peru and Mexico at the forefront. The formerly socialist countries of East and Central Europe privatised thousands of units, initially with mass-voucher schemes and subsequently through case-by-case sales with significant proceeds. After the 1997 crisis, East Asian countries have become more active as well. Even in the Middle East, countries such as Morocco, Tunisia, Jordan and Qatar have privatised some key sectors. In South Asia, Pakistan and Sri Lanka have had active programmes while Bangladesh and India have made sporadic attempts. In Africa, the number of sales increased and almost 3,000 firms had been privatised, with active programmes in Mozambique, Ghana, Angola, Zambia, Kenya, Tanzania and Guinea.

The experience with the rise and decline of the public enterprises has been a big factor in reorientating the role of the government away from ownership and management of enterprises to policy making and regulation of the economy in which these enterprises operate. This is a global phenomenon with far reaching consequences. This trend represents a move towards more focused government, concentrated on its core functions. A move towards better quality than more quantity of government. A more optimal sharing of the responsibilities between the public and the private sectors, based on the relative mandates and the comparative advantage of the two parties.

## THE PAKISTAN EXPERIENCE

### Economic Performance and Big Facts

The main periods of Pakistan's economic growth are summarised in the table. It is a stylised table, and needs to be worked upon to finalise. But this and related data is used to establish certain big facts about our economy, and the relationship between economic performance and government.

First, Pakistan has had only three episodes of economic growth, in the 60s, 80s and the 00s. None of these have lasted for more than 4-5 years. None of them have been accompanied by deep structural change. All three of these growth spurts have been driven by a combination of external aid, good crops and some policies of macro-economic stabilisation. External aid has always been a windfall for external circumstances, always tied to war: the cold war, the Soviet-Afghan war, and the Post-9-11 war. In two cases the spurts have ended when the aid has ended. All growth spurts have been accompanied by growing disparities in personal and regional incomes.

Second, these "war bonanzas" have not been entirely unlike extensions of the Dutch Disease problem in terms of the decision-making with respect to reforms. Like the cases of plentiful natural resources and easy access to foreign capital, these windfalls have been able to avoid needed reforms. It is important to recognise their impact *à la* Norway and Botswana for example, and neutralise them by prudent fiscal and monetary policies, by non-avoidance of structural reforms and making the political effort to overcome vested interests. An important indicator of the differential quality of policy response to these bonanzas is the manner in which growth is financed and in particular the size of the tax effort is measured by the tax to GDP ratio.

Third, the structure of the economy has remained largely unaltered. It is still dependent on agriculture and the vagaries of weather. Its industrial base is still narrow and it remains largely a one-item export economy. With the increasing openness of the global economy, if the exports of this one item—textile—come under threat the whole economy will be exposed to a high risk situation.

Fourth, the country has never been a favourite destination for foreign investment, only once crossing the one billion dollar mark in 95/96 due to the IPPs, until a marked improvement in the last couple years, when it went to \$1.5 billion in 04/05 and \$3.5 billion in 05/06. However, a significant portion of this FDI is due to privatisation transactions involving capital flows from abroad. The reasons for this limited attraction to international investors will be discussed below.

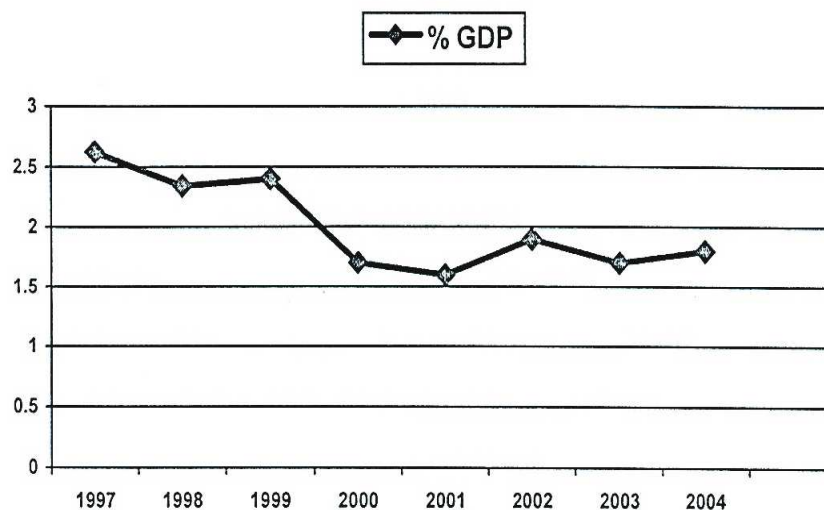
Fifth, Pakistan has never been able seriously mobilise its tax collection to reach anywhere near its needs or its potential. Irrespective of the nature of the regime or the performance of the economy. The tax to GDP ratio, as a measure of this effort has always been less than 12 percent.

Sixth, Pakistan has not benefited from the lessons of experience highlighted above in terms of focusing upon human development. The graphs—and — show the pitifully low figures spent on both education and health, and their stagnation over time. These highlight the wrong policies of resource allocation. If one considers that much of this money is spent directly through a highly inefficient government apparatus the impact becomes even lower. For example, latest figures on enrolments in schools in Sindh show actual declines.

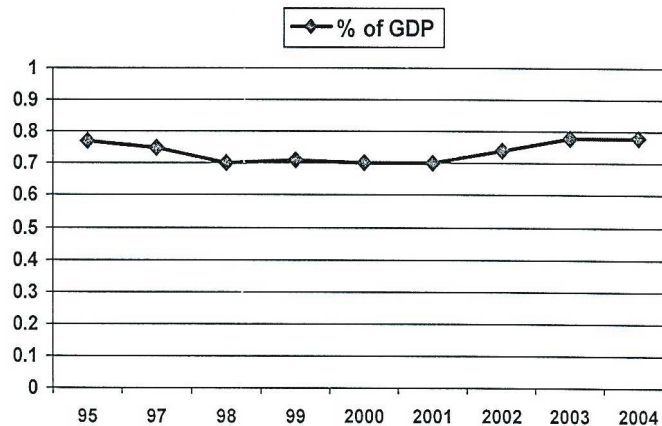


1960s	1970s	1980s	1990s	2000s
6.97	4.58	6.09	3.86	4.55
1st Aid Episode	Aid stoppage	2nd aid episode	Afghan war ends—Aid cutoff	3rd aid episode/rescheduling
Factor accumulation	Populism	remittance boom	incomplete IMF prog/ FCD crisis	post 9/11 remittances
Growing disparities	Industry Takeover	Institutional deterioration	Democracy / Instability	Successful IMF programme/macro consolidation
Political polarisation	decline of civil service	Increase in Military Expen.	perceptions of Mis-governance	Growing disparities
War and civil disturbance	77 + Military Rule	Missed opportunity/reform postponed	Banking reform/ privatisation efforts	Privatisation Results
Planning/PIDC	Government Projects	expansion of public sector	Infrastructure and IPP	Unsettled politics/limited institutional reform

### Education Expenditure Is Very Low, Has Declined, and Is Stagnant



### Expenditure on Health Is Very Low and Stagnant



Seventh, institution building has not been the dominant consideration throughout Pakistani history. The matter has been compounded due to the fact that big issues of Pakistan remain unsettled. These big issues include the form of the government, the role of military in politics, the independence of judiciary, the relations between the centre and the provinces and the formulae for the distribution of resources. These unsettled issues create opportunities for the government to expand and encroach upon all areas of economy under the pretext of national interest, security, emergency, etc.

### Three Recent Analyses

I now look at three very important and very recent (all completed in 2006) analyses by three independent and respected international agencies, each dealing with a facet of the role of government and trying to see where Pakistan stands. These analyses point to the centrality and urgency of reorientating the government in Pakistan.

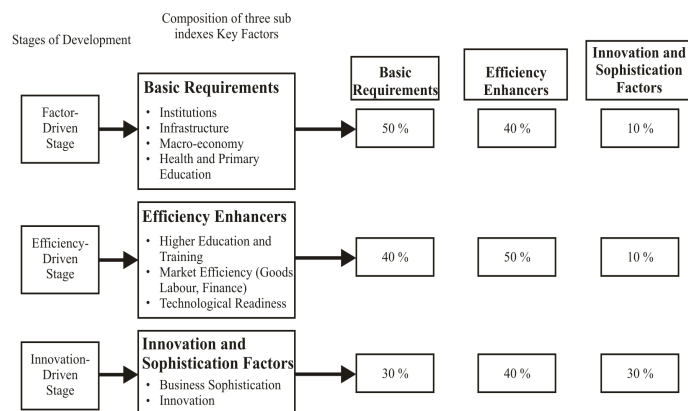
- (1) *International Competitiveness Ranking by the World Economic Forum.* The World Economic Forum (WEF) using Michael Porter's ideas and with the help of Jeffery Sachs and Xavier Sala-i-Martin has developed the Global Competitiveness Index (GCI), which is a comprehensive measure of a nation's competitiveness based on nine indicators, grouped under three broad areas: Basic Requirements, Efficiency Enhancers and Innovation Factors. These indicators are adjusted for the stage of development to derive the score of different countries and arrive at a ranking. Pakistan's overall rank in this index is 91 out of 125 countries. However, for our purpose what is important is to see the 5 areas that are considered the most problematic factors for doing business in Pakistan shown in Chart. What is interesting is that all the five factors, corruption, government instability/coups, policy instability, inefficient government bureaucracy and inadequate supply of infrastructure, are connected to government failure.
- (2) *The Corruption Perception Index by Transparency International.* The role of corruption in public life, and as a factor retarding investment is a serious form

of government failure. Combating corruption has high pay-offs. According to a leading authority of the subject “an estimated 400 percent improvement in per capita income is associated with an improvement in governance by one standard deviation” [Kaufman (2003)]. The perception of Pakistani governments as highly corrupt that first emerged internationally in the nineties has taken hold. The latest international survey assigns Pakistan a score of 2.2 out of 10 and a rank of 147 out of 163 countries. Pakistan has managed to languish at these scores and ranks for some time consolidating its global reputation in this area. From my own experience in Sindh, participating in a briefing on the achievements of the Sindh anti-corruption department, I discovered that not a single corrupt official had ever been successfully prosecuted in the entire history of the Sindh anti-corruption department. It has proven difficult to sustain credible anti-corruption programmes or to undertake meaningful civil service reforms.

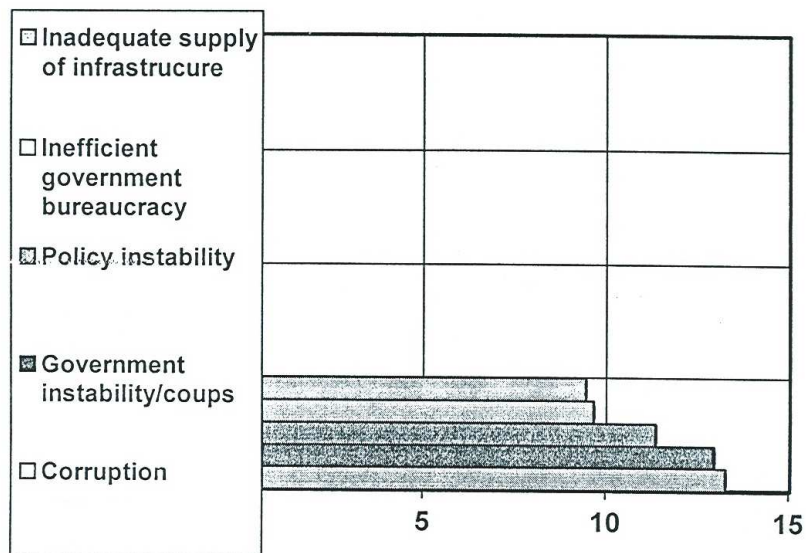
- (3) *Value Chain Analysis by the World Bank* to increase the efficiency and international competitiveness of Pakistani industry. The World Bank analysed in great detail five sectors of the economy: ready made garments, fisheries, mining, light engineering and dairy. All these have great potential but face serious constraints preventing this potential from being realised. The results of their detailed value-chain analysis are summarised for three sectors—ready made garments, shrimps and dairy in the Charts –to– . Almost every single item hindering the efficient development of each of these sectors is directly traceable to bad government. Whether it is the high freight, electricity outages, delay in collecting rebates, government involvement in cotton seeds, bribes at the harbour and customs, inadequate sanitation at the harbour, the ill defined fishing policy, the non-transparent leases of marble mines, the poor property rights and short-term leases, all are the symptoms of an overstretched, unfocused, unaccountable, inefficient and corrupt government structure in need of immediate reform.

### Global Competitive Index

- The importance of each of the nine pillars depends on a country’s particular stage of development. These pillars are organised into three sub-indexes.



### 5/14 Most Problematic Factors for Business in Pakistan



### Value Chain Analysis

- BJ/Denim:
  - long shipping time
  - higher freight
  - Customs admin
  - Port operations
  - Inland transport + logistics
- Spinning:
  - high electricity tariffs
  - power outages
- Weaving:
  - Society of trained workers/technician
- Dyeing:
  - Delay in collecting rebates
- Cotton:
  - Inefficient management of Government involvement in seeds
- SHRIMPS:
  - √ Fishing policy ill-defined
  - √ Overcrowded harbour
  - √ Inadequate sanitation
  - √ Low quality freight forwarding
  - √ Ports Fees+bribes+taxes+ other costs=25 % of X costs

- **MARBLES TILES:**
  - Marbles losses = 70%
  - International = 25-50%
  - ill-defined non-transparent
  - Short-term leases
  - Poor regulation
  - poor property rights
  - High taxes on marble machinery

### **THE PUBLIC ENTERPRISE EXPERIENCE AND EFFORTS TO REDUCE THE SIZE OF PEs**

Pakistan followed the path of private sector-led development until the seventies. This model delivered in terms of higher growth. However, the pattern of uneven regional development, worsening income distribution and perceived bias in the favour of a select group of industrialists discredited the Ayub government and led to its fall. In the ensuing political debate, and in step with the fashion of the times, the public opinion shifted in favour of state ownership.

The Bhutto period of the early seventies saw the takeover of banks, insurance and other financial institutions, and manufacturing units in automobile, cement, chemical engineering, fertiliser and vegetable oil sectors. These nationalisations had the effect of pushing the share of the PEs in the national economy from about 7 percent of the GDP to over 11 percent of the GDP. The first privatisations also took place during the PPP government when the nationalised rice mills and cotton ginning firms were returned to their owners. Perhaps the realisation that bureaucrats could not manage factories and that nationalisations had gone too far had begun to sink in.

After the Zia takeover, the public sector continued to remain dominant in the economy. In the early years it even expanded, as projects initiated during the previous government came on-stream. At their peak, the number of public enterprises exceeded 200 and their estimated share in the GDP reached 14 percent. By now, the international tide had turned against PEs. This change in international opinion, the mounting fiscal burden of the Pakistani PEs and lacklustre results of the PE reform efforts, forced a rethink on the issue. The Zia government's rhetoric began to change decidedly against PEs and in favour of privatisation. However, no concrete steps were undertaken to push the agenda forward.

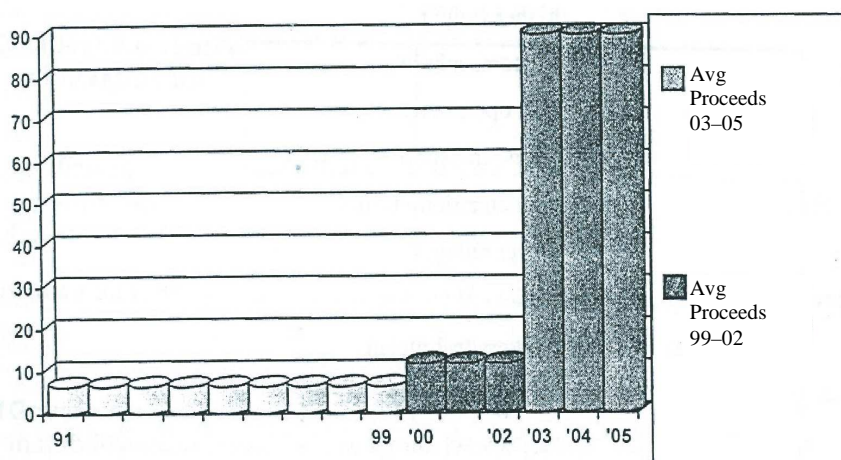
Throughout the nineties, the four governments of the PPP and the PML, as well as various interim regimes, continued with the privatisation programme. Many small and medium-sized manufacturing units were privatised. Muslim Commercial Bank was privatised and it thrived under private ownership. Allied Bank was given to an employee group and the experiment proved a failure. A successful domestic and international offering of 12 percent of Pakistan Telecommunications Company Limited (PTCL) was undertaken. A large electricity generation plant at Kot Addu was privatised to a British firm. The first steps were taken to set up regulatory bodies to facilitate private ownership of utilities in telecom, electricity and gas. The total value of the privatisations undertaken in the nineties amounted to about Rs 60 billion.

The numbers involved were quite staggering. Karachi's electric utility, KESC, alone had required Rs 108 billion to cover its losses in the three year's prior to its privatisation. The company was collecting only fifty percent of its bills. While private sector banks were thriving the nationalised banks hardly gave any dividend to the government in over two decades. In fact, every few years the government had to pump in tens of billions of rupees to prevent their formal bankruptcy. Even the profitable companies, such as those in the oil and gas sector or the telephone monopoly, PTCL kept our national development in check due to their lack of initiative and limited expansion. For example, in 2003, the number of people with telephone connections was not even 3 percent. Estimates of the fiscal burden of PEs reached as high as Rs100 billion a year.

The government owned companies had shown tremendous resilience in the face of earlier attempts at privatisation. Thus, in spite of efforts throughout the nineties, the privatisation amounted to only Rs 60 billion, i.e. about six billion rupees per year. In the first three years of President Musharraf's government managed to privatise about 36 billion rupees i.e. an average of 12 billion a year. However, in the next three years there was an acceleration of the programme to a scale unprecedented in our history. During this time our privatisation transactions amounted to Rs 285 billion, an average of Rs 95 billion per year, representing an 800 percent increase over the previous three years (Chart—shows a comparative picture). Thirty three firms were privatised including banks and financial institutions, fertiliser and cement companies, an oil refinery and most importantly, utilities in the electricity and telecom sector.

In spite of these efforts, the remarkable feature that remained was the resilience of the public sector and its ability to subvert privatisation. After one decade of rhetoric, another decade of attempts, and some recent successes, the role of the public sector even in the purely commercial arena remains undiminished. It continues to dominate untouched. The country and its weakest groups continue to pay the price.

**Privatisations**



Sector	Policy	Regulation	Ownership	Management
Telecom	√	√	√	√
Electricity	√	√	√	√
Steel	√	√	√	√
Aviation	√	√	√	√
Banking	√	√	√	√
Gas	√	√	√	√
Water	√	√	√	√
Petrol Stations	√	√	√	√
Insurance	√	√	√	√
Manufacturing	√	√	√	√
Retail Shops	√	√	√	√
Extraction	√	√	√	√
Ports	√	√	√	√
Airports	√	√	√	√
Real Estate Management	√	√	√	√
Land Management	√	√	√	√
Asset Management	√	√	√	√
Tourism/Hotels	√	√	√	√
Provincial Banks	√	√	√	√
Trucking	√	√	√	√
Construction	√	√	√	√
Railway	√	√	√	√
Farms/Agriculture	√	√	√	√
Shipyards	√	√	√	√
Shipping	√	√	√	√
Holding Corporations	√	√	√	√
Consultancy Services	√	√	√	√
Engineering Goods	√	√	√	√
Electrical Equipments	√	√	√	√

### Organisations Involved in Fisheries

#### • National Level

- √ Planning Commission.
- √ Environment and Urban Affairs Division, (MoE).
- √ WAPDA.
- √ Federal Institutes.
- √ Federal Govt. (EEZ beyond 12 n.m).
- √ Ministry of Communications.
- √ Port Authority.
- √ Pasni and Gwadar Port Authority.
- √ Maritime Security Agency.
- √ National Institute of Oceanography.
- √ Indus Water Authority.
- √ Environmental and Urban division (MoHW).

### More Organisations Involved in Fisheries

#### • Local Level

- √ Environmental Protection Agency.

- ✓ Karachi Development Authority.
- ✓ Sindh Dept. of Forestry Fisheries.
- ✓ Balochistan, Dept of Forestry and Fisheries.
- ✓ Balochistan Development Authority.
- ✓ Government of Sindh.
- ✓ Government of Balochistan.
- ✓ Sindh Fisheries Dept.
- ✓ Balochistan Fisheries Dept.
- ✓ Provincial Dept.
- ✓ Karachi Fish Harbour Authority.
- ✓ Karachi Port Trust.

• **Local Level**

- ✓ Korangi Fish Harbour authority.
- ✓ Port Qasim Authority.
- ✓ Sindh, Environmental Protection Agency.
- ✓ Balochistan, Environmental Protection Agency Government of Sindh, Min. of Fisheries and Coastal Development /Government of Sindh, Irrigation Dept.
- ✓ Water and Sewage Board.
- ✓ Government of Balochistan, Min of Fisheries and Coastal Development.
- ✓ Sindh Board of Revenue.
- ✓ Government of Sindh Planning and Development.

**Where Do We Stand?**

- (1) The Chart—summarises the involvement of the government in many commercial activities of the economy, in its multiple roles as the policy giver, regulator, owner and manager of what are essentially business activities. It shows how pervasive government involvement is in all facets of every business. It also reveals how marginal the impact of privatisations has been and the long road ahead.
- (2) The Chart—summarises the situation of government involvement in one industry: fisheries. The picture says it all. It takes three slides just to list all the thirty three government agencies involved.
- (3) Two personal examples from the Sindh days. During my time as Minister for Finance and Planning in the Government in Sindh, there were many examples relevant to the discussion today, but two I will recount for you here:

First example. We made a list of all the government agencies whose representatives interacted with a single factory. It turned out that the number of these inspectors from different government agencies was 23. They all showed up to meet the manager and of course make their visit worthwhile for them. We had the number reduced to four, to visit the factory all on one day, accompanied by a representative of the local Chamber of Commerce. I am not sure if the practice is still followed. Actually I am pretty certain it is not.

Second example. As Planning Minister, I noticed that my department's secretary, the Additional Chief Secretary (ACS) of Sindh, was always on the move from one



meeting to the other. He was an efficient and hardworking officer but always seemed to be on the move. So I had him count the number of committees that he was chairing. It turned out that he was the head of 147 committees! If you account for holidays, personal days off, occasional international travel, frequent Islamabad visits and tours into the interior of the province, he definitely has less than one day per year per meeting per committee. The third example is the efforts to reduce the Bureau of Supplies.

In fact not only have all efforts to reduce the size of the government and make it potentially more effective appear not to be working, the relentless march of the government to a bigger and more unmanageable size is continuing. Some reasons why government is continuing to grow:

- (1) The devolution programme has been one of the bold and potentially far-reaching of the current Government's measures. However, while a third tier of the government has been added it has not been accompanied by a total stripping away of government at the other levels. The net result is often overlapping and definitely more government. Equally importantly, the functions of the Federal government, the most centralised, bloated and distant part of the overall government, is not only untouched, in fact it has grown.
- (2) The trend for the government to grow was only temporarily halted in the first 2-3 years of the current government, when efficiency considerations and fiscal prudence appeared important. However, after the first three years, due to a combination of additional resources and other factors, the size has continued to grow. One indicator of that is that the Centre, and several if not all the provinces have the highest number of ministries, divisions, and accompanying ministers to head them in the history of Pakistan. Compared to 18 ministers in the Federal Cabinet in the first three years, the current number easily exceeds 70. The ministries that were integrated to save costs and achieve efficiency in the first three years have all been revived and unbundled. Several new ones have been created. Compared to the heyday of bureaucratic rule under Ayub, when we had 11 full Federal Secretaries, we now have at least 32.
- (3) There has been a proliferation of regulatory bodies such as PTA, NEPRA, OGRA, PEMRA, etc. This is a welcome trend as high quality regulation is critical for the success of sector reforms, for providing the right incentives for investors and comfort to the consumers. However, these agencies have proliferated and increased the size of the government without a corresponding decrease in the interventionist activities of the line ministries. The result is that the businesses have to contend with the regulators but also continue to have to contend with the ministries. The result has been more government, delays in tariff-setting formulae, in approvals and sanctions of projects. This situation has contributed to the evolving shortages in electricity and gas sectors.

### **Some Success Stories**

*Telecom, Media, Banking.* In all three sectors government has been able to reorientate its role, shifting to policy-making, while allowing relatively independent regulation and most importantly getting out of the management function via privatisation and providing policies

conducive for competition and promoting entry of new firms. The results have been impressive in terms of sector growth, new products, efficiency, tax collections and job creation.

*Lessons: Reorientating the role of government; results will follow; can be done*

### **Some Guidelines?**

- Learn from failures and successes.
- Intervene in areas where there is systematic and significant influence of special interest groups; show restraint in others.
- Intervene in favour of increasing competition; resist government action to curb competition.
- Intervene on behalf of openness in government and against secrecy.
- reduce corruption, improve access, decrease costs, avoid collusion.
- Intervene to encourage private provision of public goods including through NGOs to simulate competition and give “voice”.
- Intervene to achieve balance between expertise and democratic representation and accountability e.g. regulatory bodies, central bank, etc... experts may also be susceptible to influence by special interest.
- Intervene to “use” the markets more for subcontracting out e.g. janitorial services, car fleets, maintenance contracts etc. this is a less costly way to avoid mistakes than the proliferation of mistake-avoidance rules and regulations which focus on lapses rather than results.
- Intervene to focus more on institutional construction.
- Intervene to improve policies and regulation; get out of management of business.
- Focus on core government functions; avoid overreach and diffusion.
- Try to measure performance in core activities; develop incentive systems for functionaries.
- Avoid interventions on behalf of a particular industry or even individual firms.

### **CONCLUDING COMMENT**

The biggest challenge facing Pakistan is to make the government work. To ensure that it is responsive to the needs of the citizens; efficient in the delivery of its services; free of corruption in its dealings and, that it is focused. Governments in many countries have tried to do too many things—as a result they have not been able to do anything well. Often they have failed to do anything at all. In particular, they have ignored their core functions: providing security, justice, regulation, basic needs and an environment for business to succeed. Governments running commercial enterprises—bureaucrats running businesses—represents this drift, this lack of focus. As a result, in countries including ours, the treasury suffered fiscal drain, the economy endured higher costs and the citizens put up with poor quality of service. And the nation as a whole had its development thwarted. Reorientating the role of the State, confining it to its core functions and getting it out of activities better performed by others is a priority for Pakistan.

*The difficulty lies, not in the new ideas, but in escaping from the old ones!*

Keynes