

DOING DEVELOPMENT BETTER



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The federal government in the budget for the fiscal year 2024-25 proposed an outlay of PKR 1,400 Billion for the Federal Public Sector Development Programme (PSDP), which was later reduced to PKR 1,150 Billion and approved by the parliament with the passing of the Finance Bill 2024-25. This is the first occasion when the PSDP allocation in the federal budget has crossed the one trillion-rupee mark. Over two-thirds of the PSDP funds have been allocated to the ongoing schemes for FY25, indicating the mammoth size of the PSDP portfolio. The focus this year too remains on dealing with infrastructural development challenges along with the transportation, energy, IT and Water Resources Sectors.

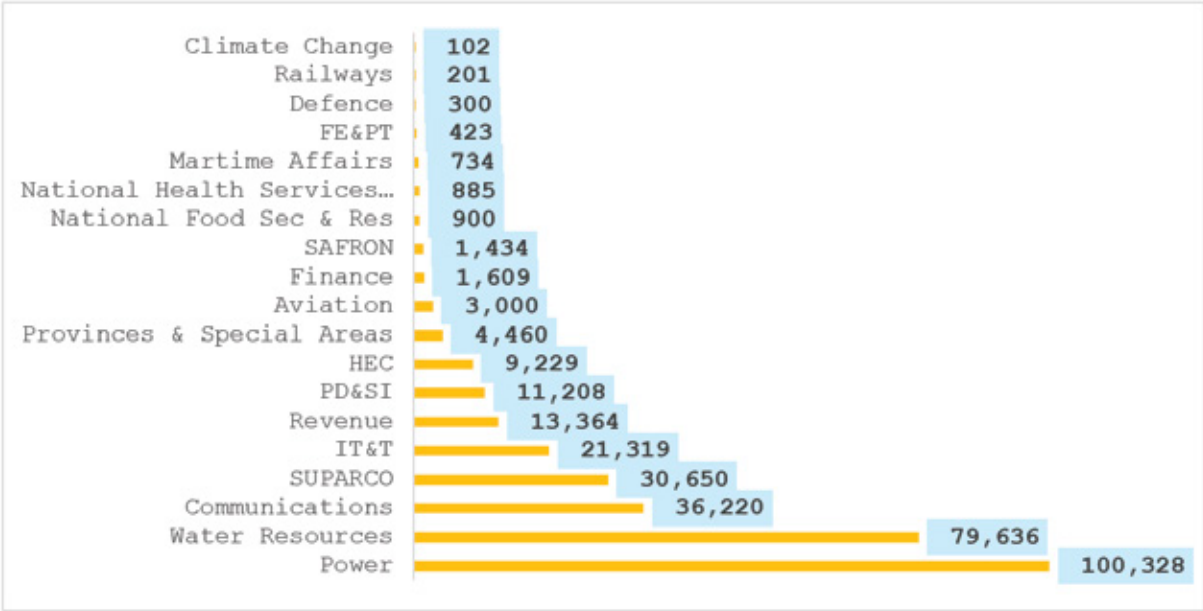
The PSDP 2024-25 allocations, as per the guidelines of the National Economic Council have been prioritized on the following:

- a. Projects about Water Resources, Transportation, Communication and Energy. These projects have been categorized as Strategic and Core Projects.
- b. Projects with a major foreign loan component to ensure timely completion of such projects
- c. On-going schemes upon which 80% of expenditure has been conducted FY24 to complete such projects in FY25.

While the government has further expanded the PSDP by introducing a little below 200 new schemes, the challenges associated with it seem to not be decreasing any time soon. The throw forward as of 01-07-2024 has exceeded PKR 11 trillion. A third of the ongoing projects remain incomplete despite completing their gestation period while cost overrun is

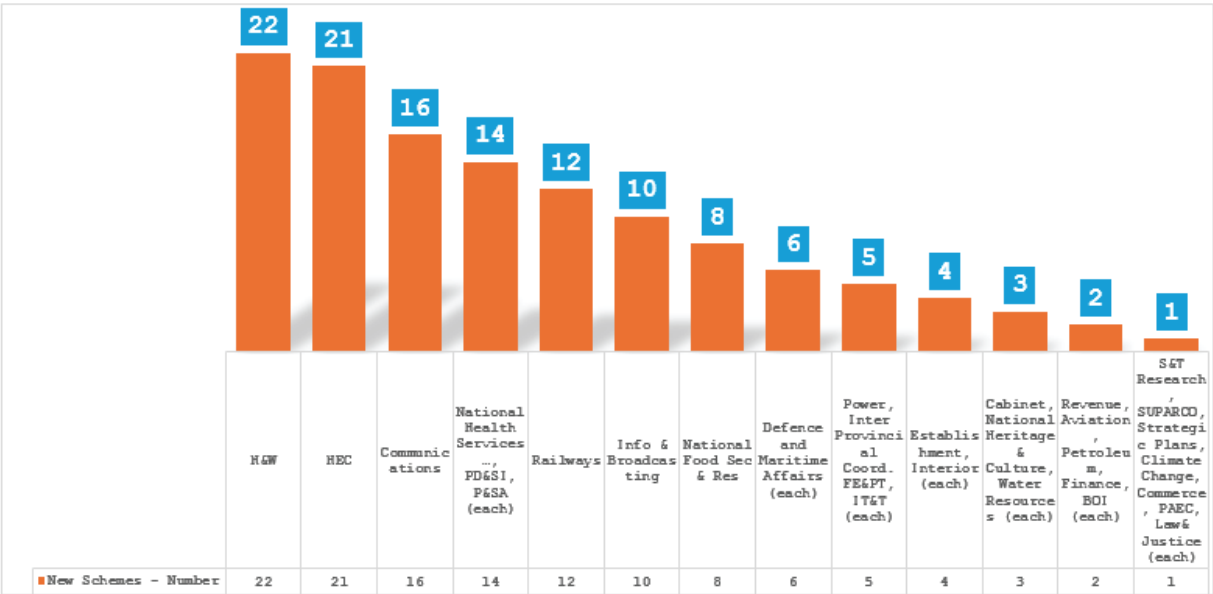
a common occurrence in various projects as well. In addition to the throw forward, the foreign loan component of the PSDP projects is also significant. The foreign aid component forms over 40% of the total PSDP portfolio and 22% of the ongoing fiscal year’s PSDP allocations (Figure 1).

Figure 1: Foreign Loan Allocation - PSDP 2024/25 (PKR Million)



The PSDP focus has remained primarily on infrastructure and real estate projects. Even in the PSDP 2024-25, the new schemes introduced focused on the same areas, with a few ministries taking most of the cake. (Figure 2).

Figure 2: New Schemes per Ministry/Division - PSDP 2024/25



This, however, has not happened overnight or in a few years. Instead, this is a direct consequence of the long-term development focus of the federal government which has remained consistent under different governments over the decades. It does beg the question; how did the decision-makers converge to adopting this developmental approach in Pakistan?

EMERGENCE OF PAKISTAN'S DEVELOPMENT APPROACH

After independence from British India in 1947, Pakistan was faced with severe economic challenges. With a negligible industrial base and limited infrastructural development, stimulating economic growth was quite an uphill task. In the initial decades, the agriculture sector shouldered the country's economic progress; however, the need for industrialization in the country was timely identified. To crowd in investment in the manufacturing sector, the country needed to develop the necessary basic infrastructure and allied facilities to make investing in Pakistan a viable and practical option.

Consequently, in the decade of 1960s, Pakistan adopted a new development model for nationwide infrastructural development through project-based public sector investment to attract private investment with three following key aspects to the public sector investment:

1. Building physical infrastructure/Expenditure on brick and mortar
2. 5-year plans for expenditure consistency on physical infrastructure
3. Seeking foreign loans and aid to finance physical infrastructure projects, if need be.

This development model was proposed by the world-renowned Pakistani economist Dr. Mahbub Ul Haq, and was supported in this by the Harvard Advisory Group and hence is referred to as the Haq/HAG Model. Dr. Haq believed that it was essential to pursue high growth in developing economies, but it is unattainable unless necessary infrastructure is present in the country. As a result, his development model proposed directing public sector investment towards developing physical infrastructure including transport network, land development and other allied utilities and necessities. To ensure that public sector investment in physical infrastructure remains an expenditure priority, medium-term budget planning under the umbrella of five-year plans was introduced to maintain financing the sectoral hardware.

Moreover, realizing the fiscal constraints for the country to effectively finance such large-scale physical infrastructure development, Dr. Haq recommended that the financing gap must be filled by obtaining foreign loans to fund the brick-and-mortar infrastructure projects when domestic savings fall short of financing this expenditure.

Given the economic challenges faced by Pakistan at the time, coupled with the negligible industrial and infrastructural base, the Haq/HAG model presented an adequate development approach as per the needs of the time. Research, even decades later, supports the hypothesis of Dr. Haq at the time. Hussain et.al. (2017) and Butt & Faraz (2022) have both found that PSDP expenditure crowds in private investment. However, Hussain et. al. (2017) and Butt & Faraz (2022) also concluded that this applies only to a few sectors and not all

sectors of PSDP spending. Ahmed & Ammad (2011) have extended this argument to state that while PSDP does crowd in investment to some sectors, it also crowds out in other sectors. Therefore, while Dr. Haq's thesis is that public sector investment to develop physical infrastructure is necessary for attracting private investment and stimulating economic growth, there is a limit to it as well.

While all the developed economies in today's world focused on necessary infrastructural development to promote economic growth and development, unlike Pakistan, they over time have successfully managed to evolve their development approach as per the needs of changing times and economic conditions. Pakistan, on the other hand, is still stuck in the same hardware focus as proposed by the Haq/HAD Model.

Modern policy globally focuses on promoting economic growth through a focus on developing human capital, increasing productivity, enhanced policy management, innovation and strong institutions. In simpler words, developing the software of the economy is the catalyst for economic growth in the modern world. Unfortunately, Pakistan still finds itself focused on developing the hardware of the economy without due diligence to evaluate the effective utilization and management of the physical assets it keeps building.

THE PSDP OF TODAY

As aforementioned, the focus of the federal PSDP has not evolved in the last half-century. Long-term project-based spending on physical infrastructure with a high foreign loan component has made the PSDP not just a major liability but a fiscal threat to the federal government. In the annual budget for the Fiscal Year 2024-25, the debt servicing cost for the federal government is equal to the targeted tax revenue. This means that if the government can achieve its targeted tax revenue for the year, it will entirely be used to pay just the interest on the already accumulated debt. To finance all other current expenditures as well as development expenditures, the government will be forced into raising further debt. As mentioned earlier, the foreign loan component is approximately 22% of this year's PSDP allocation. This is the direct debt in the project costs, however, given the current fiscal scenario of the country, the remaining expenditure will also be financed through raising further debt thus making the entire PSDP debt funded.

This has however not happened overnight but is a continuation of the Haq/HAG development model long past its effective life. In recent times, the Pakistan Institute of Development Economics has done a considerable amount of work in analyzing the persistent issues within the PSDP and proposing necessary reforms. Over three-fourths of the PSDP still consists of infrastructural and real estate development projects.

Zubair et al. (2023) conducted bucket analysis to conclude that there is no clear trend of annual decay i.e. reduction of throw forward present in the PSDP, while Haque et al. (2020) have estimated the output efficiency of public capital to be only a meagre 33.0% in Pakistan. Zubair et al. (2023) and Haque et al. (2020) both highlight that public investment has failed to drive economic growth in the country. This is substantiated by Pasha et al. (2011) estimates that the fiscal multiplier of the development spending in Pakistan stands equal to two, thus, showing that public sector development expenditure is unable to invigorate economic activity and growth in the country.

Moreover, Butt & Faraz (2022) and Ammad & Ahmed (2014) both through empirical analysis concluded that the development spending in the country while might be able to generate some employment opportunities in the short run, there is no long-run relationship visible between public sector development spending and employment generation in Pakistan.

FROM HAQ/HAG MODEL TO THE HAQUE MODEL

The Haq/HAG model has outlived itself in Pakistan. It is about time that Pakistan shifted its development model based on a modern approach as per the needs and requirements of the 21st-century world. While criticisms of the Haq/HAG model and the current state of the PSDP can be found in abundance, what must replace this development model is a topic less talked about.

The Pakistan Institute of Development Economics organized a conference titled 'Doing Development Better' in 2020 where a study under the same title was presented and discussed. The reform idea as presented in the study and hence discussed in the conference focused on shifting the development approach of the country from the hardware of the economy towards the software. It emphasized strongly the need for developing a research-backed coordinated development strategy to drive economic growth in the country. Haque et al. (2020) also pressed upon the need for adopting a pre-approval cost-benefit analysis (CBA) of the proposed projects while also ensuring post-completion project evaluations to assist in improved and informed decision-making about public sector investment.

Considering, the Pakistan Institute of Development of Economics (PIDE) based on its research, consultations and conferences has chalked up the following recommendations for reforming the PSDP:

1. Cleaning the PSDP portfolio
 - a. Systematic portfolio cleaning which involves early completion of projects nearing completion or having completed gestation period, identifying low return projects and projects yet to take off and immediately shut down to save costs.
2. Placing a moratorium on new PSDP projects
 - a. The throw forward has crossed PKR 11 trillion and requires at least one decade of entire allocation and complete utilization for clearing the entire throw forward.
 - b. Moratorium on new schemes will allow more funds directed towards ongoing schemes to speed up completion and clearing the throw forward significantly.
3. Devolution of Development
 - a. The Federal PSDP must not be used for micro-managing development in cities and villages.
 - b. Development should be localized, with local governments empowered to carry out development work in their areas.
4. Focus on mega projects
 - a. The federal PSDP must only focus on mega-national projects as identified and approved by the parliament.
5. Creation of a sovereign wealth fund

- a. All public assets that yield returns must be used to create a sovereign wealth fund which must then be used to finance future development expenditures.
6. Refocusing development from hardware to software of economy
- a. The focus of federal PSDP must be diverted from just physical infrastructure to capacity building, human resource management, productivity and innovation.
7. Adopting a Result Based Management Framework for approval, monitoring and evaluation of PSDP
 - a. Under the RBM Framework, a baseline survey is conducted to assess the status quo
 - b. Intermediate and final project outputs are identified based on supporting research
 - c. Identification of inputs and aligning with outputs
 - d. Setting quantifiable and measurable targets at various stages of implementation as well as tangible post-completion outcomes

The above can be termed as the “Haque Model of Development”, based on the fact that Dr. Haque presented a comprehensive analysis of the underlying issues within the PSDP, the issues associated with the Haq/HAG model of development in today’s world while also presenting a wide-ranging development reform proposal. Doing Development Better, and other associated work done by PIDE during this time for the reformation of PSDP must be taken as the blueprint for future decision-making about the public investment.

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