A POSSIBLE REFORM AGENDA

Shahid Kardar

Pakistan today is perilously close to declaring its inability to settle its external debt obligations: default. What has brought about this possible point of inflection? In the opinion of this writer, the situation has come to such a pass both because of long-term trends and recent developments, primarily due to the fact that our style of governance and economic management has remained more or less unchanged for more than four decades. Growth rates have been stimulated every few years by running large fiscal and current account deficits until the process became unsustainable (widely described as the boom-bust cycle) and needed visits (totaling 22 now) to the IMF's assistance parlour for financing the external imbalances. But as soon as the IMF help eased some of these pressures, we harked back to these merry ways, which earned us the dubious distinction of being branded a 'one-tranche country'. This outcome, abetted by cheap external inflows and rescheduling of debts owing to fortuitous international events in our history (the Cold War, Afghan War, 9/11 and the War On Terror), kept us afloat and a host of our luxurious privileges protected. Poor governance was continually incentivised as fundamental and structural issues remained unattended to.

The cumulative costs of our failure to address these weaknesses have manifested in slower economic growth and increased vulnerability of the economy and the currency, feeding other crises. However, until now there was no crisis of the magnitude seen today (by some accounts the worst in our history) – prompting genuine fears of sovereign default.

Throughout this period the entire focus, and tenacity of efforts, has tended to be finding resources to finance the balance of payments deficit rather than boosting the productivity and competitiveness of our exports in particular and the economy in general.

The economy is like a machine. All things within it are interconnected. Fixing a weakness in one place impacts other parts. To this end, donors are also to blame for creating a perception that repairing or removing blockages in one or two areas will set a self-sustaining process of growth in motion. Since they have limited knowledge of local conditions and lack the scale of the essential resources required for achieving such a grand objective they exaggerate the outcome of their proposals.

This article, after setting out the key challenges, attempts to identify policy measures, actions, instruments and institutional arrangements that can improve prospects of economic recovery and facilitate growth and employment by improving mobility and productivity of the workforce.

CHALLENGES

The incentive structures guided by the systems in place have aided misgovernance by the political, civil and military leaderships, culminating in the confluence of a number of crises (economic, political, regional, ethnic, etc.). This has resulted in Pakistan becoming a highly difficult and complex country to govern, which would be challenging for the most capable leadership anywhere in the world. And we are not really blessed with the quality of leadership that can steer this ship safely to a shore where there would be a brighter future for its 230 million passengers.

Driven by the imperatives of a security state, espousing a self-serving definition of national interest (with the expenditure on defence exceeding the combined spending on education and health), a rational view on engagement with the rest of world is missing. We seemingly suffer from a victim syndrome, while holding an exaggerated view of our importance (more due to our nuisance value) – mainly because of the fortuitous global events referred to above. We are not serious-minded people, and are simply not willing to accept that we have been living on borrowed time: way beyond our means for far too long. Also, that we are too large a population for anyone to be able to help.

We have a high rate of population growth, with the economy growing at a pace less than half the rate required to absorb those entering the labour force and a pattern of growth that continues to widen income and wealth inequalities. And this youth, exposed to global developments courtesy internet and cable television, is angry. This is laying the foundations of a much more challenging spectre, the management of ensuing expectations. What is making the challenge even more intimidating is that of a divided, fractured and deeply polarised society: both horizontally and vertically.

Furthermore, owing to a host of factors (with varying qualities of governance an important contributory element) disparities in levels and rates of growth and quality of physical infrastructure and social and economic services have widened between Punjab and the smaller provinces. This has fostered the alienation of youth along national/ethnic/values lines. The space for talks has continued to narrow as social divides deepen, hampering coexistence possibilities - a critical need for fostering social cohesion.

For a social cohesion to be built around a set of values requires a holistic approach to our socio-political and economic affairs. This needs reconfiguration of state and society, raising the question of whether we even have the leadership which can take on this intimidating mission.
This article, however, owing to space considerations, will only highlight some of the key economic issues and ways to address them. We have finally hit a road block, a brick wall. Others have lost patience with us. Our credibility is in tatters. Even our friends have made it patently clear that they are under no compulsion to sort the out mess of our own creation.

But despite this clear signaling, much of our discussion continues to be around symptoms" treatment for blood pressure while problems are deep-seated and structural, requiring fundamental painful reforms. What is needed is life-saving surgery by local doctors. And this time there is little anesthesia being made available by the rest of the world to ease the pain. The challenge of an equitable distribution of this pain on the ability of different income segments of the population to bear the burden of adjustment looks gargantuan.

KEY ECONOMIC ISSUES

Much of the debate is focused on the low tax-to-GDP ratio, rampant tax evasion and differential treatment of same levels of income from different sources. While not disagreeing with the import of these claims, in this writer's opinion the bigger issue is the expenditure side of the fiscal equation.

We continue to have a large Federal Government even after the 18th Amendment, under which a host of functions were transferred to the provinces. And despite this division of responsibilities there are 43 Divisions at the Federal level, with an additional 400 Attached Departments of 650,000 personnel and autonomous organisations with 520,000 personnel. Excluding the cost of losses, or subsidies, to the autonomous organisations, more than Rs.750 billion is spent annually by the Federal Government either on functions actually transferred to the provinces – on agencies and activities whose cost should be shared by the provinces – or on intra-provincial schemes. The trend has been for structures to grow by the creation of new entities and staff positions, their continued existence ensured by system beneficiaries, despite many tasks having become redundant.

Just drive down Blue Area in Islamabad to see buildings housing government funded organisations sanctified with exotic names, with few in the Secretariat knowing what functions were mandated to them, let alone those they actually perform.

A reduction in the number of Divisions at the Federal level is opposed by both politicians and bureaucrats, the former seeking ministerial positions and the latter positions as Secretaries and the associated perks and privileges, influence and power that come with the post – along with the generous retirement packages.

The case of the provincial governments is even more disconcerting. They are not only doling out all kinds of allowances to those on their payrolls, they have also become huge employment bureaus, engaging a veritable army of unskilled peons, chowkidars, drivers and clerical and supervisory staff, while lacking personnel with adequate domain knowledge. We therefore find that, for example, the Punjab province which had 22 Departments in 2000, now has 48!

A consequence of the above is that the pension liability of the Federal and Provincial Governments, excluding such liabilities of several other State sponsored entities (e.g. public universities), has crossed Rs. 25 trillion.

This structure has contributed to the State having a huge footprint in the economy. According to a PIDE study it is almost 67% of economy, although through price setting by government of some goods and services, requirements of NOCs, legal and judicial intrusions and a variety of regulations, checks and inspections, it makes it significantly bigger. This has distorted markets while the excessive, obsolete regulatory system presided over by more than 120 regulatory agencies has, by constraining economic activity, raised the cost and ease of doing business. Lest we forget, GDP is the sum total of the number and size of transactions in the market. Hence, the smoothness or otherwise of the process to undertake transactions affects the cost of carrying out transactions. Streamlining the multitude of agencies and simplifying the layers of approval processes for policy actions, activities, and transactions will enhance the organisational structure of government. This, in turn, will modernise the governance system, improve resource and functional allocations, and enhance administrative efficiency, ultimately resulting in reduced management costs.

Next are the growing losses of state owned enterprises (Rs.143 billion just in 2018/19). In the case of PIA, Steel Mill and Railways, accumulated losses have crossed Rs. 2.5 trillion (with the top 10 SOEs accounting for close to 90% of the cumulative losses). Then there are the electricity and gas circular debts which had hit Rs. 4 trillion in the last count. It's another matter that those making profits are generating returns much lower than their potential.

Whereas the Planning Commission should, in principle, be designing policy measures, instruments, institutional structures, etc. to stimulate growth, setting priorities and sectoral approaches, its role has been reduced to supporting the enlargement of the size of the PSDP - with limited influence on the need and design of schemes and assessment of institutional absorptive capacity. The outcome is a highly politicised expanded portfolio of development schemes, without any accountability for unsatisfactory impact. Schemes get approved and started with extremely small allocations, even though it is obvious that there will be huge time and cost overruns. Project staff, connected to important decision makers get hired while cars, mobile phones, laptops, etc. are procured years before real work starts. And those recruited for the life of the project get a job for life since the scheme never gets completed!

The result of all this is that we now have a PSDP of more than 1,750 projects, with a throw-forward equivalent to 17 years of present levels of allocations, implying that there will eventually be huge cost and time overruns. State policies have supported a rentier economic structure - protecting a wide range of sub-sectors from competition, e.g. sugar, motor vehicle assembly, polyester, electricity meters, fertilisers and even segments of the textiles sector. The growth of one industry created a market for another (e.g. the vendor industry for automobiles), each operating at different degrees of efficiency. And once vested interests got created it became politically difficult to withdraw these concessions, especially with the economy growing at an anemic pace.

Moreover, the structure of the economy has changed over the last two and a half decades: with the sharp increase of the GDP shares of the Financial, IT, Telecom, Automobiles, and Oil and Gas sectors. These sectors tend to be capital and skill intensive. These developments have widened the inequality of incomes and wealth, further amplified by the taxation structure. This has determined the composition, the size of economy and production technology (more imported inputs) and level and skill mix of employment. The free play of market forces then reinforced these inequalities.

The less affluent segments of the population, endowed with limited education and skills, are unable to participate meaningfully in this configuration of growth, thereby disenfranchising the vast majority of the population, with all its social and political implications.

A POSSIBLE WAY FORWARD

RIGHT-SIZING OF THE FEDERAL AND PROVINCIAL GOVERNMENTS

As implied above, we need to start shrinking the over-staffed Federal Government by more than two thirds to reflect the transfer of functions post 18th Amendment.

Next we need to finalise the list of several attached departments, agencies and autonomous organisations to be wound up (because of the redundancy of purposes or uses for which they were initially established), since there would at best be a handful that could be candidates for privatisation. And then for the two proposals above we should:

a) Retire those who have completed 30 years of service (protecting pension entitlements attained to date). If it becomes politically difficult to retire them they should be placed in a 'surplus pool', thereby saving on rent, utilities, maintenance of cars, etc.

b) Surrender all vacant posts and all such positions (banning new recruitments).

A similar exercise needs to be conducted for the provincial governments.

The right sizing of the two levels of government then needs be complemented by a move away from the direct provision of some services to just their financing - the actual provision to be outsourced (e.g. education).

REVISITING THE SIZE AND STRUCTURE OF THE PSDP

No additional projects should be launched for at least two years. Only donor assisted (provided an assessment of their economic return suggests continuing availability of counterpart funding) and on-going trunk infrastructure projects (inter provincial but not intra provincial) or nearing completion should be funded, treating as sunk investment and writing off those on which less than 20% expenditure has been incurred.

OTHER AUSTERITY MEASURES

- Hajj/Umrah and medical treatment abroad on government expense should be withdrawn.

- All schemes for bestowing land/residential and commercial plots should be discontinued.

- The practice of Camp Offices of the President, PM and CMs should be terminated.

- Discretionary funds and allocations for parliamentarians' development schemes should be abolished.

- All travel of less than 7 hours should be in economy class. And only the expenses of the Principal Secretary and the Minister whose subject would be taken up with counterparts should be official.

- All papers related to decisions taken by the Central Development Working Party (CDWP) and Economic Coordination Council (ECC) should be available in the public domain.

- The Debt Ceiling should be a percent of tax revenues and the government should be required to seek parliamentary waiver when it has to transgress this limit.

REFORMING THE CIVIL SERVICE

For new and existing civil and military bureaucracies we need to redesign the compensation structure, monetising all perks and privileges and demand a civil service with adequate domain knowledge. In the case of the former, compensations should be linked to market rates for similar skills. Furthermore, we should embrace a contributory pension system for new entrants to the Civil Service. For existing employees, we should adopt it, protecting pension entitlements attained to date.

The salary revisions, monetisation of perks and adoption of a contributory pension scheme can be financed by savings from the proposed reduction in the size of government and the disposal of prime commercial land held by government and used to provide housing to the civil and judicial bureaucracy.

We should also take away the right of any state functionary to allot any land (including to those in the military). The generalist cadres should be required after, say 7 years of service, to choose a service stream and acquire the relevant domain knowledge for continuing their service in the bureaucracy.

EASING CONTROLS OVER CONDUCT OF BUSINESS TO IMPROVE COMPETITIVENESS

The role of State Institutions is critical, requiring, as argued above, a reduction of its footprint in the economy through deregulation of commercial activities - the software aspect of laws, regulations, procedures and processes to stimulate investment and productivity. Today, a large part of the regulatory framework exists because of a lack of clarity on the role of the government and the need for excessive and archaic regulatory control. New products and instruments are better replacements and more effective mechanisms for achieving the objectives underlying the rules and regulations and the institutional arrangements for their enforcement in areas of market failure.

To dismantle this pernicious, discretion-laden and outmoded regulatory regime, a radical way forward would be to identify some sectors, essentially electricity, gas, State Bank of Pakistan (SBP), Securities and Exchange Commission of Pakistan (SECP), judicial processes and law and order, whose regulatory systems be mapped and reviewed clause by clause. All other regulatory rules (including the provincial ones) should be suspended literally overnight, requiring their proponents/protectors to argue the case publicly for their retention for serving a laudable public good purpose.

This move should be complemented by addressing the trust deficit impacting investor sentiment owing to unpredictability of government policies and actions. The government, which must serve as the signaling agency, is invariably in a fire-fighting mode - unable to reflect beyond the short-term. To expect the investor to take a long-term view is a palpable contradiction.

REMOVE DISTORTIONS IN TAX STRUCTURE

As indicated above, there is a need to revamp the tax structure. We need to simplify it: fewer number of taxes and rates (for example there are 68 withholding taxes with 45 generating less than 1% of revenues), easier compliance costs for taxpayers because of the multiplicity of taxes and agencies - all functioning with little coordination between them.

Next there should be a lowering of tax rates while ensuring a similar treatment for same levels of income irrespective of source (presently retail, wholesale and transport services and capital gains in equities and real estate are lightly taxed, with real estate made a haven for black money), tax exemptions or concessions to agricultural income (supplemented by subsidies for fertiliser, irrigation water and electricity for tubewells, with support prices; wheat and sugarcane maintained at higher than global prices).

PHASING OUT RENTIER STRUCTURES

For improving efficiency and competitiveness of the economy, a strategic move needs to be made to establish a level playing field. To this end we need to phase out, in the next 3-4 years (with a clear sunset clause) the vestiges of crony capitalism, reflected in the of overly generous concessions/protections for excessively long periods to several industries referred to earlier.

This shift needs to be complemented by improvements in trade facilitation systems and processes and, more importantly, by rationalising the customs tariff (with import duties ceasing to be the main source of tax revenues - presently in excess of 45% of total FBR collections). These reforms should be aimed at enabling the participation of efficient enterprises in global supply chains: the producer driven chains (e.g. Samsung, Nike, Adidas, Polo) and buyer driven chains (Wal-Mart, Amazon, Alibaba), as well as the services sector (by providing a broader variety of services in a much bigger and comprehensive manner). And as a starting point we need to lower, if not remove, barriers to trade with our neighbours. Admittedly, the role of the private sector will be equally, if not more, important in raising its own productivity and ability to participate in these chains.

GAINS FROM ENHANCING CONNECTIVITY AND SUPPORTING INNOVATION

This being the age of software and connectivity, with the frightening pace of change in technology (AI, 3-D printing, and robotics) disrupting activities linked to the production of goods, services and types of jobs, we have little choice but to reorient government thinking: away from an investor in hardware to being an enabler, creating an ecosystem that supports innovation and transition to a digital economy.

Whereas we already have an expanded and relatively decent network of poorly exploited physical infrastructure (especially roads and presently also Gwadar) compared with our counterparts (other economies at similar levels of income and stage of development), both the Federal and Provincial development programs continue to add to its enlargement. Some of these investments need to be shelved and many on which, as argued above, less than 20% has been spent should be discontinued and the expenditure incurred to date to be written off as sunk investment. Some of the resultant savings should be set aside for investments in improving connectivity, partly by reducing the tax on hardware and fibre-optic cable installation. And the approach to enhance connectivity and access to the internet requires that the available Spectrum not be viewed as a revenue source. Presently, telecom operators in the country only have access to 274 MHz Spectrum to serve the seventh largest number of telecom users in the world, whereas a single telecom operator in Australia uses in excess of 345 MHz.

By facilitating the use of technology, we can not only develop regional trade but also augment our capacity to collect taxes, instead of increasing reliance on turnover taxes and withholding taxes which tend to discourage formal commercial transactions and thereby loss of revenue.

Reforms along the lines argued above, complemented by limits on the use of discretionary powers and greater transparency (through expansion of digitisation and on-line availability of information on rules and regulations) will also assist in reducing the incentive for holding public office for those with dubious intentions and credibility.

DEFENCE RELATED REFORMS

We need to revisit our defence strategy and associated frameworks, starting with them shedding their non-core and commercial activities: the National Logistics Cell (NLC), and projects of their Foundations and Trusts. Although it is not my area of expertise, it is becoming fairly apparent that it will require some cropping of the size of conventional forces (considering that the annual bill of military pensions absorbs close to three quarters of the pension allocations of the Federal Government) and other non-combat expenditures. Examples requiring an urgent review are: a) the upgrading of a wide range of posts to accommodate the growing numbers of officer cadre; b) the time and expenditure (transportation, marquis, furnishings, food, etc.) incurred on protocols followed in the routine visits of senior officers; and c) a decisive shift to technology for conducting meetings and some basic training.

In view of the significant share of the overall liability of military personnel their pension regime needs an urgent comprehensive review. Today there are 1.4 million military related pensioners (who are entitled to a commutation of 35% on retirement, which is restored after attaining 72 years) and approximately 32,000 retire each year. Soldiers and, strangely, even medical personnel like lab assistants, radiologists, etc. are retired at the age of 40. Considering how the health and nutritional status of all, and especially of these personnel, have improved, the number of years of service of soldiers can easily be increased by 4-5 years and those of other non-combat categories by much longer.

CONCLUSION

The above is, admittedly, a formidable, and politically daunting, reform agenda. Can it be executed in 4 to 6 years? This writer is of the view that conducting our affairs as in the past, more of the same style of governance, can no longer be a credible and viable preference. The only serious option left is to adopt some of these reforms for crafting an equitable and sustainable growth path for the economy.

The author is a former Governor of the State Bank of Pakistan and Minister for Finance and Planning in the Government of Punjab.