INCREASING SPACE FOR

INVESTMENT & ENTREPRENUERSHIP

THROUGH REDUCING THE FOOTPRINT OF GOVERNMENT ON THE

ECONOMY IN PAKISTAN

A Report by Pakistan Institute of Development Economics (PIDE) in partnership with Planning Commission, Ministry of Planning Development & Special Initiatives.

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Executive Summary

One of the main reasons behind Pakistan's long term downward growth trajectory is the chronically low level of private investment in the economy which is one of the lowest in the region. Successive governments have tried to spur economic growth by encouraging private investment in economy with little success. One fundamental reason behind low private investment is the fact that owing to its large footprint on the economy, the government in Pakistan crowds out private investment. Using an innovative methodology, we have illustrated that the *total footprint of government on the economy* in Pakistan amounts to at least 67 percent of Pakistan's GDP, which is substantially higher than what Pakistan government's general yearly expenditure as a percentage of GDP (22 percent) might suggest.

In addition to general government expenditure, the government exerts significant control over the economy through an extensive regulatory framework, control of state owned entities, direct market interventions and ownership of land & capital.

With the imminent need to reduce the government footprint to attract private investment and involvement of private sector, three main policy approaches need to be adopted i.e. deregulation, privatization and public private partnerships (PPPs).

Deregulation alone, if executed properly can reduce the footprint of the government; increase the GDP by approximately 24 percent.

Privatization of state owned entities (SOEs) is another useful policy instrument but is often hard to implement due to a range of factors. Nonetheless, we estimate that there is indeed scope for a reduction in government's footprint through privatization, which can potentially be reduced by a further 6 percent using this particular policy strategy.

Public private partnerships (PPPs) can also be utilized to spur private sector investment in areas where it might be difficult for the government to fully divest its share to the private sector. Public private partnerships (PPPs) can particularly be utilized to make government owned land and capital more economically productive. Such assets can be leased out to private sector for development and value addition. This will not only increase their economic productivity but can also serve as a potentially significant source of revenue generation for a government that often struggles to balance its books.

1. Background

1.1 Downward Long Term Growth Trend

Year-on-year growth rate (% of GDP) in Pakistan has been following a downward trajectory for the past 50 years. (See Figure 1) Sustained long-term economic growth has eluded the country due to a myriad of contributing reasons.

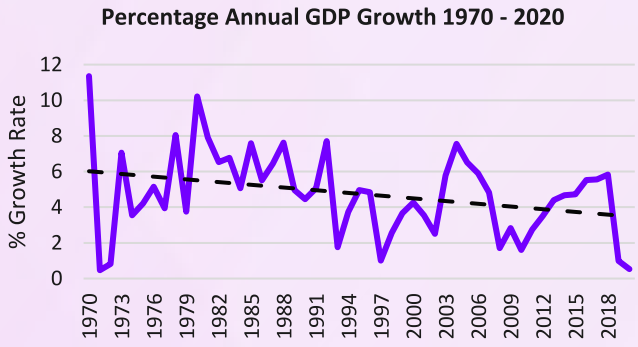


Figure 1: Annual GDP Growth (% of GDP)[1]

[1] PIDE Reform Agenda for Accelerated and Sustained Growth (2021), Pakistan Institute of Development Economics, pg. 1

1.2 Low Investment-to-GDP Ratio

One key reason that has contributed to the long-term suppressed economic growth has been chronically low investment levels in economy. This is reflected in Pakistan having one of the lowest investment-to-GDP ratios among it comparator countries. (See Figure 2)

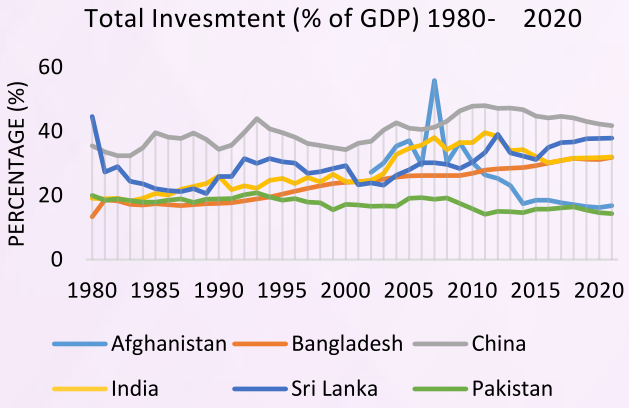


Figure 2: Total Investment (% of GDP)[2]

"One of the central reasons why efforts to spur investment have had limited success is the large footprint of the government on the economy. This leaves little room for private investment in most sectors of the economy."

The low investment-to-GDP ratio is almost near the accounting depreciation rate meaning that new investment that is needed to expand the economy is virtually not happening.[3] One key contributor to this low investment-to-GDP ratio is low amount of private investment in the economy. The foremost reason for this low level of private investment is the large footprint of the government on the economy in Pakistan that permeates almost all sectors and sub-sectors of the economy.[4]

BOX 1: Definitions

What is Footprint?

Dictionary Definitions....

1- Footprint (Literal)-The mark made by a person's or animal's footprint.
2- Footprint (Business, Environment, Economics - a measurement of size effect, etc. of something.
3- Footprint- The area of surface covered by something e.g. "tire with a large footprint", and the " footprint of a laser beam".
4- Footprint- Range operation (as of a service) e.g. "a global footprint".
5- A marked effect, impression, or impact e.g. " left a footprint in the field of research".

Our Definition of Footprint..

Ore Definition.....

Government Footprint - Measure of the influence of Government on the Economy the through:

I) Excessive regulations that increase transaction costs.
ii) Government has large presence in markets inhibiting processing of in information.
iii) Space regulation (including monopoly of city center land) prohibits the development of everything including housing, education, retail etc.

Box 2: Our Definition of Government's Footprint on Economy

[2] World Economic Outlook (2020), IMF

[3] Haque, N. and Ullah, R. (2020), Estimating the Footprint of Government on the Economy in Pakistan, PIDE Working Paper Series, Pakistan Institute of Development Economics (PIDE), pg. 10. Footprint was first calculated in the *Framework for Economic Growth* of the Planning commission in 2011.

[4] Ibid.

Large footprint of government on the economy has the effect of crowding out private enterprises from most sectors and sub-sectors in the economy.

2. Footprint of Government on the Economy in Pakistan

For the purposes of this report, we define the *footprint of government as market space occupied by excessive market interventions, such as regulations, price and transaction controls or direct government interventions along with control/monopoly on production factors*. (See Box 1) A reduction in the government footprint therefore means more space for markets transactions which may result in growth via increase in the number of transactions in a period.

The different avenues through which the government exerts influence on the economy include the regulatory control of government through government laws and regulations, market interventions by government either directly or through its state-owned-enterprises (SOEs) and through government's ownership and control of land space that results in dead capital that inhibits economic growth.

2.1 Estimating the Footprint of Government on the Economy

The following approaches can be used to estimate the footprint of the government on the economy in Pakistan.

2.1.1 Approach 1

a) Step 1 – Total Government Expenditure – *Total expenditure of the government* as a percentage of the GDP of the country underestimates the footprint of government on the economy in Pakistan. For Pakistan, this figure is 23 percent of the GDP and is similar to regional comparator countries. (See figure 3)[5]

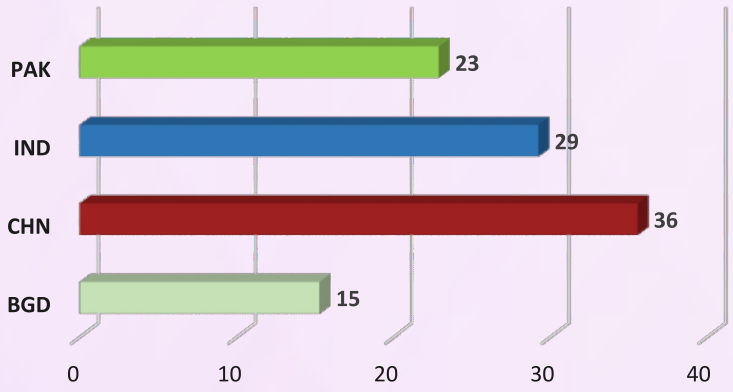


Figure 3: General Government Expenditure (% of GDP) 2021

b) Step 2 – Control of State of Owned Entities in addition to the Total Government Expenditure – The largest entities in the stock market are state owned entities (SOEs) (PSO, OGDC, SUI etc.). The fact that majority of the large companies listed on the stock exchange in Pakistan are public sector companies is a testament to the influence of the government through these state-owned entities.[6] According to recent figures, there are over 200 state owned entities (SOEs) spread across all major sectors in the economy.

[5] World Economic Outlook (2021), International Monetary Fund

[6] Haque, N. and Hussain, A. (2021), A Small Club: Distribution, Power and Networks in Financial Markets of Pakistan, PIDE

(See Figures 4 and 5) figures, there are over 200[7] state owned entities (SOEs) spread across all major sectors in the economy. (See Figures 4 and 5)

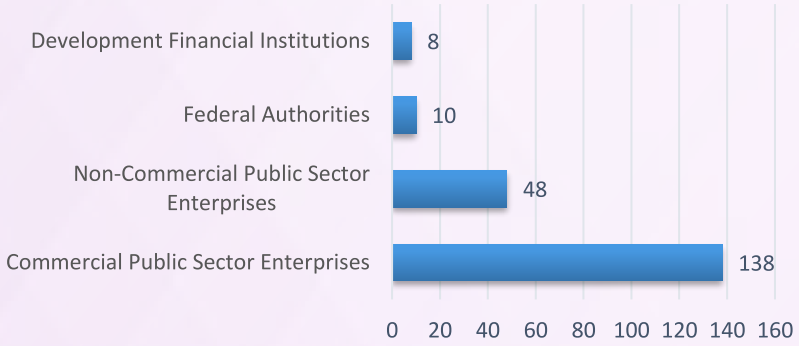


Figure 4: Number of SOEs by Type (2017)[8]

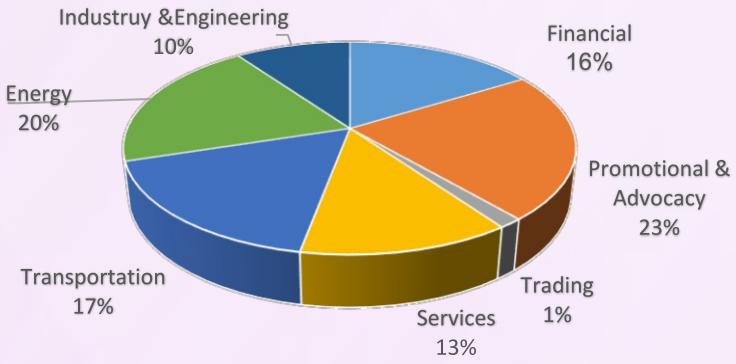


Figure 5: SOEs % Sectoral Classification

The overall total revenue of all SOEs in FY 2018-19 was nearly Rs. 4 trillion while the book value of their assets amounted to Rs. 19 trillion. These revenues represented roughly 10 percent of the GDP in FY 2018-19.[9] Additionally, these SOEs provided employment to about 450,000 people which contributed to approximately 0.8 percent of the total workforce in the country. [10] Furthermore, approximately 47 percent of all Federal Government employees on BPS scales were employed by these SOEs.[11][12]

If we add the annual revenues of the state-owned enterprises to government expenditures, the footprint of the government is then 33 percent of GDP in Pakistan in 2021. This still underestimates the footprint because it neither includes the market distorting presence of the SOEs, nor the impact of the many market restricting regulations in place.

c) Step 3 – Adding costs of regulations and opportunity cost of dead capital

If we include the costs of regulations (24 % of GDP)[13], the *total footprint of government on the economy* through this primary method is about 57 percent of the GDP of Pakistan in 2021. If one was to account for

[7] Federal Footprint SOE Annual Report (2017), Finance Division
[8] Ibid.
[9] Triage Report (2021), Finance Division, pg. 6
[10] Ibid.
[11] Size, Growth and Functions of the Federal Government (2021), Institutional Reforms Cell, Government of Pakistan
[12] Pakistan Railways is treated as a SOE rather than an attached department for calculation of this figure.
[13] See Box 2 and Box 3

opportunity cost of dead capital (5-10 % of GDP)[14], the total footprint can be safely assumed to be greater than 57 percent of the GDP according to most recent GDP figures.

2.1.2 Approach 2

a) Step 1 – Calculating Market Share of Government by Sector

An alternative approach used in FEG (2011) was to calculate the footprint of the government through evaluating the market presence in each sector of the economy. In 2011, while working on the Framework for Economic Growth (FEG), a group of experts and economists under the ambit of Ministry of Planning calculated government's share in each sector to calculate the total direct share of governments in the markets. Their calculations, adjusted for recent sectoral percentage share of GDP are summarized in the table above. (See Figure 6) According to this approach, the government directly controls about 43 percent of the GDP of Pakistan (See Figure 6).[15]

Sector	GoP Share in Sector (%)	Sector Share in GDP (%)	GoP Share in Economy (%)
Agriculture	43.1	19.3	8.3
Manufacturing	11.9	12.5	1.5
Mining & Quarrying	79.6	2.5	2.0
Construction	75.0	2.5	1.9
Transport & Communicatior	73.4	12.3	9.0
ElectricityOil & Gas	77.6	1.8	1.4
Wholesale & Retail	7.9	18.2	1.4
Health & Education	49.3	6.5	3.2
Finance & Insurance	45.5	3.6	1.6
Other Services	60.0	20.8	12.5
Total		**100 (%)**	**42.8 (%)**

Authors' Calculations – Based on estimates from Framework from Economic Growth (2011) and Haque, N. & Ullah, Raja. (2020)

Figure 6: GoP's % Share in the Economy, Total & by Sector

b) Step 2 – Market Share, Regulatory Costs and Cost of Dead Capital – In addition to the direct market share of the government (Step 3), what adds to the footprint of government are both costs of regulations and the opportunity cost of dead capital.

[14] See Box 4
[15] Haque, N. & Ullah, R. (2020), Estimating the Footprint of Government on the Economy, PIDE
[16] Framework for Economic Growth (2011), Ministry of Planning
[17] Haque, N. & Ullah, R. (2020), Estimating the Footprint of Government on the Economy, PIDE

Regulatory costs further are divided into two categories:

1) *Cost of Paperwork, Transactions, Permissions etc.*[18] [19] – In Pakistan there is an extensive system that requires businesses to go through government regulatory agencies and other related government bodies to gain permission to do business in almost all sectors of the economy. PIDE has initiated extensive research into the cost of regulation and is presenting estimates every month to show that this cost is huge. PIDE Sludge series will be coming out weekly and are worth serious review by policy makers. Although most countries have permissions and licensing frameworks in place, in Pakistan these frameworks often involve countless procedures, lengthy delays and high transaction costs to go along with complex rent-seeking games between businesses and regulators. (See Box 2 and Appendix A)

BOX 2: Regulatory Costs: Cost of Paperwork, Transactions & Permissions

- It takes an average of 9 procedures to gain a construction permit in Pakistan. Furthermore, the total monetary cost of these procedures is approx. 9 percent of the total construction project which is the highest in South Asia.
- Net yearly average transaction cost per firm in Pakistan is approximately 0.5 million according to PIDE estimates.
- Documentation costs (Average *No. of Days Lost Per Firm)* – Starting a Business (16 Days), Dealing with Construction Permits (237), Getting an Electricity Connection (144), Registering a Property (140), Tax Compliance (10), Trading Across Borders (395), Contract Enforcement (952)

2) *Barriers to competition* –Within an extensive regulatory framework, government intervention in the economy can often have distorting effects that ultimately result in efficiency costs. These regulations can take the shape of regulatory orders, taxation/subsidies, licensing requirements and trade barriers among other things. In the case of Pakistan, examples of such government regulation that results in efficiency costs reducing the potential GDP include, but are not restricted to Statutory Regulatory Orders (SROs), NOCs, tariff barriers etc.

Estimating Cost of Regulations **–** Measuring costs of regulations is a complex task that requires innovative methodologies. Research on this is largely missing at both international and local level. However, using suitable proxies from research conducted elsewhere we have estimate the total cost of regulations in Pakistan. Our estimate indicates that cost of regulations in Pakistan is approximately 24 percent of the total yearly GDP of the country. (See Box 3)[20]

Box 3: Estimating Costs of Regulations

Crain & Crain (2014) estimated the costs of government regulation on the economy of the United States.[1] The study was commissioned by National Association of Manufacturers and in its latest version put the total cost of regulation at 12 percent of the total national income in the United States.

Pakistan's percentile score on Worldwide Governance Indicator's 'Quality of Regulation' indicator is 27.40 compared to United States' score of 92.31. This alone would argue for the cost of regulation in Pakistan to be a multiple of the cost in the US.

If one were to double the 12 percent cost of regulation as estimated by Crain & Crain (2014) to 24 percent and take that as an estimate for Pakistan. This would be rather conservative estimate to the actual cost for the Pakistan economy.

We will use this for cost of 24% for the purposes of our study.

[18] Bardhan, P. (1989). The New Institutional Economics and Development Theory: A Brief Critical Assessment. World Development. Vol. 17(9), pp. 1389-1395

[19] Transaction Costs, Market Failures and Economic Development, Todorova, T. (2016), Journal of Advanced Research in Law and Economics. Vol. 2(71), pp. 678-684.

[20] Crain & Crain (2014), The Cost of Federal Regulation to the U.S. Economy, Manufacturing and Small Business

Opportunity Cost of Dead Capital – In Pakistan, the government and the public sector owns large tracts of land that is often not put to optimal economic use. The opportunity cost of this inefficient use is most profoundly felt in the cities of Pakistan. For instance, according to estimates the public sectors owns approximately 10,000 acres of prime commercial land which is mostly used as government/public sector office space and for providing housing to public sector employees.[21] An accurate measurement for the total *footprint of the government on the economy* should take into account public sector ownership of land in Pakistan and the attached economic losses resulting from this ownership.

Box 4: Utilizing Dead Capital

The Framework of Economic Growth (FEG) that the National Economic Council accepted in 2011 estimated the gains from a monetization of housing reform only in Islamabad.

Cost: The reform would begin by adequately compensating all civil servants so that their welfare is not reduced.

Our estimates suggested that the cost of this reform would range from about Rs. 30 billion annually (restricted to housing monetization for grades 17 through 22) to about Rs. 165 billion (if all grades included).

Value if business as usual: CDA estimates suggested that about 864 acres would be available after if all these government houses were vacated in Islamabad. Importantly thus land is available in large parcels of about 20 to 50 acres.

If we go the route of the usual CDA planning and sell this land in small housing parcels, the value is estimated to be Rs.233 billion.

FEG Build for growth approach: Assemble the land into large parcels for mixed use complex development. Zoning building laws would be changed to accommodate such construction.

Even with a generous allocation (about 50%) for common areas and amenities, about 423 of the 864 acres would be available for complex modern development. Note that Centaurus Mall was built on 5 acres with an investment of USD 0.5 billion. Let us say we build the equivalent of 40 Centaurus Malls on the vacated land; we are then looking at an investment potential of USD 20 billion.

Jobs: Looked at from any perspective these are staggering numbers. If the construction of each of these buildings directly involves about 3000 workers and indirectly another 3000. We are talking of about 0.5 Million new jobs.

It is estimated that up to about 60 million square feet could be added in Islamabad through this construction boom. Even if a third of it is devoted to flats, we could add on well over 15000 dwellings to the housing stock. Let say each apartment generates 5 job to service it, we are talking of over 75000 jobs.

Growth: If this development is done well and without significant bureaucratic interference, it could take around 10 years. Let us take a straight-line approach, investment would increase by 3 to 5% of GDP annually. Based on our existing growth-investment relationship, this could increase growth by 1-2 % annually over and above other initiatives.

[21] Haque, N. The Opportunity of Dead Capital (2019), Pakistan Today

BOX 5: Quantifying the *Total Footprint of Government on the Economy*

TGP (>67 %) = MS (43 %) + ERC (24 %) + DC (5 10%)***

TGF = Total Government Footprint
MS = Market Share across Sectors
ERC = Estimated Regulatory Costs
DC = Cost of Dead Capital

***** Total Government Footprint on the Economy in Pakistan is greater than 67 percent and is a sum of the above-mentioned sub-categories.***

**Cost of Dead Capital is estimated using Rs. 300 Billion worth urban land holding of Federal Government as reported by the PM office (See Pg. 14); and through using the methodology employed in Box 4 to estimate potential investment and GDP growth.*

Using the market share of the government across all sectors in Pakistan (See Step 3) and combining it with estimated proxy for regulatory costs. ***We estimate that the total share of the government in Pakistan is at least 67 percent. If we were to add to this the cost of dead capital and public land ownership, the figure of percentage government footprint on the economy would be even higher than 67 percent, as much as 80% of the economy.*** (See Box 5).

This substantially large footprint on the economy leaves little room for private investment across almost all sectors in the economy and serves as a significant disincentive for private sector involvement. In the next section of this report, we will identify possible strategies that can be adopted to reduce the footprint of the government on the economy which can consequently facilitate private investment and increase private sector involvement in the economy.

3. Strategies to Reduce Footprint of the Government

. . . the total footprint of government on the economy is more than 67 % (perhaps more than 80%) which leaves little room for private sector involvement and serves as a significant disincentive for private investment in the economy …

There are three fundamental strategies to reduce the footprint of the government on the economy:

i. Deregulation
ii. Privatization
iii. Public Private Partnerships

In the sections that follow, each of the three above mentioned strategies will be discussed with regards to their potential to reduce the footprint of the government on the economy in Pakistan.

BOX 6: The Role of Government in Economic Development

"This is an important subject that is often left out of textbooks and courses. Yet it evokes the most debate, showing up in various guises, such as neo-liberalism, laissez-faire economics, globalization, privatization, public-private partnerships and outsourcing government activities. The post-war rush to development in poor countries, with multiple aid agencies holding their hand and gradually taking over policy, contributes to weakening state autonomy and capacity. Instead of rebuilding the state and redefining the role of the state, the donor community backed academia in the West with huge funds to develop indicators for weakened and fragile states. Governments in countries like Pakistan lost all agency as well as ability to manage their own affairs.

1. *The magisterial good:* Human endeavor is set in the famous phrase in the Declaration of Independence of the US— "life, liberty and the pursuit of happiness." Historically, states have evolved from the initial stage of guaranteeing security, property rights and the freedom of enterprise. The magisterial good involves a legal framework for preserving life, property rights, market transactions and for keeping the state in check from predation. This legal framework is supported by institutions of governance—the police executive and the justice system—that efficiently provide these services to the people. This is a core government function where little if any outsourcing can be done.

2. *Physical Infrastructure:* States have ensured the provision of physical infrastructure, such as systems of communications—road, railways, postal systems, etc.—and systems for the provision of electricity and water. States even provide some measure of public transport in big cities. This infrastructure is important for both the physical cohesion of the state and for enabling citizens to invest more by reducing their transactions costs.

States provide some of these services themselves, while in others (such as telephone, post and electricity) the state may establish legal and regulatory frameworks to ensure quality of service and fair pricing. Regulation and monitoring is necessary in areas of infrastructure provision because, in many of these areas, decreasing cost monopolies and competition may be difficult.

3. *Social good and infrastructure:* The twentieth century saw the rise of the welfare state, which ensured all citizens equal opportunity (education and skills) while also providing them with some form of risk insurance (for managing health, disaster and unemployment). While the state backed by donors had argued for the development of welfare goods, even writing it into the constitution, little progress was made. Now, we need a better definition of the role of state in the provision of these goods and a clear process for achieving these goals.

For the supply of these three types of goods, government will have to be reconfigured into autonomous agencies with clear goals and accountability mechanisms."

From Looking back: How Pakistan Became an Asian Tiger in 2050" by Nadeem Ul Haque

3.1 Importance of Deregulation

Deregulation is a fundamental cross-cutting policy theme that needs to be adopted not merely to reduce the role of the government but to develop market competition for productivity improvement. Pakistani policymakers can learn from examples of other countries that have successfully developed markets through deregulation and achieved higher economic growth. (See Box 7)[22]

Deregulation will reduce government footprint by more than 24% of GDP.

[22] Justin Douglas (2014), Deregulation in Australia, Economic Roundup

While it is important to stress the significance of deregulation to reduce the footprint of the government on the economy, it should be pointed out that 'Deregulation' doesn't imply removal of all business regulations. In fact, effective regulatory frameworks are necessary to develop and sustain well-functioning markets. It is those regulations that end up impeding business activities are the ones that should be reduced/removed. For this purpose, it is important to periodically review regulations and get rid of the ones that are suppressing private investment and growth of markets. For the case of Pakistan, the following steps need to be taken:

BOX 7: Story of Australia:
Deregulation to Reduce Government Footprint to Spur Economic Growth

- Australia has had 5 decades of sustained deregulation which started in early 1970s with the deregulation of its financial sector.
- 1970s – Financial Sector Deregulation. Regulatory control over interest rates loosened, foreign banks entered the market, floating of the exchange rate etc.
- Effective tariff rate gradually declined resulting in reduced international trade barriers.
- 1980s – Removal of controls on foreign capital inflows in the country.
- Late 1980s – Deregulation of Labor Markets. Shift from central wage fixing to enterprise bargaining.
- 1985 onwards – Business Regulation Review Unit. Efforts to reduce compliance costs and paper burden on businesses.
- 1990s – National Competition Policy. Permeating the benefits of deregulation and liberalization across sectors in the economy.

- **Perform regular 'Sludge Audits'** – Pakistan Institute of Development Economics (PIDE) has started a 'Sludge Series'[23]. The definition of 'Sludge' is "unjustified and excessive frictions that makes economic transactions difficult." In terms of economics and business, this includes paperwork, compliance costs, permissions, waiting times etc.
- **Removing barriers to market development and economic activity.** – Not all types of Sludge come in the shape of paperwork. In some cases, onerous regulations can restrict investment for human needs. For example:
  - Building regulations have for decades prevented construction of anything other than single family homes in the form of housing societies. The result is that flats, schools, leisure shopping offices etc. are short in supply.
  - Similarly, protection of automobile and engineering industry has for decades inhibited investment in and the development of this industry.
- **High-level government body such as the ECC with the PC as a secretariat must lead the deregulation agenda.** Deregulation is not easy or quick to achieve. PIDE sludge series and "PIDE Reform Agenda for Accelerated and Sustained Growth"[24] have shown deregulation lies in the detailed study of transactions and markets. As shown in Box 7 with the case of Australia, in numerous countries it took many years of detailed examination for layers of cumbersome procedures and permissions to be peeled away for cost of transactions to be brought down to facilitate economic growth.

[23] Sludge Series (2021), Pakistan Institute of Development Economics (PIDE)
[24] PIDE Reform Agenda for Accelerated and Sustained Growth (2021), Pakistan Institute of Development Economics

BOX 8: Examples of Deregulation

- Freeing up markets once again to allow new transactions and economic activity to take place, e.g. opening out of the education, telecom and the media markets which have driven growth in Pakistan over the last 3 decades.
- Opening out of city space for investment activity (See Haque 2015 and 2020). Cumbersome zoning (excessive restrictions on type of use of areas) as well as building regulations (excessive height and space restrictions) have for decades forced all city and construction activities into housing societies and urban sprawl with several negative consequences, including the country having some of the most polluted sites in the world and traffic congestion of large proportions. The Prime Minister has recognized that construction is a suppressed growth industry which is in need of deregulation.
- Excessive zoning restrictions have generated excess demand for sprawl while severely constraining the supply of space for schooling, office, commerce, leisure and many other activities.
- Permissions, licensing and excessive documentation requirements that take up time, resources and attention away from core business.
- Restrictions on free trade such as limiting exports of rice and wheat, and giving sustained protection to some industries such as the automobile industry.

All such excessive regulations have reduced initiative, innovation and entrepreneurship.

GDP is that is the sum of transactions in the economy. If the number of transactions increases in the economy, GDP will increase as well, leading to growth and employment. For this reason, most countries put in place substantial deregulation of excessive permissions and paper movements to enable smooth and speedy transactions.

BOX 9: Deregulating agricultural markets

The agriculture sector is a major contributor to the economy and also has a substantial government footprint (over 40%). The bulk of this government involvement comes through procurement and storage of agriculture produce by state owned entities and food departments. Government procurement of agriculture produce for strategic and food security purposes is often a very politicized issue, and it would be really difficult for the government to stop its procurement of agriculture produce overnight. PIDE has long argued about the pitfalls of government procurement of Wheat at Minimum Support Price (MSP). [1] However, the Wheat MSP and grain procurement on the whole remains a highly politicized issue.

Another linked area that is more conducive to immediate involvement of the private sector is the market for storage of agriculture produce and in particular grain storage in Pakistan. For instance, the grain procured by PASSCO and the Provincial Food Departments is stored in sites that are owned and operated by these federal and provincial agencies. Most of these storage facilities are in the shape of godowns and covered shelters, majority of which are not up to the standard of modern storage facilities.

Opening up the agricultural value chain to private market development without the involvement of government would open up large opportunities for private investment while also encouraging productivity in agriculture and leading to higher growth (See PIDE Reform Agenda for Accelerated and Sustained Growth (2021))

3.2 Privatization

The most talked-about strategy for reducing the footprint of the government on the economy is privatization of state-owned entities. This has been a major policy in the past and has yielded dividends. In the past 25 years, the banking sector in the country which was predominantly publicly owned has been successfully privatized and research suggests that both the privatized banks and the consumers have benefitted as a result. [25]

Privatization will reduce the total footprint of the government by less than 6%.

Pushed by the IMF, Pakistan has conducted review of its 85 commercial state owned companies and has outlined plans to privatize 44 of these commercial SOEs by 2025. [2627]This will certainly help in reducing the footprint of the government, and is estimated to be about 6 percent of the economy as measured in terms of their yearly GDP contribution.

Furthermore, whether this will be achieved fully remains to be seen as there are bound to be headwinds from politics, public employee resistance and existing laws and legislations.

Even with successful privatization care has to be taken to ensure that market competition in the sector in which privatization takes place is increased. If the government merely transfers its monopoly power to a private monopoly with excessive market share and price-setting power, welfare and investment opportunity may not increase.

BOX 10

"One commonly held view about the difference between continental European countries and other OECD economies, especially the United States, is that the heavy regulation of Europe reduces its growth. Using newly assembled data on regulation in several sectors of many OECD countries, we provide substantial and robust evidence that various measures of regulation in the product market, concerning in particular entry barriers, are negatively related to investment. The implications of our analysis are clear: regulatory reforms, especially those that liberalize entry, are very likely to spur investment."

Regulation and Investment (2004)

Alberto Alesina, Silvia Ardagna, Giuseppe Nicoletti & Fabio Schiantarelli

3.3 Public Private Partnerships (PPPs)

Public Private Partnerships (PPPs) can increase private sector investment across a range of sectors in the economy. Public Private Partnerships (PPPs) come in various shapes and forms depending on the specific contractual arrangements that are agreed upon between the public and private partners. Using a pictorial representation to depict an increasing level of risk sharing and private sector participation, one can create a spectrum that describes various forms of PPPs. (see Figure 7)[28] A detailed description of each type of PPP arrangement is given in the appendices. (See Appendix B)

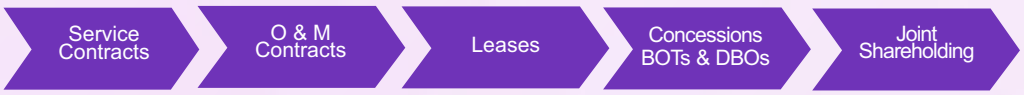


Figure 7: Spectrum of Public Private Partnerships

[25] Shoaib, Muhammad (2012) Impact of Privatization on Banking Sector Performance in Pakistan
[26] State-Owned Entities Triage (2021), Finance Division, Government of Pakistan, pg. 19-34
[27] Abbas, Kalbe & Malik, Manzoor (2010), Impact of Financial Liberalisation and Deregulation on Banking Sector in Pakistan, PIDE Working Papers, PIDE
[28] Public Private Partnerships, World Bank

Box 11: Prerequisites for Facilitating Successful PPPs

- Have favorable legal frameworks.
- Identify stakeholder commitment and responsibilities.
- Have strong, capable private consortia.
- Have stable macro-economic conditions.
- Appropriate risk allocation and sharing.
- Draft effective contracts using Results Based Management frameworks.
- Transparency and trust.
- Monitoring and evaluation.

3.31 Public Private Partnerships Authority (PPPA): a nascent industry in Pakistan

Some significant strides have been made in Pakistan across various sectors to bring private sector involvement in sectors that have traditionally been dominated by public and government institutions. Despite the progress that has been made, the idea and implementation of Public Private Partnerships (PPPs) is still in its early development in the country. The Government of Pakistan has set up a Public Private Partnership Authority through the Public Private Authority Act 2017. It is a regulatory body tasked with overseeing PPP transactions at the Federal level.

Given below are sector-wise and implementing agency-wise distributional summaries of pipeline projects currently being pursued under the ambit of the Public Private Partnership Authority.[29] (See Figure 8 and Figure 9)

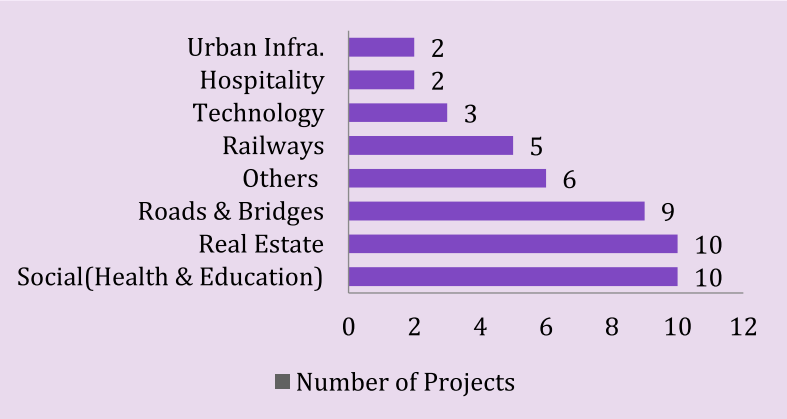


Figure 8: Sector-wise Distribution of Pipeline Projects – PPPA

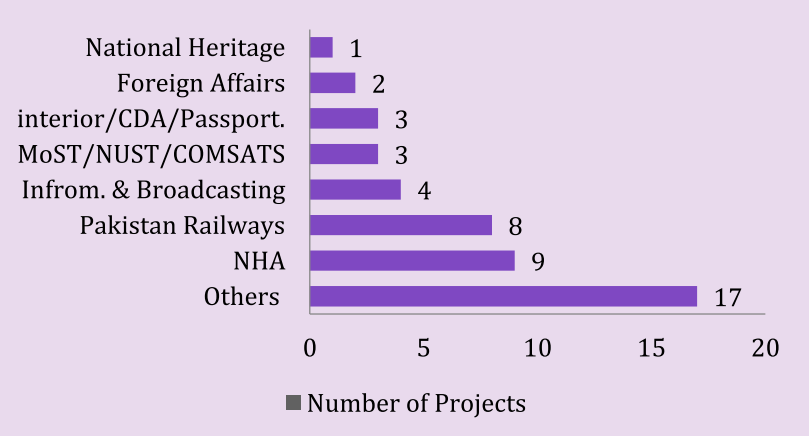


Figure 9: Implementing Agency-wise Distribution. of Pipeline Projects – PPPA

[29] Public Private Partnership Authority, Government of Pakistan

PPPs are still in an infant stage in Pakistan—a country characterized by many allegations of corruption and large mistrust in government transactions. Attempts at PPP such as Royal Palm club were hounded in court and finally annulled while those at track access in railways and the Karachi-Sukkur highway were stillborn.

PPPA has been in existence for at least 15 years in some form and has not fully executed any PPP project yet. The task of the PPPA will be to create an environment of trust where PPPs can be carefully and fairly negotiated.

There is considerable role and need for public private partnerships and yes the ECC with the PC as secretariat can create that necessary environment for PPPs.

Some areas where PPP can enhance growth and welfare are:

i. ***Public Private Partnerships (PPPs) to Utilize Dead Capital –*** There is significant potential for public private partnerships through which the government can utilize land that is owned by the government, ministries, and departments and state-owned entities allied with these ministries. This dead capital as it is known can be developed through this means.
The Cabinet has recently approved the formation of the Federal Government Properties Management Authority (FGPMA). In this regard, the Cabinet has approved promulgation of two separate ordinances that will make litigation and legal enforcements easier for the land owned by the Federal Government, ministries and allied departments. This is a good starting point and will enable leasing out of this land to private sector partners to generate funds for parent departments/ministries. Such efforts need to be replicated in all the provinces and should be fast tracked in the CCI and other forums.

ii. ***Health and Education –*** While the government should continue to pay for health and education services, it is no secret that quality of both in Pakistan is not at par with even comparable private sector counterparts. The government can outsource operational service delivery in these sectors to the private sector and shift to regulation of private enterprises that utilize public funds.

iii. ***Public Office Management –*** There is significant scope for private sector involvement in public office management; this includes functions like maintenance of public infrastructure, HR and back-office functions, ICT and payroll management.

4. Outsourcing Increases Public Sector Efficiency

Box 12: How is Outsourcing Different from Traditional Public Private Partnerships

- Outsourcing contracts are generally short-term contracts often administered on ad-hoc basis based on requirements.
- Outsourcing contracts generally do not involve equity sharing among private and public partners.
- Outsourcing contracts are limited to specific projects, whereas PPP arrangements could be both specific contracts or long-term public-private

Government can use outsourcing to galvanize private sector investment and improve its efficiency. As is currently done on tolls and even parking franchises in cities, government can outsource many public sector activities.

One typical example of outsourcing contracts is outsourcing of IT related services to the private sector. These contracts have already been undertaken by various government departments at both federal and

provincial levels. Similar agreements should be put in place for other goods and services to increase efficiency while keeping in mind the associated pros and cons of outsourcing. (See Box 12)[30]

Though not a direct instrument for decreasing the footprint of the government, it is an instrument for increasing private sector activity and creating jobs. Rather than setting up a government agency with permanent employees and a permanent footprint, private sector can be galvanized to do deliver certain public services or government objective on contract.

An important issue in Pakistan is doing this credibly and transparency. The history of rent-seeking and corruption raise suspicions on all outsourcing activity. Indeed, many are fraught with possible "connectedness" issues. Sadly, no government reports exist on this issue. There should be regular monitoring of these issues with transparency and reporting to the people and parliament.

Contractors become lobbyists and can influence outcomes, and this can be harmful unless fully and carefully monitored and checked. The case of outsourcing US prisons is a legendary case that illustrates how the outsourcing model can influence larger public policy and produce higher incarceration rates in minorities and other disadvantaged groups than in the rest of the population.

Box 13: Outsourcing: Pros & Cons Pros.

- The competition effects of privatization make private provision more efficient than public provision.
- Outsourcing public services can lower costs and increase consumer choice.
- Competition in service provision stimulate innovation, for example in the quality of education and more efficient use of resources.

Cons.

- Private-sector cost minimization efforts risk worsening the quality of public services, depending on the type of service outsourced.
- Some public-sector employees may lose their jobs.
- Natural monopolies (water supply, the electricity grid) cannot be privatized without risking a hold-up problem or corruption.

5. Conclusion

We have argued that:

1. Pakistan Long run GDP and productivity is declining.
2. Pakistan investment rate has always been very low about 15% of GDP, the lowest in the region.
3. PIDE has argued that one factor responsible for the low growth and investment is the rather large footprint of the government on the economy.

The footprint of government on the economy in Pakistan is far greater than what *General Government Expenditure (% of GDP)* might suggest. Government influences the economy through numerous avenues which include large market share of government across several sectors through control of state owned entities (SOEs), direct markets' distorting expenditure, and excessive regulations that increase business transaction costs. This *total estimated footprint on the economy* is higher than 67 percent of GDP in Pakistan. If the opportunity cost of government ownership of prime land and capital was to be included in the analysis, the *total government footprint on the economy* is as high as 80 percent of GDP.

Such a high government footprint leaves little room for private sector investment and development across most sectors in the economy resulting in Pakistan having one of the lowest investment-to-GDP ratios in the region. There is an imminent need to reduce the footprint of the government to spur private sector led sustained economic growth. We recommend the following Strategies to reduce the footprint of the government:

[30] Panu Poutvaara (2014), Public Sector Outsourcing, IZA World of Labor

1. Concerted deregulation to reduce transaction costs which will reduce the footprint by about 24% of GDP. For do this well there must be an agency such as the Planning Commission that must be empowered to unravel the plethora of regulations and seek cabinet approval for the needed reform. *PIDE sludge* series is developing data and suggestions of reform that the PC might find useful. This was the approach taken in many countries to affect substantial deregulation.
2. The strategy of privatization is likely to reduce the footprint by 6% of GDP. If done well to increase market competition, privatization has the potential to increase much needed private investment. CCOP and the privatization commission has developed an agenda for privatization. It should be effectively implemented. It might be useful to have the CCP investigate the prost-privatization market to see how private investment might be accelerated.
3. Public private partnerships (PPPs) could be very useful to develop the substantial *dead capital* in our cities. If done right this could maximize the value of private investment as well as the value of the land that is now wasted in *dead capital.* In addition, it will also maximize city wealth and local and federal revenues. Critical to the success of PPPs, however, is the establishment of a good legal framework and a transparent and effective monitoring system.

To further increase private investment, outsourcing contracts can be used to increase economic productivity of government activities, although these arrangements need to be tracked diligently given Pakistan's record of rent-seeking and corruption.

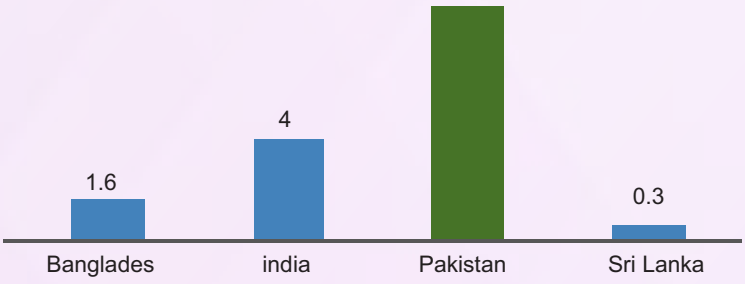
Appendix A

A1. Regulatory Costs and the Permission Economy in Pakistan

In Pakistan there is an extensive system that requires businesses to go through government regulatory agencies and other related government bodies to gain permission to do business in almost all sectors of the economy. Although most countries have permissions and licensing frameworks in place, in Pakistan these frameworks often involve countless procedures, lengthy delays and high transaction costs to go along with complex rent-seeking games between businesses and regulators.

A 1.1 Construction Permits

instance, in the construction industry which other than being an important industry in its own right is further integrated with other industries, it takes an average of 9 procedures to gain a construction permit in the country. Furthermore, the cost of these procedures is at average 8.8 percent of the actual value of the intended construction project. This percentage cost is highest for Pakistan when compared to other three major South Asian economies i.e. India, Bangladesh and Sri Lanka.



Dealing with the Permission Economy: Cost of Construction Permit (% of Warehouse Value)[31]

A 1.2 Transaction Costs

Research shows that higher transaction costs in an economy repress economic activity, which in turn is one of the main reasons behind poor economic performance of developing countries. (Todorova 2016, Bardhan 1989)[32] [33] Estimates of transactions costs for each firm in Pakistan show substantial loss of time in undertaking different transactions. (see figure 13)

[31] Ease of Doing Business (2020), Doing Business, World Bank

[32] Todorova, T. (2016), Transaction Costs, Market Failures and Economic Development, Journal of Advanced Research in Law and Economics. Vol. 2(71), pp. 678-684.

[33] Bardhan, P. (1989). The New Institutional Economics and Development Theory: A Brief Critical Assessment. World Development. Vol. 17(9), pp. 1389-1395

PKR		
Type of Transaction	**Time Cost Per Firm**	**Total Time Cost (Millions)**
Starting A Business	4190	55.43
Construction Permits	62,015	75.72
Electricity Connection	37,502	496.42
Property Registration	36,690	485.46
Paying Taxes	2,666	325.723
Trading Across Borders	103,446	774.82
Contract Enforcement	249,109	304.16
Transaction Costs Per Frim in Pakistan [34]		

A 1.3 Documentation Costs

Documentation costs add to the total transaction costs that a firm/business has to incur while doing business. Higher documentation costs are a significant impediment to ease of doing business. Estimates based on unique data sets and cutting edge research methodology show that firms in Pakistan lose a great many days in dealing with documentation requirements; ranging from 952 days for contract enforcement to 16 days for starting a business per firm.

(Days)		
Documentation Required For	Days Lost Per Firm	Days Lost (Aggregate)
Starting a Business	16	211,680
Dealing with Construction Permits	237	289,133
Getting an Electricity Connection	144	1,894,536
Registering Property	140	1,853,523
Tax Compliance	10	1,243,742
Trading Across Borders	395	2,958,583
Contract Enforcement	952	1,161,415
Number of Days Lost in Completing Documentation Requirements in Pakistan [35]		

Appendix B

B 1. Types of PPP Arrangements/Contracts

Public Private Partnerships come in varying forms each of which can be effectively utilized given the nature of the project/task at hand for efficient service delivery. The fundamental features that vary across these different types of PPP contracts are the level of involvement and the amount of associated risk that is taken on by the private sector partners.

[34] PIDE Reform Agenda for Accelerated and Sustained Growth (2021), Pakistan Institute of Development Economics, pg. 19
[35] Ibid., pg. 20

B 1.1 Civil Works and Service Contracts

Often government departments and enterprises require goods and services from the private sector. In such cases, the goods and services are procured from private sector in return for fixed payments. A few examples of such transactions are procurement of office supplies from the private sector, or on a more service related spectrum lying of pipes, cables etc. Although, these transactions are not full-fledged examples public private partnerships as they often occur on an ad hoc basis with minimum contractual underpinnings, still they represent a significant way in which the public sector enterprises interact with the private sector.[36]

B 1.2 Management/Operation and Maintenance Contracts (O&M)

These are types of contracts in which the public institution/enterprise hires a contractor for a usually small period of time to operate and manage one specific area of a venture. Remuneration to the private sector partner in these contracts is usually dependent on a fixed rate to be paid by the government institution rather than on collection of tariffs from end-line consumers. An essential feature of such contracts is that the private contractors take on minimal amount of risk associated with the asset.[37]

B 1.3 Leases

Lease agreements differ from O&M contracts with respective to the fact that in these contracts the private sector partner instead of getting a fixed fee for its involvement gets to charge end-line consumers. Also, the involvement and the risk undertaken by the private sector partner is pronouncedly more than in O&M contracts. Lease agreements also tend to be usually longer in time duration typically lasting 8-15 years.[38]

B 1.4 Build-to-Operate (BOT) and Design-Build-Operate (DBO)

These agreements are examples in which private sector is heavily involved and at times fully responsible for construction and operation of a project for a mutually agreed period of time after which the project may or may not be transferred back to public ownership (BOT) depending on contractual design. Furthermore, in DBO projects, the private sector partners are also responsible for designing the project. Such arrangements are also used for brownfield projects where the government is trying to extend the domain and size of projects and hence decides to bring in the private sector.[39]

B 1.5 Joint Venture/Government Shareholding

A percentage of shares are divided amongst private investor and the government. A common example of this is when shares in a state owned enterprise are divested to the private sector. The level of share ownership will differ depending on whether the government is seeking to get the enterprise off balance sheet and whether the government wishes to retain management control of the enterprise. Rights attaching to shares and the rights between the shareholders are typically set out in the constitutional documents of the company (typically in the articles of association) and the shareholders' agreement.

[36] Public Private Partnerships, World Bank
[37] Public Private Partnerships, World Bank
[38] Public Private Partnerships, World Bank
[39] Public Private Partnerships, World Bank

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