

Institutional Reform

An Imperative for Development

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Why Institutional Reform?

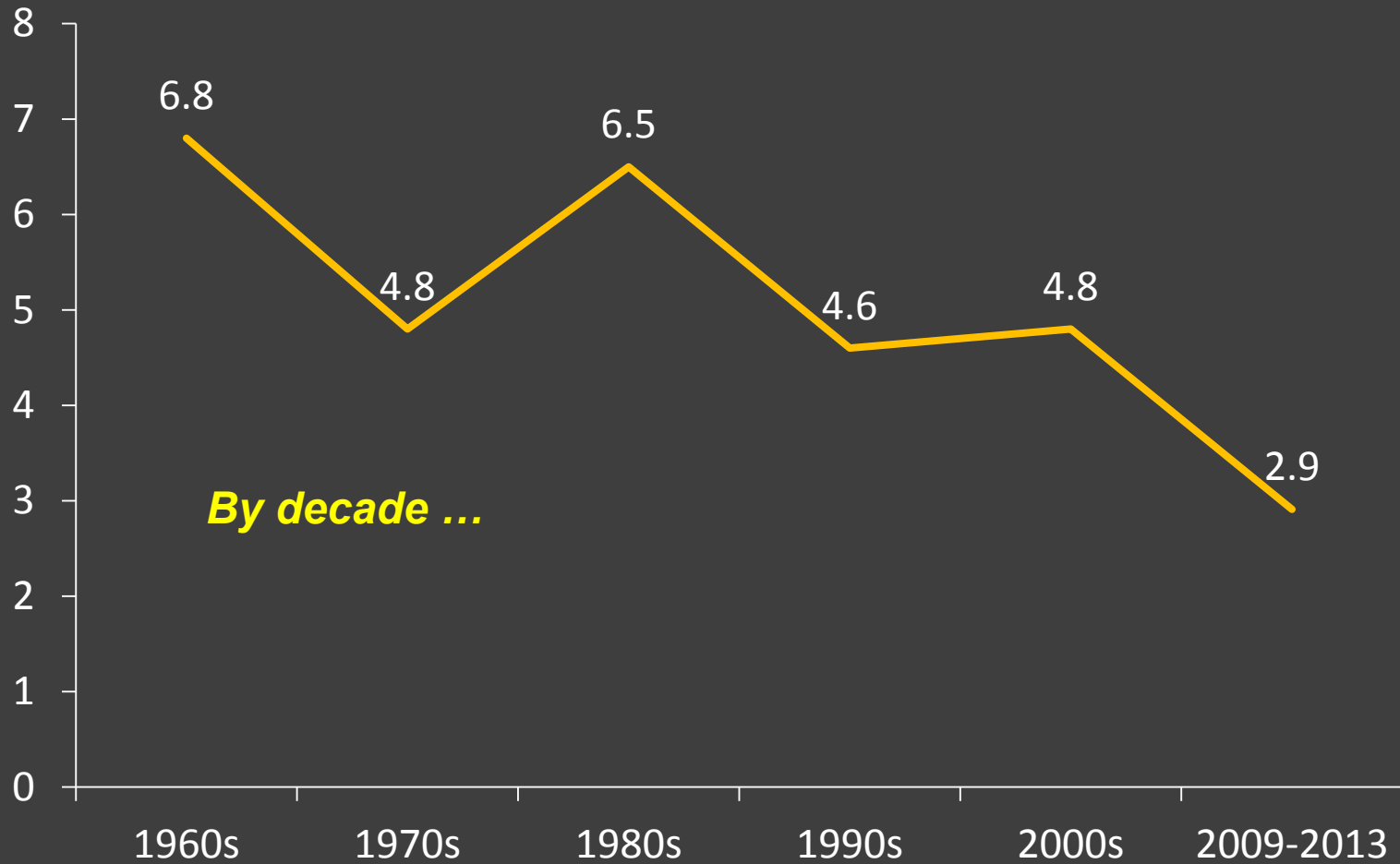
⊙ **Pakistan's economic performance is in secular decline**

- 5-yr avg GDP growth = ~half of LR avg.
- ~ half of South Asia avg.

⊙ **Social indicators + MDGs performance poor**

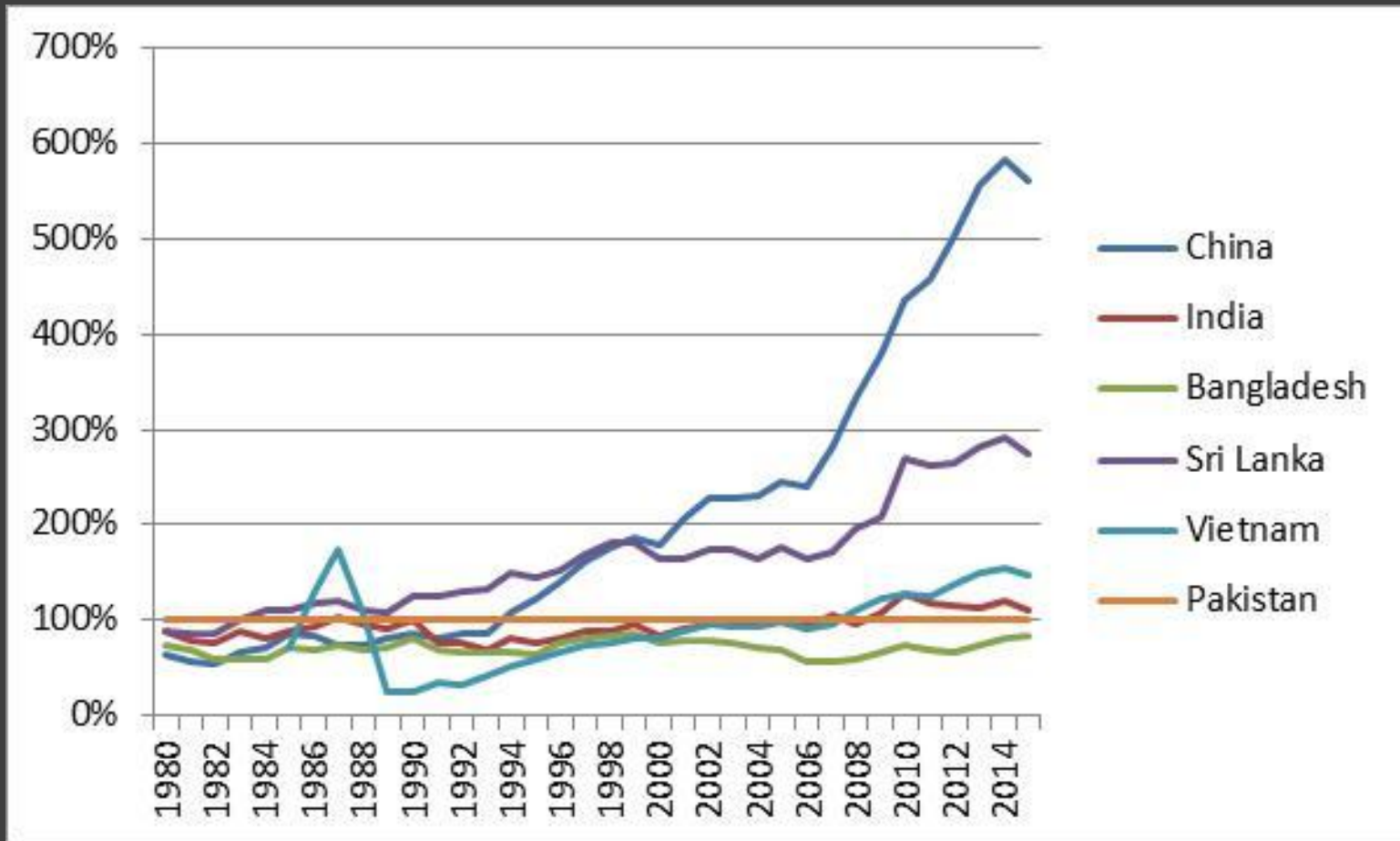
- Human Development Index rank: 147

Growth Performance

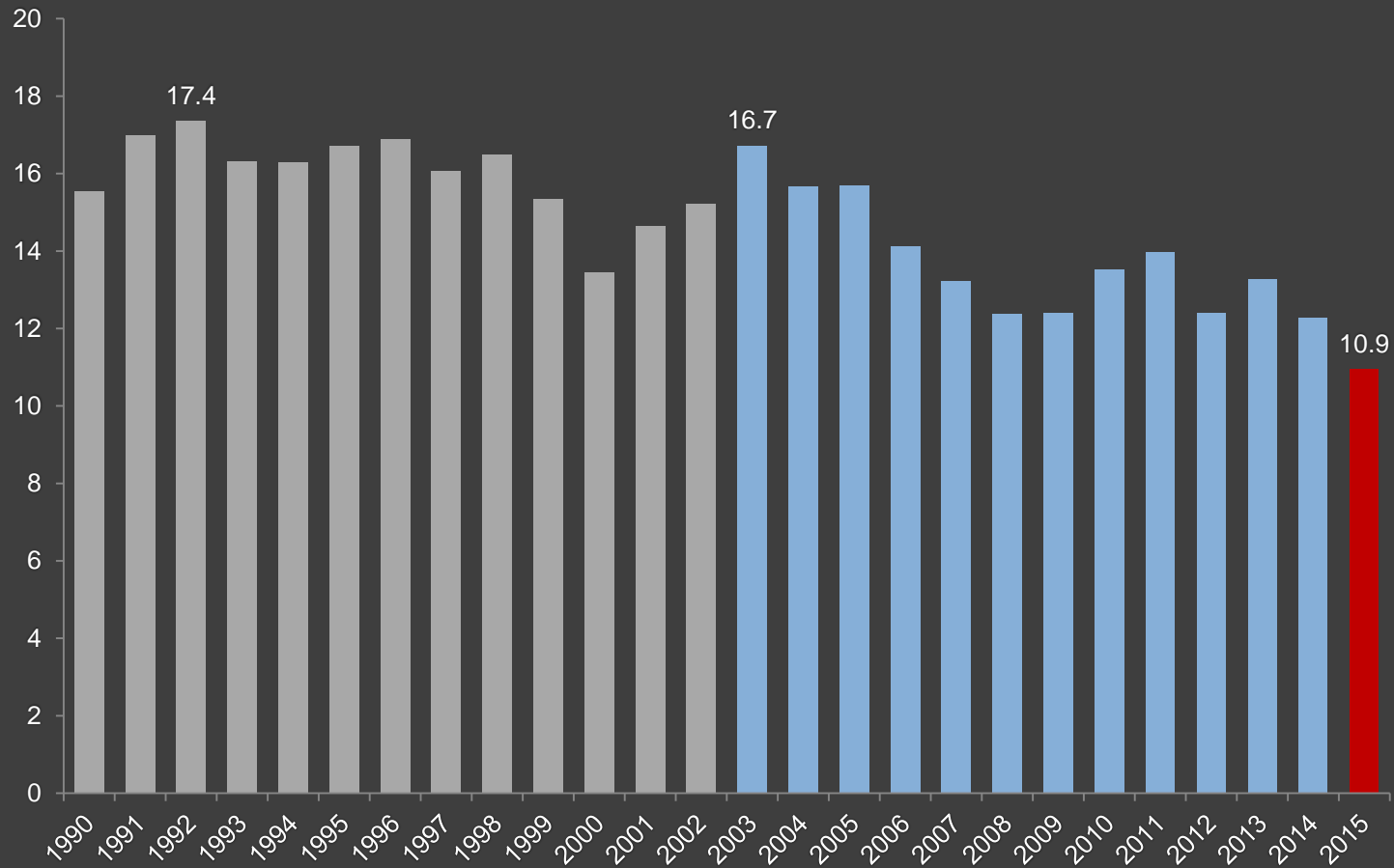


Growth Performance

Per capita income, US\$

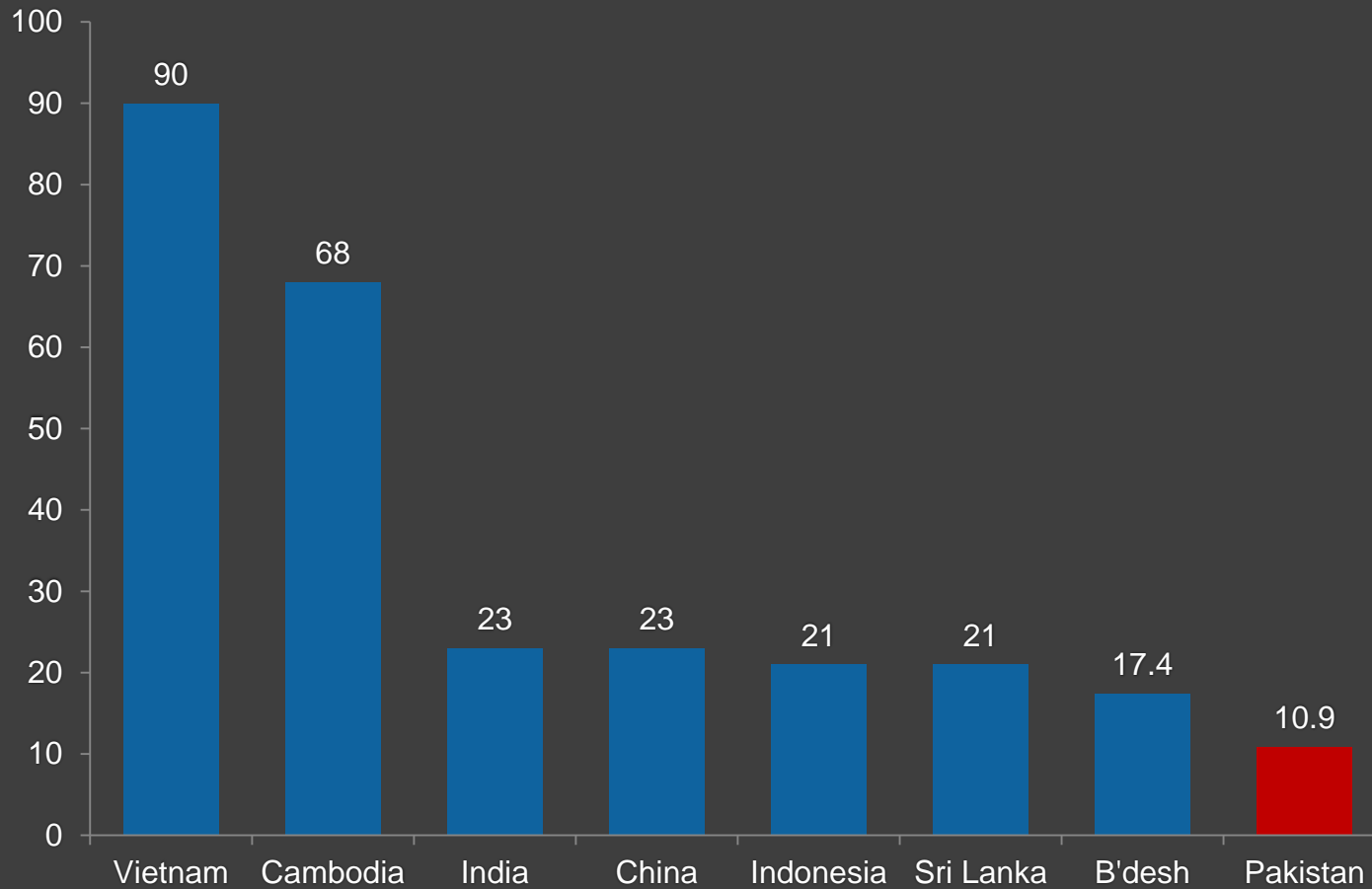


Exports to GDP (%)



Source: World Bank

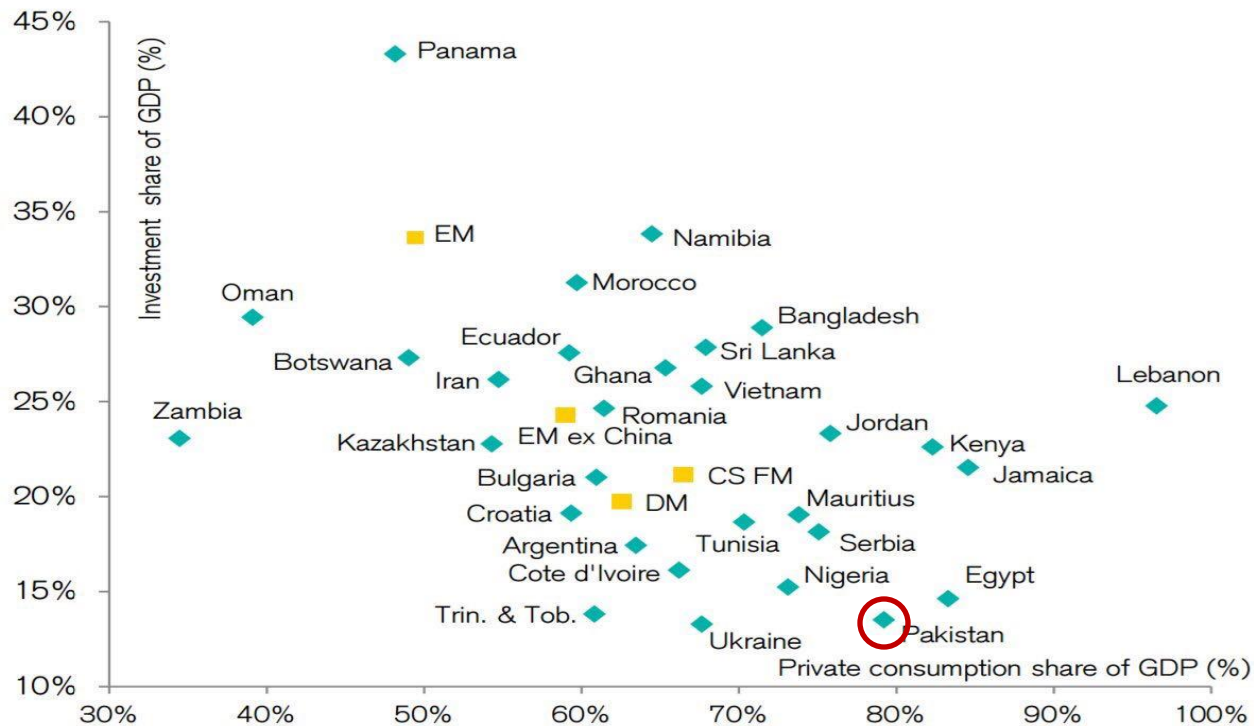
Exports to GDP (%)



Source: World Bank

Economic Performance

Frontier market private consumption versus investment share of GDP (2015)



Source: Oxford Economics, Credit Suisse research

Development Indicators

Pakistan's rank in Human Development Index		<u>147</u>
Spending on education (% of GDP)	:	2.7%
<i>Global rank</i>		172
Health spending (% of GDP)	:	0.7%
<i>Global rank</i>		187
No. of children out of school	:	12 mn
Persons per hospital bed	:	1,600

Source: UNDP

Global Rankings

Defining Governance

- ⦿ *Governance is the manner in which power is exercised in the management of a country's social and economic resources for development. [ADB]*

Defining the Institutional Framework

- ⦿ *Governance is enacted via the institutional framework*
 - *Who* makes the policies; *How* they are made; For *whom* they are made; *When* they are made (if at all);
- ⦿ A robust institutional framework ensures a *responsive, responsible, competent, accountable* system of political and economic governance

Framework

<u>Level</u>	<u>Activity</u>	<u>Concept</u>
Meta	Politics	Governance
Macro	Policy	Policymaking
Meso	Program	Administration
Micro	Project	Management

Hyden, Court and Mease, 2004

Cost of Indifferent Governance

- ⊙ Even a slight (one standard deviation) improvement in governance results in a *threefold* increase in income per capita in the long run. (*World Economic Forum, 2006*).
- ⊙ “[..] developing Asian economies with government effectiveness, regulatory quality, and rule of law scoring above the global means [..] grew faster on average during 1998-2008 by 1.6, 2.0 and 1.2 percentage points annually, respectively” . (*ADB, 2010*).

Case Study

Dysfunctional Tax System

Bad policies; Weak Enforcement; Corruption



Predatory Taxation

Low tax base; Low compliance; Indirect taxation



Sub-optimal Outcomes

Informality; Low investment + jobs creation

Burden of Taxation

Parameter	Source		2013	2016	Chg.
Ease of doing business	WB	Rank	128	138	-10
Ease of paying taxes	WB	Rank	168	171	-3
No. of tax payments	WB	Rank	165	168	-3
No. of hours spent on tax matters	WB	Rank	176	177	-1

Source: World Bank

Consequences of Poor Governance

⦿ **Corruption + patronage:**

- Rule of law + meritocratic norms undermined
- Absence of “inclusion”
- Higher uncertainty
- Higher transaction costs
- Lower investment horizon
- Skewed investment incentives

Consequences of Poor Governance

○ Absence of inclusiveness:

- Concentration of wealth + power -> "capture"
- Income + opportunity inequality
- Competition stifled
- Innovation + efficiency adversely impacted

Consequences of Poor Governance

⦿ Educational quality:

- Lower labour force productivity
- Lower social mobility

⦿ Civil service meritocracy:

- Ability to plan
- Ability to deliver
- Impartial, rules-based decision-making

Consequences of Poor Governance

⦿ Unfair + inequitable tax system:

- Misallocates resources
- Perpetuates inequity in society
- Increases incentives to “informalise”
- Lowers investment and job creation
- Lowers the tax base ...

... and reduces tax revenues even further

The Way Forward

- ⦿ ***Insiders* have little or no incentive to change or modify the status quo**
- ⦿ **Economic governance is not divorced from political governance**
 - Institutions of economic governance are nested within a political eco-system
 - Expecting to introduce reform without wider political reform is unrealistic

The Way Forward

- ⦿ **Imperative of institutional reform needs to be recognised**
- ⦿ **Choice of reform + sequencing important**
- ⦿ **Selection should be based on:**
 - Low political capital expended
 - Relatively high(-er) pay-off
 - **Examples:** Tax Revenue Administration, Planning Agency, National Statistics Agency, Right To Information (RTI) law, Parents-Teachers Councils ...

FES Study on Institutional Reforms

**FRIEDRICH
EBERT
STIFTUNG**

Institutional Reforms in Pakistan The Missing Piece of the Development Puzzle

Sakib Sherani
November 2017



- After nearly three decades of strong performance in terms of economic growth, Pakistan's economy has floundered since the 1990s. The country's economic performance has deteriorated both with regards to its own historical trend as well as when benchmarked against developing country peers. The deterioration is structural and not cyclical, manifesting itself across a wide front and has persisted for a protracted period.
- The weak secular performance of the economy has occurred in a context of a broad atrophy of the country's institutional framework. Is there a correlation or, indeed, even causality between the two developments? The corpus of growth literature on Pakistan has largely ignored to study the country's historical economic performance, in particular the period of decline from the early 1990s, through an institutional prism.

ॐ Thank You ॐ

Questions?

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