Institutional Reform

An Imperative for Development

Sakib Sherani
CEO Macro Economic Insights (Pvt) Ltd
Ex-Principal Economic Adviser, Ministry of Finance

FES I December 2017
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Macro Economic Insights (SMC-Pvt) Ltd.
Registered address: Suite H-4, Karakoram Enclave 1, F-11/1, Islamabad, Pakistan.
Outline

- Why institutional reform?
- Which institutions?
- Way forward ..
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
Why Institutional Reform?

- Pakistan’s economic + development situation not studied through institutional prism
Growth Performance

By decade …
Growth Performance

Per capita income, US$
Exports to GDP (%)

Source: World Bank
Exports to GDP (%)
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** : 147

**Spending on education (% of GDP)** : 2.7%

*Global rank* : 172

**Health spending (% of GDP)** : 0.7%

*Global rank* : 187

**No. of children out of school** : 12 mn

**Persons per hospital bed** : 1,600

Source: UNDP
Impact of (Good) Governance

- Even a slight (one standard deviation) improvement in governance results in a *threelfold* 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)*.
Corruption & development

A correlation between corruption and development

Corruption and human development

Sources: Transparency International; UN Human Development Report
Consequences of Poor Governance

- **Corruption + patronage:**
  - Rule of law + meritocratic norms undermined
  - State capacity to plan, implement, respond weakened
  - Higher economic uncertainty
  - Higher transaction costs
  - Lower investment horizon
  - Skewed investment incentives
Consequences of Poor Governance

- Absence of inclusiveness:
  - Competition stifled
  - Innovation + efficiency adversely impacted
  - Concentration of wealth + power -> ”capture”
  - Income + opportunity inequality
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
## Case Study: Tax System

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<th>Parameter</th>
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<th>2013</th>
<th>2016</th>
<th>Chg.</th>
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<td>138</td>
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<tr>
<td>Ease of paying taxes</td>
<td>WB</td>
<td>168</td>
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<tr>
<td>No. of tax payments</td>
<td>WB</td>
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<td>No. of hours spent on tax matters</td>
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</table>

Source: World Bank
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
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

<table>
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<th>Level</th>
<th>Activity</th>
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<tr>
<td>Micro</td>
<td>Project</td>
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*Hyden, Court and Mease, 2004*
The Way Forward

Stylised facts:

- *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

- 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 ...
Which Institutions?

- **Institutions of Economic Governance**
  - Planning, formulating, implementing, monitoring & evaluation functions
  - Policy coordination
  - Institutions of economic regulation
  - State fiscal capability institutions

Civil service, tax administration, Planning function (PC, P&D), SBP, SECP, CCI, NEC, ECC, NFC
Next Steps ...

- Recognition of imperative for institutional reform
  - A ‘reform constituency’ needs to be seeded

- A structured process needed (formal?)
  
  Following questions need to be answered:
  
  *What* needs to be done; *Who* will do it; *Why* will they do it; *How* will they do it?

- Research:
  - Which institutions (sequencing)
  - How best to reform them
  - How to seed a reform constituency in Pakistan
Next Steps ...

- **A National Reforms Commission**
  - Permanent, high-powered body
  - Representation from different segments (levels of govt, private sector, academia etc.)
  - Related eclectic disciplines represented
    - Political scientists, political economists, development specialists, social anthropologists, sociologists, change/transformation specialists, systems design specialists etc.
FES Study on Institutional Reforms

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.
Thank You

Questions?