Why Institutional Capacity Matters and Where Reforms Should Start[1]

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Pakistan was one of the top 10 economic performers among the developing countries in the world during the first 40 years of its existence. Given its very weak economic base at the time of independence in 1947 and a tumultuous period of nation building marked by continuing political instability in the aftermath of the death of its founder, Pakistan's record of achievements in its first four decades was impressive. It successfully absorbed and rehabilitated 8 million refugees or one fourth of the total population, fought a war with a much larger and powerful neighbor, India, in 1965, and went through a painful and traumatic dismemberment of the country in 1971.

The emergence of a populist political regime that indulged in a massive nationalization of private assets in the 1970s accompanied by an external shock of major oil price increases gave a big blow to business confidence and contributed to the dislocation of the economy. Close involvement with the United States to oust the Soviet Union from Afghanistan in the 1980s and the associated fallout—including the spread of sectarian violence, drugs and Kalashnikovs—shook the social fabric of the country. Despite these and many other challenges, internal and external, Pakistan was able to register a 6 percent average annual growth rate during the first 40 years of its

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existence. In fact, Pakistan was ahead of India and Bangladesh in all economic and social indicators.

Since 1990, however, the country has fallen behind its neighboring countries and has had a decline in the growth rate from 6.5 percent to 4.5 percent.[2] This period has featured both booms and busts.

The booms have been short lived and could not be sustained over extended periods of time. Political instability and frequent changes in governments in the 1990s may have created uncertainty for investors, thus slowing down the pace of economic activity. While there has been a smooth and orderly transition of power from one elected government to another twice since 2008, economic and social indicators have not shown much improvement.

This paper examines several hypotheses that may explain this slowdown and the overall volatile and inequitable growth of the last 25 years, and it advances theoretical and empirical evidence to show that the most powerful explanatory hypothesis lies in the decay of institutions of governance. The paper also suggests a selective and incremental approach of restructuring some key public institutions that is meant to help boost accountability, transparency, security, economic growth, and equity.

Unsatisfactory Explanations for Pakistan's Economic Malaise

The Rise of Extremism and Terror

The popular image of Pakistan externally is that of a fragile or failed state with a large and expanding arsenal of nuclear weapons encircled by Islamic extremists, and of a safe haven for nurturing and training terrorists who pose a threat to other countries. There is considerable unease in the international community about the unending rivalry and hostility between nuclear-armed India and Pakistan, bitter enemies that have fought three wars. The eastern part of Pakistan was separated in 1971 as a result of a war in which India played a decisive role. Kashmir continues to remain a highly contentious and volatile powder keg. Relations with Afghanistan remain tense, and mutual recriminations and mistrust have vitiated the atmosphere. Though Pakistan is a non-NATO ally of the United States, popular sentiment in both countries about the other is largely unfavorable. The United States considers

Pakistan duplicitous in its dealings with the Afghan Taliban and Haqqani network, while Pakistan is bitter that despite incurring such huge losses and sacrificing hundreds of thousands of lives, its role in the war against terror is not fully appreciated.[3] Indeed, Pakistan has been hit hard by terrorist attacks for a decade.[4] Pakistan is perceived by some outsiders as a source of regional instability, and even as an ungovernable country.

Therefore, one popular hypothesis about Pakistan's economic drift is explained by this increasing influence of religious extremists and terrorists who have threatened law and order and disturbed peace and security. Economic agents are reluctant to undertake new investments under this kind of environment.

This hypothesis may be partially valid, but in fact Pakistan's economic decline started in the 1990s—well before the country got embroiled in the war against terror in the post-2001 period. The average growth rate in the 1990s when the country was relatively peaceful and tranquil was already down from 6.5 percent in the 1980s to 4 percent. Investment ratios, export growth, and social indicators all took a dip in the 1990s. Poverty, which showed a downward decline until the 1980s, had worsened by the end of the 1990s. By contrast, the 2002–08 period was one of violence and terrorist activity including assassination attempts and other violent assaults on the sitting president and prime minister. Even so, in these years the country recorded a remarkable economic turnaround. The growth rate touched 6 to 7 percent on average, the investment/GDP ratio peaked to 23 percent, and foreign direct investment flows reached above $5 billion. One of the chief investment officers of a Swedish fund, who has invested heavily in Pakistan, had this to say:[5]

> "It was not until the end of 2008 that I first travelled to Pakistan and met with around 30 companies. Some of these companies were family-owned and had been around for 40–50 years. Their businesses were growing at an average of 10 percent and the political or security situation was not having much negative impact on their performance."

The recent experience of the 2013–16 period is illuminating. Macroeconomic stability has been achieved and economic growth rates are moving in an upward direction. The confidence of domestic and international investors has been regained: Pakistan has been upgraded to the MSCI emerging market index from the less prestigious frontier market index, and its credit ratings by Moody's and Standard and Poor have improved. These recent developments also negate the view that Pakistan's security situation and particularly its deep involvement in the war against terrorism, which continues to the present day, is responsible for poor economic and social performance. Therefore, the security deficit hypothesis does not stand up to serious scrutiny.

Patterns of Foreign Assistance

Another group of analysts argues that the availability of generous foreign assistance has been the main determinant of Pakistan's economic success or failure and that the country's fortunes vacillate with the ebb and rise of flows from external donors. It has been argued that the three periods of economic spurts in the history of Pakistan—the 1960s, 1980s and early 2000s—can be ascribed to the heavy infusion of this money into the country. According to this theory, Pakistan was a recipient of large military and economic assistance and that was the major reason for the turnaround in these three periods of growth spurts. Despite this popular perception, the empirical evidence does not prove this assertion.

Let us examine the data on the foreign capital flows in the slow-growth periods of the 1950s, 1970s, 1990s, and post-2008 period. In the 1950s, Pakistan received huge amounts of military, civilian, and food aid. It was in fact large quantities of imports of food from the United States that kept Pakistan away from hunger. In the 1970s, Western aid amounted to $700 million annually. Additionally, official grants and concessional loans (some of which were subsequently transformed in grants or waived off) from oil-rich Arab countries and workers remittances financed the huge imbalances in the current account. From 1973–74 to 1977–78, commitments of assistance from Iran and Arab countries totaled $1.2 billion, mostly on concessional terms. Parvez Hasan[6] has calculated that aid disbursements during the mid-1970s were at a level far above what was reached during the 1965–70 period (when they averaged $600 million annually and included flows to East Pakistan), after allowing for international inflation. In the 1990s, foreign currency deposits of resident and nonresident Pakistanis in Pakistani banks amounting to $11 billion were utilized to finance external payments. The International Monetary Fund (IMF), World Bank, and Asian Development Bank continued to make loans amounting to several billion dollars between 1988 and 1998, while Japan was the largest bilateral provider of concessional loans and grants. In the post-2008 period, the Kerry Lugar Berman Act authorized $7.5 billion of economic and military assistance from the United States to Pakistan for a five-year period. Multilateral banks and the IMF increased the quantum of their support while Pakistan also became the largest recipient of British aid, which has numbered 1 billion pounds over a five-year period. And yet, despite higher volumes of foreign assistance, the average growth rate has hovered around 3 to 4 percent. It can therefore be seen that there was no significant difference in the availability of foreign capital flows between the periods of high and low growth rates. Thus the hypothesis of high quantums of foreign assistance resulting in high economic performance is not validated by the facts.

Military Dictators and Western Support

Coterminous with the foreign aid dependence theory is a widespread belief that America and other western countries have supported military dictators at the expense of democratic regimes. They are able to twist and turn the arms of the strongmen running the country to follow their agenda and interests. So, according to this theory, Pakistan's economy has done well only under autocratic regimes and with the blessing of the United States and its western allies. The frequent dismissal of elected regimes in the 1990s, the suspension of U.S. aid under the Pressler amendment in the early 1990s and later after Pakistan's nuclear weapons tests in 1998, the coup to overthrow Zulfiqar Ali Bhutto in 1977—all of these events were engineered under the compact with outside powers, and the drop in economic performance was caused by the consequential political instability that emerged from these disruptions. Or so goes the theory.

Alas, it must be recalled that the United States suspended or curtailed economic and military assistance at crucial times in Pakistan's history when military dictators were still in power. U.S. aid was suspended soon after the 1965 war with India, after the 1971 separation of East Pakistan, and during the early period of Zia-ul-Haq's rule, and sanctions were imposed in 1999 when General Pervez Musharraf took over the reins of government. Whenever U.S. interests have converged with those of Pakistan (such as in the 1950s, when the two nations were part of the anti-Soviet SEATO/CENTO arrangement; in the 1980s, when they were cooperating to oust the Soviets from Afghanistan; and to a somewhat lesser extent most recently from 2001 to the present day, when the United States and Pakistan have tried to partner—albeit with ample difficulty—in the war in Afghanistan), America—despite irritations and quibbles on both sides—chose to assist Pakistan irrespective of the type of regime in power.

External Economic Factors

Another explanation that may account for the decline in Pakistan's economic performance in recent decades is global economic conditions—ranging from international trade and financial flows to remittance patterns.

The fact of the matter, however, is that the external environment between 1990 and 2008 was highly favorable. Most emerging and developing countries made great strides in this period, a fact chronicled in the 2016 book *The Great Surge*.[7] Per capita incomes in emerging and developing countries (EDCs) increased by more than 70 percent between 1995 and 2013. The number of poor people was halved from 2 billion in 1990 to 897 million by 2012—bringing down the share of poor people in the total population of EDCs from 37 to 13 percent in 2012. The share of EDCs in world exports rose from 24 to 41 percent. International capital flows jumped from $91 billion to $1145 billion. Social indicators such as life expectancy, maternal mortality, infant mortality, adult literacy, net enrollment ratios, and average years of schooling showed significant improvement. In sum, the external economic environment cannot be blamed for Pakistan's poor performance.

The "Garrison State" Syndrome

Some analysts have attributed the overall poor performance of Pakistan to the "garrison state" syndrome.[8] As Pakistan has been obsessed with confronting a much larger archrival—India—since its formation, it has had to allocate a much larger proportion of its resources to defense expenditures and to preserve and expand the corporate interests of the military. Hence according to this hypothesis, the neglect of education, health, and human development in general as resources are diverted to meet the demands of defense, nuclear capability, and other security-related expenditures has led to the present unfavorable economic and social outcomes.

In actual fact, however, the ratio of defense expenditure to GDP was consistently high in the first 40 years of Pakistan's existence but is now 2.9 percent of GDP—falling from an average of 6 to 7 percent in the 1980s and earlier years. Most of the nuclear-related expenditure was also incurred in the 1970s and 1980s. In FY2016, the budgetary allocation for education was 2.7 percent of GDP.[9] Combining health and education together, the budgetary allocation is 3.7 percent—higher than that of defense and internal security but certainly lower than what is required to address the huge gap in education enrollment and primary health care services. In the education and health sectors, it is governance and management factors that are impediments to the delivery of these services, not budgetary allocations.

Another dimension of the garrison state theory—a popular myth that has now become quite entrenched and almost accepted as the gospel truth in many circles—is that of the large corporate interests of the military.[10]

It is true that the armed forces have established foundations and trusts that run enterprises, but the proceeds and profits they earn are mainly utilized for the welfare of Army pensioners—particularly soldiers who retire at an early average age ranging from 45 to 50. The education and health care costs of their families are financed by the income generated by these foundations and trusts. To put this in perspective, the total market cap in November 2016 of all the listed companies owned by the Fauji Foundation (FF), Army Welfare Trust (AWT), Shaheen Foundation, and Bahria Foundation (all military-run corporations) was only 4.5 percent of the total market cap of the companies listed on the Pakistan Stock Exchange.

Ayesha Siddiqa[11] has stated "that the military has arrived at the point where its business today control[s] about 23 percent [of the] assets of the corporate sector with two foundations—Fauji Foundation and the Army Welfare Trust representing two of the largest conglomerates in the country."

It is true that the listed companies owned by the FF, AWT and so on are big players in the fertilizer sector, but there are also equally large non-military conglomerates competing with them such as Engro and Fatima Group. All of these companies pay full taxes on their income, sales, and imports, and they do not enjoy any exemptions or concessions of a preferential nature. The share of other unlisted companies owned by these foundations and trusts in the total assets of unlisted companies is not known, but it would likely be quite insignificant as the universe of privately owned enterprises and businesses is substantial. Therefore the garrison state hypothesis, despite its highly attractive appeal, also does not meet the test of evidentiary confirmation.

In effect, factors such as security and terrorism, inflows of foreign assistance, preferences for military rule, the external economic environment, and the diversion of public expenditures toward defense may have all played some role in Pakistan's economic downturn in recent decades. However, they were not the main determinant of this poor performance. The answer to the riddle lies in the institutions of governance.

The Links Between Strong Institutions, Good Governance, and Economic Growth

Available evidence across countries suggests a positive relationship between good governance and economic growth. An IMF empirical study from 2003 found that governance has a statistically significant impact on GDP per capita across 93 countries and governance explains nearly 75 percent of cross-country variations in income per head.[12] An Asian Development Bank study from 2010[13] shows that developing Asian economies with government effectiveness, regulatory quality, and rule of law scoring above the global mean (after controlling for per capita income) grew faster on average during 1998–2008 than those economies scoring below the global mean. The authors conclude that good governance is associated with both a higher level of per capita GDP and higher rates of GDP growth over time. Numerous other studies have demonstrated the linkages between good governance and healthy economic growth. A 1998 World Bank study explicitly linked governance to the notion of institutions, defining it as "all aspects of the exercise of authority through formal and informal institutions in the management of the resource endowment of a state." The World Bank study found a high correlation between governance quality and per capita income.[14] The positive correlation between the 10-year economic growth rate and governance quality supports the argument that good governance is an important determinant of economic development. A later World Bank study found a direct causal effect from better governance to higher per capita income across 175 countries between 2000 and 2001.[15] A negative causal effect is found from per capita income to governance, implying that improvements in governance are unlikely to occur merely as a consequence of development. One scholar has reported that better maintenance of the rule of law and political stability affect economic growth.[16] Other research finds that the rule of law indicator is positively and significantly correlated with the growth in per capita incomes of the poorest quintile.[17] A 2004 Asian Development Bank study[18] discovered that political stability and rule of law exhibit negative and significant relation with inequality as measured by the Gini coefficient. World Bank analysis[19] concludes that rule of law and accountability were both positively correlated with growth. Some research argues that pro-poor reforms cannot have the intended impact unless there are significant changes in the institutions of governance.[20] Cross-country studies have demonstrated that political instability, corruption, poor bureaucratic quality, absence of rule of law, and expropriation risk are strongly correlated with lower investment and growth rates.[21]

A new branch of economics, coined by Douglass North as New Institutional Economics, has identified institutional capabilities that states need to make markets function efficiently. North[22] has defined institutions as "humanly devised constraints that structure political, economic, and social interactions and include the laws, rules, customs, [and] norms constructed to advance and preserve social order." Regarding the connection between institutions and economic development, his view is as follows:

> How do we account for poverty in the midst of plenty? We must create incentives for people to invest in more efficient technology, increase their skills, and organize efficient markets. Such incentives are embodied in institutions.

Other analysts[23] demonstrate that institutions determine the fate of nations. Success comes when political and economic institutions are "inclusive" and pluralistic, creating incentives for everyone to invest in the future.

Nations fail when institutions are "extractive," protecting the political and economic power of only a small elite that takes income from everyone else. Institutions that promote good governance and facilitate broad-based and inclusive growth have come to occupy the current consensus on development strategy. According to one study,[24] good institutions ensure two desirable outcomes: relatively equal access to economic opportunity (a level playing field) and the likelihood that those who provide labor or capital are appropriately rewarded and their property rights are protected.

Among the components of good governance, human capital is associated with both economic growth and equity. In a study on human capital and economic growth, the authors,[25] using data for the 1996 to 2011 period for 134 countries, found strong evidence that the relationship between human capital and economic growth is much less pronounced in countries with a low quality of governance. Preconditions in the form of good governance are necessary for an educated labor force to contribute to the economic growth of a country. Weak governance indicated by deteriorated law and order conditions, corruption, and maladministration result in an inefficient utilization of human resources.

Researchers have explored linkages between governance and pro-poor growth in Pakistan for the period of 1996 to 2005.[26] This analysis indicates that governance indicators have low scores and rank at the lowest possible percentile as compared to other countries. The results of this study show a strong link between governance indicators and pro-poor growth. The authors' econometric analysis shows a strong relationship between good governance and reductions in poverty and income inequality.

The model of an elitist economy that was articulated in *Pakistan: The Economy of an Elitist State*"[27] sets out the historical context and drivers of the capture of the state and rigging of markets in Pakistan. It is postulated that a narrow elite constituting about 1 to 2 percent of the population has used the state and markets for political power and self-enrichment to the neglect of the majority of the population, particularly the poor and the less privileged segments of society. This small minority has thus been able to enjoy this unjust accumulation of wealth in the midst of widespread poverty and squalor. In the absence of a neutral umpire, markets are rigged by the elites for their own advantage and thus market outcomes and resource allocations are inefficient. The state, which should be ensuring the equitable distribution of gains from economic growth, is also controlled by the same elite that evades taxes and appropriates public expenditures for its own benefit. Inequities—whether interpersonal, regional, or gender-focused—become commonplace in such an environment. Access to the institutions that deliver public goods and services is intermediated by the elite through a patronage-based system.

In sum, both theoretical and cross-country empirical evidence, coupled with Pakistan's own experience, lend a lot of weight to the argument that poor governance manifested in weak institutions is the predominant explanation for the unsatisfactory economic and social performance of Pakistan over the last quarter century. The evidence to substantiate this point of view is the gradual decline in Pakistan's ranking and score on the following indices:

- World Bank world governance indicators
- World Economic Forum global competitiveness report
- UNDP human development index
- Freedom House economic freedom index
- Transparency International corruption perception index
- International country risk guide
- UNESCO education for all index
- Legatum prosperity index

Sakib Sherani[28] has reviewed world governance indicators for the 1996 to 2015 period. His analysis shows that Pakistan has performed poorly in all six sub-components of governance. The average percentile rank for the 16 years, excluding political stability and absence of violence (extremely low), ranges from 18 to 32. He notes that in four out of the six parameters—government effectiveness, control of corruption, regulatory quality, and political stability and absence of violence—the best scores were recorded under

President Musharraf (a period when economic growth was also averaging 6 to 7 percent annually). There was some modest improvement in two indicators—ease of doing business and corruption perception index—in 2015 and 2016, when the economy was beginning to perform well.

The same picture emerges by examining other indicators and indices compared to India and Bangladesh. Pakistan has fallen below both these countries in the human development index, corruption perception index, and the Legatum prosperity index. It continues to lag behind India and Bangladesh in the education for all and economic freedom indices. The gap with India has also widened in the global competitiveness and global innovation indices.

The main argument of this paper is that the intermediation process through which good economic policies are translated into a rise in incomes and equitable distribution of benefits involves the institutions of governance. It is the quality, robustness, and responsiveness of these institutions that can transmit social and economic policies. The main institutions of governance revolve around the judiciary, which is needed to protect property rights and to enforce contracts; the legislature, which prescribes laws and the regulatory framework; and the executive, which makes policies and supplies public goods and services. If access to institutions of governance for common citizens is time-consuming, costly, or in any way hampered, then the benefits from growth get distributed unevenly. The only winners are those enjoying preferential access to these institutions.

The Decline of Civilian Institutions and the Impact on Civil Military Relations

The decay of civilian institutions can also partially explain the nature of civil-military relations in Pakistan, and the gradual ascendancy of the military in the post-1990 period.[29] For many Pakistani and international scholars, the strength of the military as an institution is also the reason why it should be blamed for the way Pakistan has failed to make progress economically, politically, and socially. A key question that needs to be asked is: How did the military acquire this superior position in the institutional architecture of the country?

In earlier decades of Pakistan's history, the civil services were at the forefront of nation-building and economic development efforts. This was because they attracted the best talent, enjoyed high standards of competence and integrity, and demonstrated a strong commitment to resolve problems faced by common citizens. The armed forces, on the other hand, recruited mostly mediocre personnel with limited education and exposure. Over succeeding decades, however, the civil services abandoned the principles of selection on merit, rigorous training to prepare for higher levels of responsibility, promotions based on performance, and the regular weeding out of those who did not meet performance standards.

And yet, during this same time, the armed forces engineered a major shift. They adopted and then continued to religiously follow these very principles that the civil services abandoned. They transformed mediocre workers into a first-rate human resource, while the civil services, ever since the 1990s, have turned previously first-rate talent into cynics or self-serving individuals. Thanks to sloth, inertia, the stubborn preservation of the status quo, and constantly catering to the parochial interests of the ruling parties, the civil services in the post-1990 era have not served the populace as they did in decades past. Instead, the civil services and the institutions they oversee have become unresponsive, inefficient, and ineffective.

The reasons for this unfortunate shift are varied. The removal of a constitutional guarantee for security of service; the introduction of new measures that brought people into the civil services on the basis of connections and loyalty rather than merit; and the discretion of politicians to remove officers all contributed to the decline in the intake and quality of civil servants.

This is not to suggest that the 1947 to 1990 period was perfect, that everything was well, that all institutions were functioning without interference from politicians, and that there was no indulging in corrupt practices by bureaucrats. On the contrary, there were indeed cases of political leaders and some of the ruling military classes indulging in corruption, nepotism, and favoritism. For example, there were allegations of election rigging during Ayub Khan's presidential election. Prime Minister Zulfiqar Ali Bhutto used the Federal Security Forces to settle personal scores against his opponents. Thousands of civil servants were thrown out of service summarily and arbitrarily by Ayub Khan, Yahya Khan, and Bhutto on charges of corruption and malfeasance. Petty corruption and extortion by lower government functionaries was rampant during that earlier period too. Patronage, kinship, and extended familial, tribal, and feudal relations pervaded the system.

However, all this said, on balance the contribution of civil servants and the institutions they ran during Pakistan's first four decades far outweighed the negative damage done by the acts of a minority among their ranks. In informal online consultations conducted in recent years, focus group participants[30] asserted that out of 10 randomly selected higher civil servants in the pre-1990 period, only two or three would have been known to be corrupt or pliable to extraneous influence. They believed the tables began turning around 1990, and that today, out of a sample of 10 such officers, only two or three would enjoy the reputation of being honest, conscientious, and immune from political pressure. A 2016 survey of nationwide public opinion conducted by the independent think tank PILDAT shows that the armed forces had the top approval rating of 76 percent, while government officers (specifically civil servants and police officers) were at the bottom, with approval ratings of 29 and 25 percent, respectively.

Whenever there is an institutional vacuum, the stronger entity fills the space. Whether it is fighting the Taliban, cleaning up Karachi of criminals and extortionists, evacuating people from flood-affected or earthquake-struck areas, constructing highways in difficult terrain, or even collecting electricity bills, the Army is called upon by the civil administration to take the lead and deliver. The constitutional requirement of holding a census every 10 years has not been met because soldiers have not been available for assistance (in 2017, Pakistan successfully completed its first census since 1998).

The incapacities of civilian institutions of governance have in fact facilitated the ability of the military to assert itself directly or indirectly and to become a dominant player in public policy. The institutional imbalance between military and civilian structures can, *inter alia*, be ascribed largely to this growing gap in the capabilities of these two structures. This does not, by any means, absolve some army chiefs and their close confidants, whose personal ambitions to take over power have been a major factor in the disruption of Pakistan's democratization. However, the collective malaise of corruption, incompetence, mismanagement, personal vendettas, and point-scoring among politicians and their cronies and the failure to deliver public goods and services to the population at large have provided the generals with the opportunity and justification to intervene. Hence, those who took over power by removing elected governments through extra-constitutional means cannot be absolved of blame for retarding the process of political development and orderly democratic transition. This periodic disruption in constitutional rule has also contributed to the weakening of political institutions.

Diagnostic studies, particularly those that emerge from the Wilson Center's frequent conferences on Pakistan's development challenges, suggest that every single crisis faced by the country—including low tax mobilization, energy shortages, a lack of law and order, losses of public sector enterprises, poor delivery of education and health services, and stagnating trade—can be traced back to governance deficits and institutional weaknesses.[31] Tax collectors enjoy wide discretionary powers that they use to extort money and enrich themselves rather than raising additional revenue for the exchequer. Power and gas companies find huge gaps between the sales revenues they assess, bill, and collect, and the purchases of units they have to pay for. Law and order suffers and the common citizen feels insecure because police officials are appointed on the basis of recommendations from elected members of Parliament and assemblies in exchange for outright payment, rather than on the basis of professional capabilities. Public sector enterprises face losses from serving as a dumping ground to accommodate thousands of unneeded employees put in place at the behest of the ruling party. In competitive markets, they lose market share. In public monopolies, they fleece consumers but still incur losses due to inefficiency, waste, and corruption.

There is a general consensus in Pakistan—and endorsed by international organizations—that the country's civilian institutions have decayed over time. According to the World Bank[32] in a 2013 policy note: "In a recent analysis of binding constraints to Pakistan's economy, bad governance and a poor civil service appear to be undermining economic growth. Without improving governance, other efforts in realizing the country's growth potential are destined to be less effective than they would be otherwise."

One main message of this essay is that the existing asymmetric power relationship between the military and the civilian sectors needs to be reversed. Frequent calls to the military for overt or covert interventions to aid civilian administrations do not serve the long-term political, economic, or social stability of Pakistan. The armed forces are best left to do the job for which they are so well-equipped and capable—the provision of external security. There is a widely accepted belief that if district administrations, law enforcement agencies, and civilian intelligence agencies had performed their job well, then the unlawful activities of militant and extremist elements would have been nipped in the bud and the country would have avoided massive dislocations in its economic and social life. If basic services such as education, healthcare, and justice had been accessible to common citizens, then the drift toward the criminal-extremist nexus would not have taken root in society.

Toward an Incremental Reform Plan for Civilian Institutions

The challenge, therefore, is how to make an ungovernable state democratically governable once again. This can be achieved by rebuilding vibrant, agile, and effective institutions of democratic governance that establish the writ of the state; that eliminate non-state actors engaged in criminal and militant activities; that deliver basic goods and services, including justice, to the majority of the population in a fair and equitable manner; and that reignite the growth impulses that characterized the first half of the country's existence.

The National Commission for Government Reforms (NCGR), consisting of members drawn from both the private and public sectors, travelled throughout Pakistan between 2006 and 2008, consulted with different stakeholders, carried out field studies, made on-the-spot observations about the delivery of public services, reviewed research work, and compiled a report.[33] The commission made exhaustive recommendations regarding institutional structures; human resource policies; and the reengineering of the federal, provincial, and local governments, public enterprises and corporations, and autonomous bodies. The recommendations of the commission have been welcomed by the previous and current governments but have not been formally accepted or implemented. Ideally, a future government would move with vigor to implement this full set of recommendations, but it seems more realistic to begin with the proposition that it is unrealistic to expect that a comprehensive reform of the civil services and of all the civilian institutions of governance is feasible given current political realities.

The dilemma facing academics and technocratic policy reformers is that the status quo of inefficient policies and institutions is defended because it suits politically influential elites. Additionally, the constituency and coalitions for efficient policies and strong institutions do not exist. If the ideal solution of across-the-board and comprehensive reform is not feasible, then perhaps a second- or third-best solution can be a more selective and incremental approach—one that focuses on a few key institutions of democratic governance. Such an approach would be formulated on the assumption that it would not meet the fierce resistance that would ensue if there were to be full-scale, comprehensive reform, given that those affected by more modest reforms would comprise a very small percentage of the overall population of Pakistani civil servants.

To that end, this paper proposes an incremental and selective reform of some key institutions, with the goal of restoring the efficacy, efficiency, and effectiveness of democratic governance. The hope is that these institutions can once again take on the admirable characteristics—merit, integrity, dedicated service, and problem-solving – that they enjoyed in earlier decades.

There are already many examples of successful institutions working well in the midst of this general atmosphere of institutional decay. The performance of the Punjab provincial government in many respects is much better than that of other provinces. This can be attributed to strong exemplary leadership. However, its sustainability would be better assured if its institutional infrastructure were to be strengthened.

A study titled *Candles in the Dark*[34] has documented at least 10 such well-functioning institutions run by the government, private foundations, and NGOs, and the authors have drawn lessons explaining their success. In addition, the State Bank of Pakistan, the National Highway and Motor Police, the National Data Registration Authority (NADRA), the Sindh Urology and Transplant Institute (SUIT), the Indus Hospital, the Aga Khan University and Hospital, the Punjab Education Foundation, the Benazir Income Support Program (BISP), the Hussain Ebrahim Jamal

Research Institute of Chemistry, and the Skills Development Council are usually considered islands of institutional excellence in the midst of overall decay. A new form of organizational structure—by which companies are established by the government of Punjab under the Companies Act—is providing an alternate model for the organizational architecture of government. So it is possible that the lessons learned from these success stories can be applied to the key institutions proposed for restructuring in this essay.

The experience of Pakistan and lessons from other developing countries suggest that it is the interaction between policies, institutions, and leadership that promote good governance. Sound economic policies do not get implemented because of poor institutions and weak leadership.

The analytical framework for this study on institutions and their linkage with economic and social development in Pakistan is based on the World Bank's 2017 World Development Report on Governance and Law.[35] Accordingly, this essay first identifies the development objectives for Pakistan that are broadly shared by a vast majority of people as well as by political parties and other stakeholders. These are security, growth, and equity. Before identifying the institutions that carry out these functions, it is important to spell out the contours of a long-term agenda of reforms to transform the structure and processes of governance that would help attain these shared development objectives.

A Long Term Governance Reform Agenda

A long-term roadmap to achieve a better and enduring system of democratic governance would have to contain certain essential ingredients. Their pace, sequencing, and implementation would depend upon a consensus among the major political parties, as the time horizon would cover several electoral cycles. No government in power can afford to take upon itself the sole responsibility to carry this forward, knowing full well that there would be resistance by their opponents or that the process would be disrupted after a change in government. Partial, incomplete, and half-hearted actions would not alter the course set out.

First, there is a need to reform the electoral process whereby constituencies are delimited afresh on the basis of the new population census.

Electoral rolls should be prepared from the new data generated through this census. The Election Commission and the chief election commissioner should be given unfettered powers to organize the elections by directly taking over the administrative apparatus of the provincial and district governments. Electronic machines should be used for voting. After careful screening, candidates for the national and provincial assemblies who do not meet eligibility criteria should be disqualified by the Election Commission from contesting elections. This weeding out process would improve the quality of elected representatives.

Second, political parties should institute more democracy within. In the 1950s, for example, elections for party office bearers were held at the grassroots level. This process has been substituted by the discretionary choices conferred upon the powerful top party leader, who selects office bearers of the party at all levels, nominates central working committee members, and allocates party tickets for the national and provincial assemblies along with the Senate. This leader also chooses ministers for federal and provincial governments if the party gains power. Such high concentrations of power in the hands of a single individual are inimical to the essence of democratic governance, which is based on debate, consultation, and consensus. Thus, dissent and difference of opinions within the party have given way to sycophancy and pleasing the boss at all costs. Furthermore, the combination of the offices of the party chief and chief executive in the same person has withered away what little accountability could otherwise be expected.

Third, the 18th amendment to the Constitution and the 7th National Finance Commission have very rightly devolved administrative, legal, and financial powers and authority from the federal to the provincial governments. However, this devolution remains incomplete. The provinces have not transferred powers and resources further down to local governments, where most of the interaction between an ordinary citizen and the government takes place. Since 2008, the powers of local governments have been assumed by provincial governments. With the exception of the Khyber Pakhtunkhwa administration, provincial governments enjoy tremendous power under newly enacted laws, making elected local governments subservient to them. This disconnect between the wishes of provincial governments to centralize power in their own hands and the aspirations of the people to access basic public services at their doorsteps needs to be resolved. Attempts to strengthen democratic governance are bound to fail in the absence of the decentralization of decision making, of the delegation of powers, and of the devolution of authority and deconcentration of resources.

Fourth, the administrative machinery of the civil services as a whole has broken down. Reforms in the police, administrative services, land management, the judiciary, and the delivery of social services need to be undertaken to set the country in the right direction. The capacity of civil servants to remain neutral and objective, which used to be their hallmark, has to be rebuilt and their morale and motivation revitalized so that they are able to once again assume their lost space in the country's governance structure and processes. Institutions that promote skill formation, higher education, scientific research, and technology transfer have to be brought to the front burner.

Fifth, the dispensation of justice in Pakistan has become time consuming, expensive, convoluted, and unnecessarily layered. A backlog of millions of cases pending in the lower courts has taken away the deterrent effect of punishment for criminals, defaulters, and other violators of laws. State revenues and bank loans, amounting to hundreds of billions of rupees, are held up due to litigation. Property titles and exchanges of deed have lost their sanctity because of prolonged disputes and complex processes prescribed by courts. Detection, investigation, and prosecution of cases are sloppy, making conviction rates too low. The whole value chain of the administration of justice needs to be overhauled.

Sixth, the federal government's Freedom of Information Act does nothing to facilitate the flow of information into public hands. The Right to Information Act in India has played a major role in keeping public servants and political leaders on their toes, because their actions and deeds could become the object of public knowledge and thereby lead to embarrassment. Civil society organizations and the media in India have played a critical role in accessing information and data under the Act. Similarly effective legislation in Pakistan, coupled with the curtailment of the Official Secrets Act—which vitiates open government—could go a long way toward ensuring transparency in government affairs. Provincial legislation, particularly in Khyber Pakhtunkhwa and Punjab, has sought to bring improvements. However, the requisite institutional arrangements have not yet been put in place.

Seventh, Parliament is supposed to provide checks and balances to counteract the excesses of the executive branch. But this is hardly the case in Pakistan. There is little legislative accountability to citizens, weak market oversight, and indifference in responsiveness to citizen demands. Parliamentary committees such as the Public Accounts Committee can, through public hearings, exert a sobering preemptive influence on government departments, ministries, and agencies by ensuring that waste, inefficiencies, and irregularities are minimized. However, the partisanship exhibited in the committees' deliberations and the lack of technical expertise among the staff assigned to these committees have weakened their watchdog and oversight functions. Strengthening these committees would help place effective controls over the misuse of power and resources by the executive branch.

Finally, management practices in the government need to be modernized and overhauled. Overcentralization and the concentration of power in the hands of the prime minister and provincial chief ministers have resulted in diffused responsibility, an absence of clear accountability, inertia, and a lack of commitment. Overly long hierarchical chains, consultation for the sake of form and procedure rather than substance, turf building and turf protection, and the tendency to pass the buck have created a big gap between promises and performance. The rules of business have to be rewritten to assign clear responsibilities to ministries, giving them the requisite authority and resources to fulfill their obligations and holding them accountable for results. Interministerial coordination and conflict resolution should take place at the level of the cabinet secretary, secretaries' committees, cabinet subcommittees, and the cabinet itself. E-government tools would help ensure transparency and the expeditious pursuit of business and coordination efforts.

Lessons from Other Countries[36]

A key question may be raised in the context of the above discussion: Is Pakistan unique in respect to poor governance? Are there countries with weak or frail institutions and poor governance that have managed to perform quite well?

In recent years, Bangladesh has been rated by Transparency International as the most corrupt country in the world. Political leaders there have been embroiled in nasty political fights for over two decades. In 2007, the situation grew so dire that the military intervened and set up a caretaker government for two years to cleanse the political system, albeit without much success. The result? The two major political parties, the Awami League (AL) and Bangladesh National Party (BNP), continued to remain the top two political powerbrokers. In 2015, the AL won an election labeled by the opposition as flawed. Since then, the ruling AL party has crushed the opposition party with a heavy hand, and gradually tamed all institutions of the state—including the judiciary. It is now on the path toward a one-party government. And yet, Bangladesh has done remarkably well over the last 25 years, as it has grown economically at a respectable rate and demonstrated improvements on a variety of social indicators.

India's institutional framework is also relatively weak, and the performance of its public institutions has become a matter of concern. Several recent studies have focused on the nexus between crime and politics in India.[37] Several ministers of the central government and several chief ministers have been accused of, indicted for, or convicted of corruption and other malpractices in recent years. And yet, despite the frailty of institutions and weak governance, India remains one of the top performers among emerging economies.

Indonesia under Suharto was cited as a living example of crony capitalism. The Suharto family, along with its business partners, was deeply involved in many large projects and business transactions. No major deal could be consummated without the blessing of the Suharto family. However, the record of Suharto in turning around the economy of Indonesia and lifting nearly one hundred million people out of poverty by 1998 was quite impressive.

A careful comparative analysis of binary pairs—Pakistan versus these other three countries—is beyond the scope of this paper, but some tentative and preliminary explanatory hypotheses can be offered. All three countries enjoyed macroeconomic stability and orderly political transitions (except Indonesia) over a prolonged period of time. A continuity of economic policies, along with the state's encouragement for and promotion of the private sector, signaled to investors that political regime change would have no surprises or unanticipated effects on economic policies. This generated a sense of confidence and predictability. Rent sharing among private businesses, government officials, and politicians was commonplace, and it got entrenched as a norm of doing business. There were no abrupt disruptions in the rent-sharing process when governments changed hands. Rent seeking was therefore growth-enhancing[38] in the sense that owners used surpluses to invest and expand their domains while the government facilitated and paved the way by removing bottlenecks and hurdles, thereby making businesses internationally competitive. This relationship unshackled the entrepreneurial energies of the private sector, enabling it to contribute to higher national growth. Bangladesh was able to raise its gross investment ratio from 12 percent in 1990 to 30 percent in 2015.

In the case of Bangladesh, an additional feature was the empowerment of nongovernmental organizations by political parties to participate in social development. NGOs facilitated the opening of schools, health clinics, and family planning services and helped provide microcredit. The country made great strides that would not have been possible if the government was the only provider of these services.

Pakistan, on the other hand, stifled private businesses. There were crude attempts by each ruling party to use the patronage apparatus on a highly selective, partisan, and parochial manner to favor their cronies. Bank loans, permits, and approvals given to them were used, by and large, for the ostentatious consumption or transfer of assets abroad and not for the expansion of productive capacity or new investment. Consequently, investment ratios in Pakistan remained in the teens, and growth rates since the 1990s have registered far below their potential.

Key Institutions Proposed for Restructuring and Strengthening

Any selection from a large universe is bound to be met with skepticism. Therefore it is important to highlight the criteria used to select the institutions listed further below. The criteria are as follows:

1. For institutions of market governance: The potential to enable private businesses to operate without hassle or high costs of transactions in a competitive environment, all while upholding strong standards of corporate governance and protecting the interests of consumers and minority shareholders.

2. For institutions associated with the delivery of services: The ability to hasten efficient and nondiscriminatory access to basic public goods and services such as education, healthcare, water, and sanitation.

3. Institutions tied to the administration of justice: An ability to provide security of life and property to common citizens and to ensure expeditious and financially affordable justice and dispute resolution.

4. Institutions of accountability, transparency, and oversight: A capacity to take timely action without fear or favor against those indulging in malfeasance, corruption, or the misuse of public office for personal gains.

5. Institutions for promoting equity: An ability to strengthen the capacity of those who do not have the assets or skills to fully participate in market-based economic activities.

Another key criterion taken into account in the selection of institutions proposed for reform is the strength of their knock-on spillover and crossover effects to other sectors and institutions. For example, reforming the Public Service Commissions would attract and retain talented young men and women into the civil services based on open, merit-based, and fair competitive processes. The higher quality of civil servants would, in turn, uplift the performance of institutions that deal with service delivery, market governance, and the administration of justice.

Accordingly, this essay identifies about two dozen key state institutions that if reformed would help meet the development objectives of security, growth, and equity for Pakistan. They have been chosen because of their inherent constitutional or legal standing, their potential to serve their intended purpose, and their possible positive impact on other sectors and spillovers to other institutions. All institutions cited below are existing ones, with the exception of a proposal for a new National Science and Technology Commission to be set up along the lines of the Higher Education Commission. Some of these institutions are deemed to require only modest reforms, such as incentive alignments and business process re-engineering, while for others major surgical operations are in order. The institutions proposed for reform are grouped together according to their possible contributions toward achieving the development goals of security, growth, and equity. In addition, there are cross-cutting institutions that directly or indirectly impact all three objectives and are mainly concerned with accountability, transparency, and oversight.

Accountability/Transparency/Oversight

- Parliamentary committees
- Local governments
- Auditor General of Pakistan and public accounts committees
- National Accountability Bureau and provincial anti-corruption departments
- Election Commission of Pakistan
- Public Service Commissions, federal and provincial
- Information commissioners under the Freedom of Information Act
- E-Government Directorate General and provincial IT boards

Security

- Lower judiciary
- Police, including investigations and intelligence agencies
- Federal Investigation Agency
- National Counterterrorism Agency
- Prosecution departments

Growth

- State Bank of Pakistan
- Securities and Exchange Commission of Pakistan
- Higher Education Commission
- National Science and Technology Commission
- Federal Board of Revenue
- Trade Development Authority of Pakistan
- Board of Investment
- Competition Commission of Pakistan

Equity

- Pakistan Agriculture Research Council and provincial research institutes
- Local governments
- State Bank of Pakistan
- HEC needs-based scholarship program
- Benazir Income Support Program, Zakat committees, and Baitul Maal (an organization that assists the poor)
- Irrigation authorities
- Urban development authorities
- National Vocational and Technical Education Commission

Conclusion

This paper attempts to explain Pakistan's declining economic growth rate and weak social indicators for the last 25 years. The most satisfactory explanation lies in the decay of institutions of governance, which have failed to achieve the interrelated development outcomes of security, growth, and equity.

The reforms outlined above are easy to describe but extremely difficult to implement. These reforms are unlikely to be introduced in one go, as it is neither practicable nor feasible to do so—due to both an absence of political will and capacity constraints. The ideal solution—sweeping reform throughout institutions of governance—is therefore ruled out. Accordingly, this paper proposes several next-best solutions that target a subset of key institutions for reform which, if done right, can generate substantial improvements in Pakistan's governance landscape over time. The spillover and knock-on effects of these reformed institutions would enlarge the space for beneficial outcomes over time.

To be sure, the challenge of reforming even this subset of institutions is formidable. Vested interests wishing to perpetuate the status quo are politically powerful, and the coalitions and alliances between the political leadership and the beneficiaries of the existing system are so strong that they cannot be easily ruptured. Elected governments, with an eye on short-term electoral cycles, are not in a position to incur the pains of these reforms upfront while the gains only accrue later on, and potentially to a different political party. Meanwhile, authoritarian governments are not effective because they do not enjoy the legitimacy needed to sustain reforms. Changing institutions is a slow and difficult process requiring, in addition to significant political will, fundamental measures to reduce the opportunity and incentives for particular groups to capture economic rents.

The exact steps required for restructuring these institutions have already been developed, some in conjunction with the World Bank, and are fully documented. A synopsis of these plans can be found in several publications.[39] Lessons learned from neighboring countries outlined in this paper, if adapted and applied, can further refine and reinforce this restructuring effort.

It will not be possible to execute these reforms unless all major political parties reach a consensus, thereby ensuring that partisanship and point-scoring do not come in the way of implementation. Civil servants would be more active in this reform process if they knew that the risks of retribution and penalties were minimal. Politicians of all persuasions in Pakistan must realize that the growing disaffection for political parties and leaders, the quickening spread of violence and intolerance, the rising popularity and respect for the armed forces, and the widening gap between the expectations of the general population and the actual deliverables of government should be a wake-up call for altering past conduct, practices, and behavior. A growing and educated urban middle class and an ongoing information and communications revolution—which extends even to Pakistan's rural areas—through electronic and social media should act as catalysts for this change.

The good news is that some key stakeholders are already on board with the idea of a reform process. Conversations with senior military officers reveal a strong desire from the Army that civilian institutions return to the level of strength that they enjoyed in previous decades.

The ultimate beneficiaries of such altered behavior would not only be the citizens of Pakistan, but also political parties. The cynicism about and wide distrust of politicians within society at large would be replaced by improved access to and delivery of essential basic services—a dramatic transformation that would bolster the public's confidence in a political class that today is highly unpopular.

Notes

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