70 YEARS OF DEVELOPMENT:

THE WAY FORWARD

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Seventy Years of Development: The Way Forward

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Economic Highs and Lows of Pakistan: Analysing the Last 70 Years*

*Ishrat Husain***

Abstract

Pakistan's economic performance over the last 70 years can be divided into two distinct phases. In the first phase, covering the first 40 years since its independence, the country was one of the best performing economies among the developing countries with recorded average annual growth rate of 6 percent, far ahead of India and Bangladesh. The second phase which started in 1990 and spanned over the next 25 years witnessed Pakistan becoming an economic laggard, trailing behind other countries in the South Asia region. This chapter explores the possible explanation for this divergence in economic and social outcomes. Five different explanatory hypotheses for the decline of the economy, oft cited in the literature as well as preponderant in popular opinions were tested against empirical evidence. None of these hypotheses could be validated. The study, then, carefully examined other theoretical and empirical evidence and came to the conclusion that it was the differentiation in the institutional capacity and behaviour, which provides a relatively more persuasive answer to this puzzle. Looking beyond these 70 years, it is argued that a selective and incremental approach for restructuring of at least two dozen key institutions responsible for security, growth, equity and transparency and accountability would be politically feasible instead of across the board reforms in order to put Pakistan on its past trajectory.

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Introduction

To propose a way forward for Pakistan's sustainable economic growth, it is essential to understand past historical patterns, outcomes and the factors that contributed to them. The goal that Pakistan has set itself for the future is to become the 20th largest economy in the world by 2025. What are the influences that can facilitate or constrain the achievement of this proposed goal?

Pakistan's economic history has gone through periods of boom and bust. Broadly speaking, the 70 years of Pakistan's economy can be divided into two distinct periods. The first 40 years (1950-90) during which Pakistan was one of the top ten economic performers among the developing countries, and the next 25 years (1990-2015) when the country fell behind its neighbouring countries, with a decline in the average annual growth rate from 6.5 to 4.5 percent (IMF 2016). The reversal of this declining trend and resumption of the past growth trajectory are, therefore, the main challenges that have to be addressed in the next eight years.

This chapter attempts to examine the several alternative hypotheses that can explain the slowdown, and the reason behind the volatile and inequitable growth of the past 25 years. Through a process of elimination, it advances theoretical and empirical evidence to show that the most powerful explanatory hypothesis lies in the decay of institutions of governance. The same institutions, on the other hand, were strong and performed quite well during the first four decades despite a myriad of difficulties and external and internal shocks. It is argued that the intermediation process through which good economic policies are translated into a rise in income and equitable distribution of benefits involves these institutions. It is the quality, robustness and responsiveness of these institutions that can impact social and economic policies.

The main institutions of governance consist of the *judiciary* that needs to protect property rights, and enforce contracts; the *legislature* that prescribes laws and the regulatory framework; and the *executive* that makes policies and supplies public goods and services. If access to these institutions for common citizens is difficult, time-consuming and costly, the benefits from growth are distributed unevenly as only those who enjoy preferential access are the gainers. The experience of Pakistan, and lessons from other developing countries, suggests that it is the interaction between policies, institutions and leadership that promotes good governance. Sound economic policies cannot be implemented under poor institutions and weak leadership.

Examining the Popular Hypotheses

This section examines the most popular hypotheses advanced in the academic literature as well as popular discourse for explaining Pakistan's economic decline since the 1990s.

The most common argument is that Pakistan is a fragile, failing or failed state with a large and expanding arsenal of nuclear weapons encircled by Islamic extremists; and a safe haven for nurturing and training terrorists who pose a threat to other countries. The long-standing hostility between nuclear-armed India and Pakistan, who have fought three wars, including the one in 1971 that led to the separation of East Pakistan continues to be a threat to world peace. Kashmir is still 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-North Atlantic Treaty Organization (NATO) ally of the United States (US), the popular sentiment in both countries about each other is largely unfavourable. The US 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 on Terror (WoT) is not fully appreciated.[1] Pakistan is perceived by outsiders as a source of regional instability, an ungovernable country.

Therefore, the 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 the country's peace and security. Economic agents are reluctant to undertake new investments under this kind of environment. This hypothesis may be partially valid, but the economic decline started in the 1990s, well before the country became embroiled in the WoT 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 (e.g. poverty) took a dip in the 1990s. On the contrary, 2002-08 was a period of violence and terrorist activities, including assassination attempts and terrorist attacks on the then-President and Prime Minister of the country. Even so, the country recorded a remarkable turnaround.

[1] The Haqqani network is allied with the Afghan Taliban and the US has accused this network of carrying out terrorist activities in Afghanistan against the US and NATO forces. The Pakistani government's participation and facilitation to the US troops has evoked negative and hostile reaction among the extremist groups. Many of these groups have coalesced to form Tehreek-e-Taliban Pakistan (TTP) which has publicly declared a war against the state of Pakistan. They have organised suicide bombing at public places, carried out assassination attempts on the President and the Prime Minister and attacks on military installations throughout the country.

The growth rate touched 6 to 7 percent on average, investment/ Gross Domestic Product (GDP) ratio peaked to 23 percent and Foreign Direct Investment (FDI) flows reached above USD 5 billion.

The more recent experience of 2013-16 is illuminating. Macroeconomic stability was achieved, economic growth rates moved in an upward direction. Confidence of domestic and international investors[2] was regained. These recent developments also negate the view that Pakistan's security situation, particularly its involvement in the WoT is responsible for the poor economic and social performance. Therefore, the security deficit hypothesis does not stand up to serious scrutiny.

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 the country's fortunes vacillate with the flows from external donors. There are two variants of this argument. First, the three periods of economic spurts in the history of Pakistan, i.e., the 1960s, 1980s and early 2000s can all be ascribed to the heavy infusion of this money into the country, and this was the major reason for the turnaround in these three periods of growth spurts. Second, Pakistan has been heavily dependent on large military and economic assistance, and this gets a boost during military rule. 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 50s, 70s, 90s and post-2008 period. Table 1 presents the data both for the high growth decades as well as by the type of regime. The data shows that the difference in the volume of assistance between the high growth-military rule periods of 1960s, 1980s and 2000-08, and those of low growth-democratic periods of the 1960s, 1970s, 1990s and 2008-13, was not very significant. In the 1950s, Pakistan received substantial military, civilian and food aid. It was the PL-480[3] imports of food from the US that kept Pakistan away from hunger. In the 1970s, in addition to Western aid official grants and concessional loans (some of which were subsequently transformed in grants or waived off) from oil-rich Arab countries and workers' remittances did not pose major problems and financed the huge imbalances in the current account. During 1973-74 to 1977-78, commitments of assistance from Iran

[2] Pakistan was upgraded to the MSCI Emerging Markets Index (EMI) from the Frontier Markets [FM] Index; and its credit ratings by Moody's and Standard and Poor improved. The MSCI EMI captures large and mid-cap representation across 24 EM countries. The acronym MSCI stands for Morgan Stanley Capital International, which compiles influential indexes tracked by fund managers.

[3] Editors' Note: The US' Agricultural Trade Development and Assistance Act of 1954, commonly known as PL–480 or Food for Peace.

and Arab countries totalled USD 1.2 billion, mostly on concessional terms. Hasan (1998) calculated that aid disbursements during the mid-1970s were at a level far above that reached during the 1965-70 period (average USD 600 million annually that included flows to East Pakistan) after allowing for international inflation. In the 1990s, while US aid was significantly curtailed, the International Monetary Fund (IMF), the World Bank, and the Asian Development Bank (ADB) continued to make loans between 1988 to 1998; while Japan was the largest bilateral provider of concessional loans and grants. The government also utilised the foreign currency deposits of resident and non-resident Pakistanis in national banks amounting to USD 11 billion to finance external payments. This amount is not shown in Table 1. In the post-2008 period, the Kerry-Lugar Bill (also called the Enhanced Partnership with Pakistan Act of 2009) authorised USD 7.5 billion of economic and military assistance from the US to Pakistan for a five-year period. Multilateral banks and the IMF increased the quantum of their support, while Pakistan became the largest recipient of aid from the United Kingdom (UK) of £ 1 billion for five years. Thus, despite higher volumes of foreign assistance, the average growth rate has hovered around 3 to 4 percent. It can 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 foreign assistance resulting in high economic performance is not validated by the facts.

Table 1: Foreign Capital Flows to Pakistan

Period	Government Type	Growth Outcome	Annual Average Flows ($ Million)
1960s vs 1970s	Military Democratic	High growth Low growth	385 588
1980s vs 1990s	Military Democratic	High growth Low growth	870 1,110
2000-08 vs 2009-14	Military Democratic	High growth Low growth	1,653 2,851

Source: Compiled from the Government of Pakistan 'Economic Survey' (various issues), The World Bank World Development Indicators and State Bank of Pakistan 'Handbook of Statistics'.

Table 2 negates the other widely held perception that Pakistan is addicted to foreign aid and has developed a kind of Dutch disease – that it cannot survive economically without the infusion of foreign savings. The data shows that at its peak in the 1960s, foreign savings for undivided Pakistan had reached 7.4 percent of GDP and investment for establishing a large industrial base, the Indus Basin works and the dams and canals, tube-wells for underground water and other capital works were undertaken in this period. The size of the economy was relatively smaller at that time. The proportion has been gradually declining since then and is now down to 1.3 percent of a much larger economy. Therefore, the perception about excessive aid dependence is also not true.

Coterminous with the foreign aid dependence syndrome is the widespread belief that the US 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 strong man running the country to follow their agenda and interests. So Pakistan's economy has done well only under autocratic regimes with the blessings of the US. The coup to overthrow Z.A. Bhutto's government in 1977, frequent dismissal of elected regimes in the 1990s, suspension of US aid under the Pressler Amendment in the early 1990s and the nuclear tests in 1998, were all engineered under this compact and the drop in economic performance was caused by the consequential political instability. It must be recalled that the US suspended or curtailed economic and military assistance at crucial times in Pakistan's history when the military dictators were still in power. US aid was suspended soon after the 1965 war with India, after the 1971 separation of East Pakistan, and the early period of Zia-ul-Haq's rule, and sanctions were imposed in 1999 when General Musharraf took over. Whenever the US' interests converged with those of Pakistan (1950s [SEATO/CENTO];[4] 1980s [ousting the Soviets from Afghanistan], and 2001-16 [War in Afghanistan] the former, despite irritants and quibbles on both sides, chose to assist the latter irrespective of the nature of the regime in power.

Table 2: Net Official Development Assistance (ODA) to Pakistan

Years	% of Gross National Income
1960 – 68	7.4
1969 – 71	3.9
1972 – 77	5.1
1978 – 88	2.9
1989 – 99	2.2
2000 – 07	1.7
2008 – 14	1.3

Source: WB (n.d.).

[4] Southeast Asia Treaty Organization and Central Treaty Organization.

Let us examine another factor, i.e., global economic conditions that may have played a negative role in this poor economic performance of Pakistan. The external environment between 1990 and 2008 was highly favourable. Most Emerging and Developing Countries (EDCs) made great strides as chronicled by Radelet (2016) in his book, *The Great Surge: The Ascent of the Developing World*. Between 1995 and 2013, per capita income in the EDCs increased by more than 70 percent. The number of poor halved from two billion in 1990 to 897 million by 2012 - bringing down the share of poor people in the total population from 37 to 13 percent in 2012. The share of EDCs in the world exports rose from 24 to 41 percent in this period. International capital flows jumped from USD 91 billion to USD 1145 billion. All social indicators including Life Expectancy, Maternal Mortality, Infant Mortality, Adult Literacy, Net Enrolment ratios, and Average Years of Schooling showed significant improvement. So, the external economic environment cannot be blamed for Pakistan's poor performance.

Some analysts have attributed the overall poor performance of Pakistan to the 'Garrison State' syndrome (Haqqani 2005&2013; Shah 2014; Abbas 2005). As Pakistan has been obsessed with confronting a much larger arch rival – India – since its formation, it has had to allocate a much larger proportion of its resources to defence expenditure and to preserve and expand the corporate interests of the military. Therefore, the neglect of education, health, human development in general and diversion of resources to meet the demands of defence, nuclear capability, and other security-related expenditures has led to the present economic and social outcomes. In actual fact, Table 3 clearly establishes that the annual growth of defence spending was much higher in the first 40 years (a period in which GDP was also growing quite rapidly) compared to the last 25 years. Table 4 shows that the ratio of defence expenditure to GDP was also consistently high in the first 40 years, and is now 2.5 percent of GDP – falling from the average of 6 to 7 percent in the 1980s and earlier years. Most nuclear-related expenditure was also incurred in the 1970s and 1980s. During fiscal year (FY) 2016, the budgetary allocation for education was 2.7 percent of GDP (Naviwala 2016). Combining health and education together, the budgetary allocation is 3.7 percent - higher than that of defence and internal security, but certainly lower than what is required to fill the huge gap in enrolment and primary healthcare services. In these sectors, it is governance and management issues that are impediments in the delivery of services, not budgetary allocations. A popular myth that has now become quite entrenched and almost accepted as gospel truth in many circles is that of large corporate interests of the military (Siddiqa 2007: 76).

Table 3: Growth Rates of Defence Spending and GDP

	Annual Growth Rate of Defence Expenditure %	Annual Growth Rate of GDP
1950 - 90	9.0	5.9
1990 - 2015	3.0	4.3
1950 - 2015	5.4	4.8

Source: Calculated from Government of Pakistan 'Economic Survey' (various years).

Table 4: Defence Expenditure, Social Spending and Development

End June	Defence		Health & Education		Development Spending	
	% of GDP	Total Expenditure	% of GDP	Total Expenditure	% of GDP	Total Expenditure
1960	5.8	28.3	1.3	6.2	10.3	49.8
1970	5.8	22.6	1.6	6.3	14.8	58.1
1980	5.4	23.1	2.1	8.9	9.3	39.9
1990	6.9	26.5	3.3	12.7	6.5	25.3
2000	4.0	21.5	2.0	10.7	2.5	13.5
2010	2.5	12.5	2.3	11.3	4.1	20.4
2015	2.5	13.0	2.9	14.8	4.0	20.7

Source: Government of Pakistan 'Economic Survey' (various years).

It is true that the Armed Forces have established foundations and trusts that run enterprises, but the proceeds and profits they earn are utilised for the welfare of Army pensioners, particularly the soldiers who retire at an early average age (45-50). The education and healthcare 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 (SF) and Bahria Foundation (BF) together was only 4.5 percent of the total market cap of the companies listed on the Pakistan Stock Exchange (PSE). Siddiqa (2007: 2) claimed that:

> The estimated worth runs into billions of dollars. Moreover, the military's two business groups - the Fauji Foundation and the Army Welfare Trust - are the largest business conglomerates in the country.

It is true that the listed companies owned by the FF, AWT etc. are big players in the fertilizer sector, but they have equally large conglomerates competing with them such as Engro and Fatima Group. All of these companies pay full taxes on their income, sales and imports and 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 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.

Having ruled out factors such as security and terrorism, inflow of foreign assistance, preference for military rule, external economic environment, and diversion of public expenditures towards defence, which may have all played some role, but were not the main determinant of the poor performance, we turn our attention to the institutions of governance.

We begin by surveying theoretical and empirical studies relating to aggregate indicators of good governance, its sub-components and economic growth, pro-poor growth, per capita incomes at cross-country global and regional level, and then focus on the case of Pakistan. Available evidence across countries suggests a positive relationship between good governance and economic growth. Governance has a statistically significant impact on GDP per capita across 93 countries and governance explains nearly 75 percent of the cross-country variations in income per head (Baldacci et al. 2003). An ADB study 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 as well as higher rates of GDP growth over time (Zhuang et al. 2010).

Numerous other studies have demonstrated the linkages between good governance and healthy economic growth. Huther and Shah (2005) 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.' In their study, they found a high correlation between governance quality and per capita income. The positive correlation between the ten-year economic growth rate and governance quality supports the argument that good governance is an important determinant of economic development. Kaufmann and Kraay (2002) found a direct causal effect from better governance to higher per capita income across 175 countries for the period 2000-01. Negative causal effect was found as well from per capita income to governance implying that improvements in governance are unlikely to occur merely as a consequence of development. Better maintenance of the rule of law and political stability affect economic growth (Barro 1991). Dollar and Kraay (2002) found that the rule of law indicator is positively and significantly correlated with the growth in per capita incomes of the poorest quintile. Chong and Gradstein (2004) discovered that political stability and rule of law exhibit negative and significant relation with inequality as measured by the Gini coefficient. Kraay's (2004) analysis led him to conclude that rule of law and accountability were both positively correlated with growth and distributional changes, while openness to international trade has a positive correlation with growth and poverty reducing shifts in incomes. Kimenyi (2005) argues that pro-poor reforms cannot have the intended impact unless there are significant changes in the institutions of governance. Cross-country studies by Mauro (1995) and Knack and Keefer (1995) 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.

New Institutional Economics (NIE) identified institutional capabilities that states need to make the markets function efficiently. North (1990) defines 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.

With regard to the link 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 (Ibid.: 12).

Acemoglu and Robinson (2014) highlight that it is the institutions that 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 Acemoglu and Johnson (2005), good institutions ensure two desirable outcomes: relatively equal access to economic opportunity (a level playing field), and the likelihood that those who provide labour 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. Ali et al. (2015), using the data for 1996-2011 for 134 countries, found strong evidence that the relationship between human capital and economic growth is much less pronounced in countries with low quality of governance. Preconditions in the form of good governance are necessary for an educated labour force to contribute to the economic growth of a country. Weak governance, indicated by deteriorated law and order conditions, corruption, and maladministration, results in inefficient utilisation of human resources.

Haq and Zia (2009) have explored linkages between governance and pro-poor growth in Pakistan for the period 1996 to 2005. The analysis indicates that governance indicators have low scores and rank at the lowest possible percentile as compared to other countries. Their econometric analysis shows a strong relationship between good governance and reduction in poverty and income inequality.

The model of an elitist economy sets out the historical context and the drivers of the capture of the state and rigging of markets in Pakistan (Husain 1999). It is postulated that a narrow elite constituting about 1-2 percent of the population has used state and markets for their political power and self-enrichment to the neglect of the majority population, particularly the poor and the less privileged segments of society. This small minority was 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 allocation are inefficient. The state, which has to ensure equitable distribution of gains from economic growth, is also controlled by the same elite that evades taxes and appropriates public expenditures for its own benefits. Inequities – interpersonal, regional, gender – become commonplace in such an environment. Access to institutions that deliver public goods and services is intermediated by the elite through a patronage-based system.

Thus, both theoretical as well as cross-country empirical evidence and our own experience lend a lot of weight in support of the argument that poor governance manifested in weak institutions, could be the predominant influence in the unsatisfactory economic and social performance of Pakistan in the last quarter century relative to both its own previous four decades and other countries in the region. The evidence to substantiate this point-of-view is the gradual decline in Pakistan's ranking and score on the following Indices compiled by international and multilateral bodies, independent think tanks, academics, researchers, non-governmental organisations (NGOs):

- The World Bank, World Governance Indicators (WGI)
- World Economic Forum (WEF), Global Competitiveness Report
- United Nations Development Programme (UNDP), Human Development Index (HDI)
- Freedom House, Economic Freedom Index (EFI)
- Transparency International, Corruption Perception Index (CPI)
- International Country Risk Guide
- United Nations Educational, Scientific and Cultural Organization (UNESCO), Education for All (EFA) Index
- Legatum Prosperity Index (LPI)

Appendix 1 shows the comparative ranking of India, Pakistan and Bangladesh against various governance indicators over time. While there is an improvement observable for India and Bangladesh (although their scores are still low), Pakistan records a downward drift.

Sherani (2017) reviewed the WGI for the period 1996-2015. His analysis shows that Pakistan has performed poorly in all six sub-components of governance. The average percentile rank for 16 years, excluding political stability and absence of violence (extremely low), ranges from 18 to 32. He writes 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 in which economic growth was also averaging 6-7 percent annually). Again there was some modest improvement in the WGI, Ease of Doing Business and CPI for 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 these countries in the HDI, CPI, and LPI, and continues to lag behind India and Bangladesh in EFA, and EFI. The gap with India has also widened in the Global Competitiveness Index and Global Innovation Index.

Any demarcation of boundaries between different periods can be challenged for its arbitrariness. Binary classifications suffer from the inherent problem of everything being painted either black or white. If we take a continuum approach, then the shift from grey towards black became perceptible in the late 1980s and early 1990s. It has to be conceded that the seeds of institutional weakening were sown much earlier in the 1970s, but the past momentum and the intervening period of Zia regime in the 1980s did create a buffer between the civil servants and political interference which unravelled in the 1990s. The brief tenure (1985-88) of Prime Minister Mohammad Khan Junejo provided an interesting interlude when a feudal politician from Sindh insisted upon following good governance practices, but this was not sustained over time. As an irony, his successors who ruled the country between 1988 and 1999 - leaders of two established major political parties - abandoned these good practices and traditions when they assumed power and the pendulum swung in the other direction.

Diagnostic studies, particularly the volumes based on the Annual Conferences on Pakistan organised by the Woodrow Wilson Center at Washington suggest that every single crisis faced by the country – low tax mobilisation, energy shortages, unsatisfactory law and order situation, losses of public sector enterprises, poor delivery of education and health services, stagnating trade - can be traced back to this governance deficit, institutional weaknesses, exacerbated by the military rule that did nothing to strengthen the institutions.[5]

Tax collectors enjoy wide discretionary powers that they use to extort money and enrich themselves rather than raise additional revenues for the exchequer. Power and gas companies find a huge gap between the sales revenues they assess, bill and collect and the purchases of units which they have to pay for. Law and order suffers and the common citizen feels insecure because the police officials are appointed on the recommendations of the elected members of Parliament and assemblies in exchange for outright payment rather than on their professional capabilities. Public sector enterprises naturally face losses when they become the dumping ground to accommodate thousands of unneeded employees at the behest of the ruling party. In competitive markets, they lose market share and in public monopolies they fleece the consumers but still incur losses due to inefficiency, waste and corruption. There

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[5] Diagnostic studies presented at the Annual Conference on Pakistan organised by the Woodrow Wilson Center include: Hathaway and Lee (2004); Hathaway (2005); Muchhala et al. (2007); Kugelman and Hathaway (2009); Kugelman and Hathaway (2010); Nayak and Hathaway (2011); Hathaway and Kugelman (2011); Hathaway and Kugelman (2013); Kugelman (2014); Kugelman (2015).

is a general consensus in Pakistan endorsed by the international organisations, that the civilian institutions have decayed over time. According to the World Bank (2013):

> 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.

The main message of this chapter 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 in aid of the civilian administration are not in the interests of long-term political, economic and social stability of Pakistan. The Armed Forces should not be distracted from performing their professional duties in an environment of high threat perceptions to the external security of the country. They are best left to do the job for which they are well-equipped and capable. There is a widely accepted belief that if the district administrations, law enforcement agencies (LEAs) and the civilian intelligence agencies were performing their job well, the illegal and unlawful activities of the militant and extremist elements would have been nipped in the bud and the country would have avoided such a massive dislocation in its economic and social life. Were basic services such as education, healthcare and justice accessible to common citizens, the drift towards the criminal-extremist nexus would not have taken root in society.

The challenge, therefore, is how to turn this ungovernable state to being democratically governable once again. This can be achieved by rebuilding vibrant, agile and effective institutions of democratic governance that can establish the writ of the state, eliminate the non-state actors engaged in criminal and militant activities, deliver basic goods and services, including justice to the majority of the population in a fair and equitable manner and reignite the growth impulses that had characterised 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 during 2006-2008, 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 (Husain 2012). The Commission made exhaustive recommendations in the structure, human resource policies, business process re-engineering of the federal, provincial and local governments, public enterprises and corporations, and autonomous bodies etc. The recommendations of the Commission have been welcomed by various governments, but have not been formally accepted or implemented. One wishes that a successor government would move with vigour 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 under the given political realities.

The dilemma facing academics and technocratic policy reformers is that inefficient policies and institutions exist and *status quo* is defended because it suits the politically influential elites; and the constituency and coalitions for efficient policies and strong institutions do not exist. If the first best solution of across-the-board and comprehensive reforms is not feasible, can a second or third best solution of selective and incremental approach by taking up a few key institutions of democratic governance be designed expecting that it may not meet the same kind of fierce resistance as those affected by these reforms would be a miniscule of the entire population of civil servants? The choice of institutions should be driven by consideration of powerful spill-over effects gradually engulfing a larger space over time.

This chapter proposes an incremental and selective reform of some of the key institutions that can help in moving towards the goal of restoring the efficacy, efficiency and effectiveness of democratic governance. It is proposed that these institutions get back on the same pathway – merit, integrity, dedicated service and problem solving – that was their main asset historically. There are already many examples of successful institutions working quite well in the midst of this general atmosphere of institutional decay and their success reflects adherence to the same principles. The performance of Punjab Government in many respects is much better than that of other provinces and it can be attributed to strong exemplary leadership, but its sustainability would be assured if its institutional infrastructure is also strengthened.

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 (WDR) on Governance and Law (WB 2016). Here, the elements of policy effectiveness chain outlined in WDR are applied to Pakistan and recommendations are made that can help in strengthening this chain.

Using the above framework, the development objectives for Pakistan are identified, which are broadly shared by a vast majority of people as well as political parties and other stakeholders. These are Security, Growth and Equity or SGE. Thus, around 25 institutions dealing with these three objectives need to be strengthened and restructured on the lines spelt out in Box 1 (Appendix 2).

The institutions are grouped together below according to their possible contribution towards achieving the development goals of Security, Growth and Equity. In addition, there are cross-cutting institutions that directly or indirectly impact all the three objectives and are mainly concerned with Accountability, Transparency, Standard Setting, etc.

Parliamentary Committees
- Local Governments
- Auditor General of Pakistan (AG), and the Public Accounts Committees (PACs)
- National Accountability Bureau (NAB)/ Provincial Anti-Corruption Departments
- Election Commission of Pakistan (ECP)
- Public Service Commissions (FPSC)/ Provincial PSCs
- Information Commissioners under the Freedom of Information Act
- E-Government Directorate General/ Provincial IT Boards

Security
- Lower Judiciary
- Police including investigation and intelligence agencies
- Federal Investigation Agency (FIA)
- National Counter Terrorism Authority (NACTA)
- Prosecution departments

Growth
- State Bank of Pakistan (SBP)
- Securities and Exchange Commission of Pakistan (SECP)
- Higher Education Commission (HEC)
- National Science and Technology Commission (NSTC)
- Federal Board of Revenue (FBR)
- Trade Development Authority of Pakistan (TDAP)
- Board of Investment (BOI)
- Competition Commission of Pakistan (CCP)

Equity
- Pakistan Agriculture Research Council (PARC)/ Provincial Research Institutes
- Local Governments
- SBP
- HEC needs-based scholarship programme
- Benazir Income Support Programme (BISP)/ *Zakat* committees/ *Bait-ul-Mal*
- Irrigation authorities
- Urban development authorities
- National Vocational and Technical Education Commission (NAVTEC).

Conclusion
Going forward, Pakistan's economy has to face a myriad of complex challenges arising from an uncertain global environment, an explosive knowledge economy, disruptive technologies, demographic transition, and climate change. Regionally, the country can take advantage of its strategic location linking South Asia with Central Asia and Central Asia and China with the Middle East. The China-Pakistan Economic Corridor (CPEC) currently being implemented can play a crucial role in establishing these linkages. In the domestic arena, the battle against terrorism and extremism, equipping the young population with education and skills for productive employment, bringing about inter-provincial harmony and social cohesion by reducing inequalities and disparities and managing urbanisation, need to be aggressively pursued.

Pakistan's goal to become the 20th largest economy in the world by 2025, in the face of these external and domestic challenges, can be achieved if the country is able to make a reasonable evaluation of the facilitating and constraining influences on its economy during the last seven decades. It would be difficult to ride the crest until the downward trend of the last 25 years can be reversed and the past trajectory of 6 to 7 percent growth rate is resumed. This chapter, therefore, examined several alternative hypotheses in an attempt to explain Pakistan's declining economic growth rate and weak social indicators for the last 25 years and compared this with the earlier 40 years. The most satisfactory explanation lies in the decay of the institutions of governance that have failed to achieve the interrelated development outcomes of security, growth and equity. It follows, therefore, that the most important task is the resuscitation of institutions functioning under the executive, legislative and judicial branches of governance to enable them to become sufficiently strong to effectively translate policies, programmes, and projects on the ground. By doing so, it is possible to make up for lost time because effective, responsive, and well-functioning institutions would help to minimise the politics of patronage, unshackle the entrepreneurial energies of the private sector, assure delivery and equitable access to basic services to the citizens, and empower civil society and local governments. The federal, provincial, and local governments, parliament and judiciary have to respect the boundaries within which each has to function without encroaching on each other's domains. The current practices, norms, and mind-set that are characterised by confrontation, polarisation, fighting for turf and engaging in 'blame the other' games will need to end. This will indeed be the most challenging undertaking which will either make or break the economic nervous system and the security backbone of the country. It may be recalled that a study by the WEF had concluded that a slight improvement in governance results in a threefold increase in per capita income in the long run. This is the likely gain, which would accrue by improving the civilian institutions of governance in Pakistan and contribute significantly to the achievement of the set goal.

A catalogue of comprehensive reforms is easy to describe but extremely complex and difficult to implement. These reforms are unlikely to be introduced in one go as it is neither practicable nor feasible to do so, both due to the absence of political will and capacity constraints. The first best solution – sweeping reform throughout the institutions of governance – is therefore ruled out. It is, therefore, proposed that a second or third best solution that targets a subset of key institutions which, if set right, can make a substantial improvement in the governance landscape of Pakistan over time. The spill-over and knock on effects of these institutions over others would enlarge the space for beneficial outcomes over time. The challenge of reforming even this subset is formidable as the vested interests wishing to perpetuate the *status quo* are politically powerful and the coalition and alliances between the political leadership and the beneficiaries of the existing system are so strong that they cannot be easily ruptured. The elected governments with an eye on the short-term electoral cycles are not in a position to incur the pains of these reforms upfront, while the gains accrue later on to a different political party. The authoritarian governments are not effective as they do not enjoy legitimacy for sustaining 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 in several publications discussed earlier. Lessons learnt from the neighbouring countries outlined in this chapter, if adapted and applied, can further refine and reinforce this restructuring effort.

In the WDR framework, the drivers of change are absolutely crucial. It would not be possible to execute these reforms unless all the major political parties agree and reach a consensus so that partisanship and point scoring do not come in the way of the implementation of these reforms. Civil servants, who have retreated in a passive mode, can be reactivated, if they know that the risks of retribution and penalties involved in implementing these reforms would be minimal. The politicians, of all persuasions, have to realise that the growing disaffection for political parties and leaders in the country, the quickening spread of violence and intolerance, the rising popularity and respect for the Armed Forces and the widening gap between expectations of the general populace and delivery by the government are indeed a wake-up call for altering their past conduct, practices and behaviour. A growing educated urban middle class, information and communication revolution permeating even in the rural areas through electronic and social media should act as catalysts for this change. The ultimate beneficiaries of such altered behaviour would not only be the citizens of Pakistan, but also the political parties themselves. The cynicism and wide distrust of politicians in society at large would be replaced by improved access and delivery of essential basic services eventually bolstering confidence in the country's political leaders and leadership.

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Appendix 1:

Comparative Indicators of Governance

Global Competitiveness Report Overall Global Competitiveness Index	Pakistan	India	Bangladesh
Earliest year (2004)	91	55	100
Latest year (2017)	115	40	99
Human Development Index			
Earliest year (1990)	120	123	136
Latest year (2015) (2016 HDI Report)	147	131	139
Ease of Doing Business Rank			
Earliest year (2006)	60	116	65
Latest year (2017-18)	147	100	177
World Governance Indicators			
Earliest year (2005)		"	"
Voice and accountability	17	60	29
Political stability and its absence	5	18	4
Government effectiveness	40	55	21
Regulatory quality	26	47	17
Rule of law	22	58	18
Control of corruption (Latest year 2015)	14	43	5
Voice and accountability	27	61	31
Political Stability & Absence of Terrorism	1	17	11
Government effectiveness	27	56	24
Regulatory quality	29	40	17
Rule of law	24	56	27
Control of corruption	24	44	18
Perception of Corruption Index			
Earliest year (1998) - Score Format	2.25	N/A	2.78
Latest year (2015) (out of 168)	117	76	139
Global Innovation Index			
Earliest year (2007)	73	23	98
Latest year (2017)	113	60	114
Education for All Index			
Earliest year (1980)	0.161	0.24	0.202
Latest year (2013)	0.372	0.473	0.447
Country EFA Rank (2012)	113	102	-
Legatum Prosperity Index: Governance			
Earliest year (2007)	46	47	48
Latest year (2016, rankings out of 149)	139	104	114
			Contd. ahead

Contd. ahead

Global Competitiveness Report Overall Global Competitiveness Index	Pakistan	India	Bangladesh
Bertelsman Stiftung: Transformation Index			
Earliest year (2006)	84	24	54
Latest year (2016)	106	26	70
Freedom House: Economic Freedom Index			
Earliest year (1998) Freedom Rating 1 – 7	N/A	2.5	3
Latest Year (2017, rankings out of 180)	41	43	128
Polity IV; Intl. Country Risk Guide			
Earliest year (2009)	_	_	_
Latest year (2010)	5	9	5
Global Food Security Index			
Earliest year (2012) out of 105	75	66	81
Latest year (2017) out of 113	77	74	89
Corruption Perception Index			
Earliest year (1997) out of 52	48	45	-
Latest year (2016) out of 176	116	79	145

Source: The indices are based on the data from various sources.[6]

[6] <http://www3.weforum.org/docs/GCR2017-2018/05FullReport/TheGlobalCompetitivenessReport2017%E2%80%932018.pdf> [Accessed December 2017].
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Appendix 2:

Box 1

Essential ingredients for restructuring and strengthening proposed institutions:

1. Select and appoint on basis of open competition and merit a widely respected, strong and competent individual of known integrity and demonstrated leadership qualities to head the institution for a fixed tenure. Removal from the office can take place only under pre-specified conditions.
2. Agree on the mandate, terms of reference, responsibilities, functions, powers, objectives, framework agreement and key performance indicators (KPIs).
3. Appoint an independent Board of Governors, wherever necessary, consisting of eminent persons for oversight, supervision, strategic plan and budgetary allocations holding the management accountable for results.
4. Grant one-line budgetary allocation to resource the organisation, allow financial autonomy subject to internal controls and external audit.
5. Delegate the powers to the head of the organisation to appoint the professional staff and human resources of calibre through an open, transparent process.
6. Submit an annual performance report to the Parliament and appear before the relevant Parliamentary Committee to answer questions.
7. The government can give policy direction, but not interfere in day-to-day operations.