

Markets, Society and the Economy

Ishrat Husain

Most of the popular discussion on the economy remains obsessively focused on the government, its policies and institutions. While it is true that these policies and institutions play a critical role, we do forget that productivity gains which form the cornerstone of economic growth and better living standards are achieved under a given factor endowment through interactions between public policies and institutions, private sector response and behavior, society's norms and culture and external environment. We should therefore shed light on the societal norms, attitudes and culture and the markets in which the private economic agents operate taking the public policy and external environment as constant and trace their consequences for Pakistan's economy. The criticisms against the successive governments – civilian and military for poor governance and institutional decay – are both valid and well documented and are not repeated here.

The interaction between public policy and politics takes primacy as these are intertwined and determine the economic outcomes in a significant way but if not only the way. Other factors also play equally important role.

Political system in Pakistan has evolved around feudal, biradri and kinships, tribal affiliations, ethnic groupings. This societal norm has become ingrained in the voters' psyche. As most of them do not have direct access to the Government Services they deploy their elected representatives as their intermediaries for interface with the government departments for their daily chores and survival. They expect these MNAs, MPAs and party leaders to provide maximum benefits to them and their kith and kin such as jobs, livelihoods, admission to schools, healthcare, land and water. It does not matter to them whether the applicants are qualified for the jobs or not. Constituency politics forces the candidates to go out of the way to oblige their voters. This pressure rather than prudence results in unqualified and incompetent persons entering public services and public enterprises. Election manifestos of the political parties become subservient to the realities of constituency politics. The consequences of such a behavior on the part of the electorate are disastrous for the economy. Public sector expands in numbers with unproductive people on pay roll and the budgetary ceilings are breached leading to increases in deficit financing. Public at large suffers at the hands of these functionaries in terms of low quality of delivery of goods and services.

Absentee teachers and health workers, corrupt Revenues and Police Officials make lives miserable for a common citizen.

Anatol Lieven aptly summarize this phenomenon in his book “Pakistan: A Hard Country”. He asserts that ‘in so far as the political system runs on patronage and kinship and corruption is in turn twined with patronage and kinship it would mean gutting Pakistan’s society like a fish. Kinship plays a vital part in maintaining the dominance of the “feudal elites and many of the urban bosses’.

The paradoxical situation whereby, local governments have been undermined by the elected government while the non-democratic Military regimes have in fact devolved powers and finances to this tier can be explained by the contest for provision of patronage. Accountability at the grass roots level is more obvious as the results of non-performance and non-delivery of services can be seen by the whole community. In the small towns, urban centres and metropolitan areas where educated middle class population is growing more rapidly, kinship and patronage are gradually giving way to performance and delivery. MNA’s and MPA’s fear loss of power and thus patronage if the local governments are strengthened. The transfer of patronage to union council, Tehsil and District Nazims during 2001-07 period was largely responsible for the weakening and maligning of the local government system. The diluted form of the system that has emerged in Punjab and Sindh recently is an attempt to recapture the lost power by the Provincial Governments, although there is overwhelming evidence a universal recognition that local governments were most effective in delivering services to the ordinary citizens and in the resolution of day to day problems faced by them. Social Audit Surveys have shown that the local Nazims were more readily accessible than the MPAs and MNAs. Unfortunately, both Punjab and Sindh – the major provinces of the country are going to have local bodies’ election soon under this highly flawed system. The Provincial Government has virtually assumed all the powers leaving only insignificant municipal functions to be performed by the local bodies. The powers to suspend, dismiss, supersede these elected bodies all reside in the Provincial governments. So any expectation that things would change for better after the election are totally misplaced. Centralization of powers has simply changed hands – from the Federal to the Provincial government. Thus kinship and patronage would continue to rule public policies and their implementation.

Over last six decades or so Pakistani society has become more fragmented, highly divisive, excessively polarized and stubbornly intolerant. Social imbalances, lack of social

capital, trust deficit, intolerance, sectarian rivalries, religious divide and ethnicity have together become a big stumbling block for economic revival. In culturally, ethically and linguistically homogenous societies, the path for economic advancement is not strewn with these boulders constricting the way forward. In a deeply divided suspicious and insecure society the transaction costs become high and unaffordable. Therefore, the speed of economic vehicle gets slowed down. This discussion is abstracting from the post- 2001 developments that have exacerbated these cleavages and given fuel to the fires of violence, extremism, radicalism and terrorism throughout the country.

The other problem that has intensified particularly since the opening up of the electronic media is the highly cynical and negative mindset of the majority of our population. If anyone says or writes something positive, he/ she is taken to task for either having a personal agenda to ingratiate himself with the government or already being in their payroll or that of ISI. The persistent gap between the promises and performance of successive governments seems to have contributed to lack of credibility and belief. Insecurity of the state generated by the experience of separation of East Pakistan is another factor which drives our thinking. Pakistan's subservience to the US, Saudi Arabia, IMF etc. over time has also given credence to the theory that the policies are being dictated by others and we have no control in shaping the events. A general feeling of helplessness and victimhood has saturated the social discourse in Pakistan.

Our belief system is premised on the notion that we as a nation cannot do anything good ourselves and all that goods happens is because of others' goodwill or charity. All the scars on our nation have been inflicted by the forces opposed to us. Extremists and radical elements roaming around in our society have been planted, nurtured, and given feedstock by those who wish to destroy us and deprive us of our nuclear capability.

The phobia and excessive preoccupation with the US and Army dominate our national psyche. Governments in Pakistan are believed to be formed and removed at the behest of the US and the Army. Millions of Pakistanis who have exercised their votes eight times since 1988 have nothing to do with this process. If Pakistan records high growth which is acknowledged by external observers and rating agencies it can either be due to exceptional flows of foreign aid or fudging of figures. But if the same official data shows that growth rate has declined we believe it readily and disseminate it widely and using it as a stick to beat the government of the day. This lack of self-confidence spurs indifference, inaction and

unwillingness to resolve our national problems. If we have lost control of the events why should we do anything?

This asymmetric thinking pattern and lack of self-confidence have given rise to a unique tendency – disbelieve and discount any good news about our country or our people but exaggerate the negatives beyond any proportions even if they are based on flimsy grounds or continued misinformation.

Prof. Muhammad Abdul Qadeer has very ably described that this mindset reflects the sense of insecurity and self-confidence. According to him, we blame someone malevolent who is thought to be pulling strings or presume that conspiracy is the driving force behind many events. It is not only the default explanation in personal matters but is often the first cause presumed in national and international events. Lack of acknowledgement for inaction have become the mainstream thinking in Pakistan which is barrier to objective and inductive thinking.

This is quite evident in our media where only those columnists, anchors and discussants are popular who portray highly negative and pessimistic views and paint doom and gloom day scenarios. Those who present a more balanced and even handed picture do not find any space or place. This malaise has spread like wild fire and become integral part of the national psyche. Students in higher educational institutions vomit out the same arguments in their term papers and debates as they have heard on TV and read in the newspapers without verifying their authenticity. Accepting the negatives and questioning the positives, blaming the others and not accepting our own responsibility have dire consequences for economic rejuvenation. Investors listening to this discourse feel disenchanted and uneasy about the feasibility of their investment and shy away from taking the plunge.

Why is trust among people, communities, and regions living in a society or nation important? “Trust reduces transaction costs, avoids future disputes and litigation, and eases settlement of contracts and acts as a lubricant for facilitating businesses and economic activity”.

Pakistan is one of the countries which suffers from Trust Deficit or low social capital. The reason for this phenomenon are historical and structural. The Punjabis and Mohajirs have always been over represented in bureaucracy and the army – the two traditional bastions of power in Pakistan. The demographic balance in the united Pakistan which was in favor of East Pakistan got heavily tilted towards Punjab in the post 1971 Pakistan. The representation

in political institutions exercising state authority was rejigged on the basis of population. With 56 percent of the population the national finances also got distributed using population as the only variable for allocation. It was perceived by the smaller provinces that being upper riparian on the Indus River system and holding large underground water resources the already fertile lands of Punjab receive disproportionate benefits from reservoirs and storage dams. The fierce opposition to Kalabagh Dam – technically and financially a worthwhile investment – by the smaller provinces represents clear manifestation of this Trust Deficit.

The over centralized nature of Federal Government (until the 18th amendment) taking over responsibilities that rightly belongs to the provinces and pre-empting the bulk share of the Divisible pool of the national finances further intensified the disharmonious and conflicted character of social order in the country.

The ethnocentrism within the country and ethnic tensions within the provincial boundaries such as Mohajirs vs Sindhis, Balochs vs Pakhtoons, Saraiki vs Punjabis and Pakhtoons vs Hazarawals are all derived from the larger struggle for autonomy and fair and just allocation of resources. Sensible win-win solutions are shelved due to mistrust, suspicion and a perception of unjust outcome likely to hurt the community's interests.

According to World Bank research (2005) “Fairer societies offer their citizens more public goods, more social support and more social capital. Hence they are more capable of sharing the costs and benefits of improving economic policies and in turn facilitating consensus building and decision making”.

What are the causes of this lack of trust and how can trust be restored are ripe issues for social scientists to analyze systematically. Social capital theory can perhaps shed some light on this topic. The coping mechanisms for this lack of Social Capital and Trust had to be evolved and these gravitate around narrow parochial interests and self-gratification.

Another social norm impeding economic growth is the poor work ethics that pervades right from the top to the bottom. Promises and commitments made to the customers are rarely kept, deliveries are never made on time, cost overruns and overcharging are commonplace, and the quality of goods and services is most of the time shoddy. Attendance and timely execution of duties assigned whether laborer, teacher, health worker or shopkeeper are exception rather than rule. High Rejection rates of Pakistani goods by international buyers along with non-timely delivery of order have edged Pakistan out of several markets.

Lack of professionalism has also become our hallmark. The same medical doctors in the US who observe highest ethical standards and carry out due diligence before diagnosis and prescription behave in quite the opposite way even in the best private clinics and hospitals of Pakistan. The same is true of lawyers, architects, engineers, pharmacists, accountants. This malaise has also spilled over to electricians, plumbers, mechanics, sub engineers, teachers and also at the level of workers in factories, farms and construction industry. Applying short cuts, cutting corners, misrepresenting facts, taking a casual attitude, making a fast buck and becoming rich overnight by hook and crook have become ingrained in our national psyche. Doctors who can issue False medical certificates, pharmacists who can approve adulterated drugs and food, architects and consultants who can put up with substandard building materials, accountants who can help in evasion of taxes are so popular and widely accepted by the society that people do not realize the material harm being caused to the economy.

The attitude and behavior of the private economic agents operating in the markets reinforces the above societal norms and contributes to this vicious culture.

Competitive markets are characterized by economic outcomes that benefit the consumers, producers etc. But when the processes are not determined by forces of supply and demand but are distorted by administered prices, manipulations, collusion, speculation and excessive rent seeking the markets fail to perform their function i.e. to allocate resources efficiently. A wedge is created between “observed prices” and their fundamental determinants. Investors shy away from the sectors and activities that the economy really needs for growth and sustenance and shift to those unproductive activities where short term quick gains can be attained because of the market distortions and imperfections. Private profits keep on piling up at the cost of benefits to the society. Low Economic growth rate as a whole co exists with excessive returns preempted by selected market players. An effective taxation system should be able to capture a portion of these returns for financing public goods and services. But here again the connivance of the tax officials who are given a small share for their ‘services’ by these ‘potential’ tax payers leads to a rupture of that possibility too. Over invoicing, Under invoicing, misclassification, understatement of valuation, misrepresentation and concealment of data, contrived shortages in inventories to suppress actual production, fake inflated purchases to exaggerate expenses and show losses, unrealistic tender bids to win the contracts and then claim large cost overruns, supplying lower quality

goods compared to the original specifications, theft during transport of goods particularly petroleum products are some of the common tactics deployed by these market players.

Economies in the long run are transformed by weeding out inefficient firms and outdated products, embarking upon innovation, risk taking and entrepreneurship and abandoning old ways of producing goods and services. In Pakistan, competitive markets have not emerged because powerful interests through their connections, influence and money have found lobbying and rent seeking to be more profitable than taking risks and setting up new ventures. Pakistan's export structure has remained largely unchanged form 1990 and its market share in world trade has declined significantly. Both India and Bangladesh have kept up with the rising demand in the international market and doubled and tripled their market share. Even in textiles we are still stuck in low value goods and do not produce cotton, man-made fiber mix that is demanded by the market. Research and Development grants and technology upgradation funds have been used as financial subsidy for the existing products rather than changing the product mix.

The State is unable to perform its functions partly because of its own inefficiencies and parochial interests of the elite classes but also the private economic agents have made nonpayment of taxes a widespread ingrained habit. The number of direct tax filers is receding over time and the collections are on a downward path. In FY'13, only 21 percent of registered companies paid any Income Tax while 80 percent of the total amount was collected from the multinationals and a few large Pakistani companies. Whenever any government wishes to take some tough measures they are immediately confronted by strikes, shutter downs and suspensions of transport causing immense grief to the poor workers and ordinary citizens. The governments back down and status quo ante is restored. The recent strikes by the business community against the withholding tax on non-filers engaged in banking transactions attest to the power and nuisance value of those who wish to perpetuate the existing situation.

So unless this norm of widespread tax evasion by the majority of economic agents is reversed the prospects of being an economically independent country would always remain a pipe dream .we cannot have our cake i.e. not pay taxes and eat it too i.e. maintain the conspicuous consumption that we have become accustomed to.

Markets for land and labor are both highly inefficient and inequitable. It is not realized that Land can be used to create wealth for the benefit of society and contribute to

eradication of poverty. During the British rule, each district used to be settled by the Revenue officials in order to update the status of current land utilization and land records. Land revenue collection was thus easy as the liabilities to pay were clearly defined and documented through systematic cadastral survey delineating boundaries of land and recording the current tenure holders. All mutations and changes that took place in the intervening period were incorporated to present an updated picture at the end of the settlement period. No such settlement has taken place for more than half a century in Pakistan and the land records are murky, land ownership is unclear and therefore competitive land market is totally absent. Inefficient land holders are underutilizing this scarce asset while those who can use land more productively cannot get access due to non-competitive prices. Excessive rent seeking does not allow reallocation of resources of pre-requisite for economic transformation. The same is true for water rights Irrigation flows in a water stressed country ought to reflect their scarcity premium. Water charges recovered today in form of abiana cannot cover even a small fraction of operational and maintenance expenditures. Land acquisition laws are outdated and confer a lot of discretionary and arbitrary powers to petty officials of the Revenue Department in determining compensation for land acquired by the Government. State lands and forests are under the occupation of influential and politically connected zamindars who do not pay market based lease money or taxes to the state. Litigation for land disputes accounts for 80 of cases in our Courts.

In urban areas, state land is continuously encroached by land mafias patronized by the political parties. Prices of land have therefore shot up because of the scarcity created by these land grabbers. Property titles, outside the Defense Housing Authorities, are not clearly established or documented. Property value are consistently understated to avoid stamp duties and other taxes. Insecure titles prevent people from taking full advantage of the productive use of the land. Zoning regulations are commonly violated in collusion with the Municipal officials. The most blatant example is that of the residential areas of Islamabad which have a large number of offices, commercial enterprises, schools, health clinics and laboratories in clear violation of the zoning laws.

Mortgage loan markets cannot function in an environment where titles are not secure and properly documented, values of collaterals offered differ significantly from the registered deeds, encumbrances on the property are suppressed or misrepresented and evidence of payments made and received in exchange of property is missing. As compared to other

developing countries, the share of mortgage lending in Pakistan is miniscule accentuating the problem of huge backlog of housing units available.

A computerized system of land registry built on the latest Cadastral surveys that can capture, store and retrieve the land rights and ownership data can also be used to issue land titles. Geographic Information System (GIS) and Google maps can be useful tools in this process. Land transactions can thus be facilitated and uncertainty removed making land market more efficient. Digital records are less amenable to fraud and manipulation and access to key information is easy. Accuracy of information can also help avoid potential disputes and reduce the congestion in our courts improving the functioning of our legal system. Alternative dispute resolution mechanisms can then be used to settle the disputes.

Turning to the market for labor, employment in the informal sector is expanding over time for a variety of reasons including the formal labor market rigidities, insider-outsider conflict of interest, and wages below efficiency level. Some of the rigidities arise due to public policies and regulations such as Social Security charges, worker's participation Fund, Employees Old Age Benefits contribution etc., multiple inspections by different agencies and arbitrary powers enjoyed by petty officials. Informality is generally associated with lower productivity which can be increased if these distortions are removed. Economic transformation takes place when more productive jobs are created and less productive jobs disappear through constant reallocation of resources including labour.

Changes in labor earnings are the largest contributor to poverty reduction. Increasing the earnings from work has made utmost difference in escaping from poverty. But in Pakistan, we are moving in the opposite direction and do not realize the deleterious consequences for the economy.

Private employers by employing contractual labor, daily wage earners, maintaining poor work place environment with no investment in learning and training, depriving their workers of health and social protection benefits have, in fact reinforced the trend towards low productivity informal employment. Letting go of their workers during economic down turns and downsizing the labor force prove to be counterproductive. The additional costs of searching and training new workers on the job far exceed the savings made through severance and downsizing.

Scales of economics are not realized because many small and medium enterprises level prefer to operate at the current level and do not want to expand because of labor market

regulations. Static and myopic views of the firm owners who believe that the premium paid for entering the formal sector and expansion is high, lead to a low level equilibrium in which the large informal and limited formal sectors coexist. It is not realized that the rural youth after completing even high school education do not wish to return to farming. Similarly, the children of urban slum dwellers who get some education are most reluctant to join the informal trading or vending or servicing jobs of their parents. The changing labour supply conditions dictate a more flexible and less rigid labour market.

While core labor standards such as avoiding child labor, forced labor discrimination and encouraging freedom of association and collective bargaining should be implemented, the harassment and extortionary practices associated with their compliance should be avoided. Unions should not be allowed the liberty to profit and benefit the insiders thus discouraging new entrant. Job security for the insiders comes at the big expense of job flows for accommodating the young people.

Skills gap between the requirements of the economy and the output produced by our educational institutions is also retarding the progress on the productivity frontier. While mobile phones, internet broadband and fiber optics have made impressive inroads they have not yet found use for training and skill up gradation. Chambers of commerce and trade associations in conjunction with technical and vocational training institutes should have organized on the job training courses and certification and diploma courses in the trades for where there is perceptible demand locally as well as regionally. It is not feasible for any individual firm to incur the costs of training when the benefits cannot be appropriated by the company itself. Government run institutions have been a failure and hence an innovative model of partnership should be experimented whereby design, delivery, curriculum and testing are done by the private operators while infrastructure, certification and accreditation are the responsibility of the government.

Another major cause of low productivity is that the academia and research institutions have not been able to make any contribution in the diffusion and up gradation of technology throughout the economy. Despite a rapid rise in the number of PhD in Science and Engineering at our universities and research institutions the link with the industry remains very weak. Business schools have also not done much to improve the organizational efficiency and strategic directions of our large or small enterprises.

In our public sector universities, professional colleges and institutions of higher learning, teachers are engaged in politics to attain administrative positions rather than interested in teaching and research. Tuition centers and individual coaching preoccupy the teacher at all levels while those who cannot afford to pay these exorbitant charges remain at a disadvantage. Groupings, rivalries, leg pulling and agitations characterize the culture in these institutions. The younger faculty members who come back with higher degrees enthused with the goal to do something good are either blocked entries, ostracized or coopted. So the hope for regeneration and rejuvenation of our academia through infusion of new blood remain unfulfilled.

Labor, capital, land, organization productivity in Pakistan are the lowest among the developing countries and are on a constant downward path. The cumulative cost of sub standards goods, supply chain inefficiency, poor work ethics, low skill sets, lack of professionalism, fake receipts and certificates, under invoicing and smuggling, evasion of taxes, etc. arising from the prevalent societal norms and culture and private economic agents' behavior and practices are estimated to reduce productivity leading up to a loss of 2 to 3 percent of GDP annually. Despite all the imperfections and weaknesses of government policies and governance it is possible to reach 6 to 7 percent growth rate by altering the behavior, attitudes and practices of our society and private economic agents. Is this possible? Because it will transfer the responsibility to our shoulders rather than keep blaming the government of the day this appears to be a herculean task. But we must not forget that responsible citizenship is a pre-requisite for a buoyant economy.