**INSTITUTIONS FOR MARKET GOVERNANCE AND DOING BUSINESS[[1]](#footnote-1)**

**Ishrat Husain**

 I would like to place the topic assigned to me in the larger context of separation of functions of policy making, ownership of the assets and regulatory oversight. Until the beginning of this decade all these varied functions in Pakistan were bundled together and carried out by each Ministry. In early 2000s the Cabinet decided to unbundle these functions to avoid conflict of interest, protect consumers and provide a level playing field for both the public and private sectors. The concern was: How can a private firm compete with a public sector firm in the same field when the owner of the latter firm enjoys substantial relative advantages. For example, the Ministry can alter the policies to favor its own firm, it can arrange tax concession specific for that firm, it can finance the losses of the firm from the public exchequer, provide subsidies for under-pricing the products the firm sells and it can create many hurdles to stifle the growth of the competing private firms. The Cabinet therefore set up an independent regulatory agency not answerable to the Ministry to carry out regulatory functions, it established autonomous Boards of Directors consisting mainly of independent non-executive Directors to govern the public sector firms and made the Ministry responsible for policy making only. This pilot experiment was carried out in the case of the Ministry of Petroleum and Natural Resources (MPNR). Oil and Gas Regulatory Authority (OGRA) was set up to regulate the oil and gas sector. State owned companies such as OGDC, PSO, PPL, SNGPL, Sui Southern were given their own Boards of Directors which carried out the governance of these entities and the MPNR was left to focus on policy making. This experiment, in my view, proved successful and should have been extended to other Ministries also. Some half-hearted attempts were made but fierce resistance by the Ministries and the bureaucrats who were clearly losing power and authority due to this separation have not so far allowed the whole water front to be covered.

 At this point, I would like to clarify a few popular misconceptions. First, independence of the regulatory agencies cannot be and should not be misconstrued as independence from the Government. All regulatory agencies will have to act within the policy framework set by the Executive branch under the laws formulated by the legislature. All actions of the regulators are open to scrutiny by the judiciary. Second, it is the governance structure that has to be carefully thought through. If the Boards of the state owned companies are saddled with too many bureaucrats representing various ministries then there won’t be much qualitative difference between the direct control of the Ministry in-charge of the SoE and the Board so constituted. Independent non-executive directors who bring expertise and knowledge in the areas of finance, accounting, law, strategy, marketing, technology should be invited to serve on these Boards. Third, the management of regulatory agencies should not be entrusted to loyal government servants as sinecure for their post-retirement life. Competence and demonstrated track record of performance in the sector or leadership qualities exhibited in their professional life should form the basis for selection. An open, transparent process for selecting the Chief Executive of the regulatory agencies and major state-owned companies and corporations should be followed. It would be desirable if the selection is endorsed by the relevant parliamentary committees to assure bipartisan support and continuity even after the government is changed. Capacity building of the regulatory agency is a sine quo non for its strength and effectiveness. Only professionals well versed in economics, finance, engineering, technology, law should be inducted, trained and attached to similar agencies all over the world for short durations. Fourth, the regulatory agency should be accountable to the Parliament. Each agency should submit an Annual Performance Report to the relevant committees of the National Assembly and the Senate. These committees should have the powers to summon the heads of the regulatory agencies and hold public hearing. As most of the agencies raise their own funds their budgets must also be approved by the Parliamentary Committees.

The next point I would like to submit before this illustrious task force is that the sloganeering or ideology-driven dichotomy between Regulation vs Deregulation is totally false and devoid of any meaningful content. AS I would show the Government and the regulators have multiple roles to play under different market structures and situations. AT times they may be regulating some activities while deregulating others. In some instances they may be exercising a light regulatory oversight while in others they may come up with strong hands. It is the empirics and not ideology that should determine as to what is the most appropriate role for the Government. Let me illustrate this point with the help of six different situations.

 In case of incomplete or missing markets, the Government or the regulator has to play the role as a facilitator or promoter. For example, the markets for microcredit did not exist in Pakistan until 2000. The State Bank of Pakistan took the lead in setting up the legal, institutional and regulatory framework to nurture this market. The role it played was very different from its traditional role vis-à-vis the commercial banks. It was more promotional-encouraging and incentivizing different actors in this field.

 Where the market failure arises due to externalities the Government has to use its Tax-Subsidy-Cap apparatus to offset these failures. Environmental degradation is an area where regulation by itself will not do the trick, but other instruments such as Tax, Subsidies or Trading or Permits may be more effective. Drug Regulatory Authority (DRA) has yet to see the light of the day in Pakistan as the patents and intellectual property rights create a wedge between the prices demanded by the companies that have developed those drugs and the affordability of prices by the public at large.

 The case for having a body such as Competition Commission is quite obvious when the market structures are imperfect. Monopolies, oligopolies, monopolistic competition, collusive practices are to be tackled by ensuring that the consumers and users of goods and services produced by these companies are paying true economic scarcity prices rather than economic rents. Public utilities are a common example of monopolies which have to be kept under strict vigilance so that they do not overcharge the consumers.

 But if the market consists of many buyers and sellers, the commodity is homogenous in nature, there are no hindrances in the mobility of commodities and information on prices and quantities is available publicly then there is no need for any regulation. Markets for Commodities such as wheat, rice, sugar, cotton which enjoy these characteristics should be deregulated and the government should not distort the markets by fixing administered prices. In Pakistan, we over-regulate the markets where there is no such need and deregulate the markets which should be regulated.

 The fifth set of interventions are those which I term ‘Market Suppressants’ or ‘Market irritants’. These have negative consequences and in fact damage the operation of well functioning competitive markets. Pakistan is replete with examples where SROs are issued arbitrarily or whimsically to favor a certain group or firm or individual. Shipments of steel are allowed to a certain importer under favorable duty structure specific to that importer. Once that shipment enters the domestic market the concession is withdrawn and other competing importers are put at a price disadvantage. In a recent well publicized case the sales of products of a public sector firm were made only to a handful of favored companies at lower than market prices. These favorite firms were able to make huge ‘unearned’ profits while their competitors suffered and the consumers had to pay higher prices.

 Finally, there are interlinked markets such as credit and land markets. The regulator for the credit market insists that the banks should not advance loans until land title is clearly established and documented. But there is no regulator for land markets to which the buyer or land owner can go for the protection of his property right. The Land Revenue Administration is acting as both the dispenser as well as adjudicator. No wonder, the courts in Pakistan are flooded with hundreds of thousands of cases pending for 10 years or so. In absence of such regulatory framework that protects property rights the banks cannot grant mortgage loans. The gap between demand for new housing units and the supply in absence of bank financing is pushing up the prices to unaffordable levels. There are very few persons who can pay a heavy lump sum amount to purchase the house. All over the world, prospective buyers make a small down payment and borrow the remaining amount as mortgage loans which they repay in installments every month from their income. This facility cannot be availed in Pakistan on a large scale because of the absence of a regulatory framework and lack of transparency in land record management.

 To end my remarks, the institutions for market governance and doing business in Pakistan, where they exist, must be strengthened and their capacity upgraded. They must also pay more attention to enforcement as strong action taken against some of the violators of regulations can act as a powerful deterrent effect upon others. Each market situation must be analyzed and the role of the government in responding to that situation must address the specific problem. There is no “one shoe fits all’ approach to government regulation and intervention. Where the regulators are missing and the damage to the economy is quite severe these gaps should be filled in by establishing the regulatory agencies.

1. Remarks made at the Private Sector Development Task Force meeting held at Islamabad on Oct 29, 2010. [↑](#footnote-ref-1)