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Presidential Address

A Governance Perspective on Development Issues

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It is with great pleasure that I welcome you to the 15th Annual General Meeting of the Pakistan Society of Development Economists. I have had the proud privilege of being associated with this Society since its inception, initially as its Founding Secretary and member and later as its President. I have watched it flourish and helped ensure that it grows from strength to strength. In this, the last meeting of the Society with me as its President, I am really cheered by the presence of so many colleagues here, particularly as we know that we live in troubled times. But I can assure you of a frank and open discussion of the key development issues of the day. Economic growth and poverty reduction are difficult to achieve in the best of times. With decaying institutions and poor governance, these goals become an impossible dream. That is why the theme of this year's annual meeting is "Governance, Institutional Reform, and Economic Growth". I hope that the papers being presented and the discussions on or around this theme during these four days will indicate the way forward from the current morass. I shall not bore you with the details of the economy's deplorable condition—most of you are familiar with them. Its deterioration is best judged by the International Country Risk Guide (ICRG) ratings for Pakistan, which are computed by weighting three elements—corruption, rule of law, and bureaucratic quality. These ratings for Pakistan in 1998 are three times what they were in 1982. This means that on a relative scale, things in Pakistan are three times as bad in 1998 as the 1982 levels.

Still, I must dwell on the essential elements of this year's theme for a way forward. I strongly believe that our salvation now lies in good governance and appropriate institutional reform which is sustained over a suitably long period of time.

PERTINENCE OF GOVERNANCE ISSUES

Let me first turn to the nature and role of policy issues in the field of governance in Pakistan, and also to what these issues imply for the development prospects of our economy. Governance is generally defined by economists as "the

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manner in which power is exercised in the management of a country's economic and social resources for development". Of particular importance to us today are two specific aspects of governance, namely, (a) the process by which authority is exercised in the management of a country's economic and social resources, and (b) the capacity of a government to design, formulate, and implement policies and discharge its functions. The first requires integrity and a commitment to a clean and efficient management. The second requires the choice of appropriately qualified manpower that is sensitive to the needs of the poor and has the capacity and institutional support to distil lessons from research, both national and international, and to adopt and apply these as quickly and efficiently as possible for the general good of all.

I would like to highlight three interlinked dimensions of poor governance in the hope that highlighting them would provide some guidelines for remedial actions. *First*, it is the decline in institutional integrity and capacity, aggravated by arbitrary actions further compromised by a conflict of interests. *Second*, the literature on governance generally agrees that a fundamental cause of weakened institutional capacity is the politicisation of public sector management. Political interference and patronage appointments systematically reduce the public sector's institutional autonomy and integrity. Under such politicisation, informal and non-transparent systems for public sector management can increasingly come to dominate established procedures. *Third*, this greatly undermines both the accountability processes and the technocratic capacity in the public service. In such an environment, coordination and technical consultation across bureaucratic boundaries become difficult. The weakened institutional capacity and control becomes a hotbed of bureaucratic corruption. The lack of effective mechanisms for formulation of policies is often linked to budgetary constraints; and the weak enforcement of the rule of law contributes to a high degree of arbitrariness in government actions. Conflict of interest in these conditions is generally overlooked and rent-seeking behaviour prevails.

Governance, still, is a multi-faceted concept, encompassing all aspects of the exercise of authority through formal and informal institutions in the management of the resource endowment of a state. The quality of governance, thus, is determined by the impact of this exercise of power on the quality of life enjoyed by its citizens. Widespread corruption is one of the most obvious signs of poor governance.

MISGOVERNANCE AND ECONOMIC PERFORMANCE

There is a vast and ever-increasing body of literature that documents the effects of bad governance, especially corruption in the economy. Numerous studies have found that corruption reduces public revenue and increases public spending. Thus, it contributes to larger fiscal deficits, making it more difficult for governments to run a sound fiscal policy. Studies also find that corruption is likely to increase

income inequality because it allows well-positioned individuals to take advantage of the government activities at the cost of the rest of the population. Corruption also distorts markets and the allocation of resources because of the following reasons:

- (1) It reduces the ability of the government to impose necessary regulatory controls and inspections to correct for market failures. When the government does not perform well, its regulatory role on banks, hospitals, food distribution, transportation activities, financial markets, etc., loses part of its *raison d'être*. On the contrary, when intervention is motivated by corruption, as for example when the government creates monopolies for private interests, it is likely to add to those shortcomings.
- (2) It distorts incentives. As already mentioned, able individuals allocate their energies to rent-seeking and to corrupt practices and not to productive activities. In some cases, the resulting activities have a negative value-added.
- (3) It acts as an arbitrary tax (with high welfare costs). Especially when corruption is not centralised, its random nature creates high excess burdens because the cost of searching for the person or persons to whom the bribe must be paid must be added to the cost of negotiating and paying a bribe. Also, when it is not centralised, the contractual obligations secured by the payment of a bribe are most likely disregarded.
- (4) It reduces or distorts the fundamental role of the government (on enforcement of contracts, protection of property rights, etc.). When one can buy one's way out of a commitment or out of a contractual obligation, or when one is prevented from exercising one's property rights because of corruption, one of the fundamental roles of the government is distorted and growth is negatively affected.
- (5) It reduces the legitimacy of the market economy and perhaps of democracy. In fact, the criticisms often voiced in many countries (and especially in transition economies) against democracy and the market economy are highly influenced by the existence of corruption. Thus, corruption may slow down or even block the movement towards democracy and a market economy.
- (6) It also increases poverty because it reduces the income-earning potential of the poor.

STATUS OF GOVERNANCE IN PAKISTAN

That the poor state of governance distorts the potential for economic growth is now conventional wisdom. It is no wonder that a lot of effort has gone into measuring the extent of misgovernance in different countries — both the developed and the developing ones.

The Mahbub ul Haq Human Development Centre, in its recent annual report on the “Crisis of Governance in South Asia”, has developed a Humane Governance Index (HGI) that attempts to quantify humane governance with the use of several indicators of economic, political, and civic governance.

Economic governance is assessed by combining different measures of fiscal policy (budget deficit), monetary policy (inflation rate), trade policy (current account deficits), social priority expenditure related to health and education, and liberalisation of the economy (shown by the wedge between the official and the parallel market rates). Political governance is determined by perception indicators such as corruption, quality of the civil service, accountability, law and order situation, as well as social and ethnic tensions. Civic governance is assessed by measures of freedom of expression on government policy and actions; non-discrimination with respect to race, ethnicity, gender, religion, and political participation, indicated by the frequency of fair and free multi-party elections; and the observance of the rule of law through an equitable legal and judicial system.

The first-ever HGI was constructed for 58 industrial and developing countries, including Pakistan, and three other South Asian countries. The value of this Index ranges between zero and one. The higher is the value of the index, the better is the state of humane governance.

Amongst the 58 countries, Pakistan is ranked at 52 on the basis of humane governance, 47 in terms of civic governance, 48 in terms of political governance, and 52 in terms of economic growth. Pakistan’s rankings confirm that Pakistan is in the grip of a severe governance crisis. With inefficient deployment of resources, crippling debt burden, glaring social divisions, arbitrary enforcement of laws, personalised decision-making, and low integrity quotient of political leadership and civil service officials, it is not surprising that the governance structures are badly shaken. It needs to be pointed out that the situation has not been engendered by the failure of any particular institution or a particular regime. It is a collective failure, cumulated over decades of misgovernance with virtually total insensitivity to the plight of a common person.

It is also interesting to point out how people in Pakistan perceive structures and processes of governance. I would like to quote again some salient findings of a Citizen Survey conducted by the Mahbub ul Haq Centre.

According to this Survey, a large majority (63 percent) have no faith in the political system and even a greater majority (88 percent) felt that the political leaders were corrupt and corruption had increased in the last five years. An overwhelming majority (74 percent) felt that elections were important even though a large proportion (52 percent) felt that the political parties did not represent their interests. A significant proportion (64 percent) felt that the legal framework was not just, women and minorities were not equal partners (58 percent), and the general infrastructure as well as the quality of health services were poor (64–65 percent); and

almost half of them were not pleased with the quality of education. Interestingly, 67 percent had themselves given a bribe, and almost all of them (94 percent) thought that the government officials were corrupt. The top three priorities of the respondents in Pakistan were: defence, education, and general development. The closest definition of corruption given by the respondents was bribery and the misuse of power.

INSTITUTIONAL REFORMS

In the economics profession, public sector reform is seen increasingly through an institutional focus. Thanks to the conceptual and theoretical breakthroughs brought about by such Nobel Laureates as Buchanan, Coase, North, and Vickrey, the profession has developed analytical tools that focus on the incentives and information that shape decision-making by public actors—political or bureaucratic—and have enabled economists to open what was previously a black box called “the state”. This institutional perspective complements recent empirical work in public economics that highlights the costs (in terms of foregone investments and growth) of over-regulation, corruption, and other manifestations of bad governance. This work also complements the work of public sector management specialists, who have for years argued for a systemic approach to public sector reform, noting the dangers of piecemeal project interventions. The study of institutions has been enriched by a growing body of work that combines “rational choice” theory, information economics, game theory, law, and organisation theory.

A key-starting point of this analysis is the recognition that public actors are often motivated not just by social goals but by the private political and economic costs and benefits of their actions—and that these costs and benefits are shaped by institutions. If the institutions that countries use to govern themselves were perfect and ensured that the private rewards of government decisions were aligned with the social costs and benefits, the distinct incentives of public actors would not matter. But in all countries, the institutions of governance are imperfect. This is especially so in our country, where institutional decay has resulted in extreme misgovernance. Massive loan defaults, laundering of money, and arrears of taxes and utility bills are some of the obvious examples of misgovernance in Pakistan.

Those who suffer from poor policies generally lack the clout and information to impose costs on the policy-makers who designed them, particularly in governments without meaningful checks and balances. Often multiple actors (cabinets, political parties, legislatures) provide the inputs for policy decision-making, and the bargaining processes may be non-transparent to favour some actors (and their private interests) over others. Even if the policy-makers agree on the socially optimal policy, their control over bureaucratic officials is always imperfect—and can be exceedingly weak in most developing countries. Furthermore, institutional obstacles may obstruct feedback from beneficiaries that could improve

policy implementation. By better understanding how institutions shape public action and by undertaking empirical analysis to measure the economic costs of poorly performing public institutions, Pakistan can be in a better position to improve governance and public sector performance.

Policies and institutions are closely interlinked in several ways. Policy design should take the institutional capacity carefully into account. When institutions are weak, simple policies with limited administrative demands and public discretion work the best. Where institutions are stronger, more challenging public initiatives can be effective. Matching the policies and the institutions is the key to good and effective governance. Policies do not emerge from a vacuum but generally are the result of bargaining among contending groups—with the interplay among them shaped by the institutional rules of the game.

The causation also works in reverse; policy choice can significantly influence the way the institutions develop. A decision to reduce tariffs or move from highly varied to uniform tax rates can dramatically shift incentives and responsibilities within the customs and tax administrations, making it harder, for the example, for officials to extract bribes in return for the lower taxes. This is a good example of why economic reform is a key pillar of a successful anti-corruption programme in any country.

CONCLUSION

Good governance, appropriate institutional reform, and broad-based economic growth sustained over a reasonable period of time are the essential ingredients of any attempt to salvage our society and economy from where it has unfortunately landed today. It is my prayer that some of the deliberations during the coming days will identify the way out of the deep crisis being faced by our society. I would like to welcome you all once again and thank you for coming.