Opportunities: The Role of State

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The whole debate of the state versus markets is completely irrelevant and outdated today. Every country needs to have a strong and effective state alongside a vibrant and dynamic private sector working together. Also, both the government and the private sector must listen and take on board the civil society to undertake initiatives successfully.

Youth & Jobs: Almost two-thirds of our population is in the age group that contributes to the youth bulge. To prevent the youth bulge, from turning into a youth bomb, jobs must be created for the youth or at least let them create opportunities themselves. Evidence suggests that it costs around Rs. 950,000/- to create a job in government relative to Rs.150,000/- only in the private sector. Given this, job creation should be left to the private sector, with the government focusing only on ensuring an enabling environment.

Footprint: Though a breakdown of national accounts expenditures suggests that the footprint of the government in the economy is around 20 percent of GDP however, considering the state-owned enterprises, the taxation, the regulatory framework, and the policy interventions, the government is much more intrusive than what the national accounts suggest – A PIDE study (Haque and Rafi, 2020) suggests that footprint of the government in the economy is 67 percent of GDP. To encourage the businesses to operate, the footprint of the government must be scaled down drastically.

Market Performance: The market underperforms primarily for two reasons:

- The market structure in Pakistan is over-regulated, and the incentive structure for innovation is not in place. The system incentivises rent-seeking instead of innovation. For businesses to come up, exist and flourish, the government should be out of the market, set the rules, develop the enforcement capacity, and enforce the rules efficiently.
- Neither the markets nor the state alone can bring an economic transformation. We need to figure out how the government can be an enabler. Despite opportunities,

there are challenges in this respect - the preference of the state in Pakistan is to preserve the status quo rather than to facilitate a transformation. Resultantly, we see a low investment rate, weak export competitiveness, and low productivity.

Market Structure in Pakistan: The market structure in Pakistan is highly regulated even though the state has serious capacity issues. The administrative burden is quite high, and the transactions/economic activity is constrained by hosts of frictions, especially where the government is involved. These frictions, known as sludge, impose extra costs on the individuals and therefore, on the economy. The costs include monetary costs, the cost of time spent, and the effort exercised to wade through the frictions. The GDP, being nothing but the sum of transactions in the economy, is adversely affected when the transactions fail to happen or are severely delayed due to frictions.

Sludge: The evidence documented in the PIDE's Sludge series suggests that the administrative frictions are quite high and vary by sector. Opportunities exist and are created in competitive markets that are efficient. Two prerequisites characterise efficient markets—the ease of entry and exit into the market and the contract enforcement. Pakistan is way behind on both these counts. To allow opportunities then, Pakistan must ensure free entry and exit into markets, ensure that the contracts executed are honoured in an expected manner—in terms of time as well as cost, and reduce the footprint of the government in the economy—to ensure a level playing to all.

Status Quo: A couple of examples tell how the government preserves the status quo rather than transform itself. Frist is the determination of the input-output coefficients. This is to determine the input ratio (of a certain output) that a firm uses for its production process. The figures are used by the government to determine the tax exemption, particularly on import duties. Despite being a technical matter, Pakistan has a bureaucratic setup to determine those input-output coefficients rather than the firms doing it themselves. Under the given setup, it would be very difficult for firms to innovate and set up businesses in Pakistan.

- Imagine if *Tesla* wanted to set up business in Pakistan, the concerned bureaucrat would probably be telling Elon Musk that *Tesla* cars have too much software and that the input-output ratio is not right. So, if a bureaucrat determines a business's input-output coefficients, it is difficult for a firm to innovate. If a business aims to depart from the status quo and use different inputs or different technology, it would probably not be allowed.
- PIDE has recently focused a lot on identifying and estimating sludge involved in different activities. The findings suggest that the sludge involved in seeking approvals from the government makes innovation quite difficult.

Where are opportunities, then? To create opportunities, the government must empower people with citizenship. Roughly 2.5 percent of the population in Pakistan does not have citizenship. Around three to four million people of Afghan origin reside in the country and are excluded from the mainstream due to the non-issuance of ID cards. This cannot be ignored because when we talk about opportunities, we must discuss those who are totally excluded—if the Afghans were to have a better legal status, they can contribute more formally to the economy by expanding their present mostly informal ventures. The same goes for people of Bengali/ Bihari, Somali, Yemeni and Palestinian origin living in Pakistan – opportunities are minimal for such people due to a lack of appropriate legal status. This 2.5 percent of the population of Pakistan is living in a state of statelessness—the country needs to enfranchise everyone to allow them to give their fuller to the economy.

Low effective rate of revenue: Though the import duties in Pakistan are quite high (20 percent on average) but still the effective rate of revenue collected is rather low due to the exemptions available to many firms that import intermediate goods or capital equipment. Quite often, such exemptions are available to large and existing firms but not to the new and small firms—a situation that needs to be corrected to provide a level playing field – something crucial to foster a competitive environment, which is at the heart of innovation and growth.

The Role of Judiciary: Given the enabling business environment perspective, the judicial arm lacks knowledge of the underlying economic dimensions of issues that land in the court. This at times, leads to uncalled-for decisions that do not go well with the investors—local as well as foreign. On contract enforcement, a serious engagement between the state and the judiciary is necessary—the effort and time involved in settling court cases, coupled with 'stay orders' wreak havoc with setting up and operational costs that an entrepreneur has projected while conceiving a business venture, potentially turning a viable business proposition into an unviable one—the cost of this to the economy are phenomenal.

Opportunities for Firms to Grow

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There is a strong linkage between total factor productivity (TFP) and economic growth—literature suggests that in G5, G7, and G20 countries, TFP growth has led to income growth rather than factor accumulation. A study suggests that in 60 percent of the