

**REPORT OF THE WORKING GROUP  
ON  
INSTITUTIONAL FRAMEWORK FOR DEVELOPMENT**

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## TABLE OF CONTENTS

Section #	Title of Section	Page #
-	ACKNOWLEDGEMENTS	iii
I	INTRODUCTION: An Alternative Policy Paradigm	1
II	POLICY DESIGN ELEMENTS FOR INCLUSIVE GROWTH	3
III	INSTITUTIONAL FRAMEWORK FOR A SMALL AND MEDIUM FARMER AGRICULTURE GROWTH STRATEGY	4
IV	INSTITUTIONAL INITIATIVES FOR INCLUSIVE GROWTH THROUGH CORPORATE ENTERPRISES OWNED BY THE POOR	7
V	INCLUSIVE GROWTH THROUGH SMALL SCALE ENTERPRISES: THE ROLE, CONSTRAINTS AND INSTITUTIONAL IMPERATIVES	14
VI	INSTITUTIONAL FRAMEWORK FOR PARTICIPATORY DEVELOPMENT	18
VII	THE INSTITUTIONAL FACTORS IN UNSTABLE GROWTH AND ENDEMIC POVERTY	23
VIII	INSTITUTIONAL CHANGE FOR EXPORT DIVERSIFICATION AND ACCELERATED EXPORT GROWTH	38
IX	TRUST' AS AN INSTITUTION FOR SUSTAINED ECONOMIC GROWTH	46
X	INSTITUTIONAL FRAMEWORK FOR SOCIAL DEVELOPMENT	51
XI	INSTITUTIONAL REFORMS FOR STRENGTHENING FISCAL FEDERALISM	54
XII	CONCEPTUAL OUTLINE FOR INCREASED DOMESTIC RESOURCE MOBILIZATION	57
-	CONCLUSION	62
-	APPENDIX I	64
-	APPENDIX II	70

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# **REPORT OF THE WORKING GROUP ON INSTITUTIONAL FRAMEWORK FOR DEVELOPMENT**

## **PREFACE**

Pakistan is in the midst of a war of national survival as Taliban-Al Qaeda combine have captured large swathes of Pakistan's territory in the NWFP and are now launching guerilla operations in some of the major cities such as Peshawar, Lahore and Karachi. As military combat is undertaken it is clear that an important dimension of prosecuting the war against extremism is to provide a stake in citizenship to the large proportion of the population that is suffering from growing poverty, unemployment and the deprivation of basic services. Economic growth in the past 60 years has failed to make a substantial dent into the poverty problem. This is because of an institutional structure within which high economic growth has been neither sustainable nor equitable<sup>1</sup>.

## **I. INTRODUCTION: An Alternative Policy Paradigm**

The present balance of payments crisis and slow down in GDP growth brings out in sharp relief the historical pattern of Pakistan's growth process. Periods of high growth end due to mounting balance of payments pressures such as at the end of the Ayub period in the 1960s, the Zia period in the 1980s and the recent Musharraf period: High growth has been critically dependent on concessional foreign capital inflows. An equally important feature is persistent mass poverty and the inability of the trend rate of GDP growth (about 5 percent) to substantially reduce poverty<sup>2</sup>.

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<sup>1</sup> Akmal Hussain, An Institutional Framework for Inclusive Growth, Final Version, 15<sup>th</sup> May 2009, page 1.

<sup>2</sup> For a more detailed discussion of this phenomenon, see: Akmal Hussain, Institutions, Economic Structure and Poverty in Pakistan, South Asia Economic Journal, Volume 5, Number 1, January-June 2004, SAGE Publications, New Delhi.

The twin features of instability and constrained poverty reduction are located at one level in the structural characteristics of the growth process itself: (i) An export structure that prevents an export growth high enough to finance the import requirements of a high growth trajectory. (ii) A domestic savings rate that given Pakistan's existing ICOR is inadequate to finance the investment rate required for a sustained GDP growth of 7 percent. (iii) A highly unequal distribution of productive assets and hence the exclusion of the majority of the people from participation in productive enterprise, results in increasing inequality during the high growth episodes and low poverty reduction if any.

At another level it can be argued that if sustained growth and rapid poverty reduction is to be achieved a shift in the paradigm for understanding both the determinants of growth as well as the nature of poverty is required. The literature of the New Institutional Economics (NIE) shows that the most important determinant of sustained growth is the institutional structure within which it occurs<sup>3</sup>.

Applied research on Pakistan in the perspective of the NIE shows that Pakistan's stop-go pattern of economic growth is located in the limited access nature of its social order. Limited access social orders are characterized by rent creation, privileged access over economic and political power for the elite, and the exclusion of a large proportion of citizens from equal access over markets, resources and governance. Such limited access social orders as North, et.al have argued "preclude thriving markets and long term economic development"<sup>4</sup>. By contrast open access social orders provide equality of economic opportunity on the basis of systematic competition, innovation, merit and mobility. Consequently, the institutional framework of open access social orders constitutes the basis of efficient markets and sustained economic growth.

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<sup>3</sup> (i) Douglass C. North, *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, Cambridge, England, 2004.

(ii) Douglass C. North, *Understanding the Process of Economic Change*, Princeton University Press, 2005.

<sup>4</sup> Douglass C. North, John Joseph Wallis, Barry R. Weingast, *A Conceptual Framework for Interpreting Recorded Human History*, National Bureau of Economic Research, Working Paper Series, Cambridge (Mimeo), 2006.

If Pakistan is to embark on a path of sustained growth it would be necessary to establish an institutional structure for inclusive growth. Such a growth process would enable a transition to economic democracy which would sustain political democracy<sup>5</sup>. The institutional structure of inclusive growth would enable all of the citizens of Pakistan rather than only a small elite to participate as subjects of economic growth as well as the recipients of its fruits.

## II. POLICY DESIGN ELEMENTS FOR INCLUSIVE GROWTH

Successful prosecution of the battle for survival that Pakistan is currently engaged in, requires initiating the necessary structural changes and establish the institutional framework for inclusive growth.

A new approach to inclusive growth could be adopted by establishing an institutional framework for the provision of productive assets to the poor as well as the capacity to utilize these assets efficiently. In this way the poor by engaging in the process of investment, innovation and productivity increase could become the active subjects of economic growth rather than being merely recipients of a “trickle down” effect: Thus a sustained high growth could be achieved *through* equity. Inclusive growth so defined can become both the means and the end of GDP growth<sup>6</sup>.

The institutional framework of such an inclusive growth could have four broad dimensions<sup>7</sup>:

- (1) A small and medium farmer strategy for accelerated agriculture growth through the provision of land ownership rights to the landless and institutional arrangements for yield increases.

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<sup>5</sup> For a discussion on Economic Democracy and case studies of action, See: Ponna Wignaraja, Susil Sirivardana, Akmal Hussain (eds), Economic Democracy through Pro Poor Growth, SAGE Publications, Delhi, 2009.

<sup>6</sup> This paragraph is drawn from Akmal Hussain, An Institutional Framework for Inclusive Growth, 15 May 2009.

<sup>7</sup> Ibid. page-4.

- (2) An institutional framework for providing productive assets to the poor through equity stakes in large corporations owned by the poor and managed by professionals.
- (3) Accelerated growth of small and medium scale industrial enterprises through an institutional framework for increasing the production and export of high value added products in the light engineering and automotive sectors.
- (4) A process of localized capital accumulation through Participatory Development.

In this Report we will present the institutional framework and policy design which can achieve these strategic objectives. In so doing, Pakistan can embark on a path of development that has been called *economic democracy*<sup>8</sup>. It is a path of development which enables all the people, rather than only the elite to participate in the process of income generation, investment and innovation within competitive markets. Such a path of development would achieve sustained growth with equity.

### **III. INSTITUTIONAL FRAMEWORK FOR A SMALL AND MEDIUM FARMER AGRICULTURE GROWTH STRATEGY<sup>9</sup>**

An important factor in the current economic crisis is the food deficit and the underlying stagnation in yield per acre of major crops. (In the year 2007-08 crop sector growth was negative). It can be argued that if the yield potential of the small and medium farm sector (less than 25 acres) is achieved, food shortages can be converted into food surpluses. In the existing high prices of food grain in the international market, such a shift can enable Pakistan to convert its weakness into its strength: The current crippling economic burden of food imports can be converted into a strength through food exports. To bring about this

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<sup>8</sup> The term economic democracy has been developed in the book: Ponna Wignaraja, Susil Sirivardana and Akmal Hussain: *Economic Democracy through Pro Poor Growth*, SAGE Press (Forthcoming).

<sup>9</sup> This section is drawn from Akmal Hussain, *An Institutional Framework for Inclusive Growth*, 15 May 2009. pages 19 to 22.

transformation a new policy framework is required to shift from the earlier elite farmer strategy to a new small farmer growth strategy.

When the 'Green Revolution' technology became available in the late 1960s it was possible to substantially accelerate agriculture growth through an elite farmer strategy which concentrated the new inputs on large farms. Now the crucial determinant in yield differences became not the labour input per acre in which small family farms had been at an advantage in earlier decades, but the application of the seed-water-fertilizer package to which the large landlords with their greater financial power had superior access. Thus the 'Green Revolution' had made it possible to accelerate agriculture growth without having to bring about any real change in the rural power structure. Today, after almost four decades of the elite farmer strategy, the imperative of land reform is re-emerging, albeit in a more complex form than before. As the large farms approach the maximum yield per acre with the available technology, further growth in agricultural output increasingly depends on raising the yield per acre of small farms and reversing the trend of land degradation brought about by improper agricultural practices.

The small and medium farm sector whose yield potential remains to be fully utilized, constitutes a substantial part of the agrarian economy. Farms below 25 acres constitute about 94 percent of the total number of farms and about 60 percent of the total farm area. From the viewpoint of raising the yield per acre of small and medium farms (i.e. farms of less than 25 acres) the critical consideration is that 15.7 percent of the total farm area in the less than 25 acre farm category is operated by landless tenants. Another 13.07 percent of the farm acreage in less than 25 acre farms is operated by owner cum tenant farmers. Since tenants lose half of any increase in output to the landlord, they lack the incentive to invest in technology which could raise yields per acre. Because of their weak financial and social position they also lack the ability to make such investments. Their ability to invest is further eroded by a nexus of social and economic dependence on the landlord which deprives the tenant of much of his investible surplus.

This problem is further exacerbated by the absence of an efficient land market where productive land can move to the more efficient operator. Institutional changes are

required to enable flexible and secure tenancy contracts, and a competitive land market which can allow efficient operation of farm land.

The objective of raising yields in the small farm sector is inseparable from removing the constraints to growth arising out of the institutional structure of tenancy. A policy initiative that enables the tenant to acquire land is therefore an essential first step in providing the small farmers with both the incentive and the ability to raise their yields/acre.

### **III.1 State Land for the Landless**

An initial step in providing productive assets to the rural poor could be to allot the available 2.6 million acres of State owned land to the landless. This cannot be seen as a substitute for a land reform programme of 'land to the tiller'. According to the Census of Agriculture 2000, there are about 4.97 million acres of private farm area under pure tenant cultivation in farms below 25 acres. It is this acreage that would need to pass into peasant ownership for a genuine land reform to occur. Nevertheless 2.6 million acres (assuming that all of it is cultivable) could make a significant contribution to the reduction of rural poverty. For example if the 2.6 million acres of state owned land were to be transferred to landless farm households in holdings of 5 acres each, then as many as 520,000 tenant farmers would become owner operators. This means that out of the total number of tenant farmers (about 897,000) in the less than 25 acre category, as many as about 58% would become owner operators.

However, it is important to recognize that providing ownership of land to the landless is a necessary but not a sufficient condition for alleviating their poverty. Enabling the landless to make the transferred land cultivable, to actually settle on the new land and to achieve a sustainable increase in their income, productivity and savings are equally important factors in making the scheme successful. The institutional framework for achieving this objective could be to establish a Small Farmer Development Corporation (SFDC), whose equity is owned by small and medium farmers (less than 25 acres holdings), but managed by professionals.

The SFDC could provide extension services, equitable access over markets for the purchase of good quality inputs and marketing facilities for their products. The specific institutional framework for the SFDC as well as other corporate enterprises owned by the poor is proposed in the ensuing section.

#### **IV. INSTITUTIONAL INITIATIVES FOR INCLUSIVE GROWTH THROUGH CORPORATE ENTERPRISES OWNED BY THE POOR<sup>10</sup>**

Apart from the considerable yield potential of the small farm crop sector, there are three non crop sectors in agriculture which have considerable potential for stimulating GDP growth, poverty reduction and increasing Pakistan's foreign exchange earnings: (i) Milk and dairy products, (ii) Livestock and the production of meat and meat products, (iii) Marine fisheries. In this section we will briefly discuss the institutional form that can be deployed for the development of small farms as well as milk and dairy products, on the basis of public private partnership. The purpose would be to establish corporate enterprises with equity stakes for the poor. Similar institutional structures can be established for livestock and production of meat, and for marine fisheries.

##### **IV.1 Milk Production Potential of Poor Peasants**

With over 177 billion rupees worth of milk being produced annually in Pakistan, milk is Pakistan's largest product in the agriculture sector. Unlike agriculture crops the production of milk can be accelerated sharply within a couple of years. Currently Pakistan's milch cattle yield per animal is one fifth the European average. Demonstrable experience in the field has shown that the milk yield per animal in Pakistan can be doubled within two years through scientific feeding, breeding and marketing. What is required is an institutional framework for training the farmers in scientific feeding and breeding, and for establishing the logistics to collect milk from the farm door by means of refrigerated transport, domestic marketing as well as arrangements for refrigerated storage at airports and subsequent airfreight to export markets. Such an initiative could have a significant impact not only on the incomes of poor peasants but also on exports

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<sup>10</sup> This section is drawn from: Akmal Hussain, An Institutional Framework for Inclusive Growth, 15 May 2009, Section VI.

and overall GDP growth<sup>11</sup>. Pakistan lies at the hub of milk deficit regions such as Central Asia to the North, West Asia and South East Asia. Accordingly if milk output in Pakistan could be doubled, and the institutional structure established for milk and milk product exports, as proposed in this Report, Pakistan's export earnings could increase by US \$ 4.5 billion annually.

#### **IV.2. Marine Fisheries Potential and Constraints**

Marine Fisheries, also provide a significant potential for improving foreign exchange earnings although not as large as the potential for milk. Here again, what is required is improved institutional support and better management rather than huge investments by the Government. The expansion in the export of marine fisheries is constrained because the storage facilities for transportation do not match the international quality standards. Currently alternate layers of fish and hard sharp edged ice are placed in containers on the boats. Under the weight of upper layers of fish and the sharp edged ice, fish at the lower layers are crushed, and the resultant bleeding causes putrefaction. To avoid this, it is necessary to provide shelves for layered storage of fish in boats, topped by dry ice, with fiberglass covers to maintain the European Union standards of minus 7°C temperature during transportation. An export potential of 300 million dollars exists over the next three years if such improved management of the marine fisheries industry could be achieved<sup>12</sup>.

#### **IV.3 Proposed Institutional Structure for Milk and Milk Products**

It is proposed that the Pakistan Poverty Alleviation Fund (PPAF), its NGO partner organizations at the district level and provincial Dairy Development Boards be brought together into a consortium to establish a Pakistan Dairy Corporation (PDC). The principal elements of the institutional framework for the PDC could be as follows:

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<sup>11</sup> Akmal Hussain, A Policy for Pro Poor Growth, paper in Towards Pro Poor Growth Policies in Pakistan, Proceedings of the Pro-Poor Growth Policies Symposium, 17<sup>th</sup> March 2003, UNDP-PIDE, Islamabad. page 72.

<sup>12</sup> Ibid. page 73.

1. This corporation should be a public limited company, run by a professional management with poor peasants as its shareholders.
2. International donors, and the government of Pakistan can contribute to establishing a special fund within the PPAF which can be used to give either grants or loans to poor peasants to enable them to buy the equity in the PDC and also to acquire additional milch animals.
3. The objective of the corporation should be to generate profits through establishing milk collection centers in each Union Council to collect milk, from its shareholders, arrange refrigerated transport, establish milk pasteurizing and packaging facilities at the provincial level.
4. The corporation should invest in establishing an infrastructure for purchase, testing and marketing of milk at the village level on the basis of community organizations of village level share holders of the SFDC. On the basis of this infrastructure SFDC could invest in establishing village level milk chilling centres, milk testing facilities and directly paying the village level milk producers at a competitive market rate. This institutional framework could be used for marketing in both the domestic and export markets, including sales to other private sector corporations such as Nestle.
5. On the basis of its network of village level community organizations of its shareholders, the SFDC should undertake marketing in both the domestic and export markets. Domestic marketing could include selling milk to large multi nationals such as Nestle in Pakistan.
6. The PDC should also establish an infrastructure at the village level for directly collecting milk from poor peasant milk producer shareholders, testing the milk and immediate payment to the milk producers.
7. A computerized data base platform should be established at the Union Council level to keep a record of the profile of each milk producer with respect to the following data: percentage of milk that passes the quality test; payments for milk

- supplied; extension services provided; increases in yields per milch animal; changes in the stock of milch animal, initial level of and changes in household income resulting from increased milk sales.
8. The profits of the corporation should be used partly for re-investment and growth and partly for disbursing dividends to the poor peasant shareholders.
  9. The PPAF should develop new partner organizations at the Union Council, Tehsil and District levels which would be exclusively devoted to forming special purpose community organizations (COs) of poor peasants. The objective of the COs would be to enable its members to increase production and sale of milk, access credit for increasing the stock of milk animals at the household level and undertake scientific feeding and breeding of milch animals for increasing milk yields.
  10. The PPAF could also be tasked to provide credit to the milk producer share holders of PDC, arrange for extension services to the community organizations of milk producers for testing and inoculating animals against disease, scientific feeding and breeding practices.

#### **IV.4 The Concrete Elements of the Small Farmer Development Corporation (SFDC)**

The institutional framework for a small farmer led agriculture growth strategy could be to establish a Small Farmer Development Corporation (SFDC) in which farmers operating below 25 acres of land could have the opportunity of becoming shareholders. The following types of farmers could be eligible to become shareholders of such a corporation:

- (a) All those who will receive state owned land or have in the past received state owned land.
- (b) All owner farmers, owner-cum-tenant farmers and pure tenant farmers operating less than 25 acres of land could also be offered equity stakes in the SFDC.

#### IV.4.1 *How to float the SFDC*

One way of floating the SFDC is for the PPAF to sponsor the establishment of the SFDC while ensuring that the ownership and control of the corporation lies with the small farmer shareholders.

#### IV.4.2 *How to Provide Equity to Small Farmers*

- The PPAF out of its own resources or by accessing donor funds, provide to the recipients of the 2.6 million acres state owned land, a loan of Rs.65 billion to the 520,000 small farmers recipients of 5 acre packages of land. Each such small farmer would get Rs.125,000 as a loan to be invested in the SFDC.
- This loan should be deposited in the corporation as equity of Rs.25000 per acre of owned land by the recipients of State land, i.e. Rs.125,000 per five acre package.
- Small farmers who are not recipients of state land should also be enabled to become shareholders in the SFDC.

#### IV.4.3 *The Organizational Functions of the SFDC*

The equity could be leveraged to acquire loans from the domestic commercial banking sector as well as from the World Bank and ADB to be used for:

- (a) Land Development of the land operated by the shareholders.
- (b) Provision of extension services to the shareholder farmers for:
  - (i) Improving the quality of top soils.
  - (ii) Efficient on-farm water management through laser based land leveling for accurate gradient, improved water channels and where required, drip irrigation.
  - (iii) Shifting to high value added crops through innovative techniques such as tunnel farming and also dairy farming and livestock development.

- (c) Provision of loans to farmers for purchase of inputs, and investments in improving the on-farm water management.
- (d) Recent research has shown that rural markets for agriculture outputs and inputs in Pakistan are asymmetric with respect to the large and small farmers<sup>13</sup>. The SFDC could serve to provide more equitable market access to small farmers by facilitating purchase of high quality inputs and arranging marketing of agriculture products.
- (e) Investment on behalf of small farmers in agro processing industrial units such as grain milling, cotton gins and oil presses. These investments could be under written by organizations such as PPAF, Khushali Bank, Small Business Finance Corporation as well as aid donors<sup>14</sup>.

#### ***IV.4.4 Broad Basing Equity to include all Small Farmers***

Those small farmers who are not recipients of State owned land and wish to become shareholders in the SFDC can be provided loans of upto Rs.25000 per owned acre which would be automatically deposited in the corporation as their equity. The loans would be paid back from the dividend earnings of the equity under the loan agreement.

#### ***IV.4.5 The Structure and Functions of the Small Farmer Development Corporation***

The company should have five divisions with branches in each district where shareholders reside. These divisions would be:

- Land Development and Irrigation.
- Provision of Access over input and output markets
- Extension services.
- Dairy farming and livestock development
- Finance Division to manage loans given to equity holders and also to provide new loans.

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<sup>13</sup> Akmal Hussain, Poverty, Power and Economic Growth, Pakistan Country Study for the SACEPS Poverty Project, 2008. (Forthcoming)

<sup>14</sup> We are grateful to Professor Rehman Sobhan, President of Grameen Bank and Chairman, Centre for Policy Dialogue, Dhaka for this suggestion.

#### ***IV.4.6 The Management System of the Small Farmer Development Corporation: The Management Structure.***

The Management Structure of the SFDC would have the following specific features:

1. Each district level branch of the SFDC should be run by full time professional managers.
2. Each of these branches should have Management Oversight Boards in which Union Council level organizations of shareholders in the particular district are represented.
3. The Management Oversight Board should meet once a quarter.
4. District level organizations of shareholders should be represented in the Board of Directors of the SFDC.
5. The district level organizations of shareholders should be represented on the National Management Oversight Board of the corporation at the head office of the corporation.

#### ***IV.4.7 The Management System of the SFDC: MIS***

1. The corporation should have Management Information Systems run by professional managers in each district level branch of the company.
2. The district level MIS should be integrated with the national level MIS to provide weekly performance reports for each operation of each Division.

#### ***IV.4.8 The Management System of the SFDC: Financial Control***

1. Financial Control Systems should be established at the district level and MIS reports provided to the head office at the national level on a weekly basis.
2. The Financial Control Systems at the district level should be run by young chartered accountants.
3. The Financial Control Systems at the head office should be run by Senior Chartered Accountants with a small team of financial experts operating a fully computerized accounting system that is linked up with district level financial control systems.

## V. **INCLUSIVE GROWTH THROUGH SMALL SCALE ENTERPRISES: THE ROLE, CONSTRAINTS AND INSTITUTIONAL IMPERATIVES**<sup>15</sup>

Since small scale industries have higher employment elasticities, smaller Incremental Capital Output Ratios (ICORs), and shorter gestation periods. Therefore an increased share of investment in this sector could enable both a higher GDP growth for given levels of investment as well as higher employment generation for given levels of growth. At the same time if the institutional conditions could be created for enabling small scale industries to move into high value added components for both import substitution in the domestic market and for exports, Pakistan's balance of payments pressures could be eased. The key strategic issue in accelerating the growth of SSEs is to enable them to shift to the high value added, high growth end of the product market. These SSE's include high value added units in light engineering, automotive parts, moulds, dyes, machine tools and electronics and computer software.

Training of a large number of software experts with requisite support in credit and marketing could quickly induce a significant increase in software exports from Pakistan. Pakistan could build a pool of software experts for a large increase in export earnings. This would of course require a proactive government to establish joint ventures between large software companies such as Microsoft and Pakistan's private sector institutions such as LUMS and INFORMATICS. The Ministry of Science and Technology is already moving rapidly in facilitating the growth of information technology in Pakistan. In this sub-section however we will focus on small scale manufacturing enterprises.

A large number of small scale enterprises (SSEs) in the Punjab and the North Western Frontier Province (NWFP) have a considerable potential for growth and high value added production such as components for engineering goods or components of high quality farm implements for the large scale manufacturing sector.<sup>16</sup> Yet they are in many cases

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<sup>15</sup> This section has been drawn from Akmal Hussain: Poverty, Power and Economic Growth, Pakistan Country Study for the SACEPS Poverty Project, 30<sup>th</sup> September 2008. pages 115 to 119.

An earlier version of this section was published in: Akmal Hussain, Poverty Alleviation in Pakistan, Vanguard Books, Lahore, 1994.

<sup>16</sup> Akmal Hussain: Labour Absorption in Pakistan's Rural Sector, Final Report, ILO/ARTEP (Mimeo), 20<sup>th</sup> September 1989, Pages 21 to 23.

producing low value added items like steel shutters or car exhaust pipes resulting in low profitability, low savings and slow growth.

### **V.1 Constraints to the Rapid Growth of SSEs**

Small scale enterprises in small towns of Pakistan face the following major constraints:

- (i) Inability of small units to get vending contracts for the manufacture of components from the large-scale manufacturing sector (LSM).
- (ii) Due to lack of expertise in production management and the frequent inability to achieve quality control it becomes difficult to meet tight delivery schedules.
- (iii) Lack of specific skills like advanced mill work, metal fabrication, precision welding, all of which are needed for producing quality products with low tolerances and precise dimensional control. In other cases accounting and management skills may be inadequate.
- (iv) Difficulty faced by small units in getting good quality raw materials, which often can only be ordered in bulk (for which the small entrepreneurs do not have the working capital), and from distant large cities.
- (v) Lack of specialized equipment.
- (vi) Absence of fabrication facilities such as forging, heat treatment and surface treatment which are required for manufacture of high value added products, but are too expensive for any one small unit to set up.
- (vii) Lack of capital for investment and absence of credit facilities.

### **V.2 The Institutional Framework for Overcoming the Constraints to the Growth of SSEs**

Overcoming the aforementioned constraints would involve providing institutional support in terms of credit, quality control management, skill training and marketing. This could

be done by facilitating the establishment of Common Facilities Centers (CFCs) located in the specified growth nodes in selected towns where the entrepreneurial and technical potential as well as markets already exist. Such support institutions (CFCs) while being facilitated by the government and autonomous organizations such as SMEDA can and should be in the private sector and market driven.

The institutional features of CFCs are identified in the ensuing section. The specific technical facilities required for the CFCs, the product groups they could serve and the geographic locations of enterprise clusters are given in the appendix-I of this Report.

### **V.3 The Specific Institutional Features of CFCs**

1. The concept of the Common Facilities Centers is based on the fact that small scale industrialists in Pakistan have already demonstrated a high degree of entrepreneurship, innovation and efficient utilization of capital. The CFCs would provide an opportunity for rapid growth to SSEs through local participation in extension services, prototype development, and diffusion of improved technologies, equipment, and management procedures.
2. Each of the CFCs would be designed to serve a cluster of products/process related enterprises. Each cluster of enterprises could be aggregated into a corporate entity which would jointly own the CFC, with each enterprise contributing equity to the CFC.
3. Each CFC would constitute a decentralized hub for the SSE cluster for ensuring continuous easy access to a comprehensive package of support services such as: (i) product development, (ii) technical services, (iii) skill training, (iv) quality control systems, (v) managerial advice, (vi) purchase of high quality raw materials, (vii) marketing, (viii) Institutional link up with large scale enterprises to supply them with outsourced products and components, (ix) The CFCs could also perform the role of financial

intermediation with the banking system and enable individual SSEs to access credit.

4. The CFCs could also be linked up with national research centres, such as the PCSIR and donor, agencies for drawing upon technical expertise and financial resources of these agencies in the service of small scale industrial enterprises (SSEs). In this context it is advisable to establish institutional links between the research centres within Pakistan such as the PCSIR and Pakistan's manufacturing sector in general and small industries in particular<sup>17</sup>. It is important to translate science research into products, processes and technological change that is market driven and required by the small scale in the small scale sector. Of particular relevance is the need to re-orient the link between the PCSIR and industry to enable certification of products and quality standards for exportables.

#### **V.4 Organizational Features and Functions of CFCs**

The Common Facilities Centres could have the following functional dimensions:

(i) Marketing

Provision of orders from the large scale manufacturing sector for components, and from farmers for farm implements. These orders would then be sub-contracted to the cluster of SSI units that the CFC is supposed to serve. The individual order would be sub-contracted to the SSI on the basis of the skills and potential strengths of the unit concerned.

(ii) Monitoring and Quality Control

Having given the sub-contract, the CFC would then monitor the units closely and help pinpoint and overcome unit specific bottlenecks to ensure timely delivery and quality control of the manufactured products. These bottlenecks may be specialized skills, equipment, good quality raw material or credit.

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<sup>17</sup> For a detailed discussion on the PCSIR as a Case Study of this issue see: Appendix-II.

(iii) Skill Training and Product Development.

Skill training for technicians could be provided by the new good quality vocational training institutes (VTIs) established by the Vocational Training Council of Punjab. Similar VTIs could be established in other provinces. The CFC would provide specialized supplementary skill training on its premises to workers in the satellite SSI units when required. At the same time, it would provide advice on jigs, fixtures, special tools and product development where required.

(iv) Forging and Heat Treatment Facilities

The CFCs would establish at their premises plants for forging, heat treatment and surface treatment. The SSI units could come to the CFC to get such fabrication done on the products they are manufacturing on sub-contract, and pay a mutually agreed price for this job to the CFC.

(v) Credit

The CFC would provide credit to the SSE's for purchase of new equipment and raw materials. In cases where raw materials are available in bulk supply, the CFC could buy it from the source, stock it on its premises and sell at a reasonable price to units as and when they need them.

## VI INSTITUTIONAL FRAMEWORK FOR PARTICIPATORY DEVELOPMENT<sup>18</sup>

Establishing the institutional basis for enabling the poor to increase their incomes, savings and investment, would not only constitute a direct attack on poverty but would also contribute to a faster and more equitable economic growth process. In this section

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<sup>18</sup> This section is drawn from:

(i) Akmal Hussain, Poverty Alleviation in Pakistan, Vanguard Books, Lahore, 1994. Chapter III.2.  
(ii) Akmal Hussain, Pakistan: Poverty, Power and Economic Growth, South Asia Center for Policy Studies (Mimeo), 25 September 2008.

we will begin by specifying the Participatory Development paradigm which has been formulated and put into practice successfully in a number of South Asian countries (including Pakistan) by a group of action researchers from South Asia<sup>19</sup>. We examine the issue of empowerment of the poor.

### VI.1 The Concept of Participatory Development<sup>20</sup>

Participatory Development in its broadest sense is a process which involves the participation of the poor at the village/mohalla levels to build their human, natural and economic resource base for breaking out of the poverty nexus. It specifically aims at achieving a localized capital accumulation process based on the progressive development of group identity, skill development, and local resource generation. (Akmal Hussain, 1994)<sup>21</sup>.

At this level of generalization the concept has three key elements:

- (a) Process: It is a process whose moving force is the growth of *consciousness*, of *group identity* and the realization in practice of the creative potential of the poor.
- (b) Empowerment: The process of reconstructing a group identity, of raising consciousness, of acquiring new skills and upgrading, their knowledge base, progressively imparts to the poor a new power over the economic and social forces that fashion their daily lives.

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<sup>19</sup> See, for example:

- (i) Ponna Wignaraja, Akmal Hussain, Harsh Sethi and Ganeshan Wignaraja: Participatory Development, Learning from South Asia, United Nations Press, Tokyo and Oxford University Press, Karachi, 1991.
- (ii) Akmal Hussain, Poverty Alleviation in Pakistan, Vanguard Books, 1994.
- (iii) Akmal Hussain, Punjab Rural Support Programme (PRSP), The First Four Months, Report to the Board of Directors of PRSP, 1998.

<sup>20</sup> Akmal Hussain, Poverty Alleviation in Pakistan, Vanguard Books, 1994, page-26 to 28.

<sup>21</sup> Ibid.

It is through this ‘power’ that the poor shift out of the perception of being passive ‘victims’ of the process that reproduces their poverty. They become the vital subjects in initiating interventions that progressively improve their economic and social condition, and overcome poverty.

- (c) Participation: The acquisition of the power to break the vicious circle of poverty is based on *participation* within an organization in a *series* of projects. This participation is not through ‘representatives’ who act on their behalf but rather, the actual, involvement of each member of the organization in project identification, formulation, implementation and evaluation. It is in open meetings of ordinary members at the village/mohalla level organization that decisions are collectively taken, and work responsibilities assigned on issues such as income generation projects, savings funds, conservation practices in land use, infrastructure construction and asset creation.

**VI.1.1 *The Dynamics Of Participatory Development.*** The process of Participatory Development proceeds through a dynamic interaction between the achievement of specific objectives for improving the resource position of the local community and the sense of community identity. Collective actions for specific objectives such as a small irrigation project, fertilizer manufacture through organic waste, clean drinking water provision, or production activities such as fruit processing, can be an entry point for a localized capital accumulation process, leading to group savings schemes, reinvestment and asset creation. The dynamics of Participatory Development are based on the possibility that with the achievement of such specific objectives for an improved resource position, the community would acquire greater self confidence and strengthen its group identity.

## **VI.2 Empowerment and its Institutional Basis**

**VI.2.1 *The Meaning of Empowerment:*** Since the term empowerment has been loosely used in much of the literature on development it may be helpful to specify its meaning in the context of this section. Empowerment means enabling the poor to build their human capabilities and economic resource base for breaking out of the poverty nexus. It is a

process of reconstructing a group identity, of raising consciousness, of acquiring new skills and of achieving better access over markets and institutions for a sustainable increase in incomes. Such a process progressively imparts to the poor a new *power* over the economic and social forces that fashion their daily lives. It is through this power that the poor shift out of the perception of being passive victims of the process that perpetuates their poverty. Thus they become active subjects in initiating interventions that progressively improve their economic and social condition to overcome poverty<sup>22</sup>.

**VI.2.2 Institutional Basis of Empowerment:** The economic strategy requires a national campaign to empower the poor at the level of village/mohallah, Union Council, Tehsil and District. The idea is to facilitate the growth of autonomous community organizations of the poor at the village/mohallah level to be able to break out of the poverty. Through these COs the poor can identify income generating projects, initially at the household level, acquire skill training from a variety of sources such as government line departments, autonomous institutions, private sector firms, NGOs. and donors; and access credit for micro enterprise projects through apex organizations such as the PPAF, Khushali Bank, Small Business Finance Corporation (SBFC), and commercial banks. At the moment the scale of micro finance is inadequate, with only 1.5 million clients out of a total of 10 million being served with micro credit facility. Micro credit needs to be substantially enlarged. At the same time special institutional arrangements would need to be made in these apex organizations to take credit to poor women and women's COs, since poor women have even lesser access over institutional credit compared to poor men.

It is important that such village level community based organisations (CBOs) be autonomous and be permitted to form cluster apex organisations with other CBOs. Autonomous CBOs by means of social mobilisation, skill training, increased productivity, increased income, savings and investment would begin a process of localised capital accumulation. Such a process, which we have called Participatory

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<sup>22</sup> For a case study based on implementing the Participatory Development approach in nine districts of the Punjab province, see, Akmal Hussain, Honourary Chief Executive Officer, Punjab Rural Support Programme (PRSP), The First Four Months Report to the Board of Directors, PRSP, 1998.

Development<sup>23</sup> would be integrally linked with the emergence of a new consciousness of empowerment. The poor can begin to take autonomous initiatives to improve their material conditions of life. They would thus break out of the poverty nexus and shift from being victims to active subjects of social and economic change. Such a process of village level increases in productivity, incomes and savings would not only constitute a direct attack on the poverty problem but would also contribute to a faster and more equitable macro economic growth<sup>24</sup>.

Such autonomous organizations of the poor could not only become a framework for grassroots economic growth, but would also constitute countervailing power to that of the power structures of local elites. At the same time, these autonomous organizations of the poor would enable the individual poor household to get better access over input and output markets.

Facilitating the emergence of autonomous organizations of the poor particularly organizations of poor women, could enable the newly established local government institutions to function in a more equitable and effective manner. The equity would be with respect to class as well as gender. This would require establishing institutionalized links between autonomous organizations of the poor and local government bodies at the Village, Union Council, Tehsil and District levels. *These institutional links between organizations of the poor and elected local bodies would enable more participatory and equitable processes of project identification, design and implementation for local level development.*

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<sup>23</sup> The concept of Participatory Development is formulated in: Akmal Hussain: Pakistan, A Strategy for Poverty Alleviation, Vanguard, Lahore, 1994, Pages 26 to 29.

Also see: P. Wignaraja, A. Hussain, H. Sethi & G. Wignaraja: Participatory Development: Learning from South Asia, O.U.P, 1991.

<sup>24</sup> For a more detailed discussion of this issue, See: Akmal Hussain: Poverty, Growth and Governance, Chapter in, V.A. Pai Panandiker (ed.): Problems of Governance in South Asia, Centre for Policy Research, New Delhi, 2000.

## VII. THE INSTITUTIONAL FACTORS IN UNSTABLE GROWTH AND ENDEMIC POVERTY<sup>25</sup>

We begin by identifying the major features of the crisis in the real economy that need to be addressed. These are:

### VII.1 Governance, Poverty and Unemployment

Poverty and inequality increased rapidly during the 1990s due to the decline in GDP growth, coupled with a decline in employment elasticities, labour productivity, and real wages in both the agriculture and the industrial sectors. In the subsequent period 1998-99 to 2004-05, while GDP growth accelerated sharply there was no significant poverty reduction. At the same time unemployment as well as inflation rates, particularly food inflation, increased sharply. The economic burden on the poor has intensified further due to inadequacies in three major aspects of governance:

- (i) Inefficient delivery mechanisms for translating development expenditure into improved health, sanitation, education, services and access over justice for the poor. Consequently, the disproportionate shortages of these services for the poor compared to the rich, have deprived them of an important redistributive mechanism in the economy.
- (ii) During the 1990s there was a common perception that there was widespread corruption in government. To the extent it existed it had a significant adverse impact on economic growth and poverty<sup>26</sup>. During the period of the Musharraf government even though GDP growth accelerated widespread corruption persisted. In the Transparency International Corruption Perception Index, Pakistan's Country Rank increased from 87 in 1999 to 144 in 2005. In the Corruption Perception Index (CPI) which ranges from 10 (highly clean) to 0

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<sup>25</sup> This section is drawn from: (i) Akmal Hussain, A Policy for Pro Poor Growth, chapter in Towards Pro Poor Growth Policies in Pakistan, UNDP-PIDE, Islamabad 2003. (ii) Akmal Hussain, Pakistan: Poverty, Power and Economic Growth, South Asia Center for Policy Studies (Mimeo), 25 September 2008. pages 100 to 108.

<sup>26</sup> Shahid Javed Burki, Pakistan: Fifty Years of Nationhood, Vanguard Books, Lahore, 2004, Page 174.

(highly corrupt), Pakistan's CPI already at a low level in 1999 at 2.2 fell further to 2.1 in 2005<sup>27</sup>.

The latest Global Corruption Barometer released by Transparency International (December 6, 2007) shows that corruption levels have increased even more sharply in the last two years. For example the percentage of people in the all Pakistan sample, who paid bribes for obtaining services doubled to over 30 percent compared to 15 percent in the year 2006. The report places Pakistan among the top 10 countries which are most affected by bribery.

Widespread corruption in government contributes to constraining growth and increasing poverty in three ways: (a) the rising magnitude of corruption over time and at different levels of decision making in the government is a major factor in the uncertain policy environment and a constraint to estimating accurate project feasibilities. This would be expected to constrict investment, GDP growth and employment; (b) the transfer of resources from entrepreneurs to politicians and government officials results in a misallocation of national resources and a lower level of productive investment and hence GDP growth, than would be the case in the absence of such corruption. (c) the financial cost of individual projects increases, thereby simultaneously inducing slower GDP growth for given levels of investment and also reducing the employment elasticities with respect to investment. (d) To the extent that the poor are obliged to pay bribes for public services while in many cases the affluent with political influence may not have to pay bribes, means that the distribution of real income between the rich and the poor is worsened by the mode of provisioning of public services.

**VII.1.1 *Institutions for Improved Governance for Pro Poor Growth:*** In this section we have argued that two of the most important governance factors that prevent sustained high growth and rapid poverty reduction are the persistent high levels of corruption and

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<sup>27</sup> Transparency International, Perceptions Index 1999 and 2005, cited in Talat Anwar, Measurement of Absolute Poverty and Governance in Pakistan: 1998-99 and 2004-05, paper presented in the PIDE-PSDE, 22<sup>nd</sup> Annual General Meeting and Conference, 19-21 December 06, Table 4, page 15.

inefficient delivery mechanisms for the provision of public services. Addressing these issues requires establishing new institutions at different levels of governance.

The existence of corruption in government is a significant factor in constraining investment, allocative efficiency, GDP growth, employment and poverty reduction. The resource transfers associated with corruption are also a form of rent that is a structural feature of a rent based economy and polity that North, Joseph, Weingast call a “limited access social order” (North, Joseph, Weingast, 2006)<sup>28</sup>. The institutional structure that makes corruption endemic, also increases transaction costs and thereby constrains specialization, productivity and growth. Therefore, a policy of combating corruption through the establishment of institutions in state and civil society, would be important drivers of change on a development path to an advanced economy (open access social order). In this context six new institutions could help control corruption:

- An independent judiciary with adequate resources and judicial officers to provide access to justice at every tier of governance and in every region: national, provincial and district levels.
- An independent and constitutionally mandated structure of ombudsman’s offices at the district, tehsil and union council levels to listen to and rectify public complaints about the equitable provision of public services such as health, education, sanitation, and hygienic drinking water. At the same time the ombudsman’s offices at each tier, would hear and rectify citizens’ complaints about corruption and misuse of office by government functionaries.
- Citizens’ Protection Committees at the mohallah and village levels where complaints about the provision of public services and against corrupt officials can be registered and systematically taken up. In the case of complaints about public services, these can be taken up at various tiers of the local government. In the case of complaints about corruption and misuse of power against citizens by

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<sup>28</sup>

Douglass C. North, John Joseph Wallis, Barry R. Weingast, op.cit.

government officials, these can either be taken up within the ombudsman structure or in more serious criminal cases, at various levels of the judiciary.

- An independent media equipped with adequate investigative reporting capabilities to independently report corruption cases and monitor the performance of government departments with respect to the provision of public services. A special public services and corruption monitoring page can be devoted on a monthly basis by newspapers. This would contain independent investigative reports on the performance of government departments with respect to their targets for the coverage and quality of public services. The monitoring page would also report on corruption cases and monitor the efficiency of ombudsman's offices at the district, tehsil and union council levels.
- An independent Federal Bureau Statistics (FBS) that directly reports to the Parliament and not to the government. The FBS would be tasked to conduct periodic surveys on the incidence of poverty, gender specific employment, inflation, productivity and real wages. The FBS would also be tasked to provide survey based data on the quality and coverage of services such as health, sanitation, hygienic drinking water, education and vocational training. The FBS could also be required to conduct regular surveys to provide data to the public about the extent of corruption and the performance of various government departments with respect to their performance targets.
- The bilateral as well as multilateral Donors in Pakistan could establish a Multi-donor Transparency Support Unit (MTSU) whose task would be to determine the extent to which donor funds have achieved the purposes for which they had been provided to both government as well as civil society organizations. In the case of funds provided for supporting strategic 'Drivers of Change' initiatives to government and civil society, the MTSU could apart from evaluating the functioning of the concerned departments and organizations, also conduct an independent Impact Assessment Survey on an annual basis.

## VII.2 Health and Poverty

Research for the National Human Development Report (NHDR), suggests that the high prevalence of disease amongst those who are slightly above the poverty line is a major factor in pushing them into poverty. Those who are already poor get pushed into deeper poverty as the result of loss of income and high medical costs resulting from illness. The data show that on average 65% of the extremely poor were ill at the time of the survey, and they had on average suffered from their illness for 95 days. The survey data also show that the poor predominantly go to private allopathic practitioners rather than to basic health units or government hospitals. Private medical facilities in rural areas and small towns have grossly inadequate diagnostic facilities and there is wide spread prevalence of spurious drugs in private sector retail outlets. Consequently when the poor fall ill they suffer for a protracted period and get locked into a high cost source of medical treatment. This erodes whatever little asset base they have, and pushes them into indebtedness and deeper poverty<sup>29</sup>.

The NHDR data on the widespread prevalence of disease in Pakistan is supported by evidence from the National Health Survey of Pakistan<sup>30</sup>, which shows that in rural areas the prevalence of fair plus poor health for females above 25 years is as high as 75%, while that for the males in the same age group is 45%. The curative health care system has expanded substantially during the last decade (for example, the population per doctor has fallen from 2082 in 1990 to 1529 in the year 2000), yet the high incidence of disease points to both inadequate coverage and poor quality of the health care system in Pakistan.

**VII.2.1 Policy Implications:** Since the UNDP, NHDR study shows that health is a major factor that pushes people into poverty, clearly improved nutrition and health conditions are important for poverty reduction. Improving the nutrition, preventive hygiene, provision of safe drinking water, improving the service delivery of basic health units, and

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<sup>29</sup> Akmal Hussain, et.al, Poverty, Growth and Governance, UNDP, Pakistan National Human Development Report 2003, Oxford University Press, Karachi, 2003.

<sup>30</sup> National Health Survey of Pakistan, Pakistan Medical Research Council, Federal Bureau of Statistics, Pakistan and the Department of Health and Human Services, USA, 1998, Page 127.

improved diagnostic and treatment capabilities of Tehsil and District Hospitals are urgent imperatives to deal with the crisis of health and poverty.

### VII.3 Education and Poverty

Given the structure of the growth process, in spite of high GDP growth during the period a substantial reduction in poverty and unemployment could not be achieved. While livelihoods and income levels are critical to improving the economic conditions of people, yet the coverage and quality of health and education facilities are also important for improving the economic conditions of the people.

VII.3.1 *School Education.* Educational outcomes in Pakistan are measured using literacy and enrolment rates. The most commonly used nationally representative source are the PIHS data. For the most recent year (2004-2005) for which data are available the relevant source is the PSLM.

These data show a declining or stagnant trend for both male and female primary enrolment from 1991 till 2001-2002, and sharp increases in enrolment between 2001-2002 and 2004-2005. The PSLM sample for education data was some five times as large as the PIHS samples, and it is possible that the PSLM provides a more accurate picture of literacy and enrolment than the PIHS. A number of positive policy changes might be responsible for the increase in enrolment. Some of the provincial governments introduced incentives such as free textbooks and stipends (for female students) in order to encourage enrolment and retention. There has also been a rise in the availability of low-cost private schooling facilities over the last ten years or so.<sup>31</sup>

The increase in enrolment rates after a period of stagnation and decline is encouraging. For this increase to be sustainable there will be a need to give priority to the quality of

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<sup>31</sup> National Education Census 2005, Federal Bureau of Statistics, Government of Pakistan (GOP), Islamabad, 2005.

schooling. There is wide acknowledgement that the quality of schooling has undergone a steady decline.<sup>32</sup>

Aspects of Pakistan's education system have attracted the interest and attention of the international community from a security point of view. Legislation in the United States, for example, links future assistance to Pakistan to reforms in the education sector. Although some religious and cleric-run educational establishments in Pakistan have been suspected of involvement in terrorist activities, the exclusive focus on the security angle is unwarranted. Cleric-run schools (*madrasahs*) account for less than 5 percent of total enrolment,<sup>33</sup> and a majority of these schools are not engaged in violent or unlawful activities. The key issue for *madrasah* reform is not that dissimilar for the reform of the broader educational system – namely quality and equity.

**VII.3.2 Education and Curricula.** In pursuing improved quality of education it is necessary to review the curricula, particularly at the school and intermediate education level. There are reports that some elements of the existing curricula not only misinform students about facts, but also inculcate prejudice against other religions, and incite militancy and violence. According to the findings of the recent SDPI study on education and curricula in Pakistan the following problems in the current curricula and text books were identified<sup>34</sup>:

- “i) Inaccuracies of fact and omissions that serve to substantially distort the nature and significance of actual events in history.
- ii) Insensitivity to the existing religion diversity of the nation.
- iii) Incitement to militancy and violence, including encouragement of *Jehad* and *Shahadat*.

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<sup>32</sup> This is acknowledged, for example, in the Ministry of Education's White Paper prepared by Javed Hassan Aly, as an approach to a new education policy (<http://www.moe.gov.pk/nepr/WhitePaper.pdf>).

<sup>33</sup> National Education Census 2005, op.cit.

<sup>34</sup> *The Subtle Subversion: The State of Curricula and Textbooks in Pakistan*, ed. By A.H Nayyar and Ahmed Salim, (Islamabad: Sustainable Development Policy Institute), Pg v

- iv) Perspectives that encourage prejudice, bigotry and discrimination towards fellow citizens, especially women and religious minorities, and towards other nations.
- v) A glorification of war and the use of force.
- vi) Omission of concepts, events and material that could encourage critical self-awareness among students.
- vii) Outdated and incoherent pedagogical practices that hinder the development of interest and insight among students.”<sup>35</sup>

According to the report, the military government of General Zia ul Haq after the coup in 1977 tried to guise its legitimacy problems in an overarching quest for Islamization of society. Education was among the first victims. In the educational sphere, this amounted to a distorted narration of history, factual inaccuracies, inclusion of hate material, gender bias, etc.

The report claims that over the last two or three decades, the curricula and the officially mandated textbooks have contained material that is directly contrary to the goals and values of a progressive, moderate and democratic Pakistan.

For example, in Social Studies, the books systematically misrepresent events that have happened throughout Pakistan’s history. The history is narrated with distortions and omissions. The causes, effects and responsibility for key events are presented so as to leave a false understanding of our national experience. A large part of the history of South Asia is also omitted, making it difficult to properly interpret events, and narrowing the perspective that should be open to students. Worse, the material is presented in ways that encourage the student to marginalize and be hostile towards other social groups and people in the region. The curricula and textbook are insensitive to the religious diversity of the Pakistani society. On average over a quarter of the material in books to teach Urdu as a language are about Islam. The books on English have lessons with religious content. Thus the entire curriculum is heavily laden with Islamic religious teachings.

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<sup>35</sup>

Ibid.

Pakistani nationalism is repeatedly defined in text books in a manner that excludes non-Muslim Pakistanis from either being Pakistani nationals or from even being good human beings. Much of this material runs counter to any efforts at national integration.

Many of the textbook problems have their origin in two sources. 1) curriculum documents and syllabi, and 2) the instructions to textbook authors issued from the Curricula Wing of the Ministry of Education. As long as the same institutions continue to devise curricula, the problem will persist. Repeated interventions from the post-1988 civilian governments failed to overcome the institutional resistance.

Curriculum documents include specific instructions for syllabus making and textbook writing that ask for material that glorifies war, militancy and the military. Some examples of this from curriculum document instructions are:

“A feeling be created among students they are the members of a Muslim nation. Therefore, in accordance with the Islamic tradition, they have to be truthful, honest, patriotic and life-sacrificing mujahids.”<sup>36</sup>

“Suggested topics for lessons in textbooks:

Stories about the Pakistan movement, eminent personalities of Pakistan and martyrs of Pakistan”<sup>37</sup>

“Simple stories to incite Jihad.”<sup>38</sup>

“Objectives, content and activities:

To make speeches on jehad and shahadat.

Discuss important personalities, such as Mohammad bin Qasim, Mahmood Ghaznavi.”<sup>39</sup>

According to the report, the themes of Jihad and Shahadat clearly distinguish the pre- and post-1979 educational contents. There was no mention of these in the pre-Islamization period curricula and textbooks, and the post-1979 curricula and textbooks openly eulogize Jihad and Shahadat and urge students to become mujahids and martyrs.

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<sup>36</sup> ibid, 86

<sup>37</sup> ibid

<sup>38</sup> ibid

<sup>39</sup> ibid

It is clear that the current school curricula are inconsistent with building a pluralistic democratic society where education nurtures understanding and tolerance. It is advisable to set up a National School and Intermediate Education Curricula Commission with a view to correcting the distortion of facts and making them consistent with the objectives of developing a sense of objectivity, enlightenment and a humane sensibility amongst students.

**VII.3.3 Skill Training.** The Planning Commission earlier this year has undertaken an imaginative initiative for a large scale district based national skill training programme in terms of the vision of its new Deputy Chairman<sup>40</sup>. The programme called the Human Resource Development (HRD) programme envisages a social transformation through new skill provision, and up-gradation of the skills of the existing trained work force with the aim of enhancing “the employability, productivity and competitiveness”<sup>41</sup> of the middle classes and the poor. This initiative is expected to provide the trained human resource base for placing the economy on the path of a diversified and broad based economic growth. The district level organizational structure for this promising initiative needs to be quickly established with a small a highly professional, highly motivated and appropriately incentivized team to actualize this programme.

#### **VII.4 Institutional Failure in the Delivery of Health and Education Services<sup>42</sup>**

Health is a provincial subject and the responsibility of the province. However, after devolution, the provincial government’s involvement in primary level health care financing has become virtually non-existent. The provincial government is primarily involved with maintaining hospitals that have more than 50 beds, teaching hospitals and picking up salary expenses for the handful of personnel at or above grade 17.

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<sup>40</sup> Sardar Aseff Ahmed Ali, Deputy Chairman, Planning Commission, Human Development for the 21<sup>st</sup> Century, Planning Commission, Islamabad, March 2009.

<sup>41</sup> Ibid. page-1

<sup>42</sup> The Chairman gratefully acknowledges the contribution of this sub-section by Dr. Asad Sayeed, Member, Working Group on Institutions for Development, Panel of Economists.

After devolution, the control of provincial government on basic health care and education has virtually ceased to exist. Fiscal transfers from the provincial to local governments are in lump sum. It is up to the district government to not only allocate resources across sectors but also in terms of the recurring and development budgets. Thus we are faced with the institutional paradox that while health and education are provincial subjects they have little control over basic provision apart from providing salaries of grade 17 and above officers.

At the district level then, the district assembly and the Nazim decide on sectoral allocations. Subsequently it is the Executive Development Officer (EDO) of health and education respectively who decides on the development and recurring budgets. The EDO health is the office in charge and has almost complete control over the district health budget. On the recurring side, the EDO is in charge of disbursement of salaries, miscellaneous expenses, and procurement of other non-salary items.

The perversity of the institutional structure of devolution is such that in principle all reform for these basic services must now originate from the district. The district in turn is headed by an indirectly elected Nazim whose electoral prospects are by definition not determined by their record on service delivery

As an illustration, the health budget of a number of districts has remained the same over the years. Growth in current expenditure largely reflects the rate of inflation and incorporates increase in salaries. The share of salaries in the recurring budget is as high as 86% of the recurring budget. Since qualitative improvements generally take place in the non-salary budget even if there is an incentive at the level of the EDO to affect improvements they are constrained by the budgets. Increase in the share of the budget only takes place when new schemes are completed and their recurring expenditures are added to it, and since the district government has little or no incentive to launch new schemes, and the provincial government has little or no control to ensure they launch such schemes, there is no real development.

To improve health delivery at the basic level, The People's Primary Health Care Initiative (PPHI) was initiated by the previous government all over the country. PPHI is an arrangement between a quasi-government service provider and district governments. The agreement signed between district governments and PPHI entails that all BHU and dispensaries will be handed over to PPHI. The PPHI system works such that it attempts to deal with the problem of staff absenteeism by creating BHU clusters, which are served by one doctor and, depending on the number of BHUs in each cluster, the sanctioned salary for the doctor at each facility is provided to the one who is serving the cluster. Once more, just like in the case of the EDO health, the provincial government has no control over the PPHI program, only being involved to the extent that it gives the PPHI a one-off grant for repair and renovation. The funding for the PPHI program also comes from the federal government meaning, that the provincial government does not even have complete control over funding.

The PPHI program is responsible for all salary and non-salary expenditure on facilities, and has the flexibility of altering line items according to priorities that it sets for itself. The PPHI system, given this flexibility, tends to run in a very ad-hoc manner. Moreover, the single doctor serving a cluster of BHUs does not necessarily solve the absentee issue, as it means that a doctor is only available at each BHU for two days in a week, and there is no doctor available at that BHU for the remaining five days of the week. Finally, given that the provincial government has no control over the PPHI system, and there is no system of monitoring the performance of PPHI by any outside party, there is no way to really assess the success of the initiative, and no incentive to necessarily improve performance.

The lack of control and monitoring from above is the result of the weakening of the provincial government under the devolution plan, and has therefore reduced the incentive to establish and maintain an adequately functioning health sector.

## VII.5 Asymmetric Markets, Local Power Structures and Poverty

The NHDR/PIDE survey data<sup>43</sup> shows that the poor peasants face adverse input and output markets. They have to pay relatively higher prices for their inputs and get relatively lower prices for their outputs compared to the large farmers. At the same time, due to the lack of access to formal credit markets, the poor peasants often have to borrow from the landlord. As a consequence they are obliged to work on the landlord's farm at less than market wage rates. The NHDR study shows that the poor peasants could be losing one third of their income due to asymmetric markets for inputs and outputs.

In the urban and semi-urban areas where the poor households are predominantly involved in micro enterprises the data shows that low incomes are primarily due to low productivity and profitability of these micro enterprises.

**VII.5.1 Policy Implications:** The evidence shows that asymmetric markets and local power structures constitute structural factors in persistent poverty. They siphon off as much as one third of the actual incomes of the poor, deprive them of their potential savings and keep their productivity and incomes at a low level. A pro poor policy must address these structural factors if poverty is to be overcome on a sustainable basis. Better access for the poor over the markets for labour, land, agricultural inputs and outputs, means changing the balance of power in favour of the poor at the local level. This requires facilitating the emergence of autonomous organizations of the poor, particularly poor women at the village, Union Council, Tehsil and district levels. It also means enabling the poor to access credit, training, and technical support for increased employment, productivity, and incomes.

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<sup>43</sup> This survey was part of the study embodied in the Pakistan National Human Development Report, UNDP. Published later: UNDP, Pakistan National Human Development Report 2003, Oxford University Press, Karachi, 2003.

## VII.6 Institutional Factors in Slow and Unstable Crop Sector Growth<sup>44</sup>

In agriculture the average annual growth rate of major crops has declined from 3.34% during the eighties to 2.38% in the nineties. At the same time, the frequency of negative growth years in some of the major crops has increased. This has accentuated the process of poverty creation: In a year of negative growth (i.e. bad harvest) the small farmers operating at the margin, have to borrow for consumption requirements and go into debt. In the following season, in the absence of an investible surplus, they are unable to reconstitute the production cycle and hence slip into poverty. Thus the instability of crop sector growth and the increased frequency of negative growth year becomes a structural factor in poverty creation. Underlying this phenomenon are five major institutional constraints:

- (a) Reduced water availability at the farm gate due to poor maintenance of the irrigation system and low irrigation efficiencies of about 37 percent. While the availability of irrigation water has been reduced, the requirement of water at the farm level has increased due to increased deposits of salts on the top soil and the consequent need for leaching. About 33 million tons of salts are annually brought into the Indus Basin Irrigation System, out of which 24 million tons are being retained.<sup>45</sup> The consequent large water deficit means that the farmers even in the irrigated areas are dependent on rain fall. Given the vicissitudes of weather particularly due to global warming, (which has caused wide variation in the timing, location and quantum of rain fall) rain does not always fall in the right quantity at the right time for the water deficit farmers. Consequently, there is greater instability in crop sector output than before. (Akmal Hussain, 1999)<sup>46</sup>.

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<sup>44</sup> This sub-section is based on research paper by Akmal Hussain: (Employment Generation, Poverty Alleviation and Growth in Pakistan's Rural Sector: Policies for Institutional Change, Report prepared for the ILO/CEPR, (Mimeo), March 1999.

<sup>45</sup> Interim Poverty Reduction Strategy Paper, Government of Pakistan, November 2001, Page 23.

<sup>46</sup> Akmal Hussain, ILO/CEPR, op.cit.

- (b) What makes improved efficiency of irrigation even more important is that the extensive margin of irrigated acreage has been reached, so the future agricultural growth will have to rely on improving the efficiency of water use and other inputs. Thus the rehabilitation of Pakistan's irrigation system for improving irrigation efficiency has become a crucial policy challenge for sustainable agriculture growth.
- (c) It is well known that high yielding varieties of seeds gradually lose their potency through re-use, changing micro structure of soils, and changing ecology of micro organisms in the top soil. Therefore, breeding of more vigorous seed varieties adapted to local environmental conditions, and their diffusion amongst farmers through an effective research and extension programme is necessary. Yet there is no organized seed industry in Pakistan to meet the needs of farmers for the supply of vigorous varieties of seeds even in the major crops. In wheat, for example, the average age of seeds in Pakistan is 11 years compared to an average of 7 years for all developing countries. It has been shown that compared to India there was a sharp decline in growth of total factor productivity in Pakistan after 1975, which can be attributed to the poorer level of research and extension in Pakistan compared for example to India.<sup>47</sup>
- (d) A new dimension to the imperative of improving research capability in the crop sector is indicated by the possibility of declining yields per acre related with global warming. Given the sensitivity of wheat seed to temperature increase, even a 2-degree centigrade increase in average summer temperatures could mean an absolute yield decline of between 10 to 16 percent during the 21<sup>st</sup> century.<sup>48</sup> With a 2.8 percent population growth, even a decline of 5

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<sup>47</sup> Mark W. Rosegrant and Robert Evenson: "Agricultural Productivity Growth in Pakistan and India: A comparative Analysis", presented at Pakistan Institute of Development Economists Ninth Annual General Meeting, Islamabad, 1993.

<sup>48</sup> If atmospheric carbon is doubled, the average summer temperatures in Pakistan are expected to increase by 1.5 C to 4.5 C (base average of 2.5 C), over the next 70 years. This could lead to a decline in wheat yields from 10 percent to 60 percent, depending on the type of wheat seed,

percent in yield per acre associated with global warming, could mean serious food deficits and high food inflation rates for Pakistan, with relatively greater adverse consequences for the poor. It is, therefore, necessary to develop heat resistant varieties of food grains.

The current ineffectiveness of agriculture research and poor diffusion amongst farmers is a cause for concern. This is particularly so in a situation where future agriculture growth and labour absorption will have to depend more on input efficiency than on enlargement of irrigated acreage and input intensification, which were the major sources of agriculture growth in the past.

- (e) One of the most important constraints to sustainable growth in the crop sector is the degradation of soils, resulting from improper agricultural practices such as: (i) lack of crop rotation and the resultant loss of humus in the top soil; (ii) stripping of top soil and resultant loss of fertility associated with over grazing; (iii) water erosion along hill sides and river banks due to cutting down of trees and depletion of natural vegetation. According to one estimate, over 11 million hectares have been affected by water erosion and 5 million hectares by wind erosion.<sup>49</sup>

## **VIII. INSTITUTIONAL CHANGE FOR EXPORT DIVERSIFICATION AND ACCELERATED EXPORT GROWTH.**

Pakistan's slow export growth and the consequent perennial pressures on the balance of payments constitute a structural constraint to sustaining high GDP growth. In this subsection we will briefly indicate Pakistan's position in the exports of developing countries, its export structure, new opportunities available for accelerating export growth and the institutional interventions required for actualizing these opportunities.

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planting time, related atmospheric/weather conditions. See: Qureshi, Ata and Iglesias: Implications of Global Climate Change for Pakistan Agriculture: Impacts on Simulated Wheat Production, Climate Institute, Washington, D. C. USA, 1992.

<sup>49</sup> Alim Mian and Yasin Mirza: Pakistan Soil Resources, National Conservation Strategy, Sector Paper IV, Environment and Urban Affairs Division, with IUCN, 1993.

### VIII.1 Pakistan's Poor Export Performance

The share of developing countries in the world's manufactured exports has increased sharply in the last quarter century: While manufactured exports for the world as a whole increased by 8 fold over the period 1980 to 2006 (from US \$ 1.1 trillion to US \$ 8.3 trillion), manufactured exports from the 16 major developing countries has increased 30 fold over the period (from US \$ 94 billion to US \$ 2.7 trillion). Within the developing countries the share of Asian countries in manufactured exports has risen even faster, with almost the entire market share lost by the developed countries going to Asian countries<sup>50</sup>.

In contrast to the export performance of developing countries, Pakistan's share in world trade has not changed significantly and has remained at the low level of 0.15 percent. Even more dismal is the fact that Pakistan's share in world manufactured exports at 0.1 percent has fallen since the 1970s<sup>51</sup>. Furthermore Pakistan's share of manufactured exports amongst the developing countries has declined in the last two decades inspite of an 80 percent increase in manufactured exports during the period 2000-2006. The trend since 2006 has worsened with Pakistan's manufactured exports growing at half the world average. Even more serious is the fact that in the case of textiles, which is Pakistan's predominant export industry, the country's market share has declined as Pakistan's textile and garments industry was unable to respond to the new competitive environment after the phase out of the MFA<sup>52</sup>.

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<sup>50</sup> State of the Economy: Challenges and Opportunities, IPP's Annual Report 2008, Institute of Public Policy, Beaconhouse National University, Lahore, 2008. chapter 9.

<sup>51</sup> Ibid.

<sup>52</sup> Ibid.

## **VIII.2 Exports and Economic Policy**

What are the major factors behind Pakistan's poor export performance which in turn has been a constraint on sustainability of GDP growth?

Historically Pakistan's economic policy has had an anti export bias with generally high duties on imported inputs creating disincentives for non traditional manufactured exports using such inputs. At the same time direct and indirect subsidies, particularly to industries based on processing of domestic raw materials gave much larger profit margins from sales in the domestic market compared to exports, thereby creating strong incentives for inefficient, low quality production for the domestic market.

Over time some of the anti export bias in trade policy has been reduced, with export taxation of cotton ending after the decade of the 1980s, and imports greatly liberalized. The question is why has trade liberalization in Pakistan (which has gone further than India), not resulted in an increase in the share of manufactured exports? Perhaps the most important proximate reason for this is the failure to diversify Pakistan's export structure beyond textiles in a situation where the world trade in textiles is growing at a much slower rate than non traditional manufactured goods. For example, over 80 percent of Pakistan's manufactured exports consist of textiles and clothing compared to 12 percent for the developing country group and 6.5 percent for the world as a whole. India's non textile manufactured exports are 25 times that of Pakistan, while countries like Philippines, Indonesia and Turkey have non-textile manufactured export levels 15 times higher than Pakistan.

## **VIII.3 Institutions and the Failure to Diversify Exports**

The failure to achieve export diversification is rooted in the current institutional structure relating to exports and the balance of trade. This institutional structure which is manifested in formal laws and their enforcement characteristics; tacit rules of business; and procedural mechanisms provides strong disincentives for export growth and export diversification on the one hand, while encouraging imports and restricting foreign exchange inflows through outsourced international trading on the other.

The current corpus of rules, regulations and their enforcement mechanisms are associated with high direct costs of doing business and substantial transaction costs stemming from uncertainties flowing from poor information flows on the one hand and graft in governmental departments on the other.

Specifically the current structure of rules is designed for traditional sectors such as textiles and agricultural products, and discriminates towards non traditional sectors such as high value added manufacturing, agricultural product processing, light engineering, and small scale enterprises including both manufactured and cottage industry items. The discrimination occurs in a number of ways including: (a) absence of standard concessions such as duty draw backs and meaningful rebates, (b) lengthy and complicated procedures for exports, (c) inadequate working capital support e.g. low interest export refinance, (d) under provision of public goods such as marketing support and international lobbying for market access, and (e) export documentation regulations which limit the scope of international, outsourced trading, (f) bureaucratic red tape, graft in governmental departments, weak contract enforcement and lack of protection of private property rights (such as protection of export consignments from bandits during road transportation to the port) raises the costs of business across sectors and limits the development of new markets overseas<sup>53</sup>.

#### **VIII.4 Public Sector Investment and the Failure to Diversify Exports**

Adverse public sector priorities over the last few decades has resulted in the following structural constraints to export diversification:

**VIII.4.1 *Inadequate Electricity Production and Distribution.*** Inadequate investment in electricity production and distribution facilities. The consequent high electricity tariffs are an important factor in making manufactured exports internationally uncompetitive. The poor distribution facilities which lead to sharp voltage fluctuations result in frequent burnout of expensive electronic equipment even in factories that use voltage stabilizers, further adding to costs. (electricity fluctuations and frequent stoppages associated with

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<sup>53</sup> This sub-section IV.3 has been researched by Mr. Savail Hussain, Research Associate to the Working Group on Institutional Framework for Development.

'load shedding' oblige most manufacturers particularly in flow process industries to use high cost energy from private generators).

According to a recent study power outages in the year 2008-09 cost the industrial sector Rs.83 billion<sup>54</sup>.

**VIII.4.2 *Inadequate Port and Transportation Facilities.*** Inadequate investment in port and transportation facilities resulting in a long time lag (typically three weeks) between arrival of a shipment of imported raw materials at the port and its arrival at the factory. There is a similar long time lag between dispatch of export consignments from the factory gate to dispatch of cargo from the port. These time lags oblige manufacturers in Pakistan to maintain much larger inventories than their competitors which places relatively high financial costs and a significant factor in lack of price competitiveness. Equally important the long delays in getting raw materials to the factory and dispatching export consignments from the port, often result in failure of timely delivery which is crucial to getting repeat export orders.

**VIII.4.3 *Poor Quality of Training.*** Lack of investment in the quality of professional university education, technical and vocational training and institutions for upgrading skills of in-service personnel. This adversely affects every aspect of production and sale: from the productivity of machine operators, the ability to conform to statistical quality control procedures, product design, production management, inventory control and marketing. Each of these aspects of production and sale which currently suffer from poor training of workers and management personnel are crucial for achieving international competitiveness in terms of cost per unit, product quality and consistency, development of product design features, and timely delivery. It is hoped that the present severe shortages of high quality trained workers will be rectified through a fast track implementation programme for the HRD initiative involving district level vocational training centres across the country.

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<sup>54</sup> Institute of Public Policy, BNU, State of the Economy: Emerging from the Crisis, Lahore 2009. page 69, Box 4.3.

## VIII.5 An Institutional Framework for Export Diversification<sup>55</sup>.

In view of the above a number of changes in the institutional structure can be suggested which can lower the costs of business and facilitate export growth and diversification. These include:

**VIII.5.1 Targeted Development.** Selecting sectors and sub-sectors for targeted development over the next 5 years through rebates, tax relief, infrastructure development, marketing and R and D support, and removal of import restrictions. The selection and monitoring of these sectors can be managed through a bi-partisan committee comprising of members from the private sector, academics, and members of the bureaucracy.

**VIII.5.2 Rebates.** Rebates should be to the tune of 10-15% of invoice value. Furthermore the duties on imported raw materials for these sectors should be eliminated. It is important to note that elimination is distinct from refunds as the latter is cumbersome to claim and is rife with governmental graft. Removing rather than refunding duties paid on raw and semi-finished goods can also improve cash flows of non-traditional exports many of whom are working under working capital constraints. This policy intervention is inline with the one pursued successfully by the Chinese over the last decade.

**VIII.5.3 Marketing Support Framework.** Marketing support for the selected sectors. The support framework could have the following elements: (a) Subsidized warehousing facilities, (b) Appointment of effective commercial consular officers and free product road shows and sourcing of new buyers, (c) Private sector link up for outsourced production for exports to new markets, (d) Infrastructure support for export production.

(a) Warehousing is particularly important for Central Europe and Latin America where the market is fragmented and direct supplies can greatly aid growth.

(b) Appointment at Pakistan's foreign missions, of professionally qualified commercial consular officers with performance based remuneration and

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<sup>55</sup> This sub-section IV.5 has been contributed by Mr. Savail Hussain, Research Associate to the Working Group on Institutional Framework for Development.

evaluation systems. Commercial consular officers can be used as effective agents of facilitating product road shows, sourcing for new buyers and providing the much needed legitimacy to Pakistani exports by providing a physical presence in an official capacity in as yet undeveloped export markets.

- (c) Facilitate the private sector link up with sourcing agents based in India- many of whom represent large and medium sized importers in North America, Latin America and Europe. Rising costs and a stronger currency are pressuring many of these sourcing agents to look outside of India. Since proximity and the absence of language barriers lowers transaction costs, therefore Pakistan becomes particularly attractive for outsourced exports through such a private sector link up with India. The sourcing agents are also important since the law and order problems in Pakistan prevent many buyers from the Americas and Europe from traveling to Pakistan and to monitor the production of their goods and services. Sourcing agents act as the bridge thus enabling trade to continue.

Facilitation of a private sector link up with India for increased Pakistani exports, includes easing the visa regime for such companies and individuals and allowing them to open offices in major cities in Pakistan.

- (d) Infrastructure support for export production. This includes the uninterrupted provision of essential utilities at subsidized rates; development of modern cold storage facilities and packaging solutions through a public private partnership; and the establishment of a one window export documentation board.

Cold storage facilities can substantially increase exports of high value added products such as dairy, livestock, seafood and flowers.

Export diversification can be further facilitated through the development of the packaging sector such that it can cater to modern packing solutions: Acetate boxes, blister packing and PVC containers can provide manufacturers in non-traditional sectors an important advantage when competing internationally. Currently Pakistan lags behind in the type and volumes of packaging solutions it can offer especially to the international wholesale and retail chains thereby reducing its ability to win such contracts.

**VIII.5.4 *Export Documentation.*** Easing export documentation requirements by providing exporters a one stop, one window solution will increase the efficiency of existing exporters while providing incentives to small businesses to come into the exports arena. The current process is fragmented and is spread across the Chambers of Commerce, Trade Development Authority, State bank of Pakistan, private banks, port authorities, and shipping companies. Along the way are cumbersome forms and filing procedures.

**VIII.5.5 *Import of Raw Materials from India.*** Import of raw material from India (which is unavailable locally) should be allowed by expanding the negative list. The current DTRE scheme whereby quotas are fixed for raw material imports from India meant specifically for exports suffers from redtapism and graft. A better solution is to open up raw material imports across the board.

**VIII.5.6 *Capturing China's Export Markets.*** Finally Pakistan can quickly make use of the opportunities offered by international trading in the current global policy environment. The current policy especially in the Americas and increasingly in Europe is toward anti-dumping duties on Chinese products. This combined with the rising Yuan means that countries like Pakistan with a port and cheap, plentiful labor can pick up some of the business that has been routed out of China. This can be done by the following policy action:

Allow the tax and duty free import of semi finished goods into special Free Zones for value addition and then export. The key selection criteria for these goods should their

labor intensity since Pakistan has a comparative advantage in unskilled labor cost compared to China. The Free Zones can be established in existing production areas where production units or parts of production units can be declared Free Zones for Exports. To ensure that these facilities are not misused quotas can be established together with regular book keeping to ensure that all imported items into these zones are processed/packaged for value addition and then exported out of the country.

#### **VIII.6 Free Trade with and Investment Flows From India as A Means of Sustainable Growth with Equity in Pakistan<sup>56</sup>**

An economic opening up with India would sharply accelerate GDP growth in Pakistan through increased investment by Indian entrepreneurs. Moreover, import of relatively cheaper capital and intermediate goods from India could reduce capital output ratios in Pakistan and thereby generate higher GDP growth for given levels of investment. At the same time import of food products during seasonal shortages could reduce food inflation and thereby improve the distribution of real income in Pakistan. Easing of travel restrictions would give a massive boost to Pakistan's tourism, services, and retail sectors, which could stimulate growth. At the same time it would increase employment elasticities with respect to GDP growth (since the tourism sector is labour intensive), and hence increase employment and improve income distribution. Thus free trade relations with India would enable Pakistan to achieve a higher and more equitable GDP growth.

#### **IX. 'TRUST' AS AN INSTITUTION FOR SUSTAINED ECONOMIC GROWTH<sup>57</sup>**

During our research on SME growth we came across a number of instances where manufacturers, from different sectors complained that they could not enter into long term contracts with upstream or downstream players, or even with raw material suppliers, and

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<sup>56</sup> This section is based on: Akmal Hussain, Power Dynamics, Institutional Instability and Economic Growth: The Case of Pakistan, The Asia Foundation, Islamabad, 14<sup>th</sup> April 2008.

<sup>57</sup> The Chairman of the Group on Institutions for Development gratefully acknowledges the contribution of this section by Dr. Faisal Bari.

providers of services (not necessarily upstream or downstream)<sup>58</sup>. The main reason they cited for the problem was that they could not ‘trust’ these players. In other words, they were saying that they could not do any long agreements with the players as they could not rely on these players not being opportunistic (in Williamson’s sense of the word).

### **IX.1 The Concept of Trust**

This notion of ‘trust’ being invoked is a special one. It is saying that even if an agreement is reached between players, they cannot rely on the terms of the agreement being carried out in case their ‘partner’ gets even a small opportunity for gain. Usually an agreement has an expectation of being carried out. This expectation is based on either the enforcement that law provides, and redress as well, or the enforcement that social networks, norms and/or codes of the players provide. As market networks expand and transactions become impersonal, norms, social networks and small-group codes are not sufficient to provide the enforceability that is needed. We need the law to substitute for social systems of enforcement. The law ensures that the aggrieved will have access to speedy and fair redress and that, more than anything else, acts as a deterrent against breach of a contract. Once the law is well established and functions efficiently and in reasonable time, breach of contract happens less often as it becomes the costlier option. Without this ‘trust’ is legal recourse and redress, it is hard to see how economic transactions can take place even in time and specially across time.

### **IX.2 Trust, Markets and Transactions**

The problem is more general than just about long term contracting with suppliers and buyers. It transcends all markets. If employers and employees cannot go into long term

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<sup>58</sup> Retailers cannot get tailors to make clothes for them, sweet producers cannot get quality ghee producers, auto-vendors cannot find players that can make special sub-parts for them. In some cases small size of the market conspires against specialization, but in most of the cases we looked at, it was more the inability to ‘trust’ the buyer, supplier or provider of service that was the key issue.

contracts, employer's incentives to train labour, on the margin, will decrease<sup>59</sup>. If banks cannot be sure that they will get their money back, they will not lend in the first place. If they expect that collateral cannot be alienated from the original owner who had pledged that asset, banks will not accept these assets as collateral, or they will have much larger margins, to pay for cost of retrieval, for accepting assets as collateral<sup>60</sup>. In cases where quality or quantity of the good or service being exchanged is not easily verifiable the contracting will impose high transaction costs in terms of inspections and monitoring. Can you 'trust' your contractor to build your house at the contracted quality without investing in quality check managers? But if his/her reputation was at stake or if he/she was concerned about legal redress, you could be more relaxed about quality checks and have them done at the end and not have people standing on the site at all times. Businesses tend to be small in Pakistan as many businessmen feel they cannot expand their business beyond a certain size since they do not have enough sons, brothers and 'trusted' relatives and/or friends. But why should businesses not be able to rely on professional managers to deliver in the same manner as 'trusted' sons, relatives and/or friends. The biggest gains in land markets accrue to those who can secure property rights over parcels of land. The 'developers' whether they be private developers or current/retired military personnel, profit from ensuring that property rights of eventual buyers are well established (DHA premiums are based on this issue). But if property rights were generally enforceable, we would see a much more even and larger development of land and/or housing markets and fewer occurrences of monopoly rents as well as creation of real estate bubbles. One can come up with such cases from any and all markets.

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<sup>59</sup> In this case it can lead to low level equilibria in labour markets where lack of training hurts quality of product but due to the fear of labour switching to competitors employers are unwilling to invest in appropriate training. If all employers think the same way, being quite rational, the quality of labour in the particular area will be low and will hurt all producers, the industry and the country.

<sup>60</sup> Micro-credit works with reputation and possibility of ostracization as collateral. Loss of reputation or its threat can be thought of as alienation of collateral.

### **IX.3. Market Efficiency, Contract Enforcement and Judicial Reforms**

The cost of the not having a legal system that makes contracts enforceable cannot be over-estimated. It is causing business to expand inefficiently going into backward or forward integration or even horizontal integration when they should be focusing on growth in areas of their comparative or absolute advantage. It can force businesses to remain small or subdivide (between sons). It limits growth of credit and insurance markets as well as markets for contingencies and futures. It raises transaction costs for all parties and in most transactions.

One cannot move in the direction of creating enforceable property rights without serious judicial reform in the country. If the judiciary is not independent, free and accessible at reasonable cost, and if cannot deliver justice in reasonable time, property rights cannot be enforceable.

Judicial reforms are not seen as part of a ‘economic’ reforms agenda. Though they might actually be the most important reforms that need to be carried out even from an economic perspective. But this does not seem to be a priority for the government currently. If revealed preference is anything to go by the way government has gone about restoring the judges that were removed in the illegal actions of November 3<sup>rd</sup> 2007, the government has shown it does not have a strong preference for a free and independent judiciary. Furthermore, though there has been talk of judicial reforms for a long time now, actual reforms, attempted and completed, in the area of law and judiciary, have usually been quite unsatisfactory. The fate of programmes like Access to Justice, very well funded and supported by multilateral and bilateral donors, tell a rather sad story. In some cases whole programmes were shelved after the donors suspended payments due to lack of concrete progress. Attempts at reforms in the lower judiciary have been even weaker.

### **IX.4 Institutional Change in Short and Medium Terms**

Judicial reforms, reforms in related laws and changes in the relevant institutions would be based on a medium to long term engagement. However there are implications for institutional change policies even in the short term.

Short term: For the short term, a simpler but not an unimportant aspect of property rights issue could be looked at by the government. Expectations about the future are based on government policies and decisions. These expectations can become the basis for, among other things, important investment and related decisions by private players. If the government changes policies too often and changes it in ways that it leads to very different outcomes for investors, it is not only going to make some players lose money, the uncertainty created would make investors risk averse and make them shy away from investing.

In the last decade or so the successive governments in Pakistan, and sometimes even the same governments, have taken contradictory positions on the same issue. The government had a major role in procurement of major crops like wheat and rice. Then it was decided, as a part of the de-regulation and liberalization drive, to reduce the role of government in procurement, storage, marketing and even export of major crops. The private sector was 'invited' to enter these areas. But as soon as supply or demand hiccups occurred, the policy was more or less completely reversed. And government entered into forced procurement, and every so often it even resorted to Section 144 to restrict inter-district and inter-province trade as well. Eventually a term 'hoarder' was coined for dealing with people who bought wheat cheap and stored it to sell when it was expensive<sup>61</sup>. And today we have different rates of subsidy across the provinces and strict controls on movement of wheat, especially on the provincial 'borders'. Would private sector invest under these conditions? Clearly not. Why should they invest when they cannot be sure about returns from their investments? It is true that the government cannot let monopoly rents be extracted from consumers, especially in sensitive markets like food items. But that is an argument for ensuring an efficient regulatory mechanism is in place and markets work under proper legal conditions. It is not an argument for arbitrary policies or arbitrary reversal in policies.

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<sup>61</sup> If this is not what markets facilitate and exchange is supposed to do, what is? The idea is that as long as we are dealing with larger number of players, where each player is relatively small compared to the market, there should be no possibility of monopoly rents (called exploitation by some). If the wheat market does not qualify for a 'competitive' market, it is hard to see which market would be right for allowing unfettered competition to occur in.

Expectations of consistency from government, continuation of policies and expectations against arbitrary behaviour, on the part of government, need to be ensured. Otherwise a number of markets can malfunction seriously. Should people believe the government when it says it will not nationalize or freeze foreign currency accounts and people should bring their money into Pakistan? Should people believe the government when it says that it will not exploit people once they have entered the tax net? Should they believe the government figures on inflation, poverty and so on? If the government can reverse policies, take arbitrary actions and change stated positions rapidly, the 'trust' in government policies and statements will be low, and the economy will suffer accordingly.

The government clearly needs to establish its credibility. Since the government is faced with an economic crisis right now, it is important for government, when thinking of institutions even in the short run, that it should establish its credibility, not renege on promises it made in the past or on expectations whose formation it encouraged in the private sector, and think of its policies in a longer term framework despite the short term emergent situation.

In the medium run it has two important tasks. It has to ensure that policies are consistent and do not contradict incentives for the private sector over time, and secondly it has to take on the agenda of reform for the judicial sector to ensure creation of laws needed for enforcement of property rights (broadly defined) and the efficient implementation of these laws.

## **X. INSTITUTIONAL FRAMEWORK FOR SOCIAL DEVELOPMENT<sup>62</sup>**

In this section we will propose the concept of social development, indicate the linkage between Pakistan's low performance on social indicators and persistent inequalities and finally outline an institutional approach to social development

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<sup>62</sup> This section has been contributed by Dr. Haris Gazdar.

## **X.1 Distinction between Social and Economic Development**

Social development is defined to include qualitative and quantitative improvements in the physical and cultural conditions of the population, particularly those who are the weakest and most vulnerable in any given society, through the application of resources and institutional changes. Social development is the object rather than instrument of economic development, which is concerned with expanding the resource base and efficiency of resource use of an economy.

It has been customary in Pakistan for economists to ask how much social development – measured in terms of educational expansion, improvement in health, and demographic transition – might contribute to economic growth. Since fluctuations in economic growth have been dependent, however, on the nature and intensity of Pakistan’s geo-strategic engagement with the rest of the world, a growth-centric approach has allowed policy-makers to ignore social development altogether. The appropriate question, in any case, is how and to what extent economic growth might contribute to social development and not the other way round.

## **X.2 Low Achievements and Persistent Inequalities**

In Pakistan the social development gap can be thought of operationally along two dimensions. First, there are low achievements and slow progress in specific measures of social development such as mortality, morbidity, nutrition, public health, child welfare, violence against women, demographic change, education, scientific advancement, and cultural output. Second, there are persistent inequalities along the lines of gender, caste, kinship, ethnicity, class, urbanity and religious difference that are not incidental but institutionalized.

These two dimensions of the social development gap – i.e. low quantitative achievements and persistent inequalities – are inter-connected. Low overall literacy outcomes, for example, are directly related to gender and class inequalities. Poor mortality and morbidity outcomes are closely connected to restricted female autonomy and mobility in accessing health facilities. It is nevertheless important to see the issues of low

achievement and persistent social inequality as being distinct ones, in order to recognize the potential synergy between improved resource allocations and pro-active political, administrative and legal measures for directly addressing social inequalities.

### **X.3 Institutional Approach to Social Development**

In other words, an effective strategy for dealing with the social development gap must include higher resource allocations and better service delivery, in combination with direct interventions to counter patriarchy, caste discrimination, labour market inequalities and other forms of social marginalization.

An institutional approach to social development sees chronic backwardness and persistent inequalities not as merely incidental outcomes of low allocations or poor governance. Female enrolment or health access is low not simply because girls and women face disadvantage as individuals, but because of entrenched institutions of patriarchy that are sometimes even seen as social or cultural norms. Similarly, workers from particular castes and ethnic groups face unequal labour market conditions – and vulnerability to physical coercion and bondage – not merely as individuals but due to institutionalized discrimination against particular groups in accessing legal protection and contract enforcement.

The overarching institutional framework for social development must be citizenship – or the state-citizen relationship. This framework which is embedded in our constitution must take precedence over any other existing formal or informal institutional framework – such as patriarchal “norms”, caste hierarchy, or coercive informal labour arrangements. This framework also presupposes that the wider community, as represented by the state, is interested in universal minimal outcomes with respect to citizens. This is simple to see with respect to the rule of law – the guiding principle here is that law must apply equally to everyone. The same is true, but less well appreciated with respect to other aspects of citizenship. Some minimal standard of education or health must be equally available to everyone.

It is manifest that in Pakistan the state-citizen relationship remains weak and mediated. The state's organizational and resource reach remains limited and uncertain for most purposes. Then there are numerous institutional layers, both formal and informal, that intervene in the state-citizen relationship thus limiting the entitlements and the agency of individual citizens. For a social development agenda to advance it is crucial that the administrative and institutional reach of the state must be extended and strengthened.

## XI INSTITUTIONAL REFORMS FOR STRENGTHENING FISCAL FEDERALISM<sup>63</sup>

### XI.1 The Problem.

Pakistan's present inter governmental assignment of revenue and expenditure function is resulting in four main problems: (i) The vertical imbalance between provincial expenditures and revenues is large and has increased during the past seven years<sup>64</sup>. (ii) Pakistan's sub national (provincial) expenditure as a proportion of total expenditure is one of the lowest in a range of developing countries<sup>65</sup>. Furthermore Pakistan's sub national own source revenue as a percentage of GDP is also one of the lowest in a range of developing countries<sup>66</sup>. (iii) These imbalances result in either increasing provincial budget deficits or under funded provincial expenditure mandates. (iv) Rising provincial budget deficits have resulted in greater resort to borrowings in the last seven years and are adding to inflation and adversely impacting the deteriorating macro economic situation in the country.

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<sup>63</sup> This section draws upon the contribution to the Working Group Report made by Dr. Ali Cheema, member of this Working Group. His contribution is gratefully acknowledged.

<sup>64</sup> State of the Economy: Challenges and Opportunities, IPP's Annual Report 2008, Institute of Public Policy, Beaconhouse National University, Lahore, 2008.

<sup>65</sup> Shahid Kardar, 2007.

<sup>66</sup> Ibid.

## XI.2 The Solution

The institutional structure of fiscal federalism can be strengthened through the following four policy interventions to support macro economic stabilization in Pakistan:

XI.2.1 *Policy Proposal 1.* Strengthen the own source revenue base of provinces and provide incentives to increase own source revenue effort. This will include:

- Devolving the CVT on immovable properties to the provinces.
- The GST on all Services needs to be made through a straight line transfer to the province even if it continues to be collected by the Federal Board of Revenue.

Design and introduce a system of performance transfers that make certain transfers conditional upon the province improving its own source revenue collection.

- *The Logic.* Strengthening provincial own source revenues will help to reduce vertical fiscal imbalances and to ensure that tax follows function. It will also help reduce provincial fiscal deficits and the problem of under-funded provincial expenditure mandates.

Currently, the federal government is levying GST on services on electricity, telecommunications, gas, air travel etc. and retaining a proportion of these taxes even though constitutionally GST on Services is a provincial subject. The issue is somewhat different in the case of “Capital Value Tax on Immovable Properties” where a Supreme Court of Pakistan judgment has given the Federal government the right to levy and retain this tax. The latter limits the province’s ability to utilize the full potential of a functional property tax, which the province with its much better developed capacity is in a more advantageous position to levy than the federal government.

At present, there are no incentives given by the federal government to the provinces for increasing own source revenues. Conditional transfers will ensure that provinces have incentives to increase own source revenue.

**XI.2.2 Policy Proposal 2.** Stabilization must ensure that: (a) the federal government gives up its expenditure assignment with regard to all services that the Constitution suggests lie with the provinces; (b) provincial social sector expenditures are given priority during stabilization; (c) where the federal government has designed new programmes that encroach on constitutionally determined provincial expenditure mandates and/or there is duplication between federal and provincial government expenditures provincial projects and programmes should be given priority.

- *The Logic.* This will ensure that the size of the federal government is streamlined and long-run structural changes are made to the size, composition and efficiency of the federal bureaucracy. It will also make space for budget deficit reductions during the stabilization phase. Finally, it will ensure that social sector expenditures have priority during the stabilization period.

**XI.2.3 Policy Proposal 3.** There is a need to seek buy-in during the stabilization policy phase from the provinces and to get them to commit to expenditure cuts and/or undertake complementary measures that support the stabilization. This can be achieved by creating provincial buy-ins for the stabilization and by bringing the policy for discussion and agreement in the Council of Common Interest.

- *The Logic.* This will ensure that adverse macroeconomic consequences are somewhat mitigated because of the improvement in the provincial budgetary situation. It is, however, imperative that a joint decision be taken to support the economy at this stage. However, prior to this decision the details of the stabilization package need to be shared with the provincial governments at the Council of Common Interest and a joint strategy be devised by all parties to see Pakistan through this economic crisis.

**XI.2.4 Policy Proposal 4.** Setup a body of professionals that places ceiling on the size of the total credit plan and defines the process through which these funds are going to be

divided between the province and the federal government. Furthermore, design a role for parliament in this process of approval.

- *The Logic.* An important fact that has emerged during the last seven years is the issue of provincial budget deficits. There has been greater resort to borrowings to finance the rapidly increasing expenditure on development during the last seven years. IPP (2008) estimates that almost two-thirds of the development expenditure of provinces have been financed by borrowing. In this scenario it is important to work in a coordinated manner with provincial governments, especially during stabilization that is attempting cut aggregate demand.

## **XII. CONCEPTUAL OUTLINE FOR INCREASED DOMESTIC RESOURCE MOBILIZATION<sup>67</sup>**

In this section we will flag some of the issues involved in enhancing tax revenues and outline in the case of NWFP some of the specific measures that can be undertaken to increase resource mobilization at the provincial level.

### **XII.1 Enhancement of Tax Revenues**

- The new government's economic stabilization program aims for reductions in both the fiscal deficit and the balance of payments deficit.  
As regards the fiscal deficit: Reduction in expenditure is contemplated with phasing out of subsidies, while enhanced government revenue is anticipated through higher taxes on imports.
- The tax to GDP ratio (*of less than 9%*) for Pakistan is *perceived to be low* when international comparisons are made. Hence, the “*over*” emphasis on finding avenues to boost revenue collection from taxation.

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<sup>67</sup> This section has been contributed by Dr. Nasser Ali Khan.

- The government also has *non-tax* revenue base through its engagement in a wide range of commercial activities: such as the production & distribution of electricity and gas, postal services, railways, commercial air travel and banking.
- Tackling the domestic deficit in prudent manner (that is, giving due consideration to its implications for social justice, economic efficiency and economic growth) necessities focusing on comprehensive fiscal reform – that is, on an examination of the potential for reduction in government expenditure through prioritization of expenditures and reduction in the delivery cost of government services (*fat trimming*), coupled with an examination of revenue enhancement options – including revenue from taxation, *nontax* revenues (i.e., the proceeds of government commercial activities), and public borrowing.
- The government ought to consider shifting its focus on raising revenues from indirect taxation with easy “*tax handles*”, such as import duties, since tax compliance and hence revenue collection tends to decrease with higher and higher rates of taxation, aside from the fact that indirect taxes tend to have adverse implications for social justice.
- The government ought to review the *burden sharing* of taxation. The well-off (the rural and urban elite) ought to be bearing a greater burden of taxation, than they historically have, since they tend to receive disproportionately higher benefits from government expenditures. Consequently, taxation of agricultural and urban land and property ought to receive serious consideration as an additional base for revenue enhancement – a source which has favorable implications for equity, and help to reduce the undesirable effect of land speculation which has driven property prices skyrocketing. A broadening of the tax base should have favorable consequences for the revenue enhancement.
- Raising revenues from *non-tax* sources ought to receive due consideration. The operations of government commercial entities ought to become an integral part of the government’s revenue enhancement effort. The operations of some public

entities, such as the railways and PIA, which defy commercial norms and persistently vie for classification as government expenditure, ought to receive due attention – ensuring such activities contribute to the budget and not drain it.

- The sources of fiscal measures (revenue collection and effective government spending) depend on the cooperation of the public and the discipline and integrity of civil servants.
- Compliance of taxpayers

*Fiscal Federalism* – delegation and decentralization of fiscal responsibility.

## **XII.2 Provincial Resource Mobilization: The Case of NWFP**

The N-WFP government depends on the federal government for 90% of its expenditures. The Province generates only 10% of its revenue from its own sources. The federal transfers are in the form of:

- Net hydel profits,
- Transfers from the federal divisible pool,
- Subvention grants from the federal government
- Foreign and federal government loans.

It is these rather vertical fiscal imbalances that need to be addressed since most of the revenue is collected at the federal level whereas the expenditures on service delivery are provincial and local.

For the Province to increase its share in revenue generation and stimulate growth in the longer term would require raising the provinces own revenues from 0.7 to 0.8 percent of GDP over the next 3 – 5 years. This increase works out to a 13 – 15.5 percent nominal increase in own revenues. In order to mobilize more of its own resources, the Government of the NWFP will have to improve its tax policy and tax administration. A number of recently completed policy studies indicate that there is considerable potential to generate higher own revenues over the medium term — by as much as 2.3 times the

current level, in real terms.<sup>68</sup> There is even greater scope for increasing taxes such as Motor Vehicle Tax, Stamp Duty, Professional Tax and Urban Immovable Property Tax to 2.5–3.0 times. This entails a thorough review of tax structure and exemptions. For instance, although the NWFP government took a bold step of imposing the Agricultural Income Tax (AIT) on all farmers, irrespective of farm size, to-date AIT is levied in only 5 of the 24 districts in the province. This requires an immediate correction, as it not only reduces the base of the tax considerably, but also creates fiscal inequities within the province. Similarly, considerable UIPT revenue is lost due to the government's reluctance to declare additional rating areas despite considerable urban development and poor assessment of property values. Also, the ongoing conflict between the provincial government and the Cantonment Boards is adversely affecting revenue from the Profession and Calling Tax.<sup>69</sup> The province also needs to improve tax administration to increase collections within the existing tax statutes, adjust tax rates to remove exemptions and make them more equitable, expand the tax base by bringing in hitherto non-taxed areas under the tax base,<sup>70</sup> create a better tax climate by opening Tax Facilitation Centers (with support from the private sector) in order to facilitate tax payments, abolishing taxes with little yield, likely to prove an effective way to invite new investment into the province. Experience from around the world has shown that the focus should be on having a sound tax policy and an effective and corruption free tax administration.

In addition to taxation measures, the provincial government should also find innovative ways to raise more resources for growth.

This could include:

- Relying on the private sector for many activities and leasing out/selling assets. This will not only contribute to private sector development but will

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<sup>68</sup> These included studies on Reforms of agriculture Income tax (AIT) and Land Tax in N-WFP (2003), Tax Potential in N-WFP (2004), and Reforms of tax administration in N-WFP (2004).

<sup>69</sup> While the Profession and Calling tax is a provincial tax, the LGO specifies a profession and calling fee which could be levied by the local government. Levying a tax which is more or less similar in character not only creates the perception of double taxation, but can lead to significant collection inefficiencies. It would therefore be more appropriate if the profession fee could be subsumed in the profession tax (to be collected by the provincial E&T department) while revenue accruing from the fee be transferred to the local governments.

also strengthen public finances by reducing spending and raising revenues. Examples of activities that could be better performed by the private sector include: tourism services (encouraged by leasing state-owned land to the private sector to develop the tourism industry); hydel electricity development (supported by a sound policy environment to take on Build-Own-Operate (BOO) options in this sector and in other areas of infrastructure development); and tertiary education, health services, and the provision of water and sanitation services.

- Moreover, the provincial government should find ways in which it can raise resources by auctioning/leasing high-value state-owned lands for urban development. It should make efforts to privatize public assets that have been on the privatization list for a long time; by making sure that the Privatization Committee plays a more active role and, if necessary, enlist the assistance of the federal privatization commission.
- Efforts of the Government of the NWFP to increase its own revenues will help, but will be insufficient to fund an accelerated development program.

Increased resource transfers through a new NFC Award that devotes a higher share of the divisible pool to the provinces will also be necessary to complement the provincial government's own efforts. A higher award of the divisible pool to the provinces would reduce the stress on provincial finances and allow for a larger share of resources to be transferred to local governments.

- Quarterly payments of net hydel profits have often been irregular and the amount has been capped at Rs 6 billion since 1991/92. This implies that there has been an erosion in its real value by more than 60 percent between 1991/92 and 2004/05. As a minimum, the province should get timely payments of at least the capped amount.

## CONCLUSION

In this Report we have attempted to provide the analytical basis for a change in Pakistan's economic policy paradigm for achieving *economic democracy* in order to provide economic citizenship to all of the people rather than a few. This is an essential element in the prosecution of the ongoing battle for national survival.

We have argued that the observed failures to achieve sustained growth and to overcome mass poverty are both rooted in an institutional structure that excludes the majority of the population from the process of investment, access over high quality education, health and equitable access over markets. It is on the basis of this exclusion that a small elite is able to appropriate rents while leaving the majority of the population in a state of economic deprivation. Such an institutional structure not only generates mass poverty, acute inter personal and inter regional inequalities but also places severe stresses on both state and society.

The present multi faceted crisis of state, economy and society shows that the time has come to bring about structural changes in the institutional framework of Pakistan's economy to be able to achieve inclusive and sustained growth: A broad based economic growth process where the people would be both the subjects of development as well as the recipients of its fruits.

We have specified the major elements of a new institutional framework for inclusive growth. The central feature of the proposed institutional framework is to enable the small and medium farmers in the agriculture sector and small scale enterprises in the manufacturing sector to acquire productive assets and achieve equitable access over product and factor markets. The evidence shows that these markets are currently asymmetric with respect to the large and small farmers, as well as large and small manufacturers.

We have specified the concrete institutional mechanisms for enabling the deprived sections of society to acquire equity stakes in new large corporations that could provide services for land development, new technologies and marketing to small farmers: We

have also specified similar initiatives that can be undertaken through public private partnership to set up corporations owned by the poor and landless owners of cattle for the development of the dairy and livestock sectors that could induce pro poor growth as well as substantially increase exports. Finally we have proposed the institutional framework for the establishment of Common Facilities Centres (CFCs) in specified industrial clusters through which a rapid acceleration in high value added, export oriented small scale industries could be achieved.

In this Report the institutional factors underlying unstable growth and persistent mass poverty have been identified and policy initiatives proposed for overcoming these structural constraints to sustained growth and rapid poverty reduction. The institutional constraints to achieving equity in the provision of health and education have been indicated to improve the quality and coverage.

The issues involved in the institution of trust as an underlying factor facilitating efficient markets and the institutional framework for social development as both a means as well as the aim of economic development have been examined and policies outlined for the necessary institutional changes.

Finally, a brief institutional analysis of fiscal federalism has been undertaken and specific proposals for institutional change have been specified to achieve economic efficiency, improved service delivery and strengthening the federation by empowering the provinces.

# APPENDIX I

## I. SPECIFIC TECHNICAL FACILITIES FOR CFCs

The specific facilities that could be available at CFCs to fulfill their technology diffusion/fabrication functions are:

1. Materials testing laboratory.
2. Foundry.
3. Surface Treatment Plant:
  - (a) Hot Dip Galvanizing Unit.
  - (b) Paint Spray Installation.
4. Welding Workshop.
5. Sheet Metal Unit:
  - (a) This metal sheet and pipe bending unit.
  - (b) Thick metal sheet unit.
6. Heat Treatment Unit.
7. Tool and Die-making Shop.
8. Automotive Workshop/Garage.
9. Design and Information Centre.

## II. PRODUCT GROUPS

The product groups for which above facilities could provide support to SSEs are:

### i) **Agriculture**

The CFCs could provide manufacturing support and marketing for SSEs in the following products:

- a) Tools for manual work such as Hoes, Shovels, Rakes.
- b) Animal traction equipment.

In spite of rapid tractorization in Pakistan there remains a high demand for ox-drawn implements. The main technology here is the assembly of section irons

and plates. Forging is essential in this field but there is also need for cast iron. The production of this equipment may consist of:

- Ploughs: (Forging and structural steel work).
- Rotary-blade harrows (Forging, casting and structural steel work).
- Bearings and other parts for animal drawn carts.

#### ii) **Power Traction**

Popular tractor drawn equipment contains cast as well as forged and machined parts. Welding is often necessary. Items to be produced may include:

- Spare parts for power cultivators (mainly forging);
- Ground graders (mainly plate assembly);
- Rollers (mainly plate assembly);
- Seeders, harrows and cultivators (Plate stamping, casting and structural steel work);
- Components for sprayers (aluminium casting).

#### iii) **Irrigation**

This equipment includes valves and pumps for industrial and household use.

More complex technologies are involved in producing irrigation equipment. Among the technologies are the casting of non-ferrous metals and production of special cast iron.

Typical products are:

- Components for centrifugal pumps (all CFC workshop technologies are involved);
- Connections and bends (mainly aluminum technologies);
- Components for hand pumps (casting, machining and welding);
- Components for sprayers (casting and machining);
- Panels for water reservoirs and roof tanks (welding and sheet metal technologies).

iv) **Off-Road Transportation**

Off-road transportation includes rail transportation. Products are:

- Parts for railway cars and rail transport (forging, castings, plate);
- Bushings and covers (nodular cast iron);
- Traction components (forged or shaped metalwork);
- Brake components (cast iron);
- Hooks, turnbuckles, clamps and other fastenings (mainly forged).

v) **Vehicle Components Industry**

Vehicle components include spare parts for motorcars, trucks, buses, tractors and industrial conveying and hoisting equipment. Particular vehicle components subject to frequent breakdown, such as pulley systems, fans and traction hooks, should be considered. The following are representative items:

- Brake discs and drums (pig iron);
- Oil-tight covers, oil pumps, pistons (aluminum alloys);
- Fans (aluminum alloy and stamped plate);
- Lights and tool kits (aluminum alloy and stamped plate);
- Trolley roofing (stamped plate and structural steel work);
- Hubs for tractor and trolley wheels (cast iron);

vi) **Metalworking**

The metalworking industries require metal containers, conveyors, gears, pulleys, electric motors castings, and supplies for trucks and cars. Typical products are:

- Plate bins (shaped plates);
- Components for rolling conveyors (plate or cast-iron castings);

- Pulleys and gears (iron castings and forging);
- Equipment for ingots moulds (iron castings);
- Blacksmith or smelter equipment (uses all ISC technologies);
- Miscellaneous tools (mostly forged).

vii) **Food and Related Industry**

The food processing industry in NWFP is still in its infant stage. However, the scope for the production of canned fruit, fruit juices and vegetables is quite favourable. The set-up of such industries require an approach on a case-to-case basis. Among the products are:

- Containers for food liquids (normally stainless-steel stamped parts);
- Stainless steel vats, tables, containers for food-processing plants;
- Wire products (baskets, shelves, dish drainers);
- Metal hanging panels;
- Cookers, water heaters, solar heaters;
- Components for seed-oil presses;

viii) **Construction**

Building yard machines are generally imported in whole or in part from abroad. Domestic production of simple castings may partly replace imports. The following are construction products:

- Building yard equipment (mostly forging);
- Scaffolding material (mostly forging);
- Mason tools (mostly forging);
- Components for building yard machines;
- Implements for rolling shutters or window screening (shaped plate, welding);
- Components for door framing and windows (cast or stamped plate);

- Drain covers, grates, road drain wells (cast iron);
- Piping elbows and unions for drains (cast iron);
- Components for valves, gate valves, unions, for portable or street and road signs, road fencing;
- Hinges and locks.

ix) **Household Appliances**

Household appliance products for the model workshops are:

- Bath tubs, showers and sanitary equipment (mostly cast iron);
- Taps (non-ferrous casting);
- Miscellaneous household fixtures and equipment (cast iron and aluminum castings and shaped sheets);
- Brassware for fittings, stop cocks, water taps.

x) **Power and Telephone Line Fittings**

Considering the ambitious plans in Pakistan for the increase in installed power capacity and electrification of rural areas, items in this category should be subject to market surveys and, if feasible, then produced. Possible ISC workshop items are:

- Connection, support and mooring clamps for power lines (cast iron and aluminum castings);
- Accessories for overhead line supports (aluminum castings and forging);
- Cable connection boxes (cast iron and aluminum castings);
- Waterproof feeder boxes (cast iron and aluminum castings).

xi) **Valves for Industrial Use**

Valves for industrial use include products that are almost exclusively nodular cast iron. Components include those of gate valves and fittings for gas and oil pipelines. Also included are components of small rotary compressors and radial fans, which mostly use

shaped-plate castings. Cast-iron pipes, centrifugally or statically cast, must also be considered.

### **III. LOCATIONS OF SMALL SCALE INDUSTRIAL CLUSTERS**

The proposed growth nodes for rural industrialization where the new Common Facilities Centers (CFCs) could be located are as follows:

#### **PUNJAB**

- (1) Lahore-Chunian Axis. Centre: Bhai Pheru.
- (2) Lahore-Sheikhupura Axis. Centre: Sheikhupura
- (3) Gujranwala-Sialkot Axis. Centre: Sialkot.
- (4) Rawalpindi-Mianwali Axis. Centre: Mianwali.
- (5) Bahawalpur-Bahawalnagar Axis. Centre: Bahawalnagar.

#### **NWFP**

- (1) Haripur-Abbotabad Axis and Haripur-Havelian Axis. Centre: Haripur.
- (2) Islamabad-Nowshera-Peshawar Axis. Centre: Peshawar.
- (3) Peshawar-Kohat Axis. Centre: Kohat.

#### **BALUCHISTAN**

- (1) Lesbela-Quetta Axis. Centre: Lesbela.
- (2) Lesbela-Mekran Axis. Centre: Mekran.

#### **SIND**

- (1) Hyderabad-Nawabshah Axis. Centre: Nawabshah.
- (2) Nawabshah-Sanghar Axis. Centre: Sanghar.
- (3) Nawabshah-Larkana Axis. Centre: Larkana.
- (4) Larkana-Sukkur Axis. Centre: Sukkur.

## **APPENDIX II**

### **AN INSTITUTIONAL ANALYSIS OF THE PAKISTAN COUNCIL FOR SCIENTIFIC AND INDUSTRIAL RESEARCH**

#### **I. INTRODUCTION**

Given Pakistan's gloomy socio-economic situation and the challenges being faced by it, it is essential for the government to mobilize indigenous resources and capabilities so as to not only prevent Pakistan from collapsing in to a failed state but also to protect its sovereignty. This requires a coherent strategy as part of a medium-term framework to effectively pave way for industrial development as a vehicle for economic growth and societal transformation. History shows that countries that followed the path of industrialization have evolved in to strong economies and they not only enjoy better living standards but also social as well as economic stability.

For industrial development to take place it is absolutely imperative for the government to develop institutions that remove all the bottlenecks to growth and create a favorable environment for the local industries to flourish. What are these institutions? Institutions are defined as rules, enforcement mechanisms and organizations supporting market transactions. Extremely diverse across rich and poor communities and nations, they help transmit information, enforce property rights and contracts, and manage competition in markets. And in so doing, they give people opportunity and incentives to engage in fruitful market activity.<sup>70</sup> As Douglas North (2000) very aptly says "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."

Keeping in view the importance of industry-led economic growth especially in developing countries to enable them to attain parity with the developed world it is essential to define clearly the role of industrial development organizations and provide

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<sup>70</sup> Building Institutions for Markets, World Development Report 2002

them with the support they require to act as agents of technical change in the industry. For this to happen, it is very important to analyze their performance and factors that can potentially prevent them from attaining their goals or performing at an optimum level.

This paper is concerned with an institutional analysis of the Pakistan Council for Scientific and Industrial Research (PCSIR) which is by far the largest industrial development organization in the country but has not been able to contribute significantly towards development of the local industry. We conduct a thorough analysis of the organization's functioning methodology and try to develop an understanding of the factors that might have prevented it from achieving its objectives.

The rest of this paper is organized as follows: Section 2 briefs upon PCSIR's background and its mandate since its inception, Section 3 provides an overview of the technical facilities available at PCSIR, Section 4 reiterates the motivation behind writing this paper, Section 5 summarizes the organizational structure of PCSIR, Section 6 lays down a framework for institutional analysis and employs this framework to identify some of the factors that have prevented PCSIR from achieving its objectives, Section 7 contains an analysis of the findings and recommendations for strengthening PCSIR and finally Section 8 concludes the paper with a brief summary of some of the major findings under the analysis.

## **II. BACKGROUND**

PCSIR was established in 1953 and since 1973 it has functioned under the Act of Parliament. According to Act XXX of 1973 the establishment of PCSIR is stated in the following words - "It is expedient to provide for a Pakistan Council for Scientific and Industrial Research to undertake, promote and guide scientific and technological research in respect of problems connected with the establishment and development of industries under conditions prevailing in Pakistan, and to encourage extension of the results of research to various sectors of the economic development of the country in the best possible manner."

The primary objectives for the creation of this organization were to enable Pakistan to attain technological self-reliance based on indigenous capacity, provide basis for import substitution and export enhancement through development of new technologies, provide research and development (R&D) support and also a skilled pool of manpower to the local industry through targeted human resource development programs.

### **III. OVERVIEW OF THE FACILITIES**

PCSIR has a massive country-wide range of technical facilities including state-of-the-art digital libraries, research centres and laboratories. Besides Lahore, which is the biggest centre for research, PCSIR operates in almost all the major cities including Karachi, Peshawar, Islamabad and Quetta. In Lahore, facilities are available for a number of different industries including the auto industry, ceramics industry and the home appliances industry. Also available are state-of-the-art facilities for the metal industry including nano-technology equipment, material identification, heat treatment, foundry treatment and coating etc. Some of the other major industrial sectors that PCSIR caters to include minerals, glass, food technology and environment. All laboratories comply with international standards which means their data is accepted worldwide.

The Lahore unit of PCSIR has completed more than 500 processes. Out of these, 100 processes have been patented. Also it has 3500 research publications in journals of national and international standing. The laboratories are assisting the academic institutions by providing research / internship facilities to thousands of their M.Sc., M.Phil and Ph.D. students.

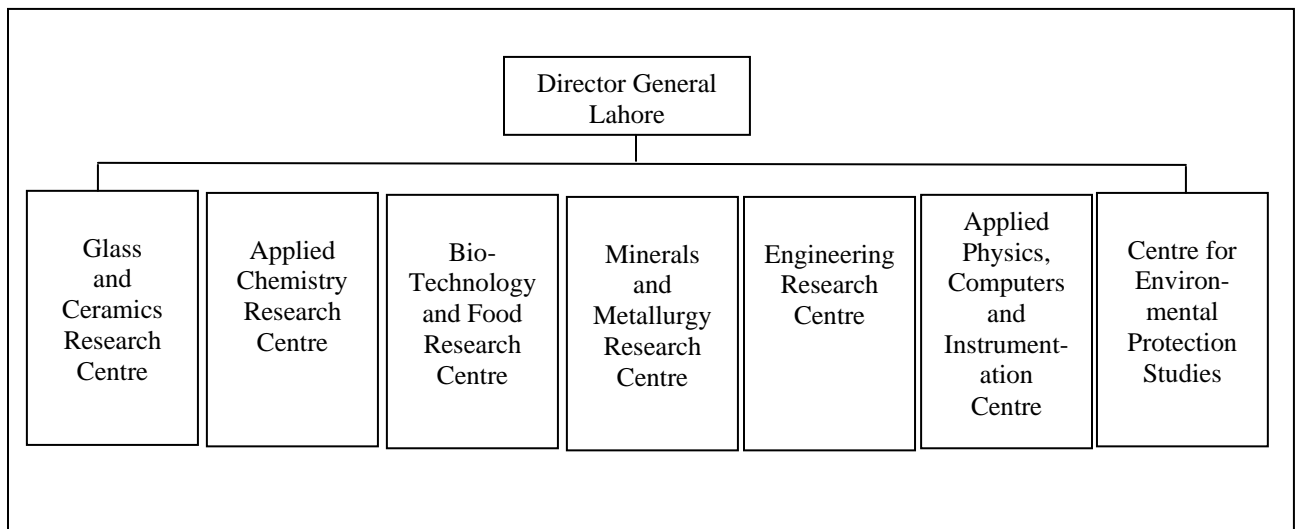
PCSIR Laboratories Complex, Karachi has the honor of being the first multidisciplinary unit in the whole Ministry of Science and Technology (MoST) to obtain the prestigious international award of being certified to ISO –9001 for the quality of its services to organizations of public and private sectors. Recently PCSIR Laboratories Complex, Karachi have also been accredited in ISO 17025 from Pakistan National Accreditation Council (PNAC), MoST.

The PCSIR Laboratories, Peshawar have over the years completed several adhoc projects referred by the industry and undertaken analyses of hundreds of samples of raw materials and products. Also about 500 research papers have been published in the national and international scientific journals of repute by the Peshawar staff.

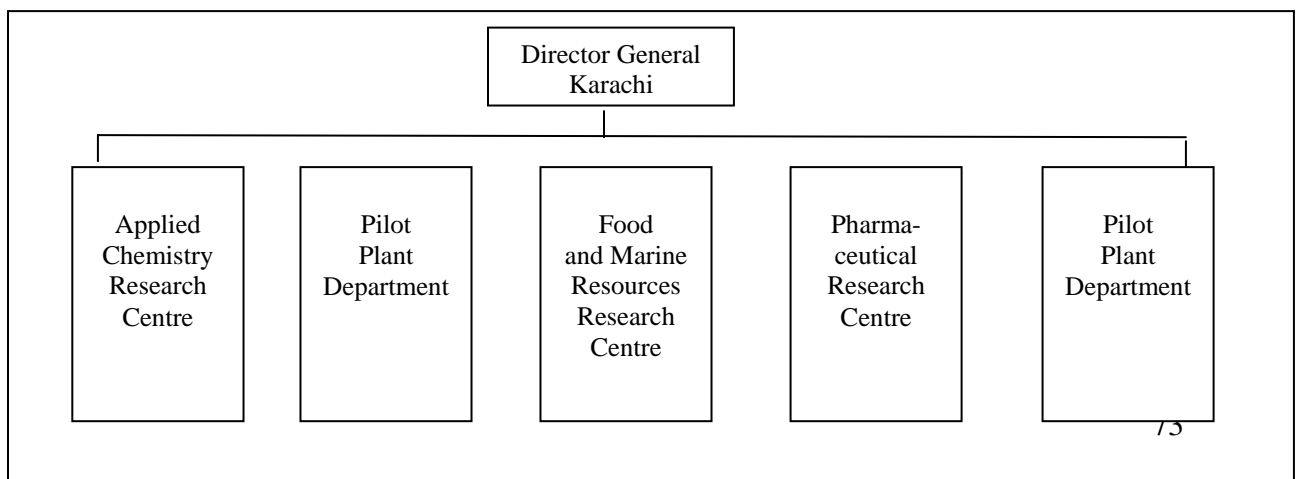
All PCSIR centres and departments are manned by highly trained researchers. Necessary additional facilities such as workshops, libraries and pilot plants are adequately available to meet the requirements of research and development teams.

The following diagrams show the facilities available in the PCSIR Laboratories Complex at Lahore, Karachi and Peshawar all of which are headed by a Director General.

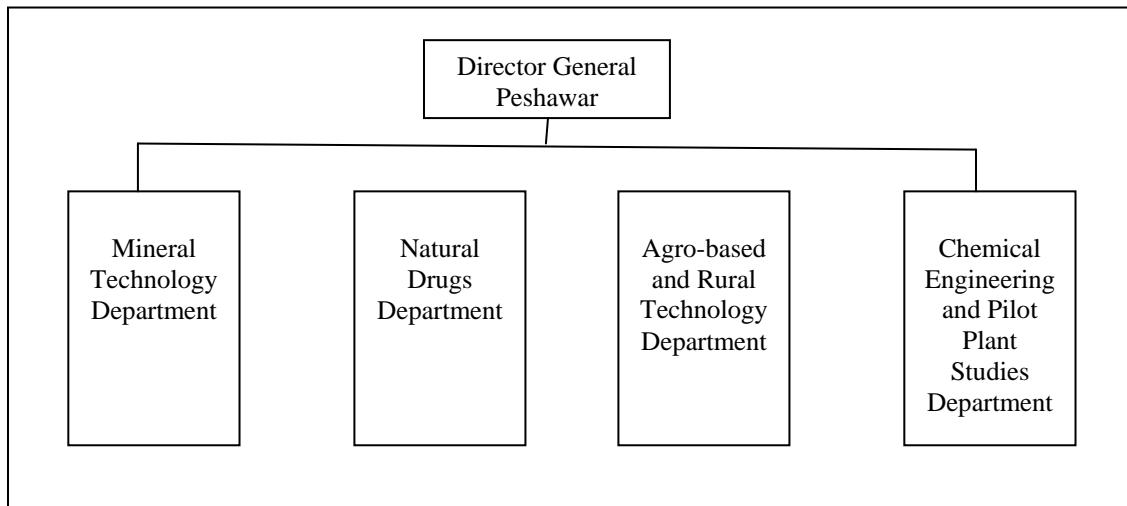
**Figure 1: PCSIR Lahore**



**Figure 2: PCSIR Karachi**



**Figure 3: PCSIR Peshawar**



Besides the laboratories complex in major cities PCSIR also has separate mono-functional centres which include: Fuel Research Centre, Leather Research Centre, Pak Swiss Training Centre and Institute for Industrial Electronics and Engineering in Karachi, Pak-Swiss Training Centre in Quetta, Solar Energy Research Centre in Hyderabad and National Physics and Standards Laboratory which is based in Islamabad.

#### **IV. PURPOSE OF THE CASE STUDY**

Keeping in view the research potential and all the facilities available for various industries at PCSIR, it would not be unreasonable to be critical of the poor performance of the industrial sector in Pakistan and question as to why has PCSIR not been effective as an industrial development organization. With a life span of almost six decades now, which is a long enough period to provide a solid platform for technological/industrial transformation in any economy, PCSIR has not been able to achieve its goals i.e. to facilitate economic development through industry led growth. Or it would be much safer to say that it has not been as effective an agent of technical change in the industry as desired.

Given its historical importance and also its mandate which highlighted the importance of industry-led socio-economic growth, it is very important to study the extent to which

PCSIR has been successful in achieving its objectives and what could be done to strengthen this organization. It is essential to gain an understanding of the reasons as to why has such a strong organization with all its facilities, research potential and manpower not been able to make a significant difference towards development of the industry. An institutional approach will be adapted here for it would give insight not only in to the external factors but also the internal processes which could be improved to make PCSIR more effective. It will also enable us to get an idea of the degree to which PCSIR is actually contributing to industrial growth.

## V. ORGANIZATIONAL STRUCTURE

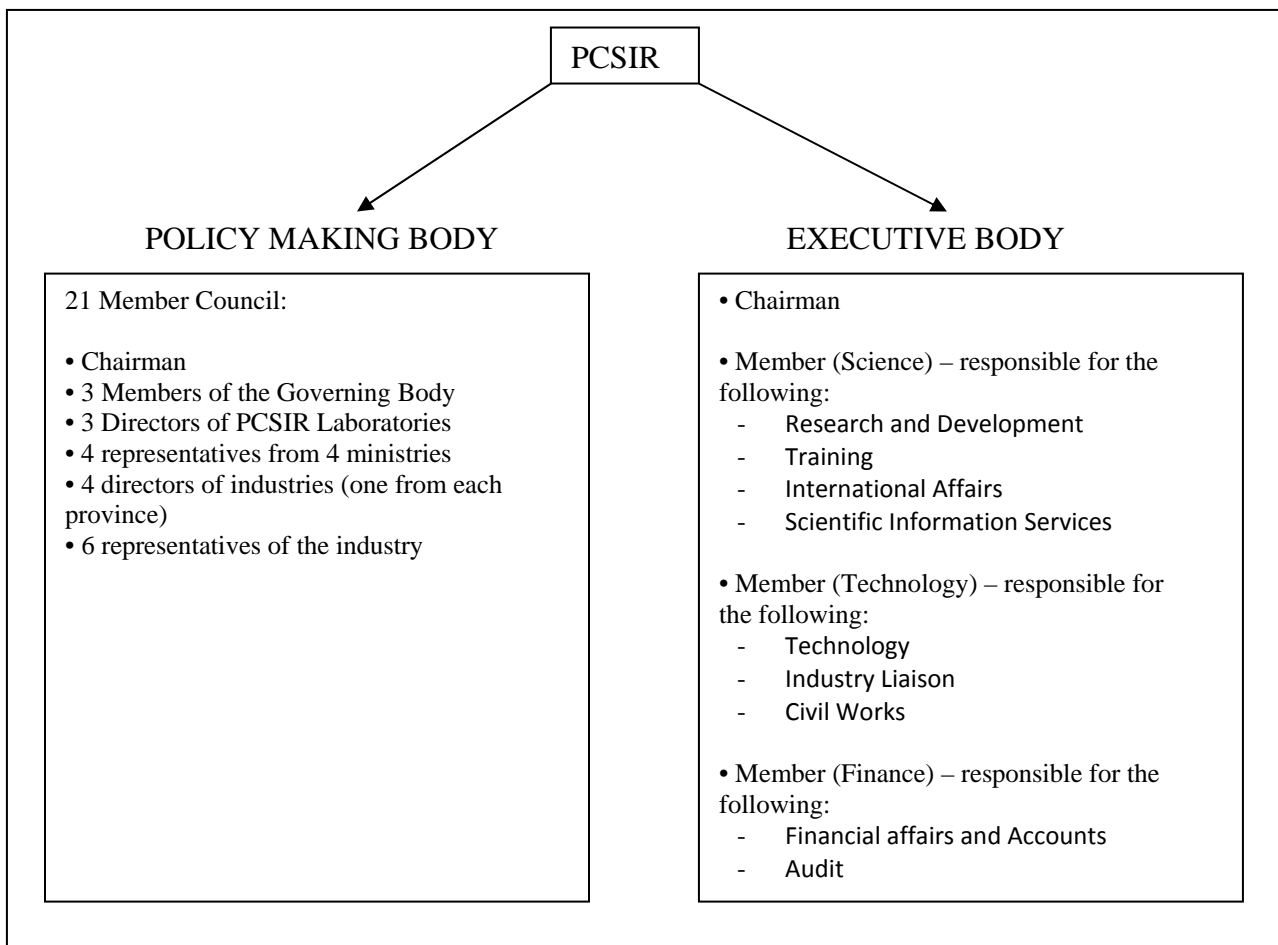
Before embarking on an analysis of the internal and external factors that have an impact on the effectiveness of PCSIR as an industrial development organization, it is important to discuss briefly its organizational structure. The Chief Executive of PCSIR is the Chairman who is appointed by the Federal Government. The 21- member Council is the policy making body of the PCSIR, which is composed of Chairman, three Members of the Governing Body, three Directors of PCSIR Laboratories, four representatives from four ministries, four Directors of Industries, one from each province and six representatives of the industry.

The Governing Body is the executive organ of the Council and comprises of the Chairman and three full-time members that are Member (Science), Member (Technology) and Member (Finance), nominated by the Government.

The Head Office of the PCSIR is functioning at Islamabad where offices of the Chairman, Member (Science), Member (Technology), Member (Finance) and Secretary PCSIR are located. The Science Wing is headed by Member (Science), who supervises matters relating to R&D, Training, International Affairs and Scientific Information Services. The Technology Wing is headed by the Member (Technology), who looks after the matters relating to Technology, Industrial Liaison and Civil Works. The Finance Wing is headed by the Member (Finance) who is in charge of activities in Finance and

Audit and Accounts Departments. The Chairman is assisted by the Secretary and Administration and Establishment Wings, working directly under him.

**Figure 4**

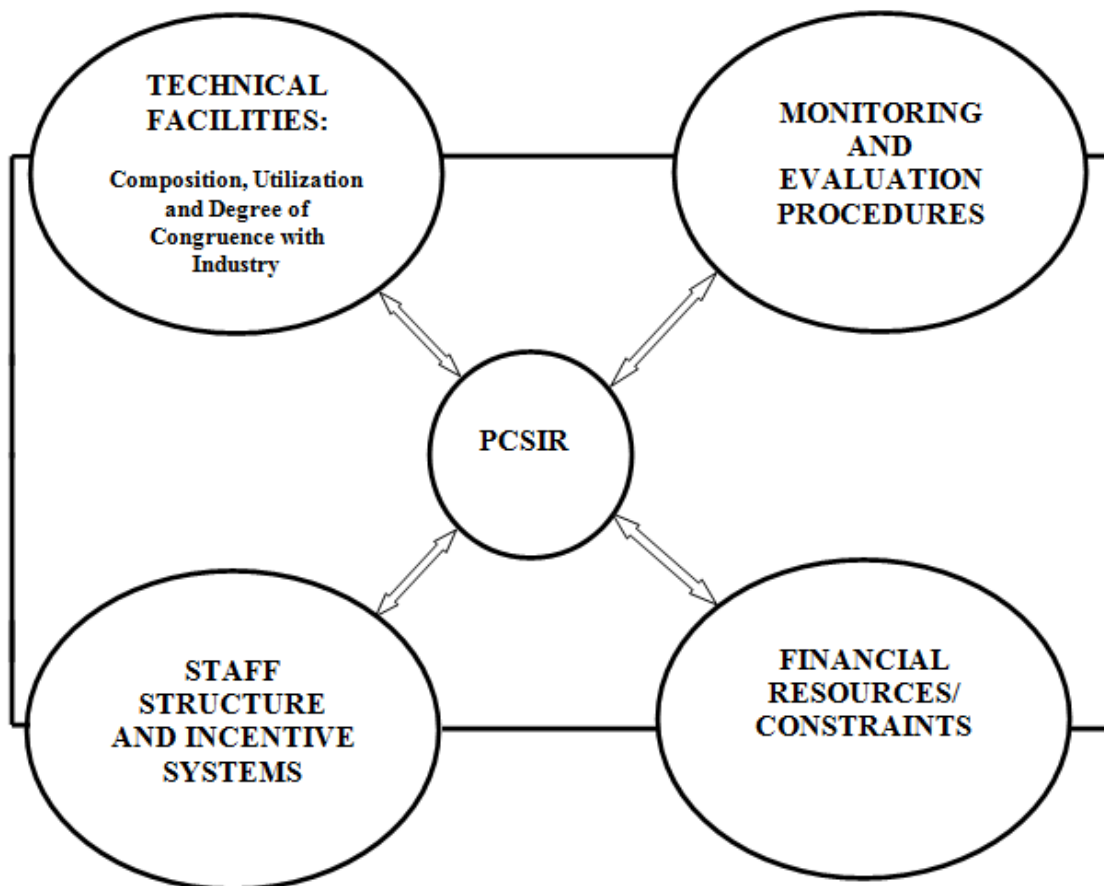


At present there are 11 Laboratories and 5 Human Resource Development Centres established throughout the country, headed by Director Generals / Directors who directly report to the Chairman. There are 681 Scientists / Engineers / Technologists working in different Laboratories out of which 80 are Ph.D.s and others have M.Sc./MS/M.Phil./B.E. degrees in multidisciplinary fields. These are supported by 1656 technical and skilled staff and 178 administrative staff. In Head Office 150 staff members including 7 Directors are working in different departments.

## VI. INSTITUTIONAL ANALYSIS

The methodology employed for the analysis was to define four broad areas for investigation to gain insight in to the internal procedures, rules and processes of PCSIR as well as some of the external factors that inhibit its effectiveness. These four categories were: Technical Facilities (Composition, Utilization and Degree of Congruence), Monitoring and Evaluation Procedures, Staff Structure and Incentive Systems, and Financial Resources/ Constraints. Series of questions were prepared for each of these categories which were then used during meetings / interviews with PCSIR officials at PCSIR Head Office in Islamabad and also its office in Lahore. Figure 6 illustrates these dimensions that were the focus of the analysis.

**Figure 5: Framework for Institutional Analysis**



A brief summary of some of the key information extracted from the meetings / interviews under each category follows:

## VI.1 **Technical Facilities**

### - *The composition of technical facilities:*

Serving almost all the industries, PCSIR does not focus on any one particular sector and never has a specific methodology been employed to identify the sub-sectors and industries that need to be focused on. The composition of the facilities is mainly inherited from the time when PCSIR was established. At that time a large number of bio-chemists started research specific to their own areas of interest (i.e. agriculture and bio-chemistry) and funding was also available only for projects pertaining to these fields. However, over time facilities were developed randomly based on demand and also foreign competition.

### - *Extent of utilization of facilities:*

The extent of utilization of facilities at PCSIR is only 30% whereas the remaining 70% of the facilities remain unutilized. Even though PCSIR is over-equipped with technical facilities pertaining to almost all industrial sectors, there is severe lack of demand.

### - *Linkages with the industry:*

Historically, PCSIR has never made any dedicated efforts to create a market for itself and increase demand / awareness among the industrialists. Up till now the major focus of PCSIR's staff has been on publishing its research in journal articles. Only recently an Industrial Linkage Program has been developed and some efforts have been made to create linkages with the industry. A number of MoUs have been signed over the last two months with different universities in Lahore (including F.C. College, Punjab University, Government College and also Sargodha University) to develop this program. PCSIR is aware of the importance of commercializing its technologies and therefore new

marketing staff is being developed which will be responsible for diffusing previous and current technologies in the industry instead of generating new research which will remain underutilized. However, since dedicated efforts were not made in the past in this regard it will take considerable amount of time for PCSIR to build strong linkages with the industry.

- ***Determination of the agenda for research and development (R&D):***

R&D agenda is determined internally and is focused on producing new products which are 'expected' to have enormous demand. No standard methodology (dialogue with industry, stakeholders etc.) is adopted while determining research agenda.

## **VI.2 Staff Structure and Incentive Systems**

- ***Staff structure:***

The sanctioned strength of BPS-20 level officers in Lahore and Karachi is 9 each while the sanctioned strength of BPS-19 level officers in Lahore and Karachi is 43 and 33 respectively. Sanctioned strength of BPS-18 officers in Lahore and Karachi is 50 and 66 respectively. Details of the qualifications and department-wise break-up of these officers were not available.

However, an interesting observation made was that, as on 22 April, 2009, out of the total sanctioned strength of officers (across all cities); 25% of BPS-20 posts, 36% of the BPS-19 posts, and 22% of the BSP-18 posts were vacant which signifies a very high vacancy rate.

- ***Staff competency:***

Another major problem being faced by PCSIR is the dearth of experienced professionals with scientific background. There are a lot of young scientists and university students

who come to PCSIR for research as part of their thesis but very few experienced people. The roots of this problem can be traced back to the period of 1965-1968 when around 70 foreign qualified PhDs returned from countries like Germany, USA and France but there were no facilities and funds to support their work at that time. Also most of them went in to retirement therefore causing significant depletion of manpower.

- ***Salary structure:***

As mentioned above, government pay scale applies at all levels which is considerably less than market rates.

- ***Employee Turnover:***

One of the major problems facing PCSIR is brain drain of the scholarship recipients and also loosing them out to academic institutions in Pakistan. PCSIR does not have the capacity to provide market salaries at par with companies like NESCOM, KRL and also universities wherein professors earn handsome monthly salaries. PCSIR's salary structure is based on government pay scale which is well below the market based rates.

- ***Incentive system for staff:***

A number of incentives are provided to staff members to improve their performance and efficiency. Of the revenue generated from a new product, 20% (now increased to 30%) is awarded to the research team (distributed among them in proportion to their current salaries and the amount of effort put in), 60% is recycled for research and the remaining 20% is given to the government. Another incentive being provided is that a full PhD scholarship is made available to young scientists after one year of work experience at PCSIR. At present PCSIR employs 3197 people and has 200 PhD scholarships available.

- Distribution/ Allocation of Overall Earnings:

All the departments send their cases of distribution of workers' share out of the earnings together with the cheque of the share of Head Office for obtaining approval of the Chairman. The Finance Wing is responsible for processing the case and seeking approval of the Chairman. The approval so obtained is conveyed to the concerned department and records are maintained by the Finance Wing. Only those employees are considered for distribution of worker's share whose attendance in that particular quarter remained 75% or more. Following mechanism is observed for utilization of self generated funds. The percentage of workers share for all categories of earnings is kept unchanged.

**Figure 6: Distribution of Earnings**

<b>Nature of Activity/ Earning</b>	<b>Worker's Share</b>	<b>Head Office Share</b>	<b>Recycling by the department</b>
Production Activity:			
i) Up to 1 million	10%	10%	80%
ii) Above 1 million	7%	7%	86%
Contract/ Sponsored Activities	10%	10%	80%
Processes leased out	30%	30%	40%
Analytical/ Repair and Maintenance/ Calibration Services	20%	20%	60%
Consultancy Services	30%	30%	40%
Training Courses at Executive Centers	20%	20%	60%

- Distribution of the overall earnings among workers of the concerned department:

Head of the Department gets 3% and the Director gets 2% of the total amount earmarked for distribution as worker's share. The remaining 95% is distributed among two categories of workers as follows:

CATEGORY A (Working Scientists/ Actual Workers)	30%
CATEGORY B (All other employees)	70%

These amounts are distributed in proportion to each worker's full current basic pay for Category A workers and half of the current basic pay for Category B workers.

Category A workers' share may be reduced or increased by the Chairman upon recommendations of the concerned Head of Department concerning the worker's professional competence or the volume of contributions he has made. The Chairman also has the power to bar any employee from his due share as an outcome of any disciplinary complaint by the Head of Department.

### **VI.3 Monitoring and Evaluation Procedures**

There are no proper mechanisms for internal monitoring and evaluation of different departments. Historically, the performance of departments has been judged on the basis of number of journal articles published but now it is planned to lay more emphasis on product development and marketing. The focus of employees so far has mainly been on earning research awards based on the amount of publications and that has been the primary criteria for success of the departments. The extent to which the industry has benefited from its research or the impact it has had on the industry is not taken in to account. There is no proper department for monitoring performance during the life-cycle of a project and also for enforcement of the rules and procedures. Further, there are no mechanisms for monitoring the overall organizational performance of PCSIR. There have been no efforts by the government to set targets for PCSIR and monitor / judge its performance on that basis.

#### **VI.4 Financial Resources/ Constraints:**

Although there is no lack of funds in terms of number of scholarships available for young scientists but the budget made available to PCSIR is not adequate for it to meet its objectives i.e. to make it more market based, link up with industry and do need oriented work. The budget allocated to PCSIR is only a fraction of what it proposes through PC-1s and even the disbursement of funds as part of this budget is a major issue. Funds are often delayed for two successive quarters and sometimes not disbursed completely.

The funds demanded by PCSIR under Non-Development Budget (for Pay & Allowance, Pension etc.) in the fiscal year 2008-09 were Rs. 973 million of which only Rs. 686 million (70%) were granted by the government. In 2009-10 Rs. 760 million (71%) were granted against a proposal of Rs. 1069 million.

Although figures for Development Budget were not available, it was learnt that they present an even more dismal picture.

### **VII. ANALYSIS AND RECOMMENDATIONS:**

#### **VII.1 Technical Facilities (Composition, Utilization and Degree of Congruence with the Industry):**

##### ***Utilization:***

The research revealed that approximately 70% of the enormous range of technical facilities including the research output and new technologies developed at PCSIR remain underutilized. This issue is of extreme importance to the Pakistan economy keeping in view the amount of investment made in setting up this huge organization. If 70% of that investment goes waste then it is a huge loss to our economy and this issue needs to be addressed immediately. Considered below are some of the factors that are potentially responsible for the current state of affairs and some of the ways in which they can be addressed.

- Lack of Awareness among Industrialists:

Despite the fact that PCSIR is over-equipped with technical facilities (ranging from product development, consultancy services, material testing, laboratory accreditation etc.) which can be utilized by any industrial sector, majority of the local industry is not even aware of these facilities. It is the government and its concerned departments who are mainly responsible for lack of promotion of the facilities on offer at PCSIR in the private sector. PCSIR is also to be blamed for not making dedicated efforts to create a market for itself. It would be interesting to research as to what are the factors that have prevented PCSIR from effective marketing of its technical facilities. Nonetheless, if all the concerned industries and sub-sectors become aware of the facilities they can avail at PCSIR, it is certainly predicted that demand for these facilities should rise if the quality of services is maintained and it is at par with those available internationally. Also important is the cost at which these services are provided. If PCSIR can provide the same quality of services as foreign firms at a lower cost to the local industry then demand will indeed rise. Therefore besides launching massive country-wide marketing campaigns PCSIR should also ensure the quality of its services, competency of its technical staff and improve its interface with the industry in order to ensure client satisfaction and increase the usage of its facilities.

- Lack of Confidence:

Besides a lack of awareness which is prevalent in the industry, there is also a lack of trust and confidence in PCSIR's capability and the quality of its services. A testimony to this very perception is the decline of textile industry's exports which can be attributed to lack of certification by an accredited lab. PCSIR has 16 laboratories focused on certification of product quality and these labs have also been accredited by a Norwegian Accreditation Body which means any products certified by these labs are recognized globally. However, local exporters still prefer foreign laboratories (in countries like India) for accreditation of their products and also they are not ready to pay for any services provided by PCSIR labs.

Earning the confidence of the industry and image-building for an organization as big as PCSIR takes a lot of time. Reputation can only be developed by ensuring quality of services and client satisfaction. To build trust PCSIR must focus on making its interface with clients more efficient so as to improve the quality of their experience and also take regular feedback from them with a view to continuously keep evolving in to a high quality organization.

- Preference of Foreign Companies:

It is evident that local companies prefer to revert to foreign companies, from whom they procure their equipment, for troubleshooting instead of PCSIR. To tackle this problem, partnerships need to be developed with foreign companies. Such partnerships should entail agreements on sharing of knowledge, technology transfer, and research and development. Besides provision of services at a lower cost than international firms, again it must be stressed here that that quality of services must also be at par with those available abroad. This can be achieved by forging such partnerships with foreign companies.

- Bias Within the International Community:

Besides the lack of confidence among these potential customers, the low demand can also be attributed to a bias or lack of awareness among foreign buyers who prefer products tested from laboratories in Malaysia and India but not PCSIR. This would require a marketing/ promotional campaign at an international level.

- Degree of Congruence with the Industry:

Besides raising awareness, efforts need to be put in to ensure that research output and technologies developed by PCSIR do not go waste and are of relevance / significance to the local industry. The research agenda in all PCSIR departments is determined internally and is based primarily on expectations / predictions of success. No dialogue with potential clients is carried out while determining the research agenda. Also there is no

involvement of the industry representatives during the research process. To ensure that there is not a mismatch between the research output and demands / needs of the industry, effective dialogue and a series of meetings must be conducted with representatives from the industry while determining the research agenda. Also a Need Assessment Survey must be conducted in the relevant industries to get feedback or the viewpoint of the industry and gauge their requirements. The research agenda must be based entirely on industrial demand to ensure better utilization of facilities and reduce risk of failure. If efforts in this regard are not made, the only beneficiary of the research would be PCSIR employees themselves who get awards based on publishing their research in journals but that will obviously not help the industry. PCSIR needs to revisit and in fact focus a lot on developing its processes / methodology for determining research agendas. This methodology must incorporate all the above.

- Composition of Technical Facilities:

PCSIR has never utilized any scientific methodology to identify the sub-sectors and industries that it should be focusing on. This method fails to take in to account the fact that we are living in an era of ever-growing technological change and global conditions. In order to keep pace with rest of the world we need to invest in industries whose world market share is increasing and not waste our resources on declining industries. A proper scientific methodology needs to be utilized in determining the industries which need to be focused on.<sup>71</sup> A focused approach would not only improve performance and quality of service but also ensure that the country's limited resources are not being wasted.

## VII.2 Staff Structure and Incentive Systems

There are 681 Scientists / Engineers / Technologists working in different Laboratories out of which 80 are Ph.D.s and others have M.Sc./MS/M.Phil./B.E. degrees in multidisciplinary fields. These are supported by 1656 technical and skilled staff and 178 administrative staff. In Head Office 150 officers / staff including 07 Directors are

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<sup>71</sup> Bokhari, A.S et. al. (2008), 'Key Manufacturing Sectors for Technology Upgradation in Pakistan: Medium-Tech and High-Tech Manufactures'. *Journal of Quality and Technology Management*

working in different departments / wings. Although the sanctioned strengths of Grade 18, 19 and 20 in all departments were provided but details of how staff is organized in each of these departments were not available. It is essential to study how staff in each department is structured and to see if the role of each staff member is defined clearly. Also a dedicated human resources department should be there to ensure that each department is functioning properly and contributing efficiently towards overall objectives of PCSIR. The high level of vacancies in each of the major departments and a high turnover rate can be attributed to low salaries. However other reasons also need to be investigated such as the working environment, rules, regulations, criteria for promotion / progression and incentives provided by PCSIR for improved performance. Staff policies need to be studied in detail e.g. the disciplinary actions in place for ensuring attendance, performance monitoring etc. Further, the incentive systems as detailed in the previous sections should be enforced to ensure no one is deprived of his / her due share in the total earnings. Also the share of the concerned staff members who directly contribute to revenue generation must be increased to ensure staff incentives are aligned with objectives of the organization.

Providing a PhD scholarship to young scientists (after one year of work experience) who do not even return to PCSIR is a waste of resources. The scholarships should be provided only to staff members with more experience or should be based on the extent to which they have contributed to PCSIR's success. The selection criteria for scholars need to be strengthened to mitigate the risk of losing PhD scholars to other organizations. But even more important is the fact that until PCSIR will be able to abolish the government pay scale system in favor of market rates and provide salaries at par with those prevalent in the private sector it will keep on losing out these young scholars to other companies and suffering from high turnover rate.

### **VII.3 Monitoring and Evaluation Procedures:**

Unless strong measures are taken to enforce rules and regulations across all PCSIR departments in the country and to keep a check on the utilization of funds and the

performance of each department – PCSIR will not be able to evolve in to a successful industrial development organization. Success criteria of each department should be clearly defined in terms of its impact on the industry for which indicators must be devised such as the ratio of the number of new technologies developed to the number of client contracts etc. If a department fails to deliver according to predefined criteria (based on the threshold level for different success indicators), a thorough analysis should be carried out to identify weaknesses and improve functioning of the department. The staff structure and competency level and also the liaison process with industry / stakeholders must be monitored regularly. There should be a monthly progress report and meeting of the directors of each department with the policy-making body and also the executive-body to ensure progress.

The performance of PCSIR should also be monitored at an aggregate level by the government. Keeping in view the amount of resources government has spent on this organization and the magnitude of the budget it allocates each year, it must also devise mechanisms to judge the cumulative performance of all the PCSIR departments, utilization of funds/ facilities allocated, and the impact on the economy. In other words a Cost-Benefit Analysis should be carried out regularly. If the organization as a whole is not delivering up to mark, then the departments that are functioning poorly must be identified and revamped. Also it must be ensured that there is greater coordination among different departments and the policy making body of PCSIR. The concerned government departments must also try to monitor all the internal procedures, rules and regulations and see how they can be improved to improve the overall functioning of the organization. Since no such mechanisms are in place at the moment and no performance indicators developed, the weak links within PCSIR continue to function and government resources wasted on such departments.

#### **VII.4 Financial Resources/Constraints**

The government must provide necessary financial support to PCSIR. Although there is no dearth of technical facilities available at PCSIR but the allocated development and non-development expenditures fall way below the requirements of the organization. The

development expenditure, which is so crucial for growth of the industry and this economy, is very limited because of which developmental activities are curtailed and PCSIR is forced to adopt a passive stance i.e. it is not very progressive as far as identification and development of new / existing industries is concerned. In non-development expenditure PCSIR should be given resources to be able to provide market salaries to its employees. Efficient wages will not only improve performance but also reduce turnover rate. Further PCSIR can not even pay pensions at the moment to its former employees. The budget allocated to PCSIR is only a fraction of what it proposes through PC-1s and even the disbursement of funds as part of this budget is a major issue. Funds are often delayed for two successive quarters and sometimes not disbursed completely. This acts as a great obstacle towards the effectiveness of PCSIR and the measures it needs to take for industrial development in different sectors. These gaps need to be investigated thoroughly. Finally, besides increasing the amount allocated to PCSIR the government should also work closely with the Finance Wing to ensure effective utilization of these funds.

## VIII. CONCLUSIONS

In this paper we analyzed PCSIR's functioning methodology and some of the factors that have prevented it from achieving its objectives and acting as a major catalyst for industrial transformation in the country. Focus of analysis was based on four dimensions which were:

1) Technical Facilities (Extent of utilization, composition and degree of congruency with the industry), 2) Staff Structure and Incentive Systems, 3) Monitoring and Evaluation Procedures and 4) Financial Resources/ Constraints. The analysis revealed that the composition of technical facilities available at PCSIR is mainly inherited from the past, these facilities are greatly underutilized and have very low degree of congruence with the industry. PCSIR also faces a number of staff issues such as high turnover rate which can be attributed to low pay scales and dearth of experienced staff. Although a number of incentives are provided by PCSIR to improve efficiency of staff but there is no internal mechanism to oversee and enforce enactment of the internal rules, regulations and

procedures. There are no internal monitoring and evaluation procedures. Success and performance criteria / indicators are non-existent / not properly defined. Finally, financial problems come in the form of low budget allocations and disbursements by the government.

Therefore, the above findings give us an insight in to some of the internal and external factors which have prevented PCSIR from making a significant contribution to the local industry. All of these issues need to be addressed immediately and rectified so as to provide PCSIR with the support it requires to effectively attain its goals and pave way for industrial growth and prosperity in the country.