

## *Mahbub ul Haq Memorial Lecture*

# **Macroeconomic Research and Policy Making: Processes and Agenda**

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It is indeed an honour to present the Mahbub ul Haq Memorial lecture this year at the PSDE. Dr Haq was the single most important economist that Pakistan has produced. He laid the groundwork for the development planning as well as affected many a policy debate in the international circles the most memorable of which is his human development Index. He is the only economist whose ideas influenced country policy and who developed an international to engage in international development discourse.

We should all feel his loss enormously. Maybe he could have led us public policy people into a profession and a community. Maybe he could have developed domestic debates and thinking. Maybe the donors would have engaged with him and allowed him to influence the domestic policy and research agenda. Yet I fear he too might have failed to form a research community where funding incentivises individual rent-seeking over debate, conversation and agenda-setting [see Haque and Khan (1998 and 2017)]. I do recall that the Pakistani economists in the World Bank could not come together to memorialise him upon his death.

### **Epistemology of Policy**

The PSDE is an evolving forum for economists, development and public policy professionals to share knowledge of their respective fields while also developing analysis and policy ideas for Pakistan. It is worth our while to keep review policy-making and the policy process at this august forum. The community and its key thinkers must reflect on the role of research and the research community on policy.

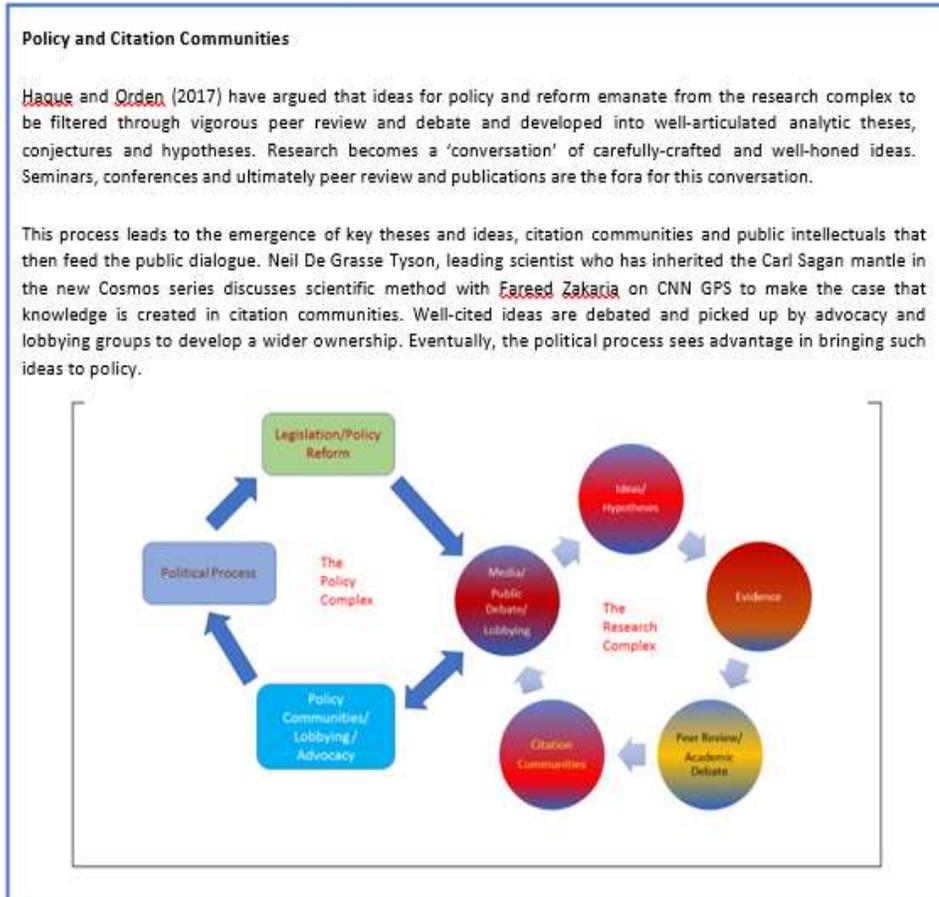
My contention is that since Mahbub ul Haq's time the economist community and our research has been totally ineffective in informing policy or even generating a meaningful debate on any policy issues. I know this is an offensive statement and many might contend it. But like all such statements it is meant to be broad generalisation covering the large mass of research. I will concede the possibility of some tail events where there could be an impact but my hypothesis is that they will be rare.

While the number of economists has increased and forums like PSDE, SDPI, the LSE conference are available and the number of universities have increased from 4 to

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180, sadly influential academics and public intellectuals in the public policy field are rare.<sup>1</sup> Why is it that we are unable to produce Dr Haq's anymore? Where is our academic community?<sup>2</sup> Are events like these conferences helping to make a community? Does it matter that we do not we do not have an academic community or research?

**Fig. 1. Research and Policy**



from Haque and Orden (2017c)

Haque and Khan (1998) pointed out the lack of an academic or policy community. Sadly, despite a sharp increase in the number of universities and scholarships, the research community remains very weak. We should all make it an important topic for active discussion and try to develop policy and citation communities. Here, I will attempt to identify some constraints to the development of such a community.<sup>3</sup>

<sup>1</sup>The vacuum has been filled by a lengthy and almost empty conversation on foreign policy and security. Surprisingly considerable donor funding has gone to developing a large supply of foreign policy and security analysts.

<sup>2</sup>In fact, the community is split as will be evident from the absences in this conference. In fact, there are silos in in the community with few crossovers.

<sup>3</sup>For more on the lack of research and academic community see Haque and Orden (2017c).

In my recent book [Haque (2017b)], I have argued that perhaps the most important agent of change is a vibrant academic community pushing policy through research generated ideas. Indeed, history is a set of ideas and humanity and the world moves with ideas.<sup>4</sup> I will also argue that without a vibrant local academia engaged in informed research there is no coherent policy or thought agenda. Fragmented and hasty policy has been the course that Pakistan has taken because academia has offered no coherence or thought leadership. I will illustrate this through an analysis of our macro-policy where policy has been ad-hoc, volatile and ill-informed.

Dr. Haq's theses on the 22 families and basic needs were taken seriously not just by policy-makers but also by the people as well as the donor [see Haq]. While I am sure that Dr Haq's brilliance could not have been suppressed in any way, I do reflect on the counterfactual of him operating in these times when the donor infrastructure is massive and fully captured by consulting firms, universities and aid funded think tanks and NGOs. Perhaps, even he might have stifled were he were alive today?

Unlike Dr Haq's time today the policy process is broken.

- The Planning Commission (his home ground) is now virtually redundant. Its role as the long term, planning and vision-setting is no longer done. It is supposed to manage the development budget but it does not even do that. The CDWP/PC1 process has been taken over by political interference and whimsical projects are the order of the day.
- 30 years of adjustment programmes have reduced the budget to a quarterly or semiannual affair as the government scrambles with minibudgets to meet IMF reviews most often with ad-hoc revenue and expenditure measures.<sup>5</sup>
- Neither the Economic Coordination Committee (ECC) nor the cabinet initiate, debate or lead any serious economic policy work. Instead policy is seen especially in the ECC as economic transactions and giving tax exemptions and subsidies.<sup>6</sup> Sadly most of these transactions and giveaways are not budgeted for leading to supplementary expenditures and busted budgets.
- Policy has by default continues to follow Dr Haq. The growth framework that he left for us—fund infrastructure projects through substantial aid—is being continued to date. There is some attention given to improving access to education and health care largely because of donor funding. The attention remains on hardware (physical infrastructure) even though much research has been developed since Dr Haq's time to show that the for socio-economic betterment, society could easily regress toward chaos and fascism requirement of the day is deeper reform of institutions for a more open, inclusive and creative society (software).<sup>7</sup>

<sup>4</sup>Haque (2017a) and Jan (2017) have argued that without a vibrant local academic community offering a forward-looking vision for socio-economic betterment, society could easily regress toward chaos and fascism

<sup>5</sup>Every economist must understand how budget is made. The process is described well in this episode of *Soch Bichar* a development podcast.

<sup>6</sup>Sadly, analyses of ECC are never conducted. An episode of *Soch Bichar* a development podcast discussed issues therein based on some research by Ali Salman.

<sup>7</sup>Once again several episodes of *Soch Bichar* discuss the growth model in Pakistan and its hardware fixation while the need of the time is software development. See also Acemoglu and Robinson (2011).

- Governments at all levels remain focused on developing ‘brick and mortar’ projects and seeking aid. Policy is announced most often for political effect or more often for meeting some international commitment such as the SDGs or the MDGs with very little serious effort to implement it.<sup>8</sup> As such policy-making is mostly done on the fly without much effort at investigation and research. More often than not policies are prepared by donor consultants with the government adopting them with little effort at domestic investigation or understanding.
- Sadly, the state of the profession of economics or even public policy has not improved much. Dr Haq had developed a cluster of good economists around him at the Planning Commission. The cluster was enmeshed in the policy process. With the marginalisation of the Planning Commission, professionals have been virtually excluded from policy.
- Since donor aid readily supplies consultants and policy research, the government does not quite feel the need to patronise local research—another handicap facing local researchers. Donor consultants largely provide known and tried solutions from the rest of the world as ‘best practice.’ Unfortunately, ‘best practice’ policies frequently do not produce the intended results as they are not locally owned or maybe not easily adaptable to the local particularity.
- Since research is available from donors, the government has stopped all funding for research. Domestic researchers are few and scattered as despite an increase in scholarships and degrees as the incentives are for the highly skilled public policy professionals to seek jobs locally with donor offices where policy work is being undertaken or to migrate [see Haque (2005) and (2014)].

In short, Pakistani researchers while they are being educated on scholarships by donors may be an infant industry that is being stifled by the consultant dumping that is simultaneously being done by donors [see Haque (2015)]. In this milieu, it is not surprising that there are no domestic citation communities, theses or hypotheses.

Historical evidence suggests that development requires innovative problem-solving in local contexts which may not be fully apparent to visiting consultants [Easterly (2007) and Haque (2017)]. From all points of view, it seems that good policy making requires a dense research complex with vibrant debates that reveal citation communities to inform policy and create ownership for change.

We have yet to develop an organic academic community, confident in its research and steeped in its traditions. Today, academic debates are rare as are theses and hypotheses of known academics. For the researcher and the public policy professional, the only option is some donor funding. Such research is commission, owned and defined by the donor, it seldom builds local thought and ideas. In these reports, references from Pakistan research are rare; discussion of, or confrontation with hypotheses and theses put out by Pakistani research never take place; and there are no reviews of local research and thought when setting up agendas.<sup>9</sup>

<sup>8</sup>The most glaring example of a policy for political effect but with no desire to implement it was the national action plan made in 2015 to counter terrorism. Very little serious effort was made into both its development and implementation.

<sup>9</sup>Naveed and Suleri (2015) offer an interesting analysis of many issues in policy research and suggest directions for change.

Should we be concerned by this? Should we not be grateful that the donors and their consultants are supplying policy research? In my view, we should be concerned for the following reasons.

- The domestic research agenda addresses issues that appear important to international agendas or concerns of the headquarters of donors. The policy and research agenda remains fragmented and often repetitive as unsuccessful projects are followed up with similar programmes.<sup>1011</sup>
- Some key topics that are not studied:
  - there is little work on domestic institutions especially the governance arrangements. While the World Bank Ease of Doing business as well as several other international indicators point sharply in this direction, there is no funding for this work. The Planning Commission Framework of economic growth and several commentators [see Haque (2017)] have pointed to the need for prioritising civil service reform (complete reengineering of structure, ambit and human resource management) but no initiative in this direction has been taken.
  - Decentralisation remains an important issue for public service delivery, improved governance as well as better democracy. Yet there is limited work in this key area.
  - Government processes are over centralised and ineffective as illustrated by our discussion of the Budget and ECC above. Yet hardly any research or thought exists in this area.
  - Perhaps the most glaring example is that of the energy sector where problems have persisted for 10 years and could be as large as cumulative loss to the economy of 40 percent of GDP during this period. Yet no serious body of research has been generated on this important issue and hardly any domestic research has been commissioned in this area.

There are large gaps in our research and public policy dialog. Perhaps that is the reason progress is stymied and our growth rate remains volatile while productivity does not increase. Haque (2017) argues that there is a need of to understand the complexity of the economic and political system to identify ‘linchpin reforms’ so that productivity can be unleashed.

### **Rethinking Macro in Pakistan**

We may be entering our 14th IMF adjustment programme following the next election. Of the last 30 years 23 have been in an IMF programme. Of the roughly 13 programmes, only about 3 achieved some of the objectives of the programme. Pakistan is now among the countries that remain beset with balance of payments crises and in need of extraordinary IMF help.

<sup>10</sup>While poverty has been repeatedly studied, trade with India was in vogue from 2000-15, tax reform has been heavily funded for 20 years, education and health have been not only studied and advocated by Sir Michael Barber led it on behalf of DFID. Money is available liberally for advocacy of education taxes, mother and child health, democracy, citizen’s voice, firms. SMEs etc.

<sup>11</sup>Interestingly, very few of the donor projects have got a highly successful internal evaluation. Despite poor evaluations, projects are often repeated with little change in approach and often with the same consultants.

There is a debate on both the design and implementation of these programs. Unfortunate poor countries suffer from the beggar's curse which goes like this "if policy works, the donor was right and deserves credit; if it does not work implementation was at fault." It is generally assumed that there is no design fault in repeated adjustment programs, merely an implementation failure.

While determining both design and implementation flaws is important, there is agreement that these programs have not helped achieve either successful adjustment or the reform necessary for putting Pakistan on a higher sustainable growth path.

The coming program will have the same strategy as the previous 13 programmes based on the following elements.

- It will attempt to build up reserves (once again to 3 months of reserves) through containing domestic demand by restricting the supply of domestic credit growth.
- To meet the domestic credit growth objective of the programme it will seek a containment of the fiscal deficit to about 5 percent of GDP (again) the end of the program.
- To meet the fiscal target, it will seek revenue increasing and expenditure reduction measures. Unfortunately, these measures are ad hoc and probably adversely affecting growth and productivity.
- There will be some effort to get a programme on privatisation going even though we know that conditions are such that this might be difficult. The privatisation decision will be taken without analysis of market conditions or considering possibilities of post-privatisation monopolies or other inefficiencies.
- Some structural reform (SRO withdrawal, SBP independence, tax admin reform) might be mentioned with insufficient clarity on how and when it should be done. In actual fact neither side expects that it will happen. As before, it will be forgotten in the course of the programme.

All multilateral and bilateral institutions will rally around this programme and push for its implementation. There is little debate on this programme neither within the donor community or the Pakistani thinking community.<sup>12</sup> Among the donors the Fund adjustment programme is sacrosanct by agreement. The role of the Pakistani thinking community is marginalised into silence on this issue.

So, what is the correct macroeconomic policy approach that we should seek?

### **1. End Austerity**

Think about it adjustment is required to correct imbalances especially in the external accounts. The IMF programme primarily focuses on restraining demand growth through restrained credit growth and fiscal adjustment. Based on this model for 30+ years we have been trying to reduce the fiscal deficit mainly through expenditure controls and tax increases. Because adjustment has to be done relatively fast to meet the needs of external financing, governments opt for simple expenditure cuts and tax measures.

<sup>12</sup>There is little debate in academic conferences. People have written about it in popular media but strangely enough academic forums shy away from debate [see Hyder and Khan (2017) and Kardar and Pasha (2017)]. Meanwhile writers too write with no attention to existing writing—a very Pakistani issue. Yet debate requires some engagement.

The compulsion of adjustment programmes and their financial programming logic has made the fiscal debate into an accounting problem

$$D_t = T_t - G_t - (1 + i) D_{t-1}$$

Where  $D$  is deficit and  $G$  is government expenditures,  $i$  is the nominal interest rate and  $T$  is taxation.

Ambitious targets are set with arbitrary taxes (Surcharges, one time levies, multiple withholding income taxes on goods and services, taxes on school fees, bank transactions and internet, excises of all kinds) and expenditure cuts (salary freezes, across the board cuts) with no thought for impact on the economy. The only thing that matters to the proponents of fiscal arithmetic is the dream of reaching a deficit number of 4 percent of GDP. If this happens with 25 percent increase in taxes and 20 percent cut in expenditures, that is fine. Quick and ill-thought out measures are cited to support these cuts. The impact of these measures on economic growth, productivity and employment does not concern the proponents of *fiscal arithmetic*.

Much research [see Haque and Montiel (1991)] has shown that the sustainable fiscal deficit is

$$\frac{D}{Y} * (r - g) = \frac{T}{Y} - \frac{G}{Y} = \frac{PS}{Y}$$

Where  $Y$  is GDP,  $r$  is the real rate of interest,  $PS$  = Primary Surplus and  $g$  is the rate of growth of GDP.

This equation shows that an improvement in growth increases fiscal room and improves the country's debt position. Yet growth plays such a limited role in our policy debates and research.

'Austerity' is a term developed in Europe in the aftermath of the global crises to describe harsh fiscal adjustment through arbitrary expenditure cuts and tax increases with no regard for the impact of these on growth, productivity, society, the social contract and politics. While Europe discovered austerity in 2010, Pakistan has been the victim of austerity policy over 2 decades. Sadly, unlike European academics, we have yet to fight back.

Consider the impact of adjustment based on fiscal accounting (arbitrary expenditure cuts and whimsical tax measures) with no effort to increase growth. We have seen government efficiency decline as arbitrary unplanned expenditure cuts are put in place. Efficiency also declines when obsolete and over stretched colonial systems are given more responsibility while resources are shrinking. On the taxation side, we have seen many minibudgets over the last 2 decades which put in place many taxes upon taxes without regard to distortions or to conflicts with public policy or to the impact on productivity (eg., withholding income taxes on several transactions including utilities and bank withdrawals, tariff surcharges on some 'luxury' goods, levies on petroleum products, taxes on school fees, internet etc.). Research should have shown how these austerity policies adversely impact growth and investment [Haque (2017b)].

Austerity in Pakistan has created an economy of shortages and is choking growth and employment. Do not think that this is a well thought out policy. Instead it is happening because of inertia in thought and analysis in all segments of policy-making—government as well as donors. The economic profession sadly has not even tried to generate a debate on this issue.

## 2. Growth Must be Central to Any Policy Going Forward

This must not be seen as a Keynesian pump priming the economy with an increase in expenditure and excessive deficits. Let me convey through the PSDE that it is incumbent on academia to explain and understand the growth process and what policies are necessary for growth to accelerate in Pakistan. Perhaps the lack of a dialog on this subject is the single biggest failure of our community. We hardly have a dialog on growth. The *PDR symposium* on growth, the *Framework of Economic Growth* and the *PIDE Cities—Engines of Growth* are few of the sporadic efforts that were made but did not create a debate in academia primarily because of donor agenda setting and incapacity of domestic intellect to field a debate. We should seriously worry about the lack of a serious informed conversation on growth.

As I discussed above, Pakistan government is a ‘slave to defunct economics’ still seeking mega projects and aid. Despite large projects and much aid, policy-makers are congratulating themselves with a GDP growth rate of 5.3 percent (over the last 5 years growth has ranged from 3 to 5.3 percent) while the Framework of Economic Growth (2011) showed that our demographics require a sustained growth north of 8 percent for the next 30 years. Continuation of this policy is unlikely to achieve that.

Global experience has shown that growth is much more about putting in place a governance institutions that will transform the state from extraction based on rent-seeking (as now) to an ‘open order’ that will generate creativity, innovation and entrepreneurship (through reform) [see Acemoglu and Robinson (2012)]. Haque (2017) and Planning Commission (2011) present the minimum necessary reform agenda that is necessary to initiate this transition toward a growth acceleration. Sadly, academia has yet to pick up the conversation on growth and develop in detail the reform agenda that is necessary.

But it should be abundantly clear that growth is unlikely to accelerate on a sustained basis or productivity to pick up unless we start a major rethink on systemic reform of our government and institutions. Adjustment programs have not even framed the growth issue and they will not. This is up to the domestic academic community to address this issue. What are the key constraints to growth? To my mind this should be the subject of wider debate in the profession.

## 3. Governance, Role of Government and Fiscal Policy

Any analysis of global indicators (competitiveness, Doing Business, Social Progress etc.) points to governance remains the key issue in Pakistan driving up risk in the economy and slowing down investment and business. Unfortunately, there is hardly any debate or research on this key issue despite occasional lip service in conferences and papers. Consultants and donors freely load an already overloaded, poorly designed and poorly resourced governance system with new responsibilities, goals and policy matrices.<sup>13</sup> Rather than reform government, donors have tried to bypass it through consultant driven policy and governance,<sup>14</sup> project management units, NGOs,<sup>15</sup> advocacy

<sup>13</sup>Most recently UNDP has made Pakistan accept the SDGs without any care for local capacity. To make up for lack of capacity the UNDP is using bilateral aid funds to set up SDG units in government regardless of past experience which has shown that such add-on units don’t work.

<sup>14</sup>For example, Sir Michael Barber, a member of Tony Blair’s government spent 5 years leading ‘deliverology’ in Punjab putting in place education reforms with limited success.

<sup>15</sup>World Bank’s SAP project set up a large number of NGOs that to date are trying to do work on providing services where policy is failing.

units,<sup>16</sup> and even government owned companies.<sup>17</sup> In addition there were a number of initiatives such as capacity building, technical assistance and training as a means to upgrade existing systems without reform.<sup>18</sup>

While reform and renewal has been postponed for decades the governance system has suffered not only natural depreciation but also is weighed under with huge new responsibilities that it was not designed for. It is also under constant attack from donor interventions to create parallel systems and that and smother it with technical assistance and consultants. Would it be fair to say that all these efforts were made to preserve the status quo of poor governance and forestall the required reform? Was it donor capture or lack of understanding on part of the donors? But to be fair the Pakistani intellectual and research community remained silent on the governance reform.

Without reform, governance weighs heavily on the economy. The weakness in macro analysis and policy is that accounting and quantitative analysis prevents us from taking into account the costs of poor governance. In conventional macro frameworks, our measure of governance is merely government expenditures, taxation and deficits. While there is recognition of public goods like law and order, legal and regulatory framework, physical infrastructure, organisational and human capital are all very important for growth, investment and market development, macro analysis makes no attempt to incorporate these. This is why most macroeconomic analysis falls into fiscal arithmetic.

Going forward, the thinking community of Pakistan must take up the impact of poor governance in its every detail in an extensive research program to develop serious reform and policy choices and plans. In doing so we must face several issues boldly and with clarity [see Haque 2017)].

- Governance involves not just the production of public goods and services but also the manner in which power is wielded and shared. The former falls in the domain of administration and civil service as well as the legal and regulatory framework while the latter is how democracy is structured and designed. Consequently, research and academic debate must focus on all aspects of our democracy and develop ideas for improving checks and balances as well as developing better competitive democracy.
- In designing governance and its institutions, the role of government must be discussed and understood with clarity. The urge to overload government with all manner of tasks regardless of its ability to deliver must be resisted. Similarly, the urge to weaken government with some idealistic notion of market efficiency must be resisted. Development happens when both the government and the market are designed well for optimal social and economic outcomes.

<sup>16</sup>All donors in Pakistan have large advocacy projects (tens of million dollars each) to promote their favoured policies through hiring local talent and media.

<sup>17</sup>Shahbaz Sharif, the chief minister of Punjab has taken the PMU approach to a higher level and started setting up public sector companies to take on tasks of providing public services bypassing government agencies and ministries.

<sup>18</sup>The World Bank conducted a 120-million-dollar capacity building project where a few hundred civil servants were sent to Harvard. There was no reform in this project and no impact on governance.

- Governance is much more than making agencies and passing laws copied from the west. At its heart are clear processes for managing government budgets and making policies and decisions on provision of public services and projects. These processes must involve evidence based research for discussion and decision at key forums. At each step there must be transparency, public participation and meticulous recordkeeping. While the decision-making forums such as cabinets and parliaments involve public representative, the research and recordkeeping activities are largely the job of technically competent public servants.

Conventional macroeconomic analysis assumes that fiscal variables adequately measure the contribution of the government to the economy. Adjustment programs assume that mere fiscal retrenchment in all countries are similar. Our research agenda must however seek to understand how these and many other aspects of governance impact the economy. At least research and academics must lay bare the various reasons why most policies including adjustment policies are blunted.

#### Box 1

"In the three-year Extended Fund Facility, which closed in September 2016, Pakistan has successfully implemented an economic reform agenda with a strong focus on achieving macroeconomic stability, achieving both external and internal balance.

- The government's plans to reform the energy sector were laid out in its July 2013 policy, including raising electricity tariffs while reducing subsidies and reforms to improve technical and commercial efficiency....
- The government has also managed to attract significant private investment into electricity generation, especially through the China Pakistan Economic Corridor program....
- Delays in the sale of three of the best-performing distribution companies in Faisalabad, Lahore and Islamabad, and the government's preference to sell shares through Initial Public Offerings (IPOs), means that a different approach will have to be adopted...
- Over the past three years, Pakistan has renewed efforts to develop its financial sector and increase access to finance. The government's National Financial Inclusion Strategy (NFIS), developed in FY15, has provided a comprehensive framework for reform efforts on financial inclusion and aims to increase access to finance for underserved market segments such as women, SMEs, and rural geographies.
- There is a need to continue efforts to strengthen and diversify the financial sector and improve its governance and transparency. The legislative agenda includes the Corporate Rehabilitation Bill, which deals with bankruptcy, and the Deposit Protection Corporation Bill, a deposit insurance scheme. Institutional reforms include the setup of the Pakistan Development Fund (to finance infrastructure) and the unified Shariah Board for the financial sector. Together, these reforms will contribute to a stronger and more inclusive financial sector.
- Tax revenues have increased from 10 percent of GDP in FY13 to 12.4 percent in FY16. This progress was achieved through a combination of eliminating tax exemptions and strengthening tax administration.
- On the expenditure side, recent amendments to the Fiscal Responsibility and Debt Limitation Act will contribute to medium term debt sustainability but it will be necessary to continue strengthening debt management given persistently high debt levels and high financing costs.
- The federal and provincial governments have developed a joint time-bound action plan to improve the investment climate and start addressing some of the key constraints for doing business (accessing credit, starting a business, registering property)."

Pakistan Development Update 2016 World Bank  
<http://documents.worldbank.org/curated/en/935241478612633044/pdf/109961-WP-PUBLIC-disclosed-11-9-16-5-pm-Pakistan-Development-Update-Fall-2016-with-compressed-pics.pdf>

#### 4. Reform, Policy and Projects

Sadly, economic thought and research in Pakistan has not clarified what the difference between policy, reform and projects is nor has it clarified what reform and policy are. Because of lack of clarity on the part of research thought and debate, policy and economic debate continues to be defined by projects and aid [Haq (1963)]. Policy and reform remain secondary and never implemented.

The way donors think of reform and policy is shown in Box 1 where the results of the 3-year adjustment program of the IMF as seen by the World Bank is presented. It is clear that the multiplicity of donors regards reform as price adjustments, copying 'best practices' from advanced countries with a focus on financial development and some privatisation. Clearly, how the government is organised (decentralisation, autonomous regulatory and investigative agencies), its human resource management (incentives, skills, morale), and its processes (budget management) seem to receive little or no attention.

There is a clear need for academia to develop a better understanding of reform and policy and guide the government to move beyond projects and aid. *Reform* must go beyond price adjustments, increased taxation and privatisation. It must seek to change institutional, organisational, human resource management and decision-making processes where necessary.<sup>19</sup> *Policy* should follow thorough research and consultation to set up coherent set of principles for guiding individual and group decision-making and interaction. Both policy and reform must be based on local context and cannot be mere aping the west as in the best practice thesis. Both policy and reform must be based on the historical evolution of organisation, HRM and processes of government and society. Local adaptation, solutions and context are critical.<sup>20, 21</sup>

Markets will develop with good policy and reform. The role of the government is to provide security of life, property and contract to reduce the costs market transactions [North (1992)], Williamson (2009) and Husain (1999). Policy and reform must be clearly guided toward this end.

For decades, the government has been developing aid financed large infrastructure projects but with little impact on growth. Studies have shown that the impact of public investment on growth and private investment is weak at best.<sup>22</sup> Weaknesses in project selection and implementation are well known and could be an important reason why the impact of public investment remains weak. These weaknesses arise from the politicisation of the planning and project approval processes.

### Thinking Systemically

Traditional macroeconomics sees the economy as a set of accounting identities (BOP, monetary sector, the fiscal balance and aggregate demand) a set of behavioural relationships (consumption, investment, demand for and supply of money, and export supply and import demand) and production function with technology embedded in it. These functions are estimated over historical data using the standard assumptions of homogenous consumers, stationary distributions, known expectation mechanisms and markets in equilibrium. We use such models for prediction, analysis and policy-making. To the extent that we can we add uncertainty on to the model but keep the model its

<sup>19</sup>Note in Box 1, in energy over 10 years of shortages, the emphasis has been on price adjustments and increased supply but limited change in organisation, HRM and processes.

<sup>20</sup>The tendency to copy best practice and lift laws and agencies from the west has fragmented governance without improving governance.

<sup>21</sup>Nation Commission for Government Reform (2008) presents a civil service reform design that must be debated and research much more than it has been.

<sup>22</sup>Many studies have tried to estimate the impact of public investment on private investment and growth. Most of them find that the impact of public investment on growth especially in the long run is weak and could even be negative in the long run [see Ghani and Din (2006) and Bint-i-Ajaz and Ellahi (2012)].

parameters and structure are kept intact. The analyses that can be made in the model are exogenous shocks or change in some of the exogenous variables.

Fig. 2.

Standard Econ	Complexity
<ul style="list-style-type: none"> <li>• Model behavior to explain observed phenomenon</li> <li>• Mathematical</li> <li>• Reductionist</li> <li>• Homogenous agents</li> <li>• Hyper-rational</li> <li>• Equilibrium</li> <li>• Optimality eg markets</li> </ul>	<ul style="list-style-type: none"> <li>• How behavior adapts</li> <li>• Computation</li> <li>• Systems approach</li> <li>• Heterogeneous</li> <li>• Cognitive/learning/adapting</li> <li>• Evolving pattern perpetual novelty</li> <li>• System gaming/evolving/feedback</li> </ul>

As economists found out to their discontent in 2008, life does not move along neatly specified behavioural equations. Nor is uncertainty only external to the model. Similarly, rationality has come into question in a whole new field of behavioural economics. Moreover, economic agents operate in groups and are in constant interaction making the assumptions of independence and homogeneity untenable.

While we must continue to exploit traditional macroeconomic research using the standard model, there is now a growing need to exploit newer approaches that have been developed and received impetus especially after 2008. Complexity is a growing analytical tool that could be a useful complement to the standard model while offering us different insights. Figure 2 summarises some key differences.

Thinking in terms of complexity changes how we view the economy, how we analyse and understand economic phenomena, and how we conduct policy analysis. Some key differences are as follows.

- (1) **Think Heterogeneity, Connectivity and Interdependence:** Agent interconnections are not bland and merely price-based, nor are all agents' market decisions independent regardless of identity and societal relationships. Agents differ in a wide variety of attributes such as skills, education, race, and are connected in societal, political and organisational relationships to interact through existing institutional market and other arrangements. These interactions and connections are too complex to characterise in equations of price production and market relationships. These relationships and connections also change over time making it very difficult to capture in the equations of conventional analysis,
- (2) **Evolution, Adaptation and not Equilibrium.** No longer is equilibrium or closed form solutions central to analysis. Instead, in complexity, there could be many equilibria in time and space. What is important is the evolution of connections and relationships over repeated interactions and among diverse and changing groupings. Through this changing interaction emerge important stable and evolving structures of institutions and organisations that could be of

economic significance. The emergence phenomenon might give us a better understanding of how institutions, markets and governments arise and evolve.

- (3) **It is not Markets or Governance:** Conventional policy advice depends on ideological leanings for ‘free market’ or ‘government-led’. One side wants the government to minimise itself to negligible levels through privatisation and outsourcing to make room for more efficient and innovative market solutions. The other cannot stop faulting the market and sees the government as solution to all problems regardless of its capability. The debate is dressed in models and data but remains at its core ideological and a matter of belief.
- (4) **Government and Private Sector Co-evolve.** In complexity, both public and private, evolve together establishing structures of connections and relationships that are required for achieving mutual objectives. There is no reason to assume why one form of organisation—private or government—is better. This approach is more amenable to understanding the key roles of government such as security-provision, regulation and maintenance of law and order.<sup>23</sup>
- (5) **Policy Is Influence, Not Command-and-Control:** Complexity analysis looks for how a deeper understanding of how a system evolves and what patterns or structures are likely to evolve within. Policy is no longer considered from one of the two polar extremes of markets or government control. Self-organisation through agent-interaction determines the structure of policy and society. The system is continuously in the process of reorganising itself. To understand the system, and seek policy prescriptions, analysts must search for evolving rules and norms shaping emergence, and identify the direction of emergent phenomena. Policy then operates to influence and accentuate directions of evolution of the system
- (6) **Bottom Up and Not Top Down:** In complexity analysis, heterogeneous agents interact in a variety of transactions over space and time to allow market and institutional capital and arrangements to emerge. The interaction is local while emergent phenomena might spread into other localities or the system through learning. By their very nature, systems of complexity are based on decentralised local interaction. Most conventional policy prescriptions are top down where the government initiates action and ideas to permeate through the system. Complexity on the other hand argues for a bottom up approach where agents search for local solutions. Government can facilitate local solutions by promoting learning from across localities within a country, as well as information from global knowledge pool.<sup>24</sup>

<sup>23</sup>Complexity offers a more pragmatic viewpoint. The government and the private sector co-evolve according to the needs of the time. It is not either-or as in conventional models but through both evolving relationships and roles that are in each other’s interests, and will benefit the economy. Through their interaction in all forms various institutions and structures can emerge to facilitate the objectives of group interaction and joint production of needs as required. This is more in keeping with reality, and reasonably free of ideological bias.

<sup>24</sup>The refrain in Pakistan policy corridors is: “Why do we have to reinvent the wheel; let us just copy what has happened in successful countries” But this approach is incompatible with complexity thinking. Because of locality and heterogeneity of transactions, transplanting solutions across time and space can run counter to the logic of the evolving system and likely to not work as intended. System thinking argues for policy and government intervention to be locally innovative, even if adapting and learning from elsewhere.

Haque (2017) conducted one such complexity analysis—a short synopsis of it is presented in Box 2. The analysis argues that without making deep systemic changes in the economy many of which seek to reconfigure government for growth the system will operate well within the production possibility frontier. With current centralisation and the rent-seeking that it supports while closing of regulatory and city space for investment and possible entrepreneurship and innovation, growth will remain well below potential as many studies have shown [see Planning Commission (2011) and Husain (1999)].<sup>25</sup>

**Box 2: Complexity analysis of the Pakistan Economy**

- Agents in the system
  - Government comprising of civil servants, judiciary and army.
  - Industrialists who are favored by government policy because of objectives of industrialization and export promotion and import protection.
  - Agriculturists who are also favored as policy feels agriculture important.
  - Donors who provide aid and policy advice
- System moves through time with the accumulation of rents
  - Dominant government captured by rent seeking elites
  - Social mobility prevented through rents
  - Markets prevented from developing because of rents
- Principal form of rents:
  - SROS, subsidies and other entry barriers specific to various activities that favor privilege
  - Government contracts and favors through controls
  - Perks, plots and protocol that play dual role for capture of government and control of behavior of key government officials
- Why elite capture remains alive
  - Noncompetitive democracy (based on dynasties and rotten boroughs) prevents entry and competition for ideas
  - Colonial legacy of highly centralized civil service prevents competition.
    - Highly centralized rule prevents local development or competition as well as keeps rent seeking and corrupt system in capture.
    - All government agencies (from universities to regulatory agencies) run through direct control
- City and market development hostage to plot culture inhibiting commerce and density necessary factors for entrepreneurship and innovation.
  - Potential groups in favor of reform are merchants and entrepreneurs who benefit from competition
  - Potential for large investment if reform and competition introduced
- Important reform possibilities
  - Decentralization based on reconfiguring colonial civil service and giving cities, markets and organization greater autonomy and room for self-organization.
  - Modernization of civil services with clear performance incentives and not inefficient rent seeking perks and plots
  - Competitive cities that seek to develop local markets and entrepreneurship as well as community and social development.
  - Competition and merit to disrupt rent-seeking patterns.
  - Reconfiguring the role of government to thoughtful policymaking and clear transparent process.
  - Vitalize thought research and debate to understand emerging patterns and serve as precursors of good policy and reform

From Looking Back: How Pakistan Became an Asian Tiger in 2050 Haque (2017)

<sup>25</sup>Haq (2004) in very prescient speech also pointed to perks, plots and protocol for the distortions and inefficiencies that they caused. Sadly, local research and debate has not picked up this message. Nor has donor funding.

Conventional macroeconomics has paid too little attention to how the government in its capture and poor policymaking has adversely affected growth. Donors and their consultants have been working closely with the government to develop adjustment programs focusing on revenue collection assuming away all the imperfections that Pakistani analysts have highlighted. It is high time that the domestic intellectual debate examined these issues with care and put growth and the supporting reform on the policy table.

### Conclusion

We must learn from Mahbub ul Haq and challenge ourselves to be relevant and use our knowledge and research to inform policy. In order to get here, the economist/public policy community must take a few important steps.

- (1) **Focus on Building Knowledge.** Knowledge is a community effort where citations and debates filters ideas. Unless there is a greater effort at developing this community and its processes for debate and citations, no real knowledge is created. We must all guard citations with moral suasion. Published work on important issues must be critically examined but never not cited. All theses and hypotheses must be respected and examined. Conferences such as these must seek to organise themselves around hypotheses. Similarly, donor reports must cite and engage with domestic research if they are serious about developing capacity. Nothing is more empowering in developing knowledge than giving parity in debate.
- (2) **Dare to Question.** Research must be entrepreneurial and engage in risk-taking through readiness to question and experiment with different methodologies and approaches. There is a tendency to follow the data and econometrics and regard other forms of evidence as not conclusive. Much has changed in recent years in economic methodology and thought (e.g., complexity). We must mainstream new thinking.
- (3) **Funders Must Listen.** Research funding must not be one way only commissioning research without learning from it. Without real-time feedback from the local community, the research agenda will never be organically rooted or well-informed. Yet I continue to be amazed at the absence of donors at premier conferences like this. Should they develop their research agendas and TORs without listening to our academic community? Does that lead to inertia in research?
- (4) **Develop More Forums.** While HEC has incentivised quantity of research papers using impact factors as a measure of quality. In social science/public policy the more immediate local impact factor is the debate that has been generated and the possible policy impact. It is now time that HEC incentivised more debate and discussion of research. For this it would be very wise to develop an active inter-varsity seminar series and a set of conferences where papers can be discussed repeatedly to allow a wider understanding to develop and perhaps trigger follow-up research. Donors could help develop in this regard.

For decades, we have followed a macro policy of ‘aid funded large brick and mortar projects’ that Haq gave us in the 60s. Research has showed us that growth accelerates with the better software (institutions) of society. Even the productivity of the hardware (physical infrastructure) of society is vastly improved with better software. Our macroeconomic research has really not challenged policy and thinking in MOF.

We have also pursued adjustment programmes based on simplistic fiscal arithmetic that seldom went beneath numbers to look at what the inefficiencies in the tax and expenditure systems were. This approach has led to a hugely distorted tax and tariff system and a wasteful and inefficient expenditure management system. Not only does the fiscal adjustment prove illusory repeatedly, the economy has been choked by an ‘austerity regimes’ ensuing from poorly designed fiscal policy. Not only is governance suffering but it is also adversely affecting the country’s growth prospects. This is most immediately obvious from our declining export numbers.

It is the responsibility of the public policy academia to keep developments in the economy and society under critical review with the hope of an early warning for changes and reform. For this to happen we need to build a policy community.<sup>26</sup> The government and donors have invested substantial amounts to develop Ph.Ds. and degrees in several areas.<sup>27</sup> We need to now develop communities and networks of these educated for policy monitoring and development. This paper has put together some ideas on the costs arising from the absence of such a community.

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<sup>26</sup>Haque (2017b) argues that such a policy community is a real agent of change.

<sup>27</sup>Brain drain from academia and policy has been higher than the creation of capacity until very recently. Yet research on Human Capital Flight has been very sparse despite Haque (2005).

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