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**Corruption Public Finance Project  
Selection; Its Impact On the Economy: A  
Case Study of Pakistan**

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# **Corruption & Public Finance Project Selection; Its Impact On the Economy**

## **A Case Study of Pakistan**

**Aasim Mashkoo, Ovais Ahmed**

### **Abstract**

This research study is demonstrated the methods of systematic financial forecasting to eradicating the corruption barriers in public and private projects which directly impact on diversify economy. The purpose of this study is to investigate the key factors of financial forecasting methods to diminish a corruption abnormality in public projects which are improbable and unavoidable factors in current business world. In order to determine the feasibility of the project there are many different methods to identify the projects evaluation. But these evaluations are manipulated in a manner that the weak areas of the project in many ways never even discussed. We have discussed some methods of project evaluation in this paper. With the help of qualitative comparative study, we try to find out the feasibility of motorways project in Pakistan. Those projects evaluation which are triangle basis external and internal third party. In this study, we have put light on financial methods of measuring public or private projects systematically. There is no irrelevant upturn and downturn in assessment that how to project evaluation selection methods which can positive impact on economic growth.

**Keywords: Economic Development, Financial Development, Corruption**

### **Introduction**

In today's world the most important point of strength for any country is Economy. Strong Economy represents strong countries. Even the most powerful political superpowers are getting weak due to their weak economies. Demise of Russia and the Problems of US and UK are clearly the best examples in this regard. Russia had more than 3 million army and unlimited war resources when they crash landed into 7 small states. Just because of their economic conditions. Same is the condition of US who is continuously pleading Japan, China for their economic support, whereas they have the largest war machine in the current world scenario.

But the question raises here that why such economic giants become so meagre in 2 or 3 decades. Their economies became so weak in such a small period of time that they are near to death economically. The answer is simple. Wrong selections of projects either intentionally or unintentionally was going on for long before. These projects are of both non-productive as well as cost-defective. The motive behind the acceptance of such projects on public expenditure is both corruption as well as ignorance.

In Pakistan both the reason applied on different projects. There are lots of waste projects lying dead on the soil of Pakistan. All these projects not only burdened the Pakistani exchequer but also not able to produce the employment and production needed. Most of the projects funded by international donors. These donors also provide the technical consultancy of the project. All those consultants charged huge sums of money and never provided accurate results.

There is efficacy of negative impact of economic performance on development projects. Even if there is a negative relationship between corruption and economic performance. According to below Table 6.1 illustrated the figures of Asian Countries. The regression analysis elucidated the relationship between corruption and poor economic Performance.

We will look at these countries at greater length later. However, the table confirms that when it is difficult to find examples of development without corruption. This does not of course mean that corruption contributed to development, but it does mean that we have to be careful in drawing conclusions about the effects of corruption from large cross-section regressions. Even if the successful countries were not as corrupt for instance, Nigeria, the difference in the scale of their corruption is unlikely to explain any significant part of their difference in economic performance. In this sense the theories that look at the differences in the types of corruption are more likely to be useful, though we will have to look at both. (Khan, 2001)

**Table 6.1 Corruption and economic performance**

<i>Country</i>	<i>Corruption Index</i>	<i>GDP Growth Rates</i>	
		1970-80	1980-92
	1980-3		
Malaysia	6	7.9	5.9
South Korea	5.7	9.6	9.4
India	5.25	3.4	5.2
Pakistan	4	4.9	6.1
Bangladesh	4	2.3	4.2
Thailand	1.5	7.1	8.2

*Source:* Mauro 1995; *World Development Report* 1994.

*Note:* A corruption index of 10 indicates 'no corruption', and an index of 0 indicates 'maximum corruption'.

This chapter explained and implied the technical corruption and its impact on the economy in the long run. There are two angles of this technical corruption we will discuss. First one is the Receiving End or the country where the project is going to build, and second one is the donor agencies who will provide both the technical input and the money.

### **Evaluation of Corruption and Barriers**

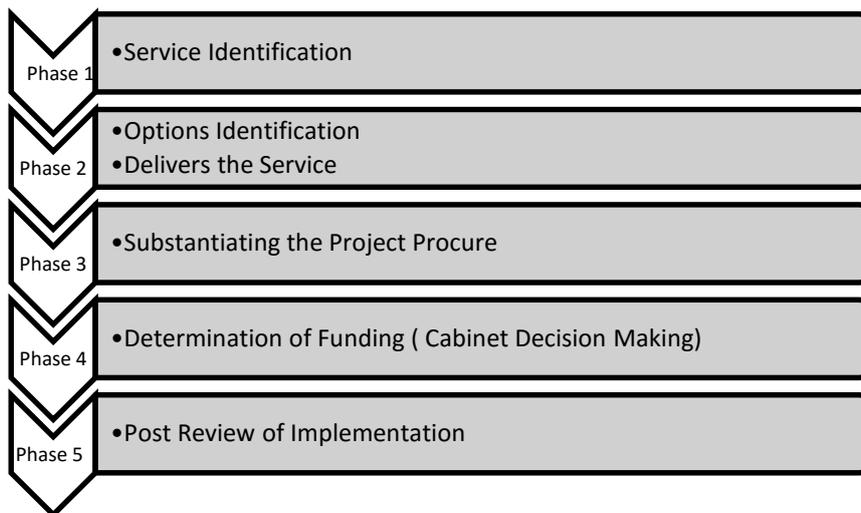
- To find out the loop holes of the project evaluation methodologies.

- To determine the impact of these errors on the economy.
- To evaluate the profitability generated through these professional errors.
- To determine the motive behind these professional errors.

In order to identify the technical corruption and its methods, we will have to look for the different methods used for project evaluation. There are many methods used for project evaluation. But the most important tool kit is CBA (Cost Benefit Analysis) it provides the basic comparison of cost of the project and the benefits it produces.

“Cost benefit analysis achieves makes numerous and varied effects commensurate by quantifying them in terms of monetary equivalents. Methods are available to estimate the monetary value of travel-time savings or of newly attracted trips and to compare costs and benefits occurring at widely different points in time. Additionally, costs and benefits can sometimes be traced to particular income, ethnic, or occupational groups so that the effect on the distribution of real incomes. (Small, 1998)

There are five phases which explained the project evaluation of development and clarity of assessments.



These above phases explained how the advantages contributes to the Government operations and to state the purpose of the study that why these initiatives essentials for before selecting the government projects. In this research,

**Phase 1: Service Identification and Needs**  
**Step 1**

The service need is to show the evaluation point to specify of the service need clearly mention in this document. It also checks the deficiencies of the services that attempted by proposal for addressing. This step is necessary for aims into output. There are some initiatives which makes contribution and dependable on government aims such as Strategic plan acknowledged by South Australia, Planning strategy made corporates aims and project goals

for further enhancement of clear identification and to make quantification of results that will ease to implementation and post-implementation review procedures.

### **Step 2**

The step two is to stipulate standards are necessary to make prescribed proposal often depend on statutory requirement. This proposal has extensive clarification of relation between the standards and objectives, it is to categorize any international and national level of compliance which is usually known as mandatory common wealth agreement. To ensure the demonstration such standards are appropriate for the South Australian conditions. These standards are ensuring the advocate appropriate agency to meet these standards.

### **Step 3**

The step three is describe the services which are assume from government authority for this proposal and project objectives. The scope of services are comprising details of assumption which makes the scope more in detail and deterministic. The services essentials can be developing from initial range related to another. The careful judgments could be identified by discrete initiatives. By definition the initiative has importance to confirm the services that intended to deliver and are precisely state that estimating funding possibilities. The government funding could be considered as below:

### **Level of aggregation**

A series of component parts might be dependent upon initiatives. There are important principles are to apply on these components.

- To the larger initiatives is likely to be critical and indispensable,
- To evaluation should be larger initiatives
- There is no individual component part
- A single initiative should have evaluated by join product or interdependent initiatives
- A discrete component has classified objectives can be evaluated individually.

### **Accounting linkages and initiatives**

The documentation of accounting for linkages to other initiatives includes all necessary elements of initiative for the achievement.

Even though if the initiative contains a growth of an organization's output, the other agency's areas might be pressure by those agencies. At the results, the expenditures and revenues have changed in these areas. These changes would account in evaluation. For instance, a public housing needs to a green fields expansion area, it may effect on the other services such as electricity, public transport, water and education.

## **Phase 2: Options Identification and Deliver the Service**

The phase two consists of fundamentals of identification of options is being addressed and explained a key goal/ Objectives of the evaluated service delivery option which makes guide the most efficient outcomes. At the time of project evaluation either is valid for future or not should be evaluate two options in any one case. It is important that the objective of stage two is provide Cabinet with rich information for deciding and the proposal has value of development.

### **Step 1: Develop the ‘base case’ or ‘do nothing’ Stages**

Generally, for any project development is start with ‘base case’ and ‘do nothing’ scenario. There are other options equated by base but there is nothing to do on it. It contains future cost and no policy benefit. Therefore, there are not continuing to provide services at levels of services which have impending external environment. The ‘do nothing’ case is specified and its cost is carefully assessing. It also quantified impact to prove the preferred options. It is not essential to apply on nothing scenario, but also it works on the service continuity. The deferral option is preferred on case of assets replacement decisions with a new asset. The other fixed cost of assets would be continuing like maintenance and eventual replacement.

### **Step 2: Develop alternatives to the do nothing case**

The ‘do nothing’ case scenario may be characterized through develop other option which involve range of alternatives ideas would be considered. The basis of characteristics may be grouped and develop alternatives which defined the ‘do nothing’ cases. There are broad categories explained the develop alternatives through enforcement versus education. It creates awareness to judge the scenario of projects and cost benefit options behind the alternatives. Secondly, it consists self-regulation versus government regulation are describe the brief intuition of intended projects. Third options are direct government involvement versus government facilitation.

There are further options which have involvement of ongoing recurrent maintenance, upfront capital expenditure has differing degrees of technological capabilities. There are some reasonable options which cannot be immediate obvious so in such type of circumstances the review techniques and use of planning for instance, SWOT (Strength, Weakness, Opportunities, Threat) analysis have to mandatory option. The viable options are measured by strategic value management sessions which helps in identification.

The guidelines explained by Department of Treasury & Finance Initiative evaluation. The points which discuss below:

1. scope of the project
2. To develop appropriate project case

3. To estimates the preliminary cost
4. If relevant the existing asset have to identify redevelopment
5. To disposal an opportunity
6. To make initial determine of funding methods which should include both risk option and financing.
7. To make broad concern of prioritisation

It is essential to make commenced initial consultation with relevant associations.

### **Discounted Cash Flow Analysis**

The nature of the project it is some time to evaluate the appropriate value of that project to present. The evaluation of present value in constant dollar term. The project might be generating revenue, savings, and other expected cost may not be accruing appropriately. The project time period is important in terms of size of project's cash flows which may differ expressively over a long period. Discounted cash flow provides particular value of the project or proposal. An appropriate discount rates needs the application of discounted cash flow requires the selection of that rate which already discussed in Phase 3 later on discussed.

### **Phase 3: Substantiating the Project**

#### **Evaluation concepts**

There are three methods to the evaluation of initiatives are social, environment and budgeting It illustrate in convinced and share characteristics for project funding. The essential difference structures of these determination are as follows.

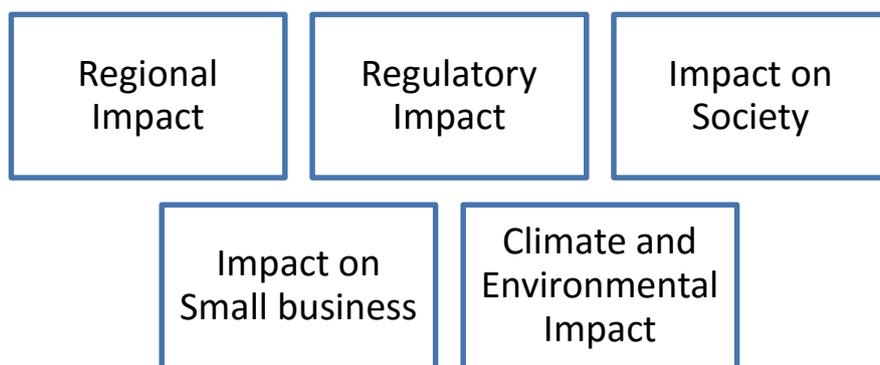
1. Perspective
  - The perspective describes the financial concerned with cash flows
  - It also dependent on environmental, Economic and social concern
  - Budget concerned with revenues that vary the whole government condition
2. Valuation
  - a. An observe prices are concerned by financial and budget with these prices.
  - b. To recognize the possible cost and benefit through environmental, Economic and social approaches. These approaches are necessary value exists in current markets. These cost and benefits will not be pragmatic or functional by assign monetary values.
3. Objective
  - Financial means to increase the wealth maximization or profitability or minimizing cost.

- Maximize net total benefits are assisted by identifying initiatives concerned.
- Budget also assess the impact on net lending, operating balance and debt/ obligations.

#### 4. Time preference

- Future costs and benefits is concerned by Financial, Environmental, Social and Economic at a single point.
- The time preference of receipts and outlays has no explicit accounts in budgets.

There are many other enlisting circular and statements follows:



We have justified the key objectives for an initiative describes the advantages to the community which exceeds the costs. Though, the above key assumptions not really imply that the initiatives will process the financial performance of the agency.

### **Financial evaluation**

There are following steps shown diagrammatically involved in financial evaluation below:

The determination cost is required by financial evaluation and which would benefit of the initiatives developed after formulation cost. The net present value techniques use during the evaluation period.

#### **Step 1: Identify relevant cash flows**

The step one entails an assessment of the cash inflows and outflows. It expected an initiative outcome which are essential for financial evaluation and business case analysis. The business case analyses prepared a proposal from an agency' point of view instead the broader community of social and economic evaluation. Some opportunity cost is become the essential requirement for economic and social evaluation. This requirement is feasible for assessing the valuation of costs and benefits. Besides market value is observed by financial evaluation. The delivery option has alternatives that are being determined every option. It needs to be

evaluated as distinct task. In evaluation process there are several options will show different factors such as risk allocations, cash flows. For other options, the SA and Government Enterprises provided the alternative financing options.

**Step two: Select evaluation period**

The step two showing appropriate element of the initiatives will be the time period for the broad policy and which the objectives of initiatives. These elements are relevantly proposing through evaluation. Particularly, the time period of evaluation period must be not greater than 30 years. It should be 10 years for equipment initiatives and 5 years for telecommunication and information technology initiatives. For regular result outcome the evaluation period should be same as for all option. The analysis should be take into account difference in the economic lives.

**Step three: Assess net financial benefits**

For further assessment the financial benefits have been evaluated through various options to determine the propose objectives of the project at given timer period not more than 30 years is the targeted. Other consequences have to maintain the standards of cost and benefits for options which are often spread over time periods. If the net benefit of a range of option compared so the common based values to present values. The costs and benefits are clearly defining that cannot objectively have determined in financial terms. At sometimes attempting the right assign values made such benefits and costs give positivity in assign project. The little reliance can be placed on the obtaining values in methodology. Initial NPV (Net present value) analysis should not be included.

It is recommended that there is not taken current price value only used constant price. The only reason not taking current prices have not been adjusted for changes in purchasing power. Such as inflation between time periods which is sometimes known real values. Current market prices are dominant each specific period. It is also called nominal prices. the following table compares the constant and current prices according to 2.5 percent per annum estimation we assume inflation rate.

	<b>2004-05</b>	<b>2005-06</b>	<b>2006-07</b>	<b>2007-08</b>
Constant price	100	100	100	100
Current price	100	102.50	105.06	107.69

**Recommended Discount Rate**

According to commercial agencies the discount rate represents agency’s hurdle rate of return which approved in performance statement. This rate is equating with WACC (Weighted

average cost of capital). The hurdle rate is greater or lower than 2% through using sensitivity analysis.

### **Calculation of Discount Rate (Hurdle Rate)**

The calculation of hurdle or discount rate ensure the estimates of benefits and costs resulting from the prior steps reflect the results. Although there is always little bit uncertainty in measures about future events to identify key assumptions. The test of variations in project would essential to be categorized into different broad risk characteristics. In this case we have derived the three broader risk – Low risk, Medium risk and High risk. There are multiple streams of benefits and costs to a project that explained essentially at different levels. Those streams are basis on risk category that is applied by the separate streams which make appropriate discount rate.

The discount rate which also known as hurdle rate applied to projects within 3 risk types.

- Low Risk - 6.0 Percent
- Medium Risk - 8.0 Percent
- High Risk -10 Percent

The reality of risk rate is reflected by risk measurement technique i.e. CAPM (Capital Assets Pricing Model) have limited significance in the private sector. CAPM cannot lead to a serious error in the public sector environment in the estimation of discount rate. These discount rates consequent and intended to reflect premium for risk over the real risk that risk generally stable during time period. These rates needs to be adjusted and accrue from period to period to replicate in the risk free rates. These changes prove to be sustained and significant.

According to Treasury and Finance Account assists to agencies should determine which risk category their project. For the initiative project stream, the NPV (Net Present Value) is calculate at appropriate discount rate which recognize. This calculation is including cost and benefit and can be measured in financial terms. The hurdle rate use there where commercial projects formally achieve by signifying that the net present value using hurdle rate calculated above is positive. Financial terms are measured by objectively where costs and benefits include in commercial projects.

### **Step four: Accommodate risk**

This step four accommodate risk which estimate benefits and costs determined from the prior steps indicating the most relevant results. If any uncertainty predicted about future events so those estimates which measured in previous step identify key assumptions and test the impact of changes in the assumptions. Simultaneously hurdle rate is adjusted through applying risk for projects of benefits and cost. This streams use the techniques for incorporating uncertainty into evaluation process.

For sensitivity analysis, the possible impact should be assessing of uncertainty to considers that what would happen if the key assumptions give wrong outcomes and key variables proved to be negative that how the various factors affect the total outcome of provided options.

For other key variable the sensitivity analysis is undertaken by separate assumption. The discount rates are conducted sensitivity analysis varying by positive/negative 2 percent for the outcome. At initial stage the net present value (NPV) is evaluated at this stage to determine the sensitivity. Whether a project sensitive to vary in hurdle rates. If the net present value (NPV) positive to negative the project will be estimated complex to discount rates. As the increasing the discount rate by 50 percent as discount rate increases.

For *switching values* the calculation made the value of a variable to determine at which the Net present value (NPV) is becomes zero or the change of risk has two options. After done this problem, the decision is whether the variable is likelihood to take on values above the switching values or not. For *scenario analysis*, the overall process looked at the conclusion of changes in many key variables at the same in time. For *range estimation*, this method is calculating and expressing uncertainty through lower and upper bounds for estimates below specified set of assumptions.

### **Economic, social and environmental evaluation**

In this financial evaluation step, the technique involve is to differs from the financial budgeting by attempting to identify where all costs and benefits have been evaluated arising from the project.

#### **Step 1: Choose the appropriate technique**

The appropriate technique used in economic and social evaluation is CBA (Cost, benefit analysis) and CEA (Cost effective Analysis). Cost benefit analysis technique is use usually where costs and benefit can be valued mostly. Cost effective analysis technique is use generally where major benefits and particularly may not be valued readily.

#### **Step 2: Identify and value costs and benefits**

The step two recognize the value costs and benefits of the initiative. These economic and social assessment shields benefits and costs to the community.

### **Budget Evaluation**

The budget evaluation includes further assessment impact which it directly effective for evaluation process step by step as an undertaken from an agency and as a government.

### **Step 1: Identify budgetary impacts**

In budgetary scenario require identification of impacts on the CA (Consolidated Account), General Government Net Lending and (GGNOB) Government Net Operating Balance. CA include governor's appropriation fund which is equal to tax and dividend. GGNOB will comprise revenues and expenses. It involves parties external to the government sector. GGNL include non-depreciation operating expenses and revenues. It also involves receipts and payment for investing purpose external to government sector.

### **Step two: Evaluate investing/operating outlays and receipts**

The step shows that once impact have been recognized, evaluation expected and predicted receipts and outlays.

### **Step three: Compare assessment to current funding levels**

“Further it is usually difficult to establish that multiplier effects would not have occurred through activity that would have occurred in the absence of the project. If we are considering impacts on the State economy, it needs to be recognised that even sophisticated models (such as computable general equilibrium models) are of little use in quantifying impacts. This is because the basic data used to operationalize these models is typically deficient. That said, such models can provide a useful framework for identifying the type of costs and benefits that might flow from the proposal. These factors are a component of the economic and social assessment of the model.” (Department of Treasury and Finance, 2009)

## **Sen's Theory**

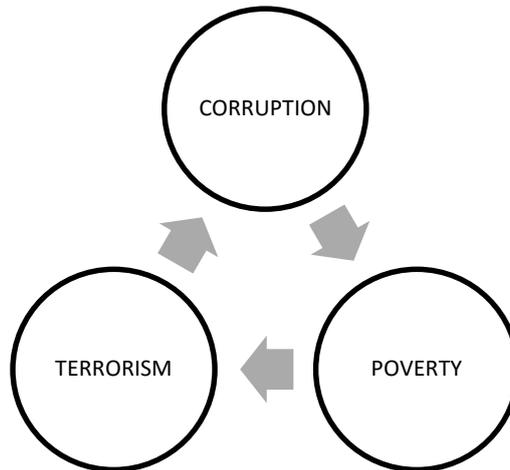
The theoretical paradigm capable of overcoming the parameters of the neoclassical method. This method is deciding on public investment including environmental goods. Particularly, the Sen's theory inherently well-being positive reflection with specific discipline. For example, Applied Ecology, that deals with the study of environmental relation with individuals. The theory of functioning and capability as the definition of an evaluating social well-being. The theory also depicts the integration of environmental problems and principles.

The formal structure of Sen's theory explained the facts of capabilities perception with opulence approach can be illustrated by the vector of goods and services. However, considers those commodities or rather, also as means which has relations of their characteristics can evaluate states of making being. The identification of a function  $C(x_i)$  transforms the commodities vector into a function  $f_i c(x_i)$  represents individual personal use of basket goods. (Sen, 1992)

The theories are new and uncommon the application level can only be tested on already developed or under developed countries. According to such analysis the result is quite eminent.

- Human development is the first priority to most of the world’s leading economies.
- The countries lagging far behind does not pay attention to human development.
- Resource profiling is missing in most of the under developed countries.
- Development plans of under developed countries are not matched with the available resources.

### **New Model of Corruption**



Source: Diagram from Economic Development Planning Book<sup>1</sup>

The above diagram clearly showed the new modulation of this troika which provides the inner relationship between the three factors. If we go through the names of least corrupt countries. We will find out that those countries which are least corrupt, those countries are also the least damaged by terrorism. On the other hand, the countries where the corruption is in full song. The terrorism is also damaging the country in many ways. If we go through the example of Pakistan, in Musharraf’s era the corruption was at lowest ebb and the terrorism was also very controlled. But in last 8 years the corruption was in full swing and more than Rs. 5000 billion were stolen from the national exchequer. Most of the projects were only on paper and the money was stolen bluntly. In the last 8 years more than 55 thousand people killed in different terrorist attacks. This is more than the total killings in 3 wars fought in 70 years of Pakistan history. In the above diagram we tried to explain the relationship between the corruption, poverty and terrorism. Corruption avoids parity among all the economic circles, which enhance the poverty. The poor people are the most important fuel of the terrorism. Poverty is the playground where human bodies burnt as fuel.

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<sup>1</sup> (Ahmed & Mashkoo, 2016)

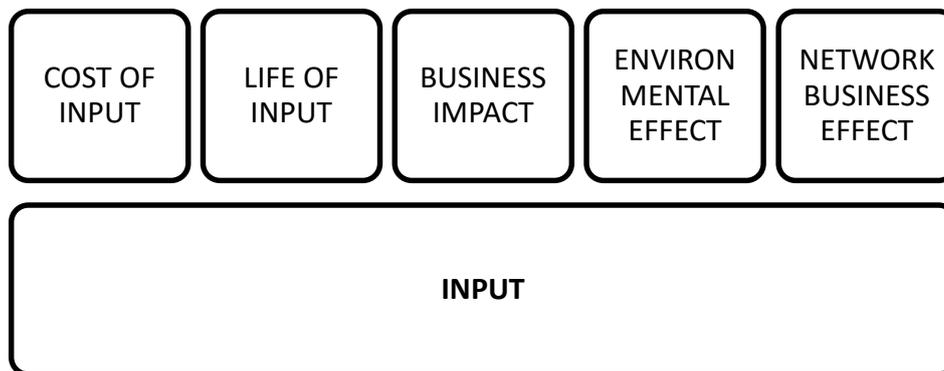
## Methodology

In this paper we are adopting the qualitative research analysis. In which we compare the standard we have developed and the conditions available to us about the project. This is called comparative study methodology. This comprehensive study showed measure the layout of the standards and the general reality of the projects.

## Project analysis

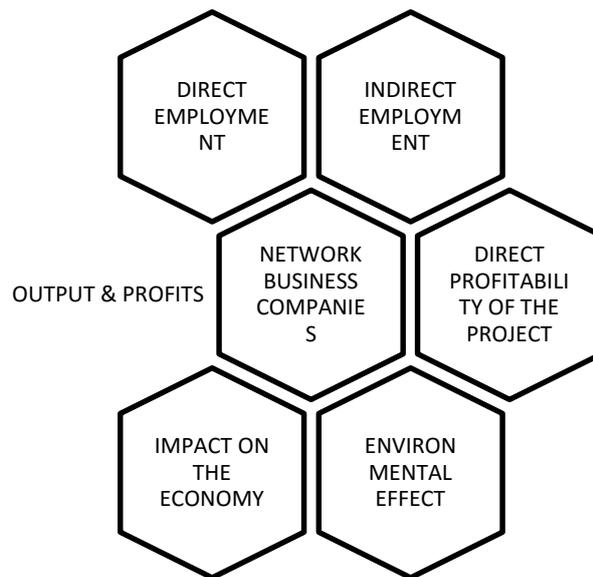
There are many ways of project analysis, three of them discussed above but how can we analyse the project so we can understand its affordability and its practicality. First we have to decide and set the parameters for this analysis.

## Input cost and life analysis



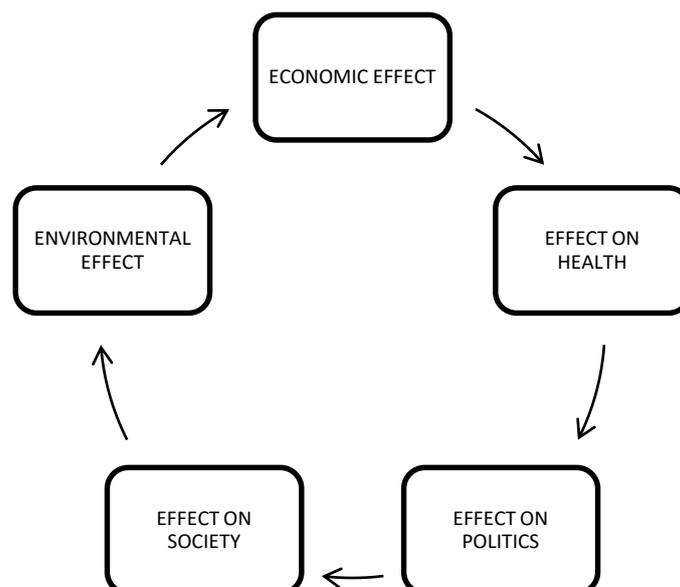
In the above diagram the inputs of any project and its evaluation of future in different parameters. Because in many circumstances the effects of putting inputs without future evaluation cause multiple regressive effects on the people and business around the project.

## Output Profitability and Time



In this analysis we evaluate the outputs and their profit abilities to the extent of their enforcing and increasing impact on the people and the environment around it, because sometimes the outputs are so overwhelming that it attracts so many intruders. This intrusion become the reason of imbalance, which is social, biological, environmental, scenario of that particular region.

## Impact of project in the life of average person



In this analysis what type of effects the project put on as whole on society, economy, health, environment, animals, and politics in precise. There are many projects which instigates the great negative vibes around the project for a very long time. Kalabagh dam is the best example of such project.

## **ANALYSIS OF MOTOR WAYS PROJECT IN PAKISTAN**

In the above analytical cycles, we have three type of analysis. These analyses have different impacts on different levels altogether. Let's check the Motorways project in the light of above procedures.

### **Input Analysis**

Cost of the input: First and most important cost of the input. If the project is built on imported inputs, then definitely the cost is high.

Life of the input: How long the life of the input. Projects built with low life inputs normally unable to retrieve their costs.

Business impact: How many local businesses get rewarded due to these inputs of the project.

Environmental Effect: inputting such material can cause any effects on environment or not.

Network business: How many indirect businesses get benefitted due to these inputs.

### **Output Analysis**

1. Direct Employment: How many persons directly employed in the project after completing it.
2. Indirect Employment: How many companies are working in the indirect support businesses and how many persons are working in them?
3. Network business companies: How many companies get business in such projects after completion?
4. Profitability of the project: If the business is profitable then what is the profitability of the company.
5. Impact on the Economy: The measurement on the economy as a whole. How much GDP it generated.
6. Environmental Effect: In modern World the environment friendly project must be accepted. Those projects not supported by the environment are not acceptable in general.

### **Impact on Life of Common Person Analysis**

1. Economic Effect: How many economic opportunities a common man can get in this project.
2. Effect on Health: Such Projects improve health conditions for a common person or not.
3. Environmental Effect: Environment conditions for a common person is improving or not.
4. Effect on Society: As a whole society is getting any boost or not.

### **Conclusion**

In this paper we have identified the standards on which the project must be established and its standards must be met. But the lack of home-work and avoidance of standards set during and before the project started made all such projects vulnerable. All such projects became burden on national exchequer and their utility is near to nil as compared to investment put on those projects.

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