Measuring the Size of Government: A case of Pakistan

(Draft)

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Introduction

The size of government is perhaps one of the most divisive issues that has attracted the attention of researchers over the years. And unfortunately, as Henry Blodget (2012) noted, this topic has largely been politicized and one cannot talk about it without been applauded or booed by supporters of respective political parties and due to this a lot of facts have been ignored or distorted.

Economists and policy makers are divided on whether expanding the size of government retards or accelerate the economic wellbeing of a country. The proponents of the bigger size of government view government as a master of correcting the inadequacies of the free markets. They opined that government, through its development and welfare programs, provide goods- national defence, health, education and basic infrastructure- which market cannot offer. This position says that the externalities created by liberalized markets result into inefficient allocation of resources, which cannot be solved on their own, and hence, it requires government intervention to overcome these expanses. This view also claims that the expansion of government pumps more money into pockets of the economy, which then accelerates the economic growth.

On the other hand, the advocates of smaller size of government argue that expanding the size of government beyond a certain tipping point can only shelter Mafia's and rent seekers.[1] They believe that special interest groups, politicians and employees of government are the rent seekers, who use government's powers to peruse their own interests. The proponents of smaller size of government declare that overreaching size of government –beyond 15 to 25 percent- takes away resources from productive sectors of the economy to the government, which is inefficient and non-productive and hence, it retards economic growth.[2] They state that expanding the size of government not only crowds out private investment (which then negatively effects the growth) but overreaching size of government also effects the economic freedom, snatch private exchange opportunities and extract the choices available for the individuals. And when this happens, government itself becomes a problem.

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[1] Howden D. and Parodi E. (2015). "How Italy's Government Enables the Mafia", Mises Institute

[2] Rahn, R. and Fox, H. (1996). "What Is the Optimum Size of Government" Vernon K. Krieble Foundation

Pakistan has a huge budget deficit of Rs. 1.4 trillion (as of March 2015) and we have a gigantic national debt of Rs. 18.1 trillion to fight with. Moreover, by adding additional liabilities[3] to debt stock one can find that Debt-to-GDP ratio in Pakistan increased to 75 percent.[4] During 2007-2014, public expenditure exceeded total revenue by 17 percent and tax revenue by 64 percent.[5] Hence, it is of great importance to discuss the causes and consequences of government's expansion on the economy of Pakistan.

Except a recent study conducted by Haque (2012), most of the research conducted in recent years on the size of government and its impact on the economic growth of Pakistan, indicates that the actual size of government ranges between 18 to 23 percent and the optimal size of government may be as large as 22 percent of the GDP.[6] This paper will propose that these findings are not based on the true measures of the size of government and the actual size is higher than what is estimated by these studies. This analysis also highlights that the size of government should be measured on the basis of the extent to which government commands or direct the resources of the economy.

The second section of this paper briefly reviews the literature on the role of government in the economy and costs of government expansion. The paper then examines the existing literature regarding size of government and its impact on the economy. Section 2 presents the facts about the actual size of government in Pakistan. The final section is devoted to the conclusion and recommendations.

How government commands the resources?

The size of government is generally related to the extent to which government or political forces command or direct the allocation of resources. Before evaluating the size of government, it is necessary to analyse the ways in which government can command the resources. Government can command or effect the economic activity through:

1. Production of goods such as infrastructure, national defence etc. In Pakistan, during past several years, defence related government expenditure is averaged around 12 percent of the total expenditure of the federal government.[7] Similarly, development expenditure is comprised of 18 percent of the total federal outlays. [8]

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[3] These liabilities include: Foreign exchange liabilities, contingent guarantees, PSEs debt, circular debt and tax refunds

[4] Calculations presented by Mr. Sakib Sherani at National Debt Conference 2015, organised by PRIME Institute

[5] Quoted by: Dr. Kaiser Bengali at National Debt Conference 2015, organised by PRIME Institute

[6] Ul Husnain, M. I. (2011). Is the Size of Government Optimal in Pakistan? *Journal of Economics and Economic Education Research*, *12* (2), 41.; Zareen, S., & Qayyum, A. (2014). An Analysis of Optimal Government Size for Growth: A Case Study of Pakistan.

[7] Economic Survey of Pakistan (2014-15)

[8] Ibid

2. Redistribution of income among different income classes through taxation and fiscal spending. It can be in the form of vertical redistribution where higher taxes are imposed on extra income and it can also take the form of horizontal transfers, such as mean tested benefits, in which a person can get the benefits by declaring that his income or capital owned is lower than a certain threshold level. For instance, in the budget for FY 2015-16, Benazir Income Support Program (BISP) Board has approved Rs. 102 billion for BISP, out of which Rs. 93.8 billion is allocated for unconditional cash transfers- for those families having monthly income less than Rs. 6000.[9]
3. Government can also command the behaviours of the individuals. For instance, government taxation on income alters the incentives for extra work effort.[10] Similarly, government can also change the consumption of certain goods by introducing rationing schemes or through taxation on consumption after a defined limit.
4. Government can introduce different laws and regulations for regulating the economic activity. These regulations can be related to protection of environment, minimum wage laws, regulations regarding work hours, regulations that direct or control trade across the borders.

How to measure the actual size of government?

The four categories explained above indicate that measuring the size of government without analysing the government's command over the resources can be misleading. There can be several ways of measuring the size of government. Each measure has its own pros and cons. However, some of the measures have more shortcomings than the others.

1. Share of government in the economy can be measured through government receipts. However, if it is measured only through government revenue then it would be an incomplete calculation. For instance, reducing the tax burden doesn't necessarily mean reduction in the government's command over the resources and hence, size of government cannot be reduced. Rather, it only changes the ways of how government finance its expenditures for participating in the economy.
2. The size of government can also be measured through the number of government employees. However, the shortcoming in this indicator is that government often substitutes labour with capital to perform different activities. Several government departments are now using information technology in performing the same tasks, which otherwise were handled by the public servants. Moreover, instead of government employees, private labour force can also be hired on contractual basis for delivering different government programs.

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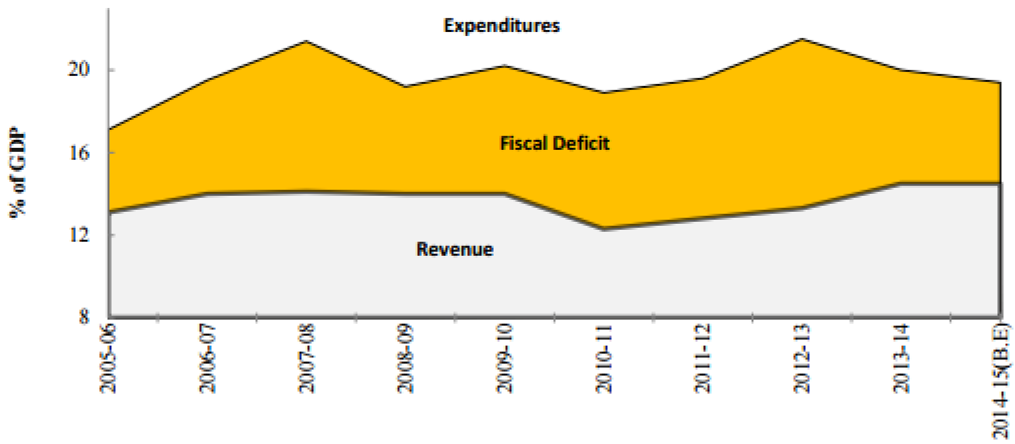
[9] Source: http://www.bisp.gov.pk/news/July%202015/boardmeetingjuly2015.pdf, retrieved on January 21, 2016

[10] Kahn (2001) explained that the differences in the employment level across different countries is due to the variances in the tax structure of the respective countries.

3. Measuring the size of government based on general government consumption expenditure is relatively a better practice than measuring it through the public receipts. Government can finance its expenditures by using resources other than the tax revenue, deficit financing can be an example of this. Rising fiscal deficit creates a significant difference between the two variables. As depicted in Fig. 1 fiscal deficit of Pakistan peaked in 2012-13 and reached to 8.2 percent of GDP. When measured through outlays, the size of government peaked in the same year and it came to 21.5 percent of the economy of Pakistan. On the other hand total revenue of the government was 13.3 percent of the GDP.

   When measured through receipts, size of government peaked in FY 2013-14 and it moved up to 14.5 percent of the GDP. Contrarily, government shrunk in the same year (2013-14) when measured through outlays i.e. it came down to 20 percent of the economy from 21.5 percent in the previous year.

Figure 1: Revenue-Expenditure, as a percentage of GDP



Source: Pakistan Economic Survey (2014-15)

   Another thing which is clear from Figure 1 is that, size of government is always larger when measured through expenditures as compared to when it is measured with the revenue. Hence, size of government can be understated when measured through government's receipts. This indicates that the impact of government expansion can be analysed more precisely on the basis of the magnitude of government spending in the economy.

4. However, the assessment of government's share in the economy can also be misleading when it is measured only through the government outlays. For instance, many government regulations may add minor or no amount to both the ledgers of the government's budget, yet have a large impact on the economy. For example, government can reduce the consumption of certain goods by imposing heavy taxes. Thus, rising prices can reduce its consumption. Similarly, government can give money

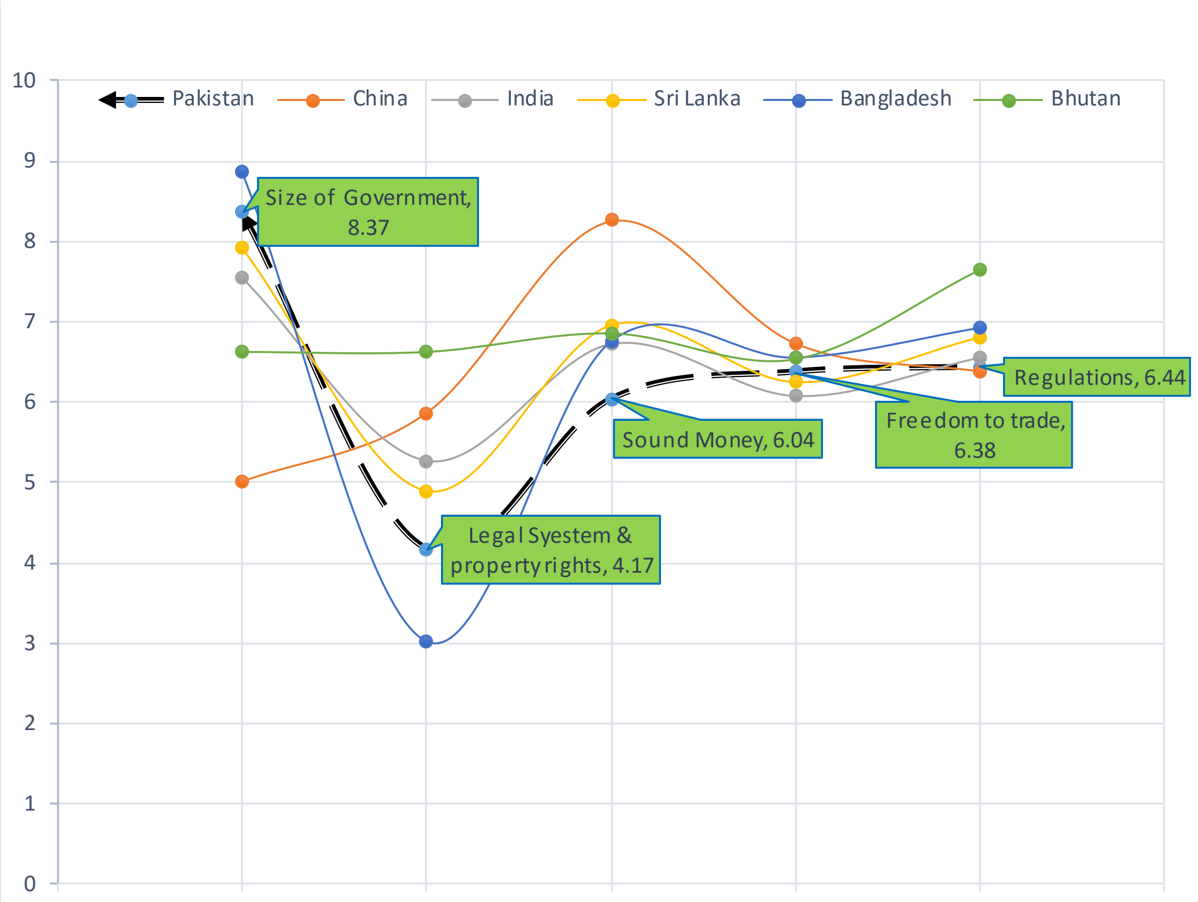
to the people for not using it. The effect of both these activities can be represented in the two ledgers of the budget. However, the usage of that product can also be reduced with the introduction of a new regulation. But this regulatory burden cannot be depicted in either of the two ledgers. For example, according to Zoning Bulk and Height regulations for residential plots in Islamabad (Schedule A), a person can only built a house up to 2 stories. This type of regulations can give rise to the average prices of housing. The outdated building and zoning regulations in Pakistan are one of the major reasons behind affordable housing shortages in the country. It was highlighted in the National Housing Policy (2001) that "The development of slums, *katchi abadis* and squatter settlements is also directly linked with the lack of plans and their implementation. The beneficiaries of this lack of planning and building and zoning regulations are the land and building mafias".[11] The true impact of these regulations is difficult to analyze and usually it is not measured by any public department.

There is a good reason to believe that overreaching government command over the resources can reduce the economic freedom in the country. The Fraser Institute's, Economic Freedom of the World Report (2015) also indicated that the government expenditure is not the only determinants of Economic Freedom and the other factors such as legal system and property rights, access to sound money, freedom to trade internationally and the regulatory burden are equally important. Fig 2 depicts that Pakistan and Bangladesh have scored well in terms of the size of government[12]. However, the governments of these two countries have generally failed in protecting property rights, ensuring free trade across the borders and reducing the regulatory burden, as a result, the situation of economic freedom in these countries is worse than their peer countries.

[11] Source: National Housing Policy 2001: http://www.mohw.gov.pk/gop/index.php?q=aHR0cDovLzE5Mi4xNjguNzAuMTM2L21vaHcvdXNlcmZpbGVzMS9maWxlL05hdGlvbmFsJTIwSG91c2luZyUyMFBvbGljeS5wZGY%3D , retrieved on January 18, 2016

[12] The size of government in the Fraser Institute's report is measured on the basis of Government expenditure as a percentage of total consumption, subsidies as a percentage of GDP, government investment as a percentage of total investment and marginal tax rate.

Figure 2: Economic Freedom Ratings



Source: Fraser Institute, Economic Freedom of the World Report (2015)

How government expands its command over the resources?

There is no disagreement that government's participation in the economy is always costly. Nevertheless, the literature indicates that there are certain possibilities where benefits of government outweigh its costs. Having said that, it is important to discuss how government enhances its command over the resources, the costs and the benefits of government expansion. Several economists worked out on the factors which encourage government's command of the resource. Garrett and Rhine (2006) divided theories of political economy regarding size of government in to two main categories. The first category encompassed the citizen-over-state theories of government expansion. The general idea behind these theories was that the expansion of government is demand driven. That is, the citizens of a particular state demand government, for the provision of some specific goods, for the correction of negative externalities and for the redistribution of income and wealth. Government then respond to these demands with the introduction of new regulations or through different welfare programs. The second category is related to government-over-citizen theories of government expansion, which means that the expansion of the size of government is supply driven. When government revenues are not completely transparent or there are inefficiencies in the system, then it provides incentives to the politicians and bureaucrats to expand the size of government without being notices by the general public. Hence, expansion of size of government does not base on the demands of the citizens.

Peacock's and Wiseman (1961) suggest that expansion of the government takes place when there is national emergency e.g. flood, war etc. Peacock's and Wiseman's hypothesis of displacement is based on the notion that there is a ceiling on maximum amount of revenue which government can collect in the form of taxes. Nevertheless, in the event of national emergency, government uplift this ceiling and increase the tax revenue. But when the national emergency ends, the spending on that national emergency is displaced by some other social security program.

Another plausible reason behind government expansion is stated by Meltzer and Richard (1981). They argue that new entrants in the vote bank are usually from low income groups. They demand overwhelming lump sum payments and vote for higher tax rates and hence, give mandate for government expansion.

The price elasticity of the demand for government and the price of publically provided goods can also be a reason behind increasing scope of government. If the prices of the publically provided goods increase and the demand for these goods doesn't go down (inelastic demand for government) then ultimately government expenditure on these goods expands. Similarly, if prices go down and demand for public goods increases then government expands due to elastic demand for government. Findings of Baumol (1967) suggest that the demand for government is generally inelastic. He found that the government is relatively inefficient in the provision of services such as defence, health, education etc. Therefore, the price of goods or services provided by the government is usually high as compared to the goods provided by private sector. But still it is evident that the demand for publically provided goods is always there.

Role of government in the economy

Literature on scope of government indicates that if government is commanding the resources in order to perform its primary functions, then it may result in the efficient operation of a market economy. Buchan (1975) defined the functions of state as protective state and productive state i.e. protection of people and property from plundering and production and provision of those goods which market is unable to produce or provide. Similarly, Adam Smith (1976) highlighted three functions of state which are of great importance for ensuring the system of natural liberty:

1) "The duty of protecting the society from violence and invasion of other independent societies"
2) "The duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice"

3) "The duty of erecting and maintaining certain public works and certain public institutions which it can never be for the interest of any individual, or small number of individuals, to erect and maintain; because the profit could never repay the expense to any individual or small number of individuals, though it may frequently do much more than repay it to a great society".

Gwartney et al. (2015) also highlighted the key factors behind economic freedom, which are: personal choice, voluntary exchanges through markets, freedom to compete in the markets and protection of people and property from plundering by others. They state that "Economic freedom is present when individuals are permitted to choose for themselves and engage in voluntary transactions as long as they do not harm the person or property of others. Individuals have a right to their own time, talents, and resources, but they do not have a right to take things from others or demand that others provide things for them. The use of violence, theft, fraud, and physical invasions are not permissible in an economically free society, but otherwise, individuals are free to choose, trade, and cooperate with others, and compete as they see fit". Hence, according to them, the key role of government is to ensure and protect economic freedom in the country.

Hall and Jones (1998) also noted that government can play a significant role in the provision of social infrastructure, which they considered as a key determinant of productivity. By social infrastructure they mean the institutions and policies that designs an environment which encourages productive activities, supports the accumulation of skills, spurs the invention and accelerates the transfer of technology. However, Hall and Jones (1998) highlighted that social institutions i.e. the institutions and regulations that protect the output of specific productive units from diversion, are the major components of social infrastructure. The authors concluded that government can eliminate the diversion but in fact can also be a key source of diverging the output of individual productive units.[13]

Costs of Government expansion

In order to perform its primary duties (enforcement of contracts, protection of property rights, national defense, establishment of basic infrastructure etc.) we have to provide government with sufficient powers (taxation, legal) and this of course, requires a certain level of government spending. For instance, if there is no government spending then presumably it is very difficult to maintain the rule of law in the economy. This does not indicate that government expansion does not incur any cost. Of course it does, nevertheless, as depicted in Fig. 2, when government spending is solely directed toward performing its core functions then benefits of expansion accede the costs. However, when it goes beyond, the benefits then dwarfed by the costs and it creates massive distortions in the economy.

[13] Nationalizing the private property, corruption and confiscatory taxation are some examples of public diversion.

Figure 3: Size of government-growth curve

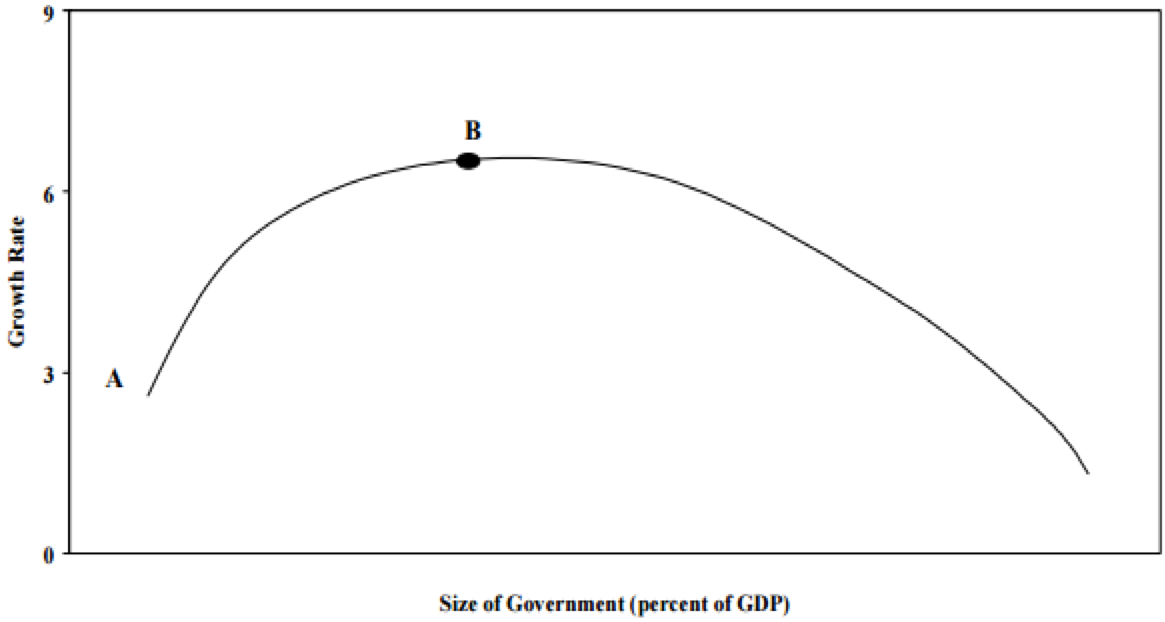


Exhibit 2: The Size of Government-Growth Curve

If governments undertake activities in the order of their productivity, at first government expenditures would promote economic growth (moves from A to B above), but additional expenditures would eventually retard growth (moves along the curve to the right of B).

Source: Gwartney, J., Lawson, R. and Holcombe, R. (1998). "The size and functions of government and economic growth," Joint Economic Committee, p. (V)

The curve indicates that as the size of government expands from complete anarchy, public expenditure is channelized into productive activities and economy grows at an increasing rate. As the government expands more, its expenditures start translating into nonproductive activities, causing reduction in the pace of economic growth. However, moving further along the curve to the right of point B, economic growth declines because this unbearable size of government creates massive distortions in the economy.

Government cannot spend money without first extracting it from someone else. Most of the instruments, which are used for this extraction, have adverse consequences for the economy. For example, government borrowing reduces the amount of capital available for private sector causing increase in the interest rate and consequently, private investment crowds out from the economy. Taxation, on the other hand, distorts the factor prices, effects the decisions to invest and hire, hence leads to an inefficient allocation of resources and diminishes productivity.

There is also a cost of displacement attached with government spending, which has a dampening effect on economic growth. Every rupee that government is spending in the name of welfare programs is displacing exactly the same amount of money available for private sector-which is arguably more productive than the government. Since private decisions of using the resources are based on market forces, the rate of return is larger. However, government first takes away the resources from the productive sector and then use them on the basis of political forces and hence, economic output of government spending is usually smaller.

There is a good reason to believe that prices determined in competitive markets, lead to most efficient allocation of resources. Production, consumption and trade under free markets, maximize the welfare of the society. However, when government intervenes in the market functions, to achieve certain policy goals, it results in socially inefficient allocation. Overreaching size of government can distort the allocation of resources, for instance, through trade restrictions, through curbing labor market by introducing minimum wage laws and restricting firms to fire labors. Government can also create inefficiencies in the economy through direct ownership/control of major industries. Similarly, flat subsidies for a certain sector protects the inefficient firms from the competition and it also creates barriers for the new entrants by keeping prices artificially low.

Similarly when government spending has a larger share in the economy, as compared to business or individual spending, personal choices are than outnumbered by government choices and as a result economic freedom is reduced.

Mitchell (2005) noted that there are several costs which are linked with government expansion such as displacement cost, extraction cost, behavioral cost, and market distortion cost etc. He concluded that "government spending undermines economic growth by displacing private-sector activity. Whether financed by taxes or borrowing, government spending imposes heavy extraction and displacement costs on the productive sector."

Kahn (2001) explained that the countries having similar share of government spending as a percentage of GDP may have different employment level. He argued that this difference is due to variances in the tax structure. The countries with more progressive taxation structure eliminates the incentive for extra work effort. On the other hand, countries having comparatively flat tax structure (where marginal rates are not much higher than average rate) have higher hours of employment.

Gwartney et al. (1998) noted that broadening the scope of government beyond its traditional functions throws economy into dismal conditions. They argue that certain government powers are necessary for the acceleration of economic growth but once endowed, the temptation to do more become irresistible. They explain, "as governments move beyond these core functions, they will adversely affect economic growth because of:

1. The disincentive effects of higher taxes and crowding-out effect of public investment in relation to private investment
2. Diminishing returns as governments undertake activities for which they are ill-suited

3. An interference with the wealth creation process, because governments are not as good as markets in adjusting to changing circumstances and finding innovative new ways of increasing the value of resources".

Optimal size of government

Several economists have identified the growth maximizing size of government in different countries. Chobanov and Mladenova (2009) examined the optimal size of government for 28 OECD countries. By applying Panel Generalized Least Squares (EGLS), on data from 1970 to 2007, they found that the optimal size of government in these countries is 25 percent of GDP. Karras (1997) examined the impact of government services on the process of economic growth in 20 European countries for the time period from 1959-1990. He found that the growth maximizing size of government for an average European country is 16 percent (+/-3 percent). However, Karras conclude that "the marginal productivity of government services may be negatively related to government size: the public sector may be more productive when small." Scully (1994) proposed that the average rate of taxes in USA should be in the range of 21.5-22.9 percent of GNP. He concluded that this range of average taxes can maximize the economic growth of USA. However, in a later study, published in 2008, Scully examined the average tax rate of USA, from time period 1960 to 1990, and found that optimal average rate of taxes for USA was 19.3 percent of its GDP.

Mutascu and Malios (2009) analyzed the optimal level of government spending in European Union (EU) member states, for the period from 1999-2008. By applying the approach of Armey et al. (1995) they found that the optimal level of public spending in EU-15[14] is 30, 40 percent of GDP and in EU-12[15] states it is 27, 46 percent of GDP. Gunalp and Dincer (2005) analysed the productivity of government services and optimal size of government in 20 transition countries. Based on the observations from 1990-2001 they found that the optimal size of government is 17.3 percent for the average transition country. Rahn et al. (1996) found that the optimal size of government is 15-25 percent of GDP and expanding beyond this level retards the growth process.

A few attempts have been made to identify the size of government in Pakistan and its impacts on the economy. Ahmad and Ahmed (2005) applied Musgrave (1969) specification for measuring the long run relationship between size of government and per capita income for Developing-8 (D-8) member countries (Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan, and Turkey). They investigated that, in Pakistan, share of general government final consumption expenditure in GDP (used as a proxy for size of government) has no long run

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[14] 15 old EU member states, including Belgium, Denmark, Germany, Ireland, Greece, Spain, France, Italy, Luxembourg, Holland, Austria, Portugal, Finland, Sweden, Great Britain

[15] 12 new EU member states, including Bulgaria, Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Romania, Slovenia, Slovakia

impact on per capita income, for the period 1973-2003. They concluded that "prudent policies with or without government intervention are more conducive to economic growth".

Ali et al. (2012) analysed the impact of fiscal policy on human development and social welfare. By applying the Autoregressive Distributed Lags (ARDL) model, on the observations from time period 1972 to 2010, they found that in the short run, current expenditure of the government has an insignificant negative impact on human development.

Husnain (2011) incorporated central government expenditure as a share of GDP for measuring growth maximizing size of government. By using the simple regression model, he found that, in Pakistan, the optimal size of government, between 1975 and 2008, is 21.48 percent of GDP. Zareen, et al. (2014) identified the optimal size of government in Pakistan. They demonstrated that optimal size of government, for period from 1973-2012, was around 17 percent of the GDP.

Size of government in Pakistan

Review of the literature indicates that most of the researchers have used share of government expenditure in GDP in order to analyze the size of government in the economy. However, this measure is incapable of measuring the true share of government's command over the resources. Nevertheless, some researchers have incorporated this broader notion to analyse the actual and optimal size of government in the economy. For instance, in addition to government expenditure, Kahn (2011) incorporated Freedom to International Trade, situation of Legal System and Property Rights, Access to Sound Money and Government Regulations, for analysing the impact of size of government on the economic growth of 18 countries, for the time period 1985-1995. Hall and Johns (1998) on the other hand incorporated measures of corruption and diversion of resources to quantify the impact of government expansion on the economy. Haque (2012) analysed the impact of foot prints of government outlays on the economy of Pakistan. He also analysed the impact of regulations in the expansion of government's share in the economy.

For assessing the size of government in Pakistan, four components have been analysed in this paper:

1. General government consumption expenditure
2. Subsidies
3. Government investment
4. Regulatory burden

The first two components indicate government spending in the economy. When government outlays are higher than the expenditure of households and businesses, personal command over the resources is replaced by government's command. When government consumption has a larger share in the economy, personal choices are then over ruled by political decision making. Similarly, by imposing taxes on the earnings of some people for providing subsidies to others, governments minimize a share of individual earnings and transfer it to someone else and in this way it reduces the personal freedom. The third component of the size of government is related to the extent to which government invest in the economy for commanding or directing the resources. When government investment increases, it reduces the investment opportunities for the private investment and as a result the private investment crowds out from the economy. The fourth component of the size of government is related to the regulatory burden in the economy. There are direct and indirect costs attached with these regulations. Direct costs generally include administrative and compliance costs. While indirect costs of government regulations include: limitation of economic freedom of the people, minimization of private exchange opportunities and reduction in innovation and productivity.

The data on the first three measures is taken from Economic Survey of Pakistan (2014-15). The calculations are presented in Table 2. However, the fourth component i.e. regulatory burden, is usually missing in the public accounts. Therefore, the regulatory burden on the economy of Pakistan is evaluated by using the approach adopted by Haque (2012)[16] and it is also analyzed on the basis of a study conducted by Fraser Institute[17].

Table 1: Size of Government in Pakistan

Variables	**Government share (Rs. bn)**	**Government share as (% of GDP)**
Consumption expenditure	3242656	11
Gross fixed capital formation	1056680	4
Subsidies	203248	0.7

Table 1 indicates that the general consumption expenditure of the government has a much larger share in the economy, that is, 11 percent of GDP. Gross fixed capital formation has 4 percent share followed by subsidies which are 0.7 percent of the GDP. The size of government calculated through these conventional measures indicates that the overall share of the government in the economy of Pakistan is 16 percent.

However, adding compliance cost of regulations can give more complete size of government in the economy. A study conducted by Frasier Institute indicates that in Canada, if public sector spends 1 dollar in administration of the regulations then private sector has to spend around seventeen to twenty dollars on compliance. The study calculated that the regulations

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[16] Nadeem ul Haque (2012). *Size of Government and Economic Growth: A case study of Pakistan,* Unpublished manuscript

[17] Source: http://oldfraser.lexi.net/publications/forum/2001/08/section_08.html#note2, retrieved on 22 January, 2015

compliance burden in Canada is 12 percent of its GDP. The Economic Freedom of the World Report (2015) specifies that in terms of regulatory burden, Pakistan is 30 percent worse than Canada.[18] Based on these calculations it is optimistically appropriate to conclude that the regulatory burden in Pakistan should be around 16 percent of its GDP. The study conducted by Haque (2012) also indicated that the government regulations in Pakistan have 16 percent share in the economy. This implies that the compliance cost of regulations (credit market regulations, regulations for labour market and the business regulations) is adding 16 percent burden on the economy of Pakistan. Adding these facts together, it is found that the actual size of government in Pakistan is nearly 32 percent of the GDP.

Conclusion

The brief survey of the literature in this study reveals that government has an important role to play in the economy. Its main duties are related to protection of life, wealth and property of its people, enforcement of contracts and maintenance of rule of law. This however, by no means, implies that government is obliged to intervene in the well-functioning market mechanisms. The present study also highlights that expansion of government is always costly but if it expands to perform its key duties the benefits exceeds the costs and further expansion (beyond its key duties) then reduce the benefits and economy has to bear a costly burden of the government.

The study reveals that measuring the size of government by just considering the share of government spending in GDP can give misleading results and so are the conclusions drawn on these findings. Some government policies do not add any substantial amount to its expenditures yet have a significant impact on the economy. For instance, many of the government regulations distort the allocation of resources by adding no or very little amount to government spending. The present study found that the size of government, when calculated through the share of government expenditure, subsidies and gross fixed capital formation in the GDP, is around 16 percent. However, by adding the regulatory compliance burden, it indicates that the actual size of government is nearly 32 percent of the GDP of Pakistan.

These findings suggest that:

1. Instead of putting redundant regulatory burden on the economy, government of Pakistan should direct its spending solely towards execution of its protective role in the economy.
2. Government of Pakistan must adopt austerity measures to reduce unnecessary spending and in this regard privatization of loss making SOEs can be a good step to start with.

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[18] According to the report, in terms of regulatory burden Canada's rating is 8.32, whereas 6.4 is the rating of Pakistan. Closer to 10, indicates lower regulatory burden.

3. The Statistics Division should maintain a proper record of government spending on implementation of regulations and this data should be publically available.

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