SPECIAL ECONOMIC ZONES IN PAKISTAN: EXAMINING THE CHALLENGES TO THEIR SUCCESS

Wajid Islam[*]

Sarmad Wali Khan[**]

Abstract

Since the last few decades, developing countries have given special importance to Special Economic Zones, to enhance the performance of their export-oriented industries. There is no doubt that some countries have benefited from establishing SEZs, however, many other countries, including Pakistan, have not reaped the desired results. Previously, Pakistan had established some SEZs, and currently, under the umbrella of CPEC some new SEZs will be set up, but it is certain that, under the current circumstances, their fate will also be the same as the previous SEZs in the form of failure. There exist some inherent flaws that are hindering the success and growth of SEZs in Pakistan, such as; absence of proper infrastructure, fragile law and order situations, bureaucratic hurdles, underutilization of women's potential, paucity of human capital, lack of research and innovations, weak judicial system, dearth of laws and regulations, absence of attention towards SMEs, and rent-seeking. Without stringent reforms in the aforesaid area, SEZs will move towards failure and a waste of valuable resources.

Keywords: Developing Economies; Industrial Clusters; Small and medium Enterprises; Special Economic Zones.

Introduction

The World War II proved a defining moment in the history of many countries. Different colonies broke free from colonizers' shackles and declared their independence. As time passes, problems emerge for these newly formed countries, which have been kept stagnant politically, socially, and economically by the draconian rule of colonial powers. These new countries started experimenting different economic models such as:

[*] Wajid Islam is a lecturer of Economics at KP_TEVTA (Email: wajidislam01@gmail.com)

[**] Sarmad Wali Khan, Political Science graduate from GCU and currently serving as a Lecturer of political science at KP HED(Email: sarmadwali.khan@gmail.com)

export-led industrialization and import substitution to bring changes in the structure of their traditional agrarian economies to a modern industrial model and ascend the ladder of economic growth. Countries like Argentina, Kenya, Brazil, Indonesia, Philippines, Bolivia, India, Pakistan, etc. adopted the model of import substitution. At the same time, export-oriented approach was adopted by Taiwan, Singapore, South Korea, and Hong Kong (the current Asian tigers). In the early 1970s, countries that have previously adopted import substitution started adopting an export-oriented approach as the former failed to yield the desired results and created an unfeasible environment for innovation, learning, and growth.[1] Contrastingly, the four counties that had earlier adopted an export-oriented approach witnessed a marvelous boom in their economies thanks to exports and proper industrialization.[2] The popularity of SEZs have grown in countries that have adopted export-oriented policies in order to attract foreign capital, investment, technology, infrastructure, and raw materials in their limited geographical area.[3] These specialized zones were not under the weak laws of the states, and thus it provided a feasible environment to the foreign industries, which resultantly benefited the host countries in the form of employment, high foreign direct investment (FDI), and exports. Moreover, it also provided backward linkages to the local economy and had a spillover effect by transferring technology and human capital.[4] SEZs became engines of growth for various economies. In Shannon, Ireland, the first zone was established in 1959. The model was replicated by several other countries after its success, like Singapore, India,

[1] Martin Landsberg, "Export-led industrialization in the Third World: manufacturing imperialism," *Review of Radical Political Economics* 11, no. 4 (1979): 50-63.

[2] Landsberg, "Export-led industrialization in the Third World: manufacturing imperialism," 50-63.

[3] Thomas Farole, "Special Economic Zones Performance, policy and practice-with a focus on Sub-Saharan Africa." World Bank (2010).

[4] Ahrens, Joachim, Astrid and Meyer-Baudeck. "Special economic zones: Shortcut or roundabout way towards capitalism?" *Intereconomics* 30, no. 2 (1995): 87-95.

Taiwan, and Iceland.[5] Other developing countries started imitating the successes of these special economic zones and its number increased manifold from 79 in 1975 to 845 in 1997[6], and reached 5400 functioning SEZs in 2019 in 147 countries and other 500 are under construction[7]. Some countries' SEZs remained very successful, like China, Vietnam, Korea, and Taiwan, while they proved a "white elephant" for others, without producing any employment or growth, and became a burden on host countries like Pakistan, India, and African countries.[8]

What are SEZs?

SEZs are any defined geographical areas within the national boundaries a country that have different business rules and regulations from the rest of the country, usually more liberal. There are a few special characteristics of SEZs, like having a geographically delimited area, having a single administration or management, offering benefits to the investors, and having a separate customs area that is mostly duty-free.[9]

There are various types of "SEZs," such as export-processing zones (EPZs), economic and technology development zones, free trade zones (FTZs), industrial parks, free ports, science and innovation parks, high-tech zones, enterprise zones, and others.

[5] Pakdeenurit, Patcharee, Nanthi Suthikarnnarunai, and Wanchai Rattanawong. "Special Economic Zone: Facts, roles, and opportunities of investment." In *Proceedings of the International MultiConference of Engineers and Computer Scientists*, vol. 2, (2014): 1-5.

[6] William Angko, "Analysis of the performance of export processing zones in Ghana." *Journal of Business Administration and Education* 5, no. 1 (2014).

[7] UNCTAD. "World investment report 2019: Special economic zones 2019".New York: United Nations Publications, 2019.

[8] Uzma Mukhtar, Syed Ainud Din, Zohurul Islam and Saubia Ramzan. "Identification of Impediments in Export Promotion Zones of Pakistan." *JISR management and social sciences & economics* 11, no. 2 (2013): 101-116.

[9] Thomas Farole, Special economic zones in Africa: comparing performance and learning from global experiences. World Bank Publications, 2011.FIAS. 2008. Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development. Washington, DC: World Bank.

According to Zeng[10], SEZs provide two types of benefits, namely dynamic and static. The former one includes employment generation, government revenues, foreign exchange earnings, and export growth, while the latter one includes technology innovation and transfer, skills up gradation, productivity enhancement of local producers, economic diversification, etc.

An Overview of Pakistan's SEZs History

After the partition, the state of the economy was in complete shambles. The country remained politically unstable in its first decade, and the so-called leaders were involved in their political squabbles, forgetting about the state of the economy. The country had only witnessed the changing of prime ministers in the first decade and nothing else. Ayub Khan ended the squabble by declaring martial law. After taking the reins of power, he started focusing on industrial development. During 1958–1969, more coherent industrial policies were evolved. Elitist industrialists have reaped all the benefits in the form of subsidies, overvalued exchange rate, tariffs, quotas, and so on.[11] Ayub's regime has witnessed about 10% industrial growth. Later, Bhutto's nationalization of 34 industries shifted the pendulum, and industrial growth has slowed to 2%.

Industries clustering have remained a favorite recipe for policy makers from the beginning of their focus on the industrial sector. Various terminologies were used like industrial clusters, Industrial estates, and special economic zones etc., more than 100 industrial estates were established in different parts of country after 1970 industrial

[10] Douglas Zhihua Zeng, ''Building engines for growth and competitiveness in China: Experience with special economic zones and industrial clusters'', *World Bank Publications*, (2010): doi: https://doi.org/10.1596/978-0-8213-8432-9

[11] Karim Khan, Krim Khan and Saba Anwar. "Special economic zones (SEZs) and CPEC: Background, challenges and strategies."*The Pakistan Development Review* (2016): 203-216.

failures. Some have remained successful but many got failed. Apart from this, from 1983–2005, seven SEZs were established in different areas in Pakistan to divert the economy to export-oriented from import substitution industrialization. Regrettably, these zones failed to achieve its result due to the paucity of proper infrastructure, incompetent policies, and structural deficiencies.[12] Currently, there are nine SEZs in the pipeline under the auspices of (CPEC), which will be established in different locations in Pakistan.

To perform the smooth functions of SEZs without any impediment, the government of Pakistan promulgated the SEZ Act on September 13, 2012, which was also amended in 2017 for further improvement.

Purpose of this study

This study aims to analyze the factors that are proving stumbling blocks in the success of Pakistan's special economic zones. It will also discuss how the country will lose billions of dollars in investments in these SEZs, with special reference to other countries where SEZs have already failed. This study will derive conclusions based on ground realities and the lessons learned from other countries.

Plan of Development

This paper has tried to give a brief overview of SEZs and how they are not successful in Pakistan. This paper is structured in the following way: The first section is introductory and deals with the definition of SEZs along with their brief history. The second section is the literature review. The third chapter discusses the factors due to

[12] Khan, Khan and Anwar, "Special economic zones (SEZs) and CPEC," 203-216

which SEZs will fail in Pakistan. The final section will be the conclusion and recommendations.

Literature Review

Mukhtar[13], carried out their study on SEZs in Pakistan and found some major hurdles in the SEZs success in Pakistan, such as political instability, paucity of infrastructure, frequent power outages, a law and order situation, a dearth of skilled labor, and a lack of security.

According to Cling & Letilly[14], Senegal's authorities have closed many EPZs, due to the excessive involvement of bureaucracy, especially customs, and needless long delays in getting necessary permits. And with unrealistic goals, poor productivity and costly labor with expensive factors of production (communications, water, and energy,) have forced the authorities to close SEZs.

Gopala Krishnan,[15] while analyzing the SEZs in India, found that SEZs had the adverse effect of threatening and sometimes closing local industries, ultimately affecting exports and foreign reserves.

Hang & Yong found in their study that grants allocated for land acquisition become a burden on national exchequers because only half the land is sometimes developed while

[13]Mukhtar, Ainud Din, Islam and Ramzan. "Identification of Impediments in Export Promotion Zones of Pakistan," 101-116.

[14]Gaëlle Letilly and Jean-Pierre Cling, "Export Processing Zones : A Threatened Instrument for Global Economy Insertion?" *RePEc: Research Papers in Economics*, November 1, 2001. https://basepub.dauphine.fr/handle/123456789/4582.

[15]Shankar Gopal Krishnan, "Negative aspects of special economic zones in China." *Economic and Political Weekly* (2007): 1492-1494.

the remaining half is wasted. Similarly, Cartier[16] discovered that speculation raises the price of land, making it unaffordable for businesses. Likewise, Warr[17] revealed in his study that the outcomes of SEZs are negative in the Philippines due to the higher cost of government infrastructure and subsidized utilities.

Zia[18] evaluated the reasons why SEZs are not giving the desired results. He found that the import of inputs or intermediate goods increased the cost of production for the competitors. Importing inputs from abroad also indicates the weak backward linkages of SEZs with domestic firms. The study highlighted the causes behind the success of China and Thailand SEZs: they have very strong local industries, which provide cost-effective and efficient inputs to the SEZs, which give them an upper hand in cost reduction.

Zia et al., also analyzed African zones that are established for the garment sector, especially in Lesotho and Kenya, and found that the employment rate has drastically decreased instead of increasing in those zones. A 15% decrease in employment rate was witnessed in Lesotho's garment sector, and a 20% employment rate has deteriorated in the EPZs of Kenya.

Mahmood,[19] revealed in his study that many economic zones of various countries like Pakistan, India, and African countries proved "white elephant" in the end for the host

[16] Carolyn Cartier,'Zone Fever, the Arable Land Debate and Real Estate Speculation: China's Evolving Land Use Regime and Its Geographical Contradictions', *Journal of Contemporary China*, Vol 10, no 28, (2001): 445-69.

[17] Warr, Peter G. "Export processing zones: The economics of enclave manufacturing." The World Bank Research Observer 4, no. 1 (1989): 65-88.

[18] Muhammad Muzammil Zia, Benaash Afzal Malik and Shuja Waqar. "Special Economic Zones (SEZs): A Comparative Analysis for CPEC SEZs in Pakistan." *Pakistan Journal of Social Sciences* 9 (2018): 37-60.

[19] Zafar Mahmood, "Opportunities and Challenges of Special Economic Zones under CPEC for Pakistan." *In Proceedings of the International Academic Seminar on Industrial Cooperation and Construction of Industrial Zones, Beijing, China*: 5-7. 2018.

country as the countries invest heavily on infrastructure of SEZs. Industries take humongous benefits in the form of tax breaks without creating employment and export earnings.

Cowaloosur[20] concludes from his study that local political agendas and drawbacks of the host country affect the industries present inside the zones. Moreover, a business-friendly and feasible environment is not often provided by the host countries and as a result industrial operation is stopped. The major factors of these failures are the difficult procedures of registration, power shortage, taxation, poor connectivity, and hectic custom clearances.

According to UNCTAD report[21], the key reason of abysmal progress of SEZs are the headless following of multi-activity approaches without enhancing the clustering and specialization in zones. Such SEZs turned only to investment promotion tools but remain unsuccessful to link itself with the native economy; such as Pakistan, India, Mauratius, Nigeria, and Zambia.

Discussion

Zeng,[22] in his study has explained that SEZs are the engines of economic growth and thus very effective instruments for enhancing industrialization in emerging countries, especially, in the Asian countries. These zones are very effective in attracting FDI, creating employment opportunities, accruing foreign reserves, generating exports and so

[20] Honita Cowaloosur, "Land grab in new garb: Chinese special economic zones in Africa." *African Identities* 12, no. 1 (2014): 94-109.

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[21] UNCTAD. "World investment report," 2019.

[22] Zeng, "Building engines for growth and competitiveness in China", (2010)

on. He has quoted the example of many successful SEZs present in China, Malaysia, Thailand, Korea etc.

However, on the other hand there are many examples of countries which have failed to get the desired results from SEZs. They have lost Billions of dollars in imitating SEZs from successful countries. The crystal-clear example of failed SEZs are present in African countries. SEZs are not a golden way or an Aladdin's Lamp to get economic success. There are some other factors which determine the success of any policy such as political stability, strong institutions, law and order situation, strong legal system, economic inclusivity etc. The ground realities and situation are different all over the countries. Similarly, Pakistan has different dimension from the other countries and by simply imitating successful SEZs model will not help Pakistan to improve its Economy. Pakistan faces some very serious problems which will make hurdles in the success of SEZs. These factors are given below.

Lack of proper Infrastructure

Paucity of proper infrastructure negatively affects the performance of Special economic zones. The main constraints are gas, power, telecom, roads, and ports and it needs humungous investment in the mentioned areas. Unluckily, the economic conditions of Pakistan are not good enough to carry out all necessary infrastructure. The country has to borrow loans on elevated interest rates. However, improper connectivity and accessibility hinder the smooth mobility of capital and labor. Moreover, without providing the basic facilities of housing, schools and hospital in SEZs, it will be a daunting task to attract skilled labor, which we currently lack. According to Abrar[23], Hattar Economic Zone was approved in 2003 but it has not operational yet due to the lack of facilities like gas, power, security and pre-requisite infrastructure. The most successful SEZs are those which are connected with national and international markets. According to The Economist report "improving infrastructure for connectivity has a bigger impact on the success of zones than tax breaks do"[24]. Without Improving the current dilapidated condition of power infrastructure, telecommunication railways, roads and ports, success of SEZs is impossible.

2012 SEZs Act

According to the study carried out by Naeem et al., (2020), while formularizing the SEZ Act 2012, the government has neither taken input from the stakeholder, nor took them in confidence. That is why the stakeholders are not happy and do not trust this policy and want a complete revision of this act. The SEZ Act also fails to provide a specific outlay for the establishing of SEZs rather it provides generic outlay and after that operating those SEZs through the Board of Approvals and the Board of Investment. Additionally, it has also failed to attract any potential investors. In addition, there is lack of professionals in the SEZs authority.

Ease of Doing Business

Business friendly environment is a pre-requisite for the success of SEZs or any other business. According to The Express Tribune report[25], one window operation is a joke. It

[23]M Abrar,"Govt to tackle impediments in development of SEZs under CPEC", *Pakistan Today*, February 23, 2019.

[24] Economist Intelligence Unit, "Special economic zones: Not so special." *The Economist* ,2015.

[25] Hassan Khawar, " SEZs: Chasing success or failure?" *The Express Tribune*, March 10, 2020.

is only used as collecting point for applications. Furthermore, investors have to run after individual departments and agencies for approvals. Likewise, investors have also to take approval from the provincial authorities for the designs, which also takes month. In addition, 256 days are required for documentation and approval as compared to international market's 24hrs approval mechanism. Moreover, Pakistan ranked at 108 on ease of doing scale which is not a good sign. The cost of labor, electricity and gas are also higher from our regional competitors. Then why an investor will come to Pakistan if he faces a lot of Hurdles? If Pakistan's SEZs authorities want to learn some lessons from African SEZs then they will certainly study their hectic registration, licensing, customs clearance, service delivery, taxation, trade logistics, and foreign exchange and will draw conclusions from it.

Lack of proper attention to SMEs

SMEs are the considered the backbone of economic success in any country. It needs little investment and helps to diversify outputs. However, in Pakistan no preference is given to SMEs. The SEZs and the whole economy are captured by large industries and elites. They have complete monopoly over the market. It is certain that Pakistan SEZs will not succeed until suitable opportunities are provided to SMEs. The main reason behind China SEZs' success is the inclusion of small industries and then providing them with modern and advanced technology. Without the economic inclusivity of SMEs, the success of SEZs will be a daydream.

Dilapidated Economic situation

The economic situation of any country shows its strength. If a country is economically prosperous, it is able to invest in its human capital, research and development, and proper infrastructure. Regrettably, Pakistan is relying on debt, and the economy is crushing under the heavy debt. The tax-to-GDP ratio is extremely low as compared to regional competitors. The economic policy is directed by the lenders. Investors fear the volatile condition of the Pakistani economy and do not want to invest here. Moreover, the debt-to-GDP ratio has become very high, and investors fear that the country will soon become a defaulter.

Political Instability

Political stability is the foremost requirement for the success of any policy. It is a common observation that countries with stable political environments are often economically strong. Investors invest in politically secure environments. Unfortunately, the political landscape in Pakistan is unstable. In the 70-year history of the country, 35 of those years were ruled by military dictators, while the remaining 35 were also indirectly controlled by them. In addition, the over-reliance on the military, including in businesses, has discouraged investors. Apart from this, there is no continuation of policies. Economic growth is hindered by political instability. Similarly, there is a great challenge to governance with rising income inequality and a burgeoning national debt. According to China's Consul General in Karachi, Li Bijian, Chinese investors are reluctant to invest in Pakistan due to the lack of political predictability.

Law and order situation

Fragile law-and-order situations are also a stumbling block to the success of SEZs. Unfortunately, the law and order situation in Pakistan is not good and faces multidimensional threats. Internal militancy from disparate or grieved groups, combined with external tensions, is harming Pakistan's industries. No investor will put his money at risk in this precarious state of affairs, as they want complete security, which Pakistan currently lacks. Without a safe and sound security environment, SEZs will not give the desired results.

Bureaucratic Hurdles

Red tape discourages investment and thus economic growth. According to Naeem et al.[26], multinational companies do not invest in Pakistan's SEZs, because they have no extra time to run after the approvals from different authorities. Moreover, the military-bureaucracy oligarchy and their vested interest in the economy are inversely affecting foreign investment and thus providing an unfeasible environment for investment. The aforementioned study also reveals that with the current bureaucratic system, no investor will bother to waste his energy and money. Without the investment, the SEZs will be a waste of taxpayer money.

Economic Exclusivity and Rent Seeking

According to Levien[27] and Farole[28], the history of SEZs is full of rent-seeking. Board members and officials of SEZs are involved in pursuing their business and political interests by influencing the regulations of SEZs. Politicians frequently engage in rent seeking by bestowing privileges on their close associates and buttering their own bread. Many studies also mention the possibility of leasing or purchasing land in proposed SEZ sites at a low cost. According to Abrar,[29] the cost of Quaid-e-Azam Apparel Park

[26] Saira Naeem, Abdul Waheed and Muhammad Naeem Khan. "Drivers and barriers for successful special economic zones (SEZs): Case of SEZs under China Pakistan economic corridor." *Sustainability* 12, no. 11 (2020): 4675.

[27] Michael Levien, "Regimes of dispossession: From steel towns to special economic zones." *Development and change* 44, no. 2 (2013): 381-407.

[28] Farole, "Special economic zones in Africa," 2011

[29] Abrar,"Govt to tackle impediments in development of SEZs under CPEC", 2019

Sheikhupura is currently so high that out of 521 plots, not a single one has been sold out. Similarly, elitist capture is a common phenomenon. They have complete control over economic resources and policy formulation. There is no economic inclusivity. In such a culture, rent-seeking SEZs will be a complete disaster.

Paucity of Research and Development

Lack of research and innovation is also a major impediment to the economic growth and success of SEZs. China succeeded in promoting the performance of its SEZs by introducing modern technology. It is very unfortunate that Pakistan still does not invest enough in research and innovation. The country lacks skilled labor. There is no linkage between our academic community and industry. Moreover, the country is also witnessing brain drain on a large scale, and our fine minds are migrating in search of better opportunities. Similarly, we have also failed to attract our skilled and educated diaspora, which can help generate entrepreneurial and innovative cultures in SEZs.

Low representation of Women in Economy

Women represent half of our country's population. They are considered a strong pillar of SEZs' success all over the world. According to a World Bank report, 60% of SEZ employees are women. Unluckily, in Pakistan, we have failed to tap the potential of women in the growth of the economy. There are only 22% of women involved in the labor force. According to Kusago and Tzannatos[30], the female workforce is much higher than the male workforce in the successful SEZs. Without involving women in SEZs and thinking about their success, it's like flogging a dead horse.

[30] Takayoshi Kusago and Zafiris Tzannatos, "Export processing zones: A review in need of update". Social Protection Group, Human Development Network. Washington, DC: The World Bank, 1998.

Lack of cooperation between the provincial and federal governments

Coordination is the spine of human success, and so are policies. However, in Pakistan, there is a lack of coordination in the SEZs. According to Kiani,[31] the board of investment has explained to the Economic Coordination Committee that there is a huge confusion between the provincial and federal governments over the overlapping responsibilities of existing SEZs. They are not clear about their roles in the development of SEZs. In such circumstances, no one can expect the success of SEZs in the country, and hoping for their success will be like living in a fool's paradise.

Weak Legal system

A vibrant legal system guarantees the rights of investors. The main reason for African SEZ failure was a lack of laws and regulations. In the same manner, Pakistan has not developed a strong legal system and proper laws to protect the property rights of investors and ensure contract enforcement. According to Wikipedia, in Pakistan, the average time for resolving civil lawsuits is 10 years. In such conditions, no one will invest in the SEZs in Pakistan.

Weak Domestic Industry

The key secret to China's SEZ success is its strong domestic industry. Inputs are easily available at a cheap cost for SEZs. The case is different for Pakistan, where industries have to rely on imported intermediary goods, which increase the cost of output and thus do not provide the desired results of boosting exports and providing employment opportunities and weak backward linkages with domestic industries.

[31] K . Kiani, "Govt likely to offer incentives for SEZs' success" *Dawn*, Feb 04, 2019.

Conclusion

Every country has its own set of circumstances. Simply imitating the success of others does not bring success. The most important aspect of achieving something is a strong commitment and struggle in the right direction. Currently, many countries, including Pakistan, are copying the successful SEZs of China, South Korea, Thailand, etc., while ignoring the heterogeneous dimensions of their countries. Pakistan has long struggled to get good results from SEZs, but it has failed over the years. The main reason for this failure is that Pakistan's policymakers are ignoring the fact that the environment is not feasible for SEZs in Pakistan. Without stringent reforms, it is extremely difficult to achieve good results from SEZs. The major hurdles to the success of SEZs are weak institutions, fragile security conditions, low participation of women in the economy, paucity of human capital, lack of research and innovation, unnecessary military interventions, political instability, weak infrastructure, dilapidated economic conditions, bureaucratic hurdles, a dearth of proper laws and regulations, a lack of cooperation, economic exclusivity, and not giving proper attention to small and medium businesses, which can bring diversification and pluralism. Success in SEZs will remain a daydream until the aforementioned impediments are properly removed.

Recommendations

Although Pakistan has failed to achieve success and the desired outcome from SEZS yet, all is not lost. Taking some steps in the right direction will bring some improvement in the progress of SEZs.

- Firstly, Pakistan has to improve its law and order situation so that investors feel safe about themselves and their investments.

- Secondly, the legal system should be strengthened. The duration of problem solving should be minimized. Trust among investors should be developed by guaranteeing copy rights, contract enforcement, and issue resolution.
- Thirdly, there is a need for time to develop human capital and improve the capabilities of the work force through research and innovation. Moreover, the linkage between academia and industry will also prove very fruitful.
- Fourthly, strict laws should be formulated to avoid rent-seeking and corruption. Moreover, proper laws and regulations should be formulated by taking input from all the stakeholders.
- Fifthly, bureaucratic impediments should be lessened to facilitate investors. A true one-window facility should be implemented so that investors feel free and easy while investing.
- Moreover, women should be involved in the development of the economy, which is currently underutilized, and necessary legislation should be made to ensure the participation of women.
- Furthermore, proper infrastructure should be developed through public-private partnerships.
- Last but not least, political stability should be ensured through mutual consensus, and institutions should be strengthened so that they may not overstep their powers.