BUSINESS RECORDER
Founded by M.A. Zuberi

7th November, 2019

Shahid Sattar & Asad Abbas

Dismal saving and investment rates

Much of Pakistan's current economic crisis revolves around the low savings and investment rates. This is the primary reason why Pakistan has been unable to compete with rest of the dynamic Asian region which has recorded phenomenal economic progress in the last three decades. Low savings rates have resulted in lower volumes of investible funds, whereas, low investment rate have stymied any growth potential. The intermittent phases of relatively high growth have been only due to the "seasonal" heavy inflow of external grants, loans and remittances. This begs the question, how can Pakistan raise the savings rate and productivity on a sustainable basis so that it can achieve a higher output to generate exportable surpluses.

Source: World Bank

Uncertain policies, poor governance, security threats, energy shortfalls, and an overall lack of investment from public sector (not that the public sector really made any difference) are the causes of the bleak investment levels in Pakistan. Besides this, in terms of "Business regulations", Pakistan has plummeted from a ranking of 83 in 2011 to 136 (out of 175) in 2019. Unfavorable, rigorous and inconsistent business conditions in Pakistan have not only discouraged the foreign investors from investing but have also deterred local businesses from expanding.

The investment rate has also been a prisoner of the cyclic changes of political regimes, changing economic policies and the resultant volatility in the balance of payments.

The investment rate in Pakistan has decreased by 15 percent over the last ten years which indicates the decrease in non-financial investment by firms (as a percentage of GDP). A high investment to GDP ratio is a sign of long-term sustainable economic growth as investment yields modernization which in return increases the output. For a sustainable level of growth, domestic savings are vital as foreign inflows are subject to change in the exchange rates, external shocks and changing world economies.

According to World Bank's Report (2019), Pakistan's economy could reach $2 trillion by 2047 with the implementation of appropriate and innovative economic policies. The enormous gaps between investment and savings have contributed to the low growth potential of the economy over the last ten years. The saving rate of Pakistan has distressed the fiscal and current account balances resulting in a low investment in human and physical capital. The current account deficit, investment and saving gap are the result of the weak policy formulation of governments. The gap between domestic savings and investments implies that one-third of the country's fixed investment was financed by foreign resources. The improper funneling of resources into uneconomic investments has also negatively impacted GDP growth. In developing countries, FDI is used as a proxy to fill the gap in financing investment when the domestic resources are insufficient.

Source: World Bank

The fiscal deficit is an indication of consistent negative savings which leads to overall low savings and investment. In previous year savings in Pakistan were approximately 11 percent of the GDP, being extremely low and therefore limiting investment. This is less than half of the saving rate of Bangladesh, one-third of India's and approximately one-fifths of China. High rate of population growth, weak tax incentives to save, deposit rates and real interest rates are the main factors that determine the levels of saving. The channelization of saving through the financial sector for efficient allocation of investment is important. A study reveals that less than 50 percent of the national savings finds their way into the financial sector whereas the rest is used in other sectors by informal channels. This is problem for Pakistan given the new anti-money laundering and FATF regulations.

Investment remains constricted due to unfavorable investment and business climates coupled with rigorous regulations and taxation. The access to finance is not only constrained by high-interest rates but also by the weak financial system, high processing costs, high collateral terms and conditions and illogical regulation. This vast gap between lending and deposit rates is a clear indicator of rivalry between commercial banks to attract additional depositors/borrowers. To protect the lenders and borrowers, the implementation of a bankruptcy law is fundamental. There should be a bankruptcy law put into practice which promotes protection to the lenders as well as the borrowers.

To increase saving and investment levels; the first and most important requirement is to provide a favorable business environment which is only possible by providing consistent policies, smooth and competitive energy availability with better governance.

The role of the financial sector is crucial in domestic resource mobilization. Commercial banks must focus on extracting stagnant household savings and channelizing them into productive investment. The dependence of the government over commercial banks for financing its fiscal deficit, exhausts the ability of commercial banks rendering them incapable of offering saving schemes to the public.

Due to weak investment levels, our exports lack modernization of technology resulting in lower quality and resultant decline of export to GDP ratio. The severity of this decline in export to GDP ratio can be derived from the fact that Pakistan's ratio is 8.2 percent while our regional competitors India and Bangladesh stand at 19 and 15 percent, respectively.

Long-term investment is vital for the export-oriented sector to enhance productivity through latest technology. Apart from increasing investment for capacity building and technology, there is need to improve the local design capacity by developing new clusters for training, design, testing and adaption of modernizing technology in the textile sector of Pakistan.

Only a comprehensive and long term industrial policy coupled with a marked increase in savings rates can improve the investment climate, reduce the cost of doing business, increasing profitability of the industry and encourage the expansion of business. The Industrial policy must focus on the improvement of productivity by increasing competitiveness in the market and resolving the obstructions faced by the business community. In short, the policy should be aimed to increase investment while making it more productive and profitable. Besides this, the policy should focus on the population, especially on youth who are suffering from mass unemployment. Over the formulation of consistent industrial policy, the government should provide incentives to encourage the manufacturers towards high value-added products as well as attracting investment in technology which would allow a shift from low value-added products to high value-added products. In the same way, the focus on expanding technical and vocational education institutions and establishing industry-academia linkages can yield fruitful and much needed positive economic results.