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Domestic industry: PBC for introducing fundamental economic reforms

Pakistan Business Council (PBC), a private sector business advocacy forum, has urged the government to conduct fundamental economic reforms to strengthen the domestic industry as the country is 'de-industrializing' prematurely.

The forum, in its report titled "contours of a new industrial policy" has revealed that the contribution of manufacturing at 12.1 per cent in 2018 is down from a high of 17.5 per cent in 2005. This decline in share of manufacturing has seen Pakistan's share of global exports staying flat while those of competitor countries have seen large increase as high input costs impeded the competitiveness of relatively low value-added, heavily textile-reliant exports.

The role of manufacturing in the economy has declined and its rate of growth lags far behind India, Bangladesh and Sri Lanka. As a result Pakistan has lost share of world exports whilst Bangladesh's share doubled and Vietnam's grew seven-fold during the same period.

The forum maintained that without significant intervention to reverse this trend of deindustrialization, Pakistan will be plagued by high unemployment and low export base as the country continues to focus on commodities, intermediate goods or low value added finished products. The current account deficit will grow if Pakistan continues to import sophisticated consumer products for which a manufacturing base no longer exists in the country, and there appears to be no plan to create, to leverage on a large domestic market of 200 million+ consumers.

"Disproportionate burden of taxes on industry, rampant under-invoicing, misdeclaration of imports, blatant availability of smuggled goods, a fiscal policy that relies on imports for revenue and fails to encourage capital formation and consolidation, together with knee-jerk measures to meet tax revenue shortfall have thwarted the growth," PBC said.

The forum observed that a tariff policy that fails to adequately differentiate between raw materials, intermediate gods and finished products has resulted in rapid growth of imports, often negating the positive impact that trade agreements could bring through cheaper raw materials. As a result, Pakistan is not integrated well into global value chains. Poorly negotiated trade agreements have failed to secure competitive tariffs for exports.

The PBC has prepared the following directional paper "contours of a new industrial policy" with the intent to highlight the key policy thrusts and focus areas which the government needs to consider as it prepares a new and long overdue industrial policy for Pakistan. The new industrial policy in the PBC's views should revolve around a "Make-in-Pakistan" theme and be driven by three key success metrics: (i) creation of incremental jobs; (ii) an increase in value-added exports; and (iii) import substitution.

Shortfall in availability of cotton inflates imports and impacts the potential of value added exports. Subsidies for sugarcane and wheat create uneconomic surpluses, denying industry adequate inputs to add value to both exports and import substitution.

The energy shortfall, high cost and generally anti-manufacturing policies have also discouraged the broadening of exports beyond textiles or of import substitution. PBC has suggested following key enablers for new Industrial Policy: Fiscal Policy Reforms: The tax burden needs to be evenly spread out with all sectors paying their due share. Manufacturing with a 12.1 % share of the GDP cannot contribute 58% to the tax collection. Fiscal policy making should be separated from tax administration. Taxes should be on profits as opposed to any other proxies of profit, further the number of taxes need to be reduced and multiplicity of tax authorities be rationalized through the creation of a National Tax Authority. Tax rates need to be regionally competitive and brought down significantly to ensure that there is a level playing field between the formal and informal sectors.

Tariff Reforms and Strengthening of the NTC: A cascading tariff structure for imports where tariffs are highest on finished products domestically produced while being lowest on raw materials and intermediate products not available locally. This cascading tariff structure is essential if Pakistan is to become part of global value chains. Similarly, the National Tariff Commission (NTC) has to take a more aggressive approach when it comes to protecting domestic industry; it needs to take inspiration from similar institutions in India, Indonesia and Turkey.

A Pragmatic Approach to Trade Agreements: A moratorium on the signing of new trade agreements. All existing trade agreements need to be renegotiated with the aim of ensuring that trade agreements, current and future lead to preferential access for value-added items as opposed to commodities or intermediate inputs. In addition, the impact on tax revenues and jobs also needs to be assessed.

Foreign Direct Investments: Policy should focus on import substitution, exports, technology, capital and risk-intensive sectors rather than on short payback, domestic consumption oriented industries that reap the demographic dividend of Pakistan's large and growing middle class.

Corporatization and Consolidation: The formation of corporates needs to be promoted as it improves the governance standards and accountability. Companies should not be taxed at rates higher than those applicable on individuals and associations of persons. Also companies should be encouraged to grow in scale through consolidation using tools such as Holding Companies and Group Relief. Anomalies in the Companies Act 2017 need to be addressed.

A Trained and Productive Workforce: Skills need to be developed through public-private partnerships. Businesses must be allowed to retain and invest the WWF & WPPF balance (after distribution to labor) to focus on upgrading skills. A common national labor policy that benchmarks competitor countries needs to be formulated.

The Small and Medium Enterprises: The Small and Medium Enterprises (SMEs) are the engine of growth for employment, whereas larger businesses are more capital intensive. The transaction costs involved in embedding SMEs in the value chains of larger businesses especially those in the export sectors needs to be addressed. The banking sector needs to be less risk-averse to lending to the SMEs and ways need to be found to make credit available to SMEs who supply large exporters.

The focus should be given to specific focus industries to promote jobs, value-added exports and imports substitution, ie, textiles; pharmaceuticals; agriculture; oil & gas sector; engineering - iron & steel; other sectors including ceramics, footwear, tires, mining & furniture; Integrated petrochemicals complex; IT & Business Process Outsourcing (BPO).

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