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BUILDING MANUFACTURING IN PAKISTAN¹

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For several years, this Institute has advocated economic growth by boosting the manufacturing sector. It is good to see that recently government has also made industrialization a priority. This paper is one part of a series of papers with recommendations to promote manufacturing in Pakistan for long term economic growth.

Experience of all growth economies shows that government must play a necessary and critical supportive role in building manufacturing. Even industrial economies of the West supported their businesses in their developing phase. They are still doing so today in high tech industry, through incentives and funding basic research.

Pakistan needs to revisit its successful industrial policy of the 1950s and adapt it for present day needs. The success of that policy was recognized all over the world. Government of that period acted as the guardian and patron of industry by facilitating businesses. PIDC played a vital role as 'pump primer' of industrialization and then handing them over to the private sector.

Below are key factors that spurred industrialization during 1950-1960s, and in fact until the 1980s. Government may focus on these again, keeping in mind the present context:

1. Industrial Parks and SEZs

- a. As our experience of 1950s and 1960s shows and also the example of China, Japan and rest of East Asia, industrial parks and SEZs have played a major role in industrialization. Industrial parks enable a resource constrained economy to provide quality infrastructure and better business climate within its limited space. SEZs is an instrument of market access for foreign investors. They act as an enclave of good economic governance for investing firms. In East Asia, industrial parks and SEZs promoted inflow of FDI, which brought capital, management, and technology to host countries and was a factor in promoting exports.

- b. In the 1950s, Pakistan built industrial parks called estates. It did so in major cities as well in distant areas. The Thal Dev Authority had several industrial nodes in Daryabad, Daudkhel, Haripur and more. Industrial estates developed land, connected utilities, and sometimes built gray structures for the factories. This took away key teething issues that many private greenfield projects face.
- c. Low cost Credit: Also, in the 1950s and onwards, DFIs fueled industrial growth. Access to credit was a key feature of growth in manufacturing in the 1950s-1960s. Industrial credit was offered by PICIC and IDBP and later by NDFC and BEL. Also, investment companies set up in partnership with gulf economies also drove large and small industrial investment. DFIs offered fixed cost capital with mid to long tenures. This reduced investor uncertainty. Fluctuating interest rates make project feasibility suspect and irrelevant. Under repeated IMF programmes, DFIs withered away. Commercial banks could not fill that role. Nor could SBP preferential credit windows, implemented via commercial banks, act as substitute.

Private project finance is not a priority for commercial banks. Their lending is subject to changes in SBP discount rates. Also, project finance demands that commercial banks must commit to training of human resource, long lead time for the loan to mature, and business risk. Government borrowings that has been growing rapidly in the last 20 years, is a low risk, low cost, and profitable alternative for banks.

DFIs' raison d'etre was private project finance. PICIC and the rest built capacity with trained human resource for industrial credit. Such lending was what spurred Pakistan's high growth period of the 1960s and beyond. In addition to nationalization of 1972, Pakistan's industrial decline has a direct correlation with decline of DFIs. It seems as though there was an agreed policy in the first decade of this century to phase out DFIs, perhaps under advice of IFIs.

- d. Our experience of doing away with DFIs is entirely contrary to the practice followed in growth economies of East Asia and even in industrial economies¹.
- e. PIDC played a key role in industrial development. Under PIDC's umbrella, the public sector shared capital and risk with private investors. Once the operation was self-sustaining, government disinvested. This created a chain where one successful enterprise followed another as PIDC recovered capital through disinvestment to invest in the next project.
- f. Punjab Small Industries Corporation: PSIC organized well managed industrial areas, which quickly became functional with well-trained and empowered local managers who could take decisions for facilitation and handholding of firms. These industrial parks were complete with common facility centers and training schools, specific to an industrial cluster. There are good examples before us: surgical goods in Sialkot, ceramics and furniture in Gujrat and metal trades in Gujranwala.

¹ For a list of development by country, see this Wiki page. The list includes USA, Western Europe, Singapore, Japan, and of course other growth economies. Pakistan's IDBP included therein is largely moribund. https://en.wikipedia.org/wiki/National_development_bank

2. SEZs:

It is time that the federal and provincial governments deliver on their promise to build SEZs in earnest. SEZs may be general purpose, but would serve greater purpose if they became specific industrial clusters, each with a specialized value chain. It is possible to have 50-100 value chains in Pakistan with clusters in separate towns. These clusters would nurture the next crop of SMEs. Government in consultation with private stakeholders must:

- a. Set up (preferably) cluster specific SEZs
 - b. Identify needs for each cluster for their growth up the value chain.
 - c. Identify, develop, or acquire technology for the cluster.
 - d. Develop linkages of firms in the cluster with the global market to build export and for continuous product improvement.
 - e. Offer cluster-specific credit at preferred rates.
 - f. Provide research grants to trade associations that can play the role of Business Support Organizations, BSOs. They must conduct joint research for technical and export growth of their clusters.
3. Political stability and internal harmony in the country are critical for economic progress. Internal harmony must exist between all parts of the state and between the state and the people. In the long term, this is possible when all segments of the Pakistan society have a stake in the country's economic progress. In Pakistan, institutions and governance have weakened. This could have grave consequences for our stability.

Linked to this is the decline in Pakistan's ranking in UN Human Development Index. The country stands well below other South Asian nations, including Bangladesh. It ranks even below the Palestinian Authority. Denied of safety, security, health, education, and essential services our human resource cannot build a dynamic economy. Also, day to day injustices create alienation among the population. Pakistan must invest in its people and help them become useful agents in the country's economic life.

4. Government policies and behaviour must be that of a benevolent elder. In fact, government and private sector must be partners in economic growth. This is far from evident in present Pakistan.
5. Rather than be too fixated on documenting the economy, Pakistan must boost economic activity. In the last two years, our preference for documentation has had ruinous results. It brought transactions and the economy to a halt with no benefit in tax collection. In fact, GoP revenue fell because of a fall in economic activity:
- a. Lack of documentation is painted as the fault of businesses. Whereas it is the result of an absence of trust between the state and the people, especially as most such businesses are small or micro. Also, SMEs lack the capacity to meet government's onerous burden of regulation. Government provides minimum or no service to SMEs that fall in the informal sector. These businesses have no access to formal credit or to utilities. They cannot freely conduct transactions. So, by belonging to the informal sector, they are the bigger loser as they cannot grow. Yet, they are harassed by state functionaries belonging to tax, labour and other departments.

- b. It is proposed that Pakistan must register all micro and SMEs while giving them the comfort of exemption from all taxes up to a certain limit. They should have access to credit, and to essential civic and utility services. They must conduct transactions without restrictions. Our focus on documentation comes at a very high cost to the economy.
 - c. In any case, with high indirect taxes and withholding taxes at each stage of transaction, all firms and individuals are overly taxed already. Often influential firms earn tax exemptions². If that be the case, more of the tax burden falls on weaker sections of the economy.
 - d. Taiwan's economy grew rapidly on the shoulder of their undocumented sector. Untaxed local money went to new investments. It also fueled FDI in the Peoples Republic of China. Often, they took a circuitous route via USA. These 'US' investors established large-scale industry in Taiwan and in PRC. Until recently, Foxconn, assembler of iPhones, employed 500,000 Chinese workers in Shenzhen. It is originally Taiwanese. Some chemical giants in PRC also received investment through this financial triangle.
 - e. Much of our SMEs are vulnerable to the country's high cost of doing business. SMEs, who are the largest employers in our economy, must have the space to grow and to create wealth. Wealth creation leads to more investment and more jobs. It must be encouraged. This paper does not recommend doing away with collection of direct taxes. The FBR or provincial tax authorities must do their job. But an environment of harassment of businesses must stop. Of course, the FBR must have the space to do its job without restriction. But business transactions must continue.
 - f. Such a policy of strategically looking the other way was exemplified in the high growth periods of many countries, including perhaps during 1970-1990 in China.
 - g. Too much reliance on IMF and World Bank guidance for our economic policies have worked to our disadvantage. Stabilization policies leave very little space for growth. Resultantly, Pakistan has moved from one fiscal and BoP crisis to another. Also, policy guidance by international institutions in specific sectors have left the sectors in disarray. The power sector is an apt but not the only example. IPPs extract surplus rent at the expense of the rest of the private sector. They have enough influence to prevent reform of the sector. WAPDA a fine institution was unbundled, and the results are for all to see.
- 6.** It is universally recognized that urban centres are large creators of wealth and economic growth. They have the country's best technology, human resource, work ethics, and infrastructure. They also have access to capital. At the federal level, this is not a priority. While Pakistan has had a ministry for rural development, but never for urban growth. Underperforming urban centres restrict investment and growth. Pakistan must revisit its urban center management. The following are important:
- a. Cities must have efficient and reliable public transport. Subsidized public transport is a norm the world over. As the recent 'full to capacity' metro services show in Pakistan, they are a great enabler of commercial activity.

² <https://tribune.com.pk/story/1999536/govt-gives-rs20b-tax-relief-richest-class>
 This is just an example of a practice that has endured for decades.

- b. City governments must have some taxation power, especially on sales, to build and subsidize public transport. Moving people rapidly, safely, and economically is a big enabler of economic growth.
 - c. We need cadres of town managers from among the bureaucracy and political class, who have formal education and training in urban development and management. Not enough people in the country consider this important.
 - d. This policy must extend to mid-sized towns. To ease congestion and long commute times, we must encourage smaller urban centers that will attract businesses.
 - e. Urban centres must have public sector education and training institutes in production technology, IT and other skills needed by industry.
 - f. Cities must revise and update building codes to promote energy efficiency, reduce environmental degradation, promote safety and health of residents. Federal and provincial governments must take lead and assist local governments to update these codes as city development authorities CDA, LDA, DHA or metropolitan organizations do not have the capacity.
 - g. Such investments promote growth. The investment is more than recovered by the savings in cost of health, road safety, and better environment. They also generate commercial activity that yield more government revenue and more jobs.
 - h. Cities must have efficient road infrastructure, sanitation, high quality cell phone and digital connectivity.
 - i. Government policies in 2002-2007 brought rapid growth in production of low cost motorcycles in Pakistan. Policies favoured the whole industry and not particular firms. Many players created competition to give quality and affordable product. Availability of low cost motorcycles has brought prosperity to the working and lower middle classes. These policies must be recognized and used as an example to have more such industries in the country.
7. GoP must also plan rapid and frequent rail transportation between urban centers. This too will build efficiencies. For example, there should be hourly high speed trains between Lahore, Faisalabad, Gujranwala, Sialkot, Multan. Similarly, there should be fast trains between other major towns and urban centres. They will be a boon for local economies. If needed, a separate provincial or federal organization may be established for the purpose. In the beginning, they may use Pakistan Railways existing infrastructure by paying a fee. Service operators may be in the private sector.
8. Regional trade is critical: We must not allow security and political concerns to prevent access to the large and growing Indian market. Nor should we lock ourselves out of import of raw materials from China and India. While across-the-board opening of our market to India may be a source of concern for some of our manufacturers, availability of raw materials from next door will make many of our exporting industries globally viable.
9. Pakistan must have frequent air links with cities in China. Pakistan cities must have direct air links with Guangzhou, Shenzhen, Shanghai, Chongqing, and Chengdu, in addition to Beijing. This will save time and cost for businessmen.

10. More urban centers are needed on Pakistan's coastline of 1050 KMs. Pakistan has only one metropolitan town on the sea. Business has been pushed upcountry, with higher logistics cost for exporters. Government must aim to have several urban centers along our coastline.
11. Similarly, we must bring prosperity to interior Sindh through commercial and industrial activity. Sukkur, Thatta and Hyderabad must return to their old status of port towns with barge traffic from Ketī Bandar to these towns. There should also be good road and rail links between them. This will urbanize interior Sindh and make the people prosperous. Industries along the route of the barge canals would lower logistic costs and make them competitive.
12. To increase LSM investments, Pakistan must also consider the following:
 - a. Avoid frequent changes in customs duty and taxes. GoP views import duty as a source of increasing government revenue. In fact, its utility lies in enhancing competitiveness of domestic industry. Government changes tariff rates frequently. In addition, when GoP is constrained for resources, it often imposes regulatory duty. Such changes make investor feasibility irrelevant. This is especially a concern for LSM and capital intensive investments.
 - b. Despite frequent proclamations, Pakistan has not been able to operate a "one-window" for investors. It is difficult to do so in a federation where permissions are needed from many federal, provincial, and local agencies. Also, investments in specific sectors need specialized approvals such as tariff approval from NEPRA or OGRA. Government must recognize these challenges and have a committee for troubleshooting monitored at the highest level to speed up approvals. Otherwise, 'one-window' will be the victim of inter-governmental and inter-ministerial turf wars, where approvals are sometimes viewed as an opportunity for rent. In the past, this Institute has recommended setting up of an 'Export, Investment and Manufacturing Promotion Board' to develop an industrial policy, provide public goods and incentives and to troubleshoot. GoP may transform TDAP, BOI, and SMEDA into a unified organization for policy making and service delivery. It must train and enhance capacity there.
 - c. GoP must give more space to the private sector. Currently, private sector has to compete with public sector enterprises in the energy, chemicals, ports, and infrastructure construction sectors. Public sector companies have many advantages of access to land and capital. They also have influence in obtaining contracts and fast tracking of approvals. With such advantages, public sector can be profitable without being as efficient as its private counterpart. This exacts a high cost on the economy because of inefficiencies.

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