INSTITUTE FOR POLICY REFORMS

IPR

FACT SHEET

THE POTENTIAL OF GOVERNMENT'S NEW ECONOMIC REVIVAL PLAN

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The potential of government's new economic revival plan

Why is the Economic Revival Plan important?

Because its goal is to increase investment and production. A boost in production of goods would likely increase exports and substitute imports to earn and save foreign exchange. It is a plan that the economy urgently needs.

Pakistan's enduring BoP crisis is because with production deficit, we must import even the most essential goods. That causes foreign exchange scarcity. Thus, Pakistan borrows to finance the imports. Now debt has grown beyond our ability to repay. So, we service the debt by borrowing, which increases the debt even more. It is a model that is doomed to fail. And so, it has.

Non-debt creating foreign exchange inflows would give a much needed stimulus to the economy.

What is the purpose of this paper?

This paper looks at the Plan's many aspects and offers inputs. This is a key GoP initiative. Its success means a lot for our economic well-being. All stakeholders must join for its profitable outcome.

How will this plan increase investment?

So far, the announcement's main focus is to have a top level Special Investment Facilitation Council and implementing committees to fast track private project approvals, especially FDIs. GoP plans to attract investment from 'friendly countries' to capitalize on the 'untapped potential in key sectors'. These sectors are 'defence production, agricultural and livestock, minerals and mining, information technology and energy'.

In addition to acting as a single window to attract investment from GCC and other economies, SIFC's ToRs include to:

1. Prepare a long-term road map for growth, investment and development, in the relevant fields.
2. Enhance awareness of Pakistan's latent potential in the relevant fields.
3. Explore new areas for cooperation.
4. Improve ease of doing business.
5. Coordinate Pakistan Army's assistance.

It is too soon to know the tools that government would use to achieve the goals. Clearly, this is a medium to long term scheme, as it should be.

What are the things to watch for?

It appears that Pakistan has received indications from the GCC of their interest to invest. In addition to prospects of high returns, recent developments in the region show their aspiration for stability and progress. Pakistan must welcome the investment and do everything for its success.

In the public space, there is too much focus on the composition of the Council. The composition clearly is meant to give comfort to GCC investors who may have understandable concerns about the country's security. Also, their past experience with GoP's approvals and processing would hardly have infused confidence in them.

SIFC is a useful instrument to get industrialization moving again.

There are bigger issues to look out for:

- **Examples of past mistakes:** The line between ensuring 'fast track approvals' and generous incentives must not blur. Pakistan's image of a weak economy and tough business conditions do not encourage investors. Thus, investors may demand concessions and incentives. Pakistan must weigh the cost of these incentives against their benefits.

  Let's go back to the major policy mistake of IPPs. Each year, IPPs receive hundreds of billion in subsidies. A UNDP report on Pakistan says that IPPs "are a key example of favourable pricing formula". Without going into details, their tariff formula along with guaranteed returns on equity yield high profits for IPPs. Despite frequent tariff increase, subsidies for IPPs have not stopped, as DISCO losses continue. IPP subsidy have about an 8 to 10% share in GoP's total expenditure. Taxpayers and consumers pay for GoP's flawed policy and poor governance. A PIDE paper shows that our power prices are about 20% higher than the tariff in India. It puts Pakistan exporters at a disadvantage.

  Other sectors too receive such incentives. One example is continued protection for the auto sector. PIDE estimates overall auto sector protection to be 45.4%. UNDP estimates up to 60% protection. The protection has been costly for us. Now, part of this industry is closing shop at the first sign of adversity. Excess incentives for IPPs, autos and construction divert investments from the more productive manufacturing sector. Also, profitable sectors become powerful lobbies. It is then hard to withdraw the incentives.

  Today, if we can get investment only by offering generous incentives, GoP and SIFC must fine tune and balance costs and benefits. Where incentives are necessary, GoP may offer them for a few years, not endlessly.

  Offer of incentives must also be linked to performance benchmarks. An obvious example is to link them to levels of export. There can be other benchmarks. For example, at present, it is possible for IPPs to underutilize capacity and yet earn profits. Also, they do not have to ensure efficient use of fuel, as it is a pass through item. Incentives must also be linked to such benchmarks.

  Whatever the criterion, they should be agreed in advance and government must enforce them with rigour. Incentives must be for the benefit of both our economy and investors. They must be for a specific period and purpose/s and with an automatic sunset.

- **Would the inflows create more debt?** The paper assumes that the inflows would not add to our debt. Inter-corporate debt is inevitable. IPR urges that GoP minimize sovereign guarantee.

- **Fast track approvals:** The main stated goal of the SIFC is to "shorten heretofore cumbersome and lengthy business processes". This is a critical factor in the investor's decision to locate production in Pakistan. Yet, GoP's effort cannot rest with just one general statement.

  There must be a detailed study of what delays approvals. For each industry, officials must identify every step the investor must take to gain approval. That would help in deciding which step or condition to keep or discontinue. Once government establishes the steps needed for approval, they must be made public. With this knowledge at the time of application, investors would be better prepared to meet government requirements. The number of days needed for approval will come down quickly.

  The SIFC notification suggests that it is possible to remove the hurdles in a high level meeting of stakeholders. That would not be sufficient. The meeting would not have the needed information. Endless discussions, postponements or even policy mistakes are the meetings' likely outcome.

  The key step in all of this is to consult with the private sector, identify the hurdles, decide which steps are necessary and to make the requirements public. Officials should be able to distinguish between the investors' genuine demands and their effort to get extra concession. If needed, government may hire consultants.

- **More value addition at home**: The PM's statement rightly refers to the need for export oriented investment. All the sectors selected have the potential to increase exports or to replace import. While this is a much desired immediate goal, IPR recommends that this goal should evolve as investments come in.

  Our effort must be to gradually move towards more processing within the country, both down and upstream. This goal must be built into the Long Term Plan for the relevant fields (ToR 1 b). Higher value addition will not happen at once as our firms would be on a learning curve. Government and private firms must both facilitate and invest in making it happen. Contrast that with the auto deletion plan, which leaves the decision to source domestically entirely in the hands of the investor. Not much happened.

  Unlike East Asian economies, the links between large manufacturing and SMEs are weak in Pakistan. SMEs are not integrated into the production system of major items. LSMs and SMEs operate in their respective spheres. That is because Pakistan's manufacturing depends heavily on imports. Pharma imports 90% of the medicine it makes. Similarly for electric fans, footwear, and perhaps also for automobiles.

- **Privatization of PSEs:** Pakistan's HMC, HEC, PMTF, Pakistan Steel Mill and the Railways locomotive factory fell into sub-optimal use soon after they came into operations. They were all 100% in the public sector. The HMC and PMTF have been brought back into useful operation by the military. Pakistan must seek foreign equity for the remaining units. This would revive and update the dormant ones, such as the Steel Mill and the locomotive factory. In FY 22, Pakistan imported steel and scrap worth $ 5.2 billion, while production at our steel mill was zero.

Since 1994, Pakistan has produced only a few locomotives in the Risalpur loco factory. It was built under Japanese assistance with Hitachi's technology, a company whose engines power the bullet trains. Yet, we have preferred to import engines. Being mostly dormant, the factory's privatization with foreign equity would increase domestic production and improve Railways performance.

Furthermore, if the military agrees to accept foreign equity, with Pakistan retaining majority stake, HMC and PMTF may also seek external cooperation, to access modern technology. There is also a shipyard with capacity for shipbuilding, repairs and training. That too could do with higher technology.

HMC and PMTF may also serve dual use. The original purpose of establishing these units was to supply technology to the private sector to produce more goods for exports.

These basic facilities are all fundamental to industrialization of an economy. Their revival would give a big boost to economic activity and growth.

Additionally, what must the Plan pay attention to?

The immediate reason for attracting investment is to stabilize the economy. That would also improve citizen welfare and their standard of living.

Improving citizen welfare is not just a moral choice. It is necessary for economic growth. If a few companies prosper without their benefit going to the larger population, the economy operates at a sub-optimal level.

So, growth in public investment in education and health must accompany our plan for seeking foreign investment. It would not be a part of the Plan, but an important enabler for its success by the public sector.

The key to East Asia's growth was human capital accumulation. That came from rapid investment in technical capacity and firms learning from each other. The biggest stimulus to economic growth is higher local capabilities. All of our plans to attract investment suffer because of not making this a priority. Without firm level and individual technical ability, Pakistan cannot have a strong industry or increase exports of complex goods.

The downside of not investing in social sector is to not have the needed talent at home. Investment is not a static idea. The investor must earn profit and be encouraged to re-invest so that industry keeps growing. It will do so if the economy supplies enough excellent talent. Otherwise, the investor will repatriate the profits and not reinvest. In FY 22, repatriation of profit was over $ 1.5 billion, despite the low FDI levels in the economy. More FDI would increase repatriation.

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