The Pakistan Business Council's Agenda for Growth & Export Competitiveness

Report of the Panel on Sustainable Macro-Economic Growth presented at the Pakistan Economic Forum

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The Pakistan Business Council
FOSTERING ECONOMIC GROWTH
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Pakistan Economic Forum

The Pakistan Business Council (PBC) is a business policy advocacy platform, composed of Pakistan's leading private-sector businesses. Its objectives are to facilitate and foster economic, social and human resource development. PBC members are engaged in thirteen important sectors of manufacturing and services and include 25 MNCs from 12 countries. Together, PBC members account of 11% of Pakistan's GDP and nearly every fifth Rupee of annual tax and export revenues. They directly employ 400,000 with millions more in the extended value chain. More information is available on www.pbc.org.pk

Summary

Economic growth has picked up to 5.3% in FY17, the fastest pace of growth in a decade. Inflation remains low at below 5% and improved energy supply to industry will support the growth momentum in the short and medium term. Long term investments from China under the $46bn CPEC (China Pakistan Economic Corridor) offers opportunities for the economy to benefit from improved infrastructure and higher job creation.

However, challenges remain with a widening balance of payments position due to a heavy consumption-led, import-fueled growth. Investment spending has stagnated and the private sector investments have declined to 9.9% of GDP in FY17, down from 10.4% in FY15. The low savings base has remained an Achilles heel for the economy and has disrupted growth many times in the past, and could lead to another Balance of Payment crisis if not addressed.

National savings rate has declined to just 13.1% of GDP in FY17, down from 14.7% in FY15. In comparison, India's saving rate was at 29% of GDP, Bangladesh at 30%, and China at 45%. Low savings are resulting in higher consumption spending and leading to a widening trade imbalance.

Another challenge is that competitiveness of the economy has eroded significantly and Pakistan lags behind competitors in Ease of Doing Business. Exports have declined 13% to US$ 21.9bn in FY17, down from US$ 25bn in FY14, whereas during the same time Imports have increased 16% to US$ 48.5bn. Pakistan's share of world exports has declined, whilst Bangladesh and Vietnam's grew two and seven-fold respectively in the last two decades. Pakistan's exports are narrow in range, low in value-addition, sophistication or import incorporation and targeted mainly at the EU and USA.

Local industries are increasingly unable to compete even in local markets, flooded with cheap imports. Competitiveness of Pakistan has eroded due to lack of investments and high cost of doing business. Pakistan ranks a lowly 147 out of 190 countries in the 2018 World Bank report on Ease of Doing Business. On the matter of paying taxes, Pakistan is ranked in bottom 20 with a ranking of 172. Similarly, on trading across borders we are ranked 171. Tax policy remains a major impediment towards new investments from private sector and foreign investors.

The PBC panel on Growth & Export Competitiveness is presenting its recommendations on how to tackle these challenges and achieve sustainable long term growth of above 7%. The headline recommendations are listed below and further details appear in the Annexure attached:

1. **Bridge the External Funding gap**
    - Balance of Payments needs a measured response with fiscal, monetary and exchange rate adjustments.
    - It is encouraging that government has allowed for a more flexible market driven exchange rate regime, overvalued PKR has fueled trade imbalances
    - Short term external debt liabilities pose significant challenge, large roll over risks
    - Relieve the pressure on the external account in the next 1-2 years, we should consider deferring some of the CPEC power projects that are in the early stage (planning, pre-financial close etc).

2. **Increase saving rate to 20% of GDP through developing housing market, mobile banking channels.**

- Use digital banking network to raise deposit base from 33% of GDP to 50% of GDP within next 3 years. Only 16% of the country has bank accounts; Cash in circulation - the measure of the 'unbanked' part of the economy - has grown to 34% of GDP, from 28% a decade ago, and is more than twice the average for low-middle income countries. High cash holdings reflect, mainly, transaction and precautionary need for cash, because banking services cannot be accessed.
- Develop alternative saving channels focusing on housing market, insurance, pension funds
- Completely digitize Government and PSE payment systems
- Abolish transaction taxes in banking and internet services to encourage documentation of economy.

3. **Long term plan for Revival of the Export sector through 5- year incentive program**
    - Incentives to Corporatize the business instead of family owned small firms and move up the value chain. Parity taxation of corporates with unincorporated entities, group taxation with relief for inter-corporate dividends
    - A fiscal policy that promotes capital formation, accumulation and investment
    - Learn from the Vietnam and China experiences including support to Export industry through reducing tax burden and cost of doing business.
    - Policy to attract FDI in value added export sector and develop supply value chains
    - Address the fragmentation of policies between ministries and between the federation and provinces. Align fiscal, trade, energy, labour, industry and agriculture polices to promote scale for industry
    - Provide energy at costs competitive with the main sourcing countries – India and Bangladesh, in particular.
    - Reverse fiscal policies such as presumptive taxes that thwart scale by promoting imports, thus preventing industry in Pakistan to develop to a stage where it can export
    - Factor exchange rate competiveness into export policies

4. **CPEC long term business strategy**
    - Government must share the detailed plan with the business community
    - Form an Authority to oversee and monitor CPEC projects
    - Long term strategy for development of industries and business, not just in SEZs.
    - Avail of the CPEC opportunity to correct the significant trade imbalance with China by promoting local value-addition through JVs.

5. **Scale up the labor force for the digital age and the jobs of the future**
    - Invest heavily in producing quality science, technology, engineering and mathematics graduates who can push Pakistan towards innovation, technology assimilation and sophistication.
    - Promote vocational and technical skills training as the employment opportunities for general degree holders are receding and the demand for para-engineers, para-medics, technicians, para-scientists, mechanics etc. are rising rapidly
    - Subsidize the research and development activities in the Defence, public and private sectors for developing new products and processes
    - Make broadband connectivity easily affordable by reducing the incidence of taxation on fixed line and cellular services

6. **Integrate Pakistan into the international Trade and Finance markets**

- Take maximum advantage of the country's strategic location by becoming a hub of Regional Trade and transit. CPEC projects particularly pipelines, motorways and railways connecting Gwadar to Kashgar should be expeditiously completed. At the same time have robust controls to prevent leakage of duty-free transit goods into the domestic market, thus avoiding a repeat of the experience with the Afghan Transit Treaty.
- Introduce internationally accepted standards certification and tests such as FDA approved food and pharmaceutical products for our industries. Adopt one national standard instead of multiple provincial standards that thwart freedom to sell nationally and impact scale and competitiveness.
- Global value chains, get big international corporations in Food, Textiles, Sports and Technology to open operations in Pakistan. This will help local industries through technology infusion and competition.

7. Maximize earnings from existing infrastructure, natural resources

- Improve the maintenance and operations of the existing capital assets-irrigation systems, leading to higher water availability and more land under cultivation
- Energy infrastructure (power & gas) is causing huge financial losses to the exchequer; recover user charges for meeting this expenditure
- Malaysian model of Khazana for running Public Sector Entities and privatization of loss making PSEs

ANNEXURE

The PBC's detailed recommendations are as follows:

Measures
1. Increase saving rate to 20% of GDP through developing housing market, mobile banking channels. **a. Use digital banking network to raise deposit base to 50% of GDP within next 3 years.** **b. Develop alternative saving channels focusing on housing market, insurance, pension funds** **c. Completely digitize Government payment systems** **d. Reduce transaction taxes in banking and internet services**
i. Pakistan savings rate is just 13.1% of GDP in FY17, down from 14.7% in FY15. In comparison, India's saving rate was at 29% of GDP, Bangladesh at 30%, and China at 45%. ii. Banking deposit base needs to increase significantly from 30% of GDP in 2017 to 50% of GDP to encourage higher savings. This can be achieved by a. Removing / reducing transaction related taxes on banking transactions and internet services b. Use success of Kenya M-PESA mobile payment platform, which in just 8 years accounts for 25% of all payments taking place in Kenya. This allows end to end user payment through mobile phones, without any intermediately. c. We have about 130mn mobile phones, covering 65% of our population. Up to 40mn hold Smart (3G / 4G) phones, which carry the technology for 'embedding' applications enabling delivery of financial services of all types, in the phone. This number could grow if incidence of taxation on cell devices, equipment and usage was reduced. iii. Develop alternative saving mechanism to channel incomes into savings. iv. Credit for housing, in Pakistan, is a miniscule Rs 65bn (0.2% of GDP). In high-income countries, mortgage lending is commonly over 50% of GDP (over 80% in UK and US); regionally, it is 9% in India, 18% in Thailand, and 30% for Malaysia. v. India has significantly increased house finance in last few years through a. lowering the Capital weightage against bank loans to the mid-lower income housing programs, from 80% to 20%; b. fiscal incentives for borrowers include partial tax offsets against income, for interest and debt payments; c. low-cost housing developers pay no/low taxes against project profits; d. the Government has created a national Mortgage registry that assists with ensuring clean title for new borrowers; e. the real estate developer industry is now overseen by national/state regulators; etc. vi. Establish a unified collateral register for all immoveable assets for getting credit vii. To kick start low-cost housing, the government should offer land as part of PPP with private developers. The ambition (and potential impact) can be big: satellite towns/cities next to the 5 big urban center's to relieve congestion, while also providing economic stimulus. viii. SBP and Planning Authorities must work on joint strategy to encourage investor interest in region, and SBP must use 'carrot and stick' policy to force banks to take the initiative for boosting credit to development sectors (i.e. MSME, Agri, Housing) in the regions. ix. Address the regional disparity and sectorial disparity in deposits and its usage. E.g. loans in KP are only 8% of the Provinces deposits, this perpetuates need for manpower from KP to seek jobs outside the provinces. Same applies to other smaller districts. x. Increase savings through developing the insurance and pension fund markets through REITs and foreign currency bonds. xi. Program to digitize all payments to Government through online banking channels
2. Long term plan for Revival of the Export sector through 5 year incentive program
i. Exports have come down sharply by 13% in the last three years to US$21.9bn, from US$25bn in FY14. ii. Pakistan's export sector is represented by SMEs that prefer to remain small for tax purposes.

iii. Looking ahead policy must encourage Corporatization of businesses and encourage them to outsource non-core functions such as warehousing, transportation, marketing etc.
iv. This will help to enhance productivity of core business while reducing costs and freeing cash flow of companies from non-core business.
v. Secondly, policy must encourage move towards higher value added manufacturing and services.
vi. These objectives can be achieved through a long term 5 to10 year policy that encourages new investment, reduces cost of doing business and supports domestic industry to become more competitive against international firms.
vii. China and Vietnam have achieved rapid success in developing a strong export oriented manufacturing industry. Vietnam exports have increased from US$40bn in 2006 to over US$ 176bn in 2016. This was achieved through
    a. The contribution of FDI to Vietnamese exports amounts to 56 percent, a percentage similar to China's (52 percent) but lower than Thailand's (63 percent). The share of FDI in manufacturing exports is over 70 percent. In some industries (cars and motorbikes, electronics), the percentage is even higher. FDI in Pakistan has not contributed to exports.
    b. Vietnam actively lobbied and gave incentives to companies like Samsung, Intel, Microsoft, Taiwanese giants Hon Hai Precision Technology group to set up operations. Incentives included no income tax for the first four years of operations and 50 percent tax for the next nine.
    c. Now, more global giants including Nike and Mast Industries plan to move a major part of their manufacturing operations to Vietnam, from China where labor costs have shot up.
    d. Global giants are driving higher value added manufacturing exports, helping Vietnam diversify away from traditional textile & clothing exports.
    e. Exports of traditional of textile & clothing products have been supported by government policies to reduce the anti-export bias resulting from the structure of trade protection, which tended to reduce the profitability of exporting compared to producing for the domestic market.
    f. Rationalization of tariffs through a simple and transparent tariff structure with low average tariffs, it will lead to higher imports but will add more to export value. Vietnams import bill expanded to US$ 174bn in 2016 vs 45bn in 2006.
viii. Tariff exemptions for imported inputs used in the production of export goods.
ix. Export processing zones set up with supply of inputs including supply chain companies (warehousing, transport etc)
x. Reduce number of payments of tax per year to 12 from 47 currently (WB Doing Business 2018) and provide refunds on urgent basis.
xi. Reduce customs costs by simplifying documentation and making the system for online applications, reducing costs to trade from over $735 to $300, and less than $100 for exports.
xii. Provide energy at production costs (not cross subsidized tariffs) to the export industry
xiii. Banks should be allowed to credit the export rebates immediately upon realization of export proceeds instead of having to wait.
xiv. The export package should be broadened to encompass all exports instead of just the main sectors. It should continue to be skewed to value addition with rebates gradually being withdrawn from commodities.
xv. Finally, holding on to exporters' tax refunds puts unnecessary cash flow burden.

3. CPEC long term business strategy

I. We would strongly recommend that the release of the Plan be urgently followed by the creation of a formal body, organized to hold discussions between Pakistan's Planning Commission, the country's Business representatives and representatives from its financial sector, and relevant regulatory authorities (SBP, SECP etc).
II. Such a forum would be necessary to move towards a common understanding on priority areas, and actions, for fresh investment, post the enhancement of Pakistan's Logistics and Energy framework by CPEC. There is an urgency for crystallizing, at least in directional form, corollary benefits from CPEC that can encourage recurring growth in exports, and aid GDP to reach sustainable annual growth rates of at least 7%.
III. Currently, queries, concerns and (different) misapprehensions, on the part of both domestic and multilateral agents, exist. These must be addressed, not only through the outcome of domestic planning

coordination, but also through a demonstrable strategy for utilizing expertise from China to supplement domestic manufacturing capabilities and enhance yields in agriculture. Chinese investment must be seen to serve as an enhancer to domestic businesses, not as an 'extractor' from them.

IV. Already damaged by the FTA with China, many businesses in Pakistan are concerned that Chinese companies will use the CPEC 'umbrella' to further increase their share of the domestic market, through the proposed SEZs, or through the incorporation of Xinjiang within CPEC. So far, their work here has involved less use of Pakistani manpower and resources than expected. It is notable that except for in Power projects, no large Pakistani business houses are known to have partnered with Chinese companies in manufacturing or other enterprise, and Chinese companies are, anecdotally, active in seeking investments within Pakistan largely on, and of, their own.

V. It is suggested that responsibility for approval and monitoring of all CPEC projects be consolidated under the aegis of an empowered, and fully staffed, Authority, as its sole responsibility.

VI. CPEC counterparts in Pakistan are different levels, and departments, of Government, and separately, the private sector. If each counter party is left to negotiate terms, oversee implementation, and respond to problems, we can end up with different responses to similar issues, and also different procedures, rates and prices; compromising our control and influence on the whole process as it rolls forward.

VII. Centralization will allow the development of common criteria, build project supervision experience and expertise at a single point, and allow smoother and faster project implementation.

4. Scale up the labor force for the digital age and the jobs of the future

VIII. Invest heavily in producing quality science, technology, engineering and mathematics graduates who can push Pakistan towards innovation, technology assimilation and sophistication.

IX. Bring top Universities from Singapore, China, and Germany to Pakistan with affiliate degree programs in Science & Technology.

X. Promote vocational and technical skills training as the employment opportunities for general degree holders are receding and the demand for para-engineers, para-medics, technicians, para-scientists, mechanics etc. are rising rapidly

XI. Subsidize the research and development activities in the Defence, public and private sectors for developing new products and processes

XII. Make broadband more affordable and available by reducing the incidence of taxation

5. Maximize earnings from existing infrastructure, natural resources

I. Improve the maintenance and operations of the existing capital assets-irrigation systems, leading to higher water availability and more land under cultivation

II. The National Water Policy pending with the Council of Common Interests seeks to address the potential:
   a. 22 mn more acres could be irrigated in Southern Punjab, Sindh, Southern KP and Eastern Baluchistan
   b. Our canal efficiency is just 33% vs. global average of 90%
   c. Pakistan's reservoirs can store only 10% vs. 40% global norm. Some $23 Bn of economic potential is lost.
   d. Additionally, securing supply under the Indus Water Treaty and from the Kabul River are also important.

III. Energy infrastructure (power & gas) is causing huge financial losses to the exchequer; recover user charges for meeting this expenditure.

IV. This is especially a concern with the rising unaccounted for losses in the gas sector. Need to rethink the best way possible to meet household needs for heating away from natural gas supplied via an expensive house to house infrastructure.

V. Malaysian model of Khazana for running Public Sector Entities and privatization of loss making PSEs

VI. Rising losses of PSEs and the sharp build-up of debt in their balance sheets is a major drain on productive resources.

Member Companies

Abbott A Promise for Life	AkzoNobel	AlliedBank	Artistic Milliners
mayfair Asian Food Industries	Atlas	Bank Alfalah Limited	CHERAT CEMENT
Coca-Cola	Colgate Palmolive	Dalda	Dawood Hercules
DESCON	efu	English Biscuits Manufacturers	engro corp
engro foods	faysalbank	FEROZSONS LABORATORIES LIMITED	GATRON
Getz pharma	gsk GlaxoSmithKline	GulAhmed TEXTILE MILLS LIMITED, KARACHI	HBL
HASCOL	HUBCO	ICI PAKISTAN	interloop
International Industries Ltd.	INDUS GROUP	TOYOTA DAIHATSU INDUS MOTOR COMPANY LIMITED	JDW Sugar Mills
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Member Companies

LUCKY CEMENT	MEGA CONGLOMERATE	MTL Millat Tractors	National FOODS SINCE 1970
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pakarab FERTILIZERS LIMITED	PSL PAKISTAN SERVICES LTD.	ptcl	PAKISTAN TOBACCO COMPANY
Philip Morris International	Reckitt Benckiser	SAIF GROUP	Sapphire
Shan	SICPA	SIEMENS	Soneri Bank
SOORTY World Of Denim	HUTCHISON PORTS PAKISTAN South Asia Pakistan Terminals	Standard Chartered	SPEL Synthetic Products Enterprises Limited
TAPAL	TCS WE MOVE YOU	Tetra Pak PROTECTS WHAT'S GOOD	TPL Holdings Tomorrow Delivered Today
Tufail Chemical Industries Ltd.	UBL	Unilever	