Improving Pakistan's competitiveness and enhancing exports

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Introduction

The focus of my talk today will be on competitiveness of the manufacturing sector because

- Historically, manufacturing sector has been the engine of growth in almost all successful developing counties, as well as during Pakistan's high growth periods
- Manufacturing sector's growth is essential for
  - Accelerating export growth to address Pakistan's chronic balance of payments problem
  - Generating employment for Pakistan's rapidly growing, young and low skilled labor force

However, by focusing on manufacturing I do not imply that we can ignore sectors such as finance, energy, ICT, Transport & Logistics as competitiveness of manufacturing also depends on the competitiveness of these sectors

Current Status of Competitiveness

- On the Global Competitiveness Index Pakistan was ranked 110 out of 141 countries in 2019 (i.e. below all other South Asia countries), while India was ranked 68

- Individual competitiveness indicators where Pakistan does very poorly in terms of ranking (and are the product of government policies, but not the focus of this talk) include:
  - ICT Adoption 131/141
  - Skills (education) 125/141
  - Domestic Credit to private sector 122/141
  - Utility Infrastructure 114/141

- However, Pakistan's worst performance in individual indicators is on Trade Openness (138/141) and in my view that is the most important reason for the poor competitiveness of its manufacturing sector

A Important Reason for Pakistan's Poor Competiveness

- Completion faced by domestic businesses is a key determinant of their competitiveness
- In Pakistan, unfortunately, government policies have been largely aimed at shielding local business from competition. As a result
- There is a large chunk of the manufacturing sector (around 30%), such as Automobiles, Petroleum, Iron & Steel, Cement, Fertilizer and Sugar, which is totally protected
- Rest of the manufacturing sector is also highly protected
  - Even in the most important export industry, i.e. textiles, sub-sectors such as spinning, man-made fibers and cloth manufacture are heavily protected

Improving Competitiveness: The Way Forward

- Historically, Pakistan has had a highly overvalued exchange rate and that has been one of the reasons for the high level of protection provided to industry

- It is seen that whenever overvaluation of the currency has increased so has the level protection, though the motivation may have been to curb imports in the light increasing deficits on the balance of payments

- However, now that Pakistan has moved to a market based exchange rate system and currency overvaluation has been largely corrected, there is an opportunity and the need to move ahead with trade liberalization, starting with raw materials and intermediate goods

- Currently, Pakistan's exports are based almost entirely on domestic raw materials. For example, domestic value added in Pakistan's exports in 2015 was 95% compared to 65% in China's exports in 2000.

Improving Competitiveness: The Way Forward

1) **Reform the tariff regime**

- Pakistan has one of the most complex, opaque and protective trade regime in the world. This is because of a combination of tariffs, regulatory duties, sales and withholding taxes, and tax emptions – over 50% of tax revenues are collected from taxes at the border

- ***First step must be to simplify the trade regime***
  - One, by eliminating regulatory duties and withholding taxes
  - Two, by reducing the use of SROs and ultimately eliminating the SRO regime

- ***Next there is a need to Reduce tariffs, staring with tariffs (plus regulatory duties and withholding taxes) on raw materials and intermediate good***

- ***Finally, the totally protected sectors such as automobiles and sugar must be opened up.*** The impact on competitiveness of this step could be huge

Improving Competitiveness: The Way Forward

2) **Ensure exporters have access to inputs at world prices by reforming existing schemes and introducing new ones**

- ***Make Duty & Tax Remission for Exporters (DTRE) scheme more exporter friendly***
  - Ratios of imports (as a proportion of exports) for each major export item should be notified by Government.
  - Based on the notified ratios & previous years export performance, exporters should be allocated the amount that she/he can import in the next year.
  - An online system for permission / clearance of imports under this system should be introduced

- ***Introduce a Central bonded raw materials & intermediate goods warehouse facility***
  - Particularly important for SMEs for whom DTRE scheme may not be suitable because of smaller quantities involved
  - Import allocation of individual exporters & list of eligible imports by export category would be same as under DTRE scheme, but exporters would be able to purchase their requirements from private bonded warehouses instead of having to import goods directly

Improving Competitiveness: The Way Forward

3) **Transform custom procedures & facilitate trade**

- ***Implement National Single Window (NSW) strategy***
  - NSW which connects trade-related stakeholders, i.e., banks, business stakeholders (i.e., exporters, importers, shipping lines, freight forwarders, etc.), government & regulatory agencies, within a country via a single electronic data information exchange platform has been under development since 2017
  - Government should immediately finalize & approve NSW strategy
- ***Establish model business-friendly custom clearance unit***
  - Pilot such units at Sialkot dry port, one SEZ and Gwadar
  - Based on experience & lessons learnt from it, similar facilities should be established at other SEZs and dry ports, and ultimately the model should be replicated at the Karachi port

Improving Competitiveness: The Way Forward

4) **Expedite sales tax refunds & duty drawback**

- Exporters face liquidity crunch due to delayed payment of sales tax refunds & duty drawbacks
- Borrowing from banks or other sources increases costs & affects competitiveness of exports
- To improve liquidity of exporting enterprises, pending sales tax refunds should be cleared immediately
- Sales tax refund claims & customs duty drawbacks should be paid by SBP, through authorized dealers immediately at time of realization of export proceeds - the current method of FBR first providing the necessary funds to SBP only discredits the State Bank

Improving Competitiveness: The Way Forward

5) Connect with Global Value Chains (GVCs)

- To improve competiveness and accelerate export growth Pakistan needs to connect with GVCs which account for almost 50% of total global trade
- Pakistan is a large market (25^{th} in the world in terms of GDP) and 94% of FDI it has received has been market seeking. Pakistan needs to leverage this fact to connect with GVCs
- Pakistan has linked access to its market, such as for automobiles, to meeting local content requirements to promote industry. However, these are global industries and local content requirements have only resulted in a non-competitive industry (both assembly and component suppliers)
- Instead of local content, market seeking FDI should be encouraged / required to meet minimum export requirements from local components / products, say 10% of the value of imported content
- To promote local component industry it would be much more effective to have supplier development programs, improve local suppliers' access to finance and invest in sector-specific skill development programs

Improving Competitiveness: The Way Forward

6) SEZs under CPEC provide an unprecedented opportunity to connect to GVCs and expand exports

- China's economy is undergoing a major restructuring because of increasing labor costs, with many labor intensive industries relocating to neighboring countries such as Vietnam. This process is likely to accelerate because of the ongoing trade tensions with USA
- Pakistan can use the proposed SEZs under CPEC to become a major beneficiary of this ongoing industrial off-shoring process
- However, international and Pakistan's own experience has shown that using SEZs for regional development never works – it only results inefficient industries which locate in backward areas only for tax avoidance purposes
- For SEZs to be successful they have to be located where there is a large pool of labor and easy access to port and other related infrastructure
- In addition, to attract GVCs to a SEZ it must be special, i.e. in terms of imports, custom clearance, legal requirements, business regulations, etc.

Improving Competitiveness: The Way Forward

7) Finally there is need for the Government to Focus on Productivity – which could be initiated by

- **Develop a Productivity Enhancement Plan (PEP)**
  - Remove constraints to productivity identified by PEP
  - Implement a program for measuring and monitoring "productivity growth" by industry / sector
- **Establish a Technology Upgradation Fund (TUF)**
  - Identify priority sectors
  - Undertake a technology "need assessment" for priority sectors, and use it design TUF
  - Operating principle of TUF should be "funding for technology upgradation on a matching grant basis" only
  - Design and continuous impact evaluation should be in collaboration with researchers

Thank you