
# STRENGTHENING INSTITUTIONS AND SIMPLIFYING REGULATIONS:

## Key to Unleashing Pakistan's Trade and Industrial Potential

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Pakistan's trade and industrial policies in the past could not deliver due to a lack of overall macroeconomic stability. The boom bust cycles have resulted in premature halting of initiatives announced for small and medium enterprises (SMEs) in the manufacturing sector. This has also meant that integration of Pakistani SMEs in regional and global value chains remains weak. [1]

After the 18th constitutional amendment provincial governments have also provided a set of incentives under (provincial) industrial policies. However, the overarching tax and regulatory environment faced by manufacturing units remains the same as much of this is the federal government's domain.[2] The federal government is responsible for indirect taxation on goods, overall trade policy, including trade negotiations, tariffs on goods, and export promotion initiatives under the Federal Board of Revenue (FBR) and the central bank. The provincial governments are then responsible for development of industrial parks and providing the necessary enabling (physical) infrastructure for industries and skills development.

Previous governments did their best on several occasions to liberalise the trade regime, reduce tariffs, provide export incentives, and improve the overall investment climate.[3] However, supply side challenges such as the energy shortages faced by manufacturing industries (particularly smaller firms), rising costs of energy and other inputs, and regulatory constraints including tax and product-specific regulators at provincial level have not helped achieve the overall trade policy objectives.[4]

The recent decline in value of the Pakistani Rupee versus other major global currencies has also implied that the cost of imported inputs on which Pakistan's manufacturing sector is heavily reliant has also gone up. The uncertain external account environment and future debt repayments results in volatility in the value of the Rupee, in turn discouraging manufacturers and traders to lock-in transactions which could potentially lead to an exchange rate loss.

Due to skyrocketing inflation seen in the past year and a half, the central bank increased the policy rate to over 20 percent during much of 2023 - making it difficult for the manufacturing sector to borrow for its working capital and other requirements.

This macroeconomic milieu and overall supply side gaps have prevented larger firms from starting their operations in special economic zones all across the country. Some large multinationals have sold their stakes as initially envisaged profits could not be realised. Some analysts have said that these reasons are also a cause of delay in envisaging the next phase of the China Pakistan Economic Corridor (CPEC)[5].

To reverse this situation, the Government of Pakistan has set up the Special Investment Facilitation Council (SIFC) in Pakistan with the aim to: i) fast-track investment approvals and facilitate the establishment of new projects; ii) reduce bureaucratic hurdles and streamline the investment process; iii) promote investment in key sectors, such as agriculture, minerals, energy, and information technology; iv) enhance synergies with the

Gulf Cooperation Council (GCC) countries on investment; and v) create a conducive environment for investment to promote Pakistan as an attractive investment destination.

Many have argued that to achieve the objectives of SIFC the reform of relevant ministries and departments mandated for trade and investment promotion is also necessary. For example, the institutions responsible for trade and industry in Pakistan are weak and fragmented even at the federal level. The Board of Investment (under the Prime Minister) and Ministry of Commerce do not house sector-specific experts from the private sector and both institutions remain understaffed and underfunded. The provincial industrial departments are also weak and lack the capacity to effectively promote industrial development or ensure that problems of those housed in industrial parks are effectively addressed.[6]

The Pakistan Regulatory Modernisation Initiative (PRMI) was started as businesses faced several obstacles in obtaining the necessary licenses and permits, and they were often subject to arbitrary and unpredictable regulations including unanticipated security clearances. An assessment of PRMI is required to see how far it has achieved its objectives and what more could be done. Likewise, an assessment of provincial boards of investment may also reveal caveats which require attention[8].

Going forward, a long term incentive scheme is required to lure local and foreign investment in manufacturing units. A well targeted scheme could also help revive the sick units in the SMEs space. As Pakistan remains in a program with the International Monetary Fund, providing tax breaks and exemptions to businesses may not be possible. Besides, such measures have often been captured by large and well-connected firms. However, some measures to reduce cost of doing business of smaller firms and potential exporters in the manufacturing sector could be designed with assistance from the central bank and energy utilities. Tariffs on import by manufacturing units could also be lowered to reduce their cost of operations. High tariffs on imported raw materials and intermediate goods make it difficult for Pakistani businesses to compete in the global market. The illegal and informal flow of goods from across the borders hurts genuine traders and this practice must be curbed[9].

To conclude, the country currently has a weak and fragmented institutional framework for promoting competitiveness, a complex and burdensome regulatory environment, inadequate and weakly targeted mechanisms of fiscal support to the industrial sector, and a complex and protectionist tariff structure. The only way this can be reversed is to strengthen the institutions responsible for trade and industry promotion at federal and provincial levels, simplify the regulatory environment for SMEs, provide more targeted and effective fiscal support to potential exporting firms, and pursue tax and tariff reforms to reduce taxes and tariffs on imported raw materials and intermediate goods.

In the longer term the country will need to focus on improving its enabling infrastructure (including digital infrastructure), developing and retaining its human capital, and promoting productivity. Augmenting trade-related infrastructure, such as roads, railways, and ports should also help to lower overall logistics costs.[10] Negotiating smart trade agreements with other countries opens up new markets for Pakistani goods and services – something which should be pursued with countries having large potential demand for Pakistani products.[11]

[1]See Ahmed, V., Suleri, A. Q., & Javed, A. (2015). Strengthening South Asia Value Chain: Prospects and Challenges. South Asia Economic Journal, 16(2_suppl), 55S-74S. https://doi.org/10.1177/1391561415594900.

[2]A case has been made for tax harmonization across the federation which could reduce business costs. See, Nazir, A., Maken, A.M. and Ahmed, V., 2018. Streamlining Tax Harmonization in Pakistan. Sustainable Development Policy Institute, Islamabad.

[3]Naqvi, W., Hayat, D., Javed, M. and Ahmed, V., 2019. A Review of Export Promotion and Exemption Schemes. Sustainable Development Policy Institute, Islamabad.

[4]See, Aslam, H., Ahmed, V., Williamson, M. and Rana, F., 2020. Reform priorities for Pakistan's energy sector: perspectives in the backdrop of Paris Agreement. UN ESCAP.

[5]Hippler, J. and Ahmed, V., 2022. Global Pakistan: Pakistan's Role in the International System. FES.

[6]Ahmed, Vaqar. 2017, Pakistan's agenda for economic reforms / Vaqar Ahmed. Oxford University Press Karachi.

[7]Khan, H.D. and Ahmed, V., 2015. Fund-raising for Energy Projects in Pakistan. SDPI

[8]Manzoor, R., Ahmed, V. and Javed, A., 2020. Addressing non-tariff measures to promote Pakistan's textile sector (No. 189). ARTNeT Working Paper Series.

[9]Ahmed, V., Suleri, A.Q., Wahab, M.A. and Javed, A., 2014. Informal flow of merchandise from India: The case of Pakistan. In India-Pakistan trade: Strengthening economic relations (pp. 47-70). New Delhi: Springer India.

[10]Shabbir, S. and Ahmed, V., 2015. Welfare impacts of Afghan trade on the Pakistani provinces of Balochistan and Khyber Pakhtunkhwa. Stability: International Journal of Security and Development, 4(1).

[11]Batool, S. and Ahmed, V., 2014. Trading with India: lessons Pakistan must learn from Bangladesh and Sri Lanka. Criterion Quarterly, 9(4).

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