What impedes our private sector

Pakistan has not been able to maintain or diversify industrial production structure as is done by comparable countries

Dr Karim Khan | August 10, 2021

The writer is an Associate Professor at Pakistan Institute of Development Economics (PIDE), Islamabad

Private sector, comprising corporate sector and the individual enterprises, plays a large part in the development of an economy. With the recent focus on growth, Pakistan has the potential for much faster and more diversified economic growth, provided that the private sector comes forward and takes the lead. This presumption can only be realised if we could create a functional market structure, with a thriving and competitive private sector. Alternatively, in order to turn private sector into an engine of growth, we have to provide an enabling environment for businesses by improving regulatory framework, reducing infrastructure deficit, and creating competition in the market.

Recently, the World Bank published the Country Private Sector Diagnostic (CPSD) titled 'Creating Markets in Pakistan'. The report, while synthesising impediments to

private sector development, asserts that the most crucial challenge to businesses in Pakistan is the lack of effective, credible, and persistent institutional environment. In particular, we could not effectively develop or employ our policies to produce the desired results. With respect to industrial policy, Pakistan has not been able to maintain or diversify the industrial production structure as is done by comparable countries like South Korea, China or Malaysia. Consequently, our performance on exports, terms of trade, and diversification, including both market and product, is poor. Likewise, if we ponder on our investment policy, we are no better, with total investment to GDP ratio hovering around 20% since the last four decades. This is roughly half of regional peers and only one-third of more dynamic emerging markets in Asia. Over the last decade, private investment has remained around 10% of GDP, and the net annual inflow of Foreign Direct Investment (FDI) has averaged at 0.8% of GDP.

Further, competition policy has failed to deliver in terms of fairer competition in the market by restricting barriers to entry or controlling deceptive marketing practices. Consequently, markets are concentrated and controlled by a handful of powerful lobbies, leading to non-competitive practices like artificial shortages, hoardings, and overpricing. This is also reflected in our lower ranking on the Global Competitiveness Index (GCI), with ranking of 110 out of 141 countries. As far as trade policy is concerned, we have been an inward-oriented and protectionist economy, with an anti-export bias, shielding some domestic producers from external competition. Despite having some successful clusters like textiles, leather products, and sport equipment, Pakistan has largely been a spectator amidst the rapid expansion of Global Value Chains (GVCs). Accordingly, we have not been able to benefit from the capital, technology, knowledge, and business networks that tend to accompany FDI and trade. Similar is the case with other regulatory institutions in key sectors of the economy.

Amid institutional decay, the structure of private sector in Pakistan has been restricted in size and scope, with limited penetration both in local markets as well as in global markets. In domestic markets, competition is muted which has adversely affected the dynamism of businesses. Especially, lack of competition reduces investments in innovation and technology and inhibits creative destruction, both impeding growth in productivity. In addition to ineffective implementation of competitive practices, state has a sizable footprint in key economic sectors which has been a deterrent to entry into markets. Given these constraints, 70% of the firms in Pakistan are classified as small. Only 8% of Pakistani firms are classified as large, compared to 54% in Sri Lanka, 52% in Indonesia and 47% in Thailand. This has also been manifested by around 30% share of Small and Medium Enterprises (SMEs) in the manufacturing

sector during the last decade. Furthermore, a sizable number of businesses in Pakistan operate in the informal sector, with the size of undocumented economic activities ranges from 25% to 35%. In Pakistan, the share of employment in informal economy is 71.4% of non-agriculture employment, including 92% of employed women. Informality in businesses has been further creating market hurdles like unfairer competition, credit constraints, and losses in revenues. For instance, according to World Enterprise Survey of the World Bank, 13% of the companies in Pakistan have been complaining about unfairer competition from the informal competitors. Likewise, unregistered firms are unable to access to the formal credit market, causing them to remain small forever. Revenue losses are yet another concern, caused by lower levels of the registration of businesses.

What needs to be done? Competition in the market is the only solution to resolving the conundrum of Pakistan's faulty private sector. The government needs to reduce the cost of doing business and remove policy distortions to investment, competition, and trade. Secondly, the government needs to reduce its footprint of inefficient and loss-making state-owned enterprises (SOEs) in all sectors, like electricity, transports, and industry. In this regard, public-private partnership (PPP) could be a strategy to restrict market distortions on the one hand, and transform the loss-making SOEs into profit-making ones, on the other. Finally, protection to domestic industry should be converted into facilitations in terms of removing infrastructure deficit to businesses.

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