Pakistan’s low investment conundrum | The Express Tribune

Karim Khan November 30, 2022

Macroeconomic stability and opening the market to global firms crucial to the country's economic survival

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Pakistan, an economy characterised by boom-bust cycles, has been under severe stagflation.

The inflation rate in the country has risen to 24%, and about 31% of our youth, with degrees, are unemployed.

In other words, we have not been able to match our rising demand due to low productivity and, likewise, we have been lacking capacity to cater to our youth bulge.

Our short-lived cycles of growth are usually followed by macroeconomic crises.

Alternatively, when the country’s demand increases much higher than its supply of goods and services, it prompts a need for higher imports, leading to a balance of payments crisis.

Likewise, when rise in government spending is not matched by a rise in revenues, it causes fiscal crisis.

Why are we so recurrent with our economic crises? It’s because our short-lived phases of growth are largely driven by private and government consumption, and not by investment and increase in productivity — the only ways to persistent growth performances.

Pakistan has been an investment deficient country, with investment-to- GDP ratio remaining below 20% over the last four decades.

In particular, private investment has remained around 10% of GDP which is roughly half of regional peers and only one-third of more dynamic emerging markets in Asia.

Likewise, FDI has averaged around 0.8% of GDP since 2010.

Overall, lower investment has kept capital deepening to decline instead of rising over time which has, in turn, severely impacted growth in labour productivity.

Precisely, aggregate productivity has been shrinking in the country for two decades.

Allocative efficiencies, i.e. reallocation of market shares towards more productive firms, have offset to some extent the decline in firm productivity, but it has not been enough to counterbalance the decline in overall total factor productivity.

A recent World Bank report 'From Swimming in Sand to High and Sustainable Growth' shows that in Pakistan, a 40-year-old firm is as productive as a young firm of less than 10 years, compared to regional peers where older firms are 30 to 40% more productive than the younger ones.

Likewise, Pakistani firms have not been able to boost gains in productivity from the economies of scale as they struggle to grow larger over time.

The decline in productivity is mainly caused by factors like low investment rate, lower innovative activities, family-dominated ownership structures, and our firms' lower exposure to global markets.

Why is investment essential for longrun prosperity of the country? I would like to posit that investment enhances production capacity of a country, leading to employment generation, persistent growth and poverty reduction.

Likewise, by spurring innovations and the adoption of efficient technologies, investments make the production process cost-effective and competitive in world markets.

Further, public or private investments in physical and digital infrastructure help create an enabling environment resulting in higher investment retention, while fueling further interest of potential investors in the economy.

So what needs to be done for fostering investment in Pakistan? First, macroeconomic stability should be the foremost priority to encourage savings and private investment in the country.

In other words, we need to ensure external sector liquidity, maintain market-determined exchange rate, improve our sovereign credit rating, and mobilise domestic revenues.

Second, we must open our market to global firms by providing them with level-playing field in terms of regulatory procedures, clearly-defined tax and trade policies, and investment-friendly infrastructure.

Third, state-owned enterprises (SOEs) are still not only a drain on aggregate productivity but they are also a burden on government fiscal space.

Alternatively, reforms in SOEs — like corporate governance, market-based induction of CEOs and joint-ownership structure — are of upmost importance in this regard.

Even we should not be hesitant in privatising those SOEs where the presence of public sector is not justified.

Only these factors can make a way for adequate investment, entrepreneurial and innovative activities, and competitive environment in the country.