GLOBAL THINK TANK NETWORK

Opinion Paper:
The Economic Reform Agenda

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3. The Bottom Line
1. Macro Transmission for a Better Pakistan

It is time to think and act on building Pakistan’s brand, focusing not on politics but on the new economic challenges. Accordingly, our policymakers have to be responsive to the global investor community, which has begun to raise doubts on Pakistan’s state of economy. Brand rebuilding through the revival of investor confidence is the need of the day. It is no longer IMF or the World Bank, we should rely on. Our politicians and economic czars have to respond positively to the capital markets for enhancing savings and channel investments for sustainable economic growth. Accelerated economic growth is mandatory and the pie must get bigger – an annual growth rate of 7.5 percent is achievable. Only if the pie is big enough is an equitable growth possible.

Pakistan’s economic potential is widely applauded due to its unique geo-political location and a relatively young population of about 180m. With per capita income reaching approximately US$1,200 (from about US$450 in the mid-1990s), Pakistan’s middle class is growing. That will impose substantial pressure on domestic consumption growth and the external deficit. The gains made over the past years are at serious risk if policy formation is delayed. As a result, the pace of foreign inflows has slowed in recent months. Due to bad governance and unstable politics, Pakistan has been unable to attract its due share of foreign and domestic investment. Similarly, Pakistan’s inability to utilize its competitive edge is causing under-investment in the system. The economy remains short of confidence and catalysts. This can only be boosted through proactive policy making, tax rationalization, and sustainable economic policies.

2. Key Areas of Policy Making and Reforms

Keeping medium- to long-term economic goals policies should be formulated to achieve common interests - development plus social security. Since independence, we have adopted short-term answers to address long-term structural issues. For instance, the recent power, water, and food shortages are prime indicators of Pakistan’s policy gaps.

The government should focus on the following key areas for holistic policy making for plugging policy gaps and redressing structural imbalances: key areas for holistic policy making for plugging policy gaps and redressing structural imbalances:

2.1. Tax Reforms: A Key to Economic Success

Pakistan needs structural taxation reforms. The root causes of all economic ills could easily be addressed through a smart tax policy. Remember Turkey, which used to be mired in a quagmire of high deficits and low economic growth. After Justice and Development Party (AKP) came to power in Turkey, it ditched Keynesianism and implemented a drastic policy change. It substantially lowered tax rates and cut all superfluous government spending. As a result, Turkey’s economy reacted immediately with a sustained explosion of growth, which has averaged 7.5 percent in 2002-2013. Instead of relying on micro measures, Turkey reduced the corporate tax rate to 20 percent from 50 percent. This production-stimulating policy motivates people back to work; it stimulates entrepreneurship and risk taking, to perform over time (not unlike what is encapsulated in Armey-effects1).

Historically, policy makers have responded to budget deficits and weak growth through higher taxation of income and higher public spending and have never trusted the efficiency of the private sector. Through heavy taxation they have long discouraged investments in key capital-intensive projects and prevented the achievement of long-term economic development goals.

The fear of low tax receipts has always convinced policy makers to keep high tax rates. As a result of high tax incidence, however, investment

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1. After Richard Keith Armey, US Republican and former House Majority leader, and a supporter of flat tax against progressive tax.
penetration has remained low in comparison with other regional economies. Pakistan’s corporate tax rate at 35 percent is higher than Turkey’s (20 percent), China’s (25 percent), and India’s (30 percent). Similarly, reliance on indirect taxes due to low tax compliance has led the Federal Board of Revenue (FBR) to flatten sales tax at 17 percent. From a macro point of view, this is not optimal as it excessively penalizes the less well-off segment of society.

Tax cuts have a positive impact on the economy in general and tax collection in particular. The effects of tax cuts (also characterized as Laffer-effects) are very strong in countries like Pakistan. Every rate cut, in fact, broadens the tax base because evasion, avoidance, and fraud become less attractive. The combination of Laffer-Armey effects would definitely increase tax receipts as tax rates go down. Tax cuts coupled with increased receipts will also have a pronounced effect on social spending as high tax receipts help assure higher fiscal spending. Hence, production-stimulating policies are indeed more beneficial from a socio-economic perspective than Keynesian demand-side policy of boosting consumption through government spending. In short, tax cuts are a motor for creativity; they spark new initiatives and job creation in productive sectors. Turkey is a good example as lowering tax rates caused Turkey’s unemployment to decline to 9.7 percent in 2013 from 19 percent in 2002. Tax cuts would certainly help but tax incidence must rise too mainly through the efficient enforcement of tax collection.

Consumption taxes are flat in Pakistan at 17 percent. This does not discriminate between the consumption patterns of the rich and the poor. Practically, consumption should be taxed progressively as this will make consumption expensive and boost savings. A progressive tax on consumption reduces demand pressure, particularly on high-end imported goods, and hence alleviates pressure on the current account.

With the implementation of reduced income taxes and progressive consumption taxes, Pakistan can go a long way toward solving the issues of low tax compliance, fraud, and evasion. This, in turn can improve the macro-indicators of tax-to-GDP ratio, debt-to-GDP ratio, and weak economic growth. The government should consider reducing taxes on corporate income and salary income. The recent wave of inflation has seriously dented the purchasing power of the public. With a cut in taxes on salary, there will be little pressure on wage increases. This will add to contain producer wholesale prices.

Globally, taxing consumption over direct taxes has pronounced effects:

a. Countries with a higher consumption rate than saving rate tend to grow slower. Therefore, a policy shift from consumption to saving would lead to higher income generation.

b. Raising taxes on consumption allows for lowering direct taxes. Lowering social contributions improves wage productivity and stimulates growth.

c. On an individual level, higher net incomes motivate employees, decrease pressure on wage negotiations and improve competitiveness.

d. Higher consumption taxes provide incentives to save and invest. Hereby, part of private income is directed toward productive sectors.

2. After the American economist, Arthur Laffer, of the Laffer Curve fame, one of the implications of which is sound effects of lowering taxes.
equitable than direct taxes as they discriminate between the rich and the poor. Consumption taxes are not socially unequitable. Consumption taxes are simpler and balance income more equitably through higher taxes on luxury goods than on daily necessities. By default, consumption tax should be progressively enforced rather than applied at a flat rate. Certain basic use items like domestic food, domestic clothing, health care, housing up to a certain level and education should be exempted from consumption tax.

i. The complexity of income tax is much higher than consumption. Lower income tax may lead to reduction in evasion and the rich must be refrained from evasion, while higher consumption tax cannot be escaped if consuming high value products.

j. Direct tax has high transaction costs as it requires tough compliance, enforcement and administration.

Similarly, Pakistan faces a huge risk of high external deficits due to the import of durables. The consumption tax on durables should change to a progressive system rather than a flat regime. This will penalize those who are driving high-end vehicles, using imported cosmetics, buying imported foods, etc. because consumption tax is neutral and does not discriminate between local and foreign goods as well as increasing saving and discouraging conspicuous and superfluous consumption. To promote efficiency and investment, the FBR should take the following bold tax decisions:

i. Corporate taxes and personal taxes should be reduced to 20 percent from the existing 35 percent.

ii. Consumption taxes should be imposed on a progressive basis of 12 percent – 15 percent. Goods that exhaust more foreign exchange and precious natural resources should be taxed at a higher rate. For example, consumption tax should be higher on cars with higher fuel consumption.

iii. The capital market should be exempt from capital gains tax for an indefinite period, as this is vital to raise equity in the high interest rate environment.

iv. Education, construction, exports, tourism development and mining should be declared tax-free industries.

v. The government should provide free land to developers for the construction of hotels, schools, cheap housing for the poor, and tourist attractions.

vi. To tap the natural resources of the country, the provinces should issue licenses for the exploration of minerals. Import of all machinery for mining and the exploration of natural resources should be exempted from customs duties.

2.2. Regional Trade: Pakistan’s Strategic Location – Think Trade

Pakistan is not short of opportunities; amongst its many natural endowments is its unique geographical location. Realizing the potential of its strategic geographic location at the crossroads of three sub-regional systems in Eurasian super-continent- South Asia, West Asia, and Central Asia, Pakistan’s trade can grow manifold with the prospects of economic development in the western regions of China as well as the emerging economic opportunities in the land-locked Central Asian States.

Interaction between South Asia, China, and the Central Asian Republics is not possible without Pakistan. We should be cognizant of and interested in the fact that China has opened up to the outside world and is exponentially investing around the globe. It gets oil from Saudi Arabia and transports that oil all the way round to its east coast. It trades with Europe, Africa, Middle East and India most of which is transported to its east coast. A cursory examination of the changing geopolitics of Asia and the balance of forces in the Pacific will show that sea lanes and China’s eastern seaboard are faced with different kinds of risks. Therefore, how can all of China’s trade be
through its east coast alone? China now plans to go through Pakistan and Pakistan is aware that it can provide a reliable and safe link facilitating the overland transport of China’s Persian Gulf energy imports. Our relationship with China and also with the Central Asian Republics allows us to provide a short-cut route and contribute to all kinds of trade and energy cooperation.

To realize the potential of becoming a “Trade and Energy Corridor” (TEC), Pakistan has primarily focused on China and also other neighboring countries to join hands. Moreover, Iran has offered Pakistan land access through its territory to Central Asia and Russia for trade; in return, Iran has asked Pakistan for similar access to China, through the Karakorum Highway (KKH). India has also shown keen interest in obtaining access to Iran, Afghanistan, Central Asia, and the western regions of China. The Gulf Cooperation Council (GCC) countries are also looking to utilize Pakistan’s trade corridor to access western China.

The importance and usefulness of Pakistan's TEC is valid for many countries. Pakistan is keenly interested in serving China’s interest as the two countries are cementing their economic relations; they also enjoy a long-standing strategic partnership which is now evolving to greater breadth and depth. Moreover, the infrastructure for TEC requires multi-billion dollar financial commitments, for which only China has the interest and financial capacity. Feasibility studies are being carried out for laying a railway track and a pipeline along the KKH up to the Chinese border. The successful realization of TEC should have a profound impact on regional integration and would help in creating a web of regional inter-dependencies that will spur regional trade and mobilization of resources.

The pre-requisites for becoming a trade and energy corridor are sound financial sector, quality infrastructure, and free trade zones. Unfortunately, on the policy front, nothing special has been provided to private sector on infrastructure and real estate development, except from government-to-government level.

Pakistan needs trade with its neighbors. Although main objective of Economic Cooperation Organization (ECO) was to enhance economic cooperation amongst its member states\(^3\), it has failed to achieve this. Still Pakistan, like Turkey, should work to conclude bilateral Free Trade Agreements with all the member states of ECO. There is also huge potential for trade with Iran, particularly for home textiles and value-added products. Pakistan has failed to take advantage of special opportunities that has existed in the last few years due to sanctions, while Turkey-Iran trade in 2012 rose to US$ 21.3 billion from US$ 1.2 billion in 2002. Similarly, India has taken full advantage and now its trade with Iran is slated to exceed US$ 20 billion. Almost all its trade is now in Indian rupee, thus relieving balance-of-payments pressures.

Pakistan should accede to TIR convention without further delay. This would help make its dream of regional trade a reality. Pakistan needs to build regional alliances with a focus to enhance trade. Regardless of geopolitical realities conduct trade with all neighbors. China has become factory of the world and conducted trade with all nations without hindrance. The exponential growth of its economy in the last three decades is purely based on its policy to expand trade with neighbors and all corners of the world.

2.3. Youth: Fountain of Energy

Besides its strategic location, Pakistan is privileged to have a large young population, with around 55 percent below the age of 24, making Pakistan one of the world’s youthful nations. Roughly, 7-10 million young people will join the labor force in the next few years. This will increase economic growth, consumption, and investments in the country. However, the existing low skill-set level is undermining Pakistan’s growth potential with 21 percent of the population living below US$ 1.25 a day, deprived of bare minimum consumption required for decent living. The employment-to-population ratio of

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3. Afghanistan, Azerbaijan, Iran, Kazakhstan, Kyrgyzstan, Pakistan, Tajikistan, Turkey, Turkmenistan, Uzbekistan, including the Turkish Cypriot State as an Observer.
Pakistan was only 50 percent, compared to 62 percent of Australia, and 68 percent each of China and Bangladesh. To realize the potential of the population, massive investments are required in the education sector to uplift the skill level of young people and promote a culture of entrepreneurship. Prime Minister’s Youth Loan Scheme is a step in the right direction but it needs strategic planning and a pool of mentors to guide the promising young businessmen, which can be established with the help and collaboration of institutions like IBA and LUMS.

2.4. ICTs

Pakistan also has a potential to be a major software exporter. It is evident from the fact that in recent years there is massive increase in software exports. Pakistan has made its mark in the development of new Apps. Unfortunately, the front office of most IT companies are in the US and Europe, where they book all their sales whereas the development work is undertaken in Pakistan. There is need for a more proactive IT policy to attract global software companies to set up their sales and development offices in Pakistan. India has set global standards in this field already. Its companies like Infosys and Tata are indeed among global leaders. There is no harm in replicating the Indian model to attract IT companies to operate from there.

2.5. Tapping into Pakistani Diaspora

Undoubtedly, Pakistan is rich in resources and has the ability to confront the emerging challenges of higher twin deficits and inflation through correct policy choices. A relative improvement in Pakistan’s fundamentals can keep structural flows intact. It is important to mention here that right policies will have a very good effect on the overseas Pakistanis who are a great source of capital and skills that is required for long-term growth in the country. Recent increase in remittances to almost US$15 billion is an evident proof of their ability to shoulder attract this great source of human capital for our long term growth. Both India and Brazil have done so very successfully by implementing a clear policy to attract their diasporas for capital and skill. Most of the IT development in India was made possible only by incentivizing overseas Indians. Same is true for the Eastern European transition countries. If Pakistan has to achieve a growth rate of 7.5 percent for the next 10 years then we have to make our diaspora part of our development and economic policies. Some tough and bold decisions would be required to boost their confidence.

2.6. Tourism and Construction: Engines of Employment

It is important to realize the importance of tourism and construction industry and encourage foreign and local investors through tax incentives and providing free land. In selected areas, bids should be invited to construct resorts, hotels, theme parks and provide free land for 50 years on both sides of the highways. Through this, the government will be able to attract substantial tourism from the region as well as promote internal tourism and attract substantial amount of foreign exchange. Higher tourism ratio also supports retail sales, greater mobilization of resources, and employment in the country.

Government should also encourage easily affordable housing construction, invite tenders for it, and through tenders should allocate free land and provide mortgages at cheaper rates to lower middle-class.

Construction industry has great potential to generate employment as well as cultivate the natural resources of the country. Over 150 industries get direct benefit from higher construction activities. Due to growing urbanization, there is a good case for building new cities. After Islamabad, no new city has been built in the last 40 years. Pakistan is endowed with almost 120,000 MWs of hydropower potential; developing hydropower for regional export is in line with UNFCCC charter, yet at same time also opens creates additional

4. Information and Communications Technologies
5. United Nations Framework Convention on Climate Convention
demand for the construction industry.

2.7. Agriculture - Pakistan's Greatest Competitive Asset

Pakistan is paying a huge cost of ignoring the potential of agriculture through high inflation, higher imports, and social unrest. This sector cannot be ignored any longer, as it employs almost 47 percent of the total workforce of the country, 37 percent of male and 75 percent of the female labor force, and directly and indirectly contributes about more than 75 percent of the country's exports. The future of commodity producing sector is heavily based on the performance of agriculture sector. With the efficient performance of the sector, Pakistan has the great opportunity to reap the benefit of agriculture commodity super cycle.

Pakistan is one of the major agricultural commodity producers in the world. Globally, Pakistan is the fourth-largest cotton and sugarcane producer, the fifth largest milk producer, and ninth-largest wheat producer. The current performance could increase manifold if only the government diverted sufficient sources and attention to this sector.

The underperformance of the sector is further aggravated by the unavailability of sufficient water resources. As per the World Bank Report, only 336 cu.m per capita of renewable internal fresh water resources are available in Pakistan, which are only one-third and one-sixth respectively of those of India and China. This is attributed to below par rains, low forestation and high pollution. Pakistan's forest cover comprises only 2.1 percent of the total land area which is a reduction from 3.1 percent of the total area in the mid-1990s. This is extremely low compared to 23.1 percent of India and 22.5 percent of China.

In its last many reports, World Bank has confirmed Pakistan's deteriorating yields per hectare over the past twenty years driven by low input utilization and meager spending on agricultural machinery. World Bank reports states that Pakistan’s average labor productivity per worker is capped at US$ 696 compared to US$ 1,025 of Philippines and US$ 37,776 of Norway. This suggests backwardness and inefficiency in the sector. Similarly, Pakistan's grain production per hectare was recorded at 2,834 kg, compared to 4,599 kg of Brazil, 5,837 kg of China, 5,999 kg of Austria, and 8,012 kg of New Zealand. Simply, the relative underperformance of the sector is attributed to low credit penetration, low input utilization, and insufficient machinery.

Additionally, Pakistani farmers are averse to using quality inputs, due to the uncertain support prices, low storage facility, and absence of crop insurance. It is time now to allow Agro Warehousing and Collateral Management companies in Pakistan to provide much needed logistic support and minimize crop losses and availability of cheap financing. This would also ensure fair prices for farmers. Indian experience in this sector has proven to be a great success. More than 50 companies are operating in India with over 2000 warehouses all across the country. Pakistan has so far not even framed the relevant rules to permit operation for such companies.

The agriculture sector is lightly taxed and should not be taxed until sustainable productivity levels are attained. This sector is too important to be ignored as Pakistan’s future economic sustainability is heavily reliant on the performance of the agriculture sector.

2.8. Water, Power, and Energy Management

Since the early 1970s, Pakistan has not added any significant water reservoirs to its capacity, despite being endowed with the world’s 2nd and 3rd largest mountain peaks of the world. That indicates a serious policy failure. No single faction can be blamed for the failure. All sections of society, ranging from establishment and bureaucrats to politicians and businessmen are responsible.

Due to the delay of key dam projects, all indicators, ranging from per capita surface water availability to agriculture have deteriorated since 6.

6. Merrill Lynch commodity team expects "the long-term outlook for food and energy prices remains favorable as emerging market (EM) demand has a long way to go and supply is constrained. Over the medium term, Merrill Lynch is worried about further commodity price "super-spikes". Incremental demand for commodities in recent years has mostly come from emerging, not developed markets. In turn, skyrocketing commodity prices have partly contributed to pushing up EM inflation."
1951. Pakistan’s per capita surface water availability for irrigation was 5260 cubic meters per year in 1951. It has now fallen to 1,360 cubic meters per capita in 2011, marginally higher from a benchmark of “water short country” of 1,000 cubic meters per capita and well below the acceptable average of 1,700 cubic meters per capita. If these projects are not completed, Pakistan will reach a situation where the risk of acute shortage persists and hence an unavoidable famine would ensue.

As the Water Sector Investment Planning Study had forecasted, Pakistan is facing a deficit of grain production in this year. The size of the deficit means it cannot be wiped off even with the best agricultural farming practices or quality seeds. One needs to ensure adequate water supply for farming.

To cope with the power and water crisis, Water and Power Development Authority (WAPDA) proposed few dam projects in 1980s and 1990s. But unfortunately, the construction of these dams has been on hold due to the political opposition by provinces. The situation got worse with WAPDA’s failure to provide alternative plans for energy.

WAPDA has been slow in completing most of the new dam projects. However, they were delayed due to the government failure of not: building national consensus on controversial projects; allocating funds; and, providing peaceful political and economic environment to developers of dams.

Along with big dams, Pakistan should also go ahead with small ones to avoid the crisis of water and power shortages. The province of Khyber Pakhtunkhwa (KPK) is privileged with huge water resources and uneven surfaces, which is ideal for small and large dam projects. Rough estimate suggests that KPK can generate as high as 32,000MW electricity through hydel generation, twice the country’s requirement and five times as high as the existing hydel generation capacity.

The need of the hour is for the government to allocate resources for building large dams, creating reservoirs to ensure steady supplies of water in all seasons. Besides, it is also essential to avoid severe floods. We have already seen havoc wreaked by the floods in 2010, resulting in enormous financial losses. If we have had reservoirs built in time not only the access water could be used for agriculture, but also the destruction caused to human life and property could be averted.

In its strategy plan, WAPDA has proposed 12 future dam projects. Additionally, WAPDA has five ongoing hydropower projects and over 12 hydropower projects. Few are controversial and the rest are under consideration. Pakistan has sufficient resources to generate electricity for its future generations. Most of the small projects are feasible and could be financed through IFIs, private sector and leading consortiums of the world.

Other than the risk of huge grain and water deficit, Pakistan faces massive power shortages. Currently, Pakistan’s electricity shortfall is estimated at approximately 5000MW, nearly 20 percent of the entire demand. Pakistan roughly meets 80 percent of its oil need through imports. With current high oil prices at around US$ 100 per barrel, Pakistan’s oil import bill has grown to over US$ 15bn on annual basis, more than half of the country’s total exports. The delays in hydro projects are posing a huge risk to both external and fiscal accounts. The impact of this is visible in the form of higher deficit financing and inflation. Overall, the lingering impact would crowd out private investment and reduce national income and overall employment generation.

Sadly, Pakistan has failed to add to its electricity production since 2001. This was partly due to surplus electric power during 2000. However, the surplus capacity was nearly absorbed in 2006 and since then Pakistan has been facing severe power crisis. Due to delays in hydel projects, Pakistan’s reliance on thermal generation has increased in the short-run, costing billions of dollar to the national exchequer through furnace oil imports.
The bulk of the country’s energy requirements are met through Gas (47.6 percent) followed by oil (32.0 percent), coal (6.7 percent), hydro-electricity (11.8 percent) and Nuclear (1.3 percent). The current energy mix could change substantially if we tapped the untouched resources of coal and hydro reserves. Nuclear power generation, alternative energy, and shale oil and gas should be used in place of thermal generation in Pakistan. This will save us billions of dollars in precious foreign exchange.

With the discovery of shale oil and gas and the available Technology for their extraction it has become possible to be self-sufficient in 5 years.

Recent estimates of the US Energy Information Administration (EIA) show Pakistan has reserves of shale gas of 586 TCF, with risked technically recoverable reserves of 100-105 TCF. Pakistan also has shale oil reserves of 227 billion barrels, with risked recoverable reserves of 9.1 billion barrels. These reserves are concentrated mainly in the Indus basin. These reserves exceed those present in all the Central Asian states combined, and if tapped, can allow the country to become energy-independent within two years. If Pakistan has to shelve the IP gas pipeline project due to the fear of US sanctions then we must ask the US to provide us with required technology for shale exploration on a fast-track basis. If an exploration and production (E&P) policy is framed to attract US companies, we can be self-sufficient in our energy needs within the next 5 years. It is a good sign that the US has agreed in principle to offer technical assistance for shale gas reserves exploration and should be capitalized upon further.

2.9. Democracy can do Miracles

As a result of the peaceful transfer of power to the new government after the May 2013 elections, Pakistan has been praised globally. 2014 will be very crucial for socio economic and politico economic purpose. Also, the government faces tough economic decisions and a huge law and order crisis resolving which will

The much awaited decisions are as follows:

- Revamping of tax system for ease of business and long-term structural investments.
- Withdrawal of oil subsidies
- Agriculture support prices and export policy.
- Privatization of key public entities like PIA and Pakistan Steel.
- E&P policy for shale oil and gas exploration.

2.10. Separation of Economy from Politics

The re-branding of the country is directly associated with the future mode of deficit financing and inflation. The immediate challenges of the economy must not blur our vision for growth for the medium- and long-term. The true image of the country can only be restored through revival of the long-awaited privatization theme, which will ensure Pakistan commitment to structural reforms.

In the last many years, the government focus was on quality direct investments and some IFI financing. That helps in correcting macro variables of debt to GDP, FX reserves position, low investments, and interest rates. Continuation of these macro policies is very important to lure investments. Historically, privatization or strategic sales of key national unit always proved efficient, compared to global depository receipts (GDRs).

Selling GDRs of precious national assets should not be preferred over strategic sales in the medium run, as investors chuck shares as and when a share realizes good price or during crunch time. Past sell-offs/ privatizations of the banking sector (MCB, UBL, HBL and ABL) are the success stories of Pakistan’s past privatization. All privatized banks have witnessed a major turnaround in earnings, growth, and taxes paid to the national kitty. Delay in strategic sale of the key industrial units has stalled the process of re-structuring and
the current account deficit, it is very important to revive the privatization process.

Pakistan has fond memories of privatization of key banking units, as this has not only attracted quality management but also helped in enhancing enterprise value of the banking companies and thus the value of the government equity. Strategic investors are there for long-term investors and stick to their investments even at tough economic environments, in contrast to GDR investors. The quality and commitment of GDR investors will always remain doubtful, as they have the option of dumping equities if anything goes against their expectations.

Pakistan’s exploration sector promised great potential due to high success rate coupled with higher international oil prices. This would turn out to be an ideal opportunity for government to reduce its holdings in E&P companies through strategic equity sell-off. With the efficient management and further equity injection through strategic investments, the government will position itself in a win-win situation. Higher equity injection by investors will lead to higher enterprise value of the company, higher exploration volumes, and higher dividend and tax payouts.

2.11. Steps Needed to Encourage Investments

The government should privatize public companies through capital markets to use them as a vehicle for savings, instead of relying on the public saving schemes. Pakistani corporates should also be encouraged to go to the global capital markets to raise new funding. The benefits are multi-dimensional such as help in raising capital, reducing reliance on debt, and spurring investments and savings. Through capital market investments, the government can generate significant amount of taxes from different sources (e.g. income, dividend, sales tax and excise duty, etc.).

The tax benefit should be further enhanced and attracting investments and savings. To promote investment in real estate development and infrastructure government should liberalize rules for Real Estate Investment Trust (REITs) and introduce a regulation-free environment for private equity with tax incentives.

SECP charges exorbitant fee on authorize capital. This fee discourages the development of capital formation to undertake large projects badly needed to achieve 7.5 percent growth in the coming years. The country needs a fresh look at the present rules hampering investments. A conducive and corporate friendly business environment has to be created so that our business can operate in an enabling environment, and contribute to faster economic growth.

There is not a single DFI of a considerable size in the country. There are a few investment companies established as JVs with few countries for example Pak-Kuwait, Pak China, Pak Libya, Pak Brunei and PIAR. Their capitals are very small for them to undertake any of the major infrastructure projects. There is a need to merge them all and create a mega DFI in the country which can issue infrastructure bonds and sukuk. This merged entity can attract credit enhancement guarantees from Asian Development Bank, Islamic Development Bank and IFC. This would help to keep the cost of debt at very low levels as these institutions enjoy AAA ratings. Instead of waiting for loans from the World Bank to construct much-needed dams, Pakistan can raise billions of dollars from international and local markets through this merged mega institution.

There is also a dire need to make availability of capital easier for entrepreneurs. Unless one is already wealthy or well connected, it is impossible to finance even the most deserving and promising entrepreneurial ventures. A small amount of capital handled professionally and transparently, will unleash the creativity of our youth and SMEs.

2.12. Bureaucracy Needs Reforms

After independence, the civil services remained
order and collecting land revenue. But the requirements of a truly progressive and developed Pakistan are beyond this narrow set of functions.

Pakistan’s civil serves system has remained frozen in time and remains unresponsive to the peoples’ needs and aspirations. Moreover, the preoccupation of politicians with transfers and postings for their chosen few has played havoc with the bureaucracy.

The resultant demotivation, demoralisation and despondency among the majority of civil servants are reflected in the poor services delivery. Indifference, inaction and apathy towards serving the masses and a mind-set resisting change in the process becomes ingrained in their behaviour.

Few years back a committee was formed under the able guidance of Dr Ishrat Hussain. A detailed blueprint and action plan for reforming the civil services was prepared after analysis and stake holders’ consultation. Its following basic recommendations can be implemented without much difficulty.

- The concept of the superior and subordinate services and the distinction between cadre, ex-cadre, should be replaced with equality of all service at all levels of government.
- A district service should be constituted for each district.
- Recruitment at all levels should be on a competitive basis and on merit.
- The present system of ACRs should be replaced by objective-based performance evaluation system.
- A fair and equitable compensation system should be based on performance.

- Teachers, health workers, police, technical and professional experts should be taken out of the national pay scale and given different pay scales according to local labour market conditions.

3. The Bottom Line

Pakistan has the resources to grow and prosper, which have not been optimally used so far. The risk of higher current account deficit will be easily mitigated through right policy mix instead of relying on IFIs. The obvious question would arise, for how long deficits could be financed through selling precious national assets? The answer is, privatization proceeds, if utilized for development projects, will add to national investments, reduce reliance on imports, and generate output and employment. Additionally, economics should not be mixed with politics and for personal mileage. The culture of uprooting the transparency of the past privatizations should stop for now, as this casts doubt in the investors mind and hampers the country’s brand image. Now it is the duty of the new incumbents to lead the brand development from the front and set high standards for investors and regulators.

The future structural flows are heavily dependent upon the theme of privatization, government commitment of restructuring of institutions and political stability. The process should continue and capital markets should be utilized for foreign investments and capital expansion in the country. The idea of setting up new corporates is discouraged by the unreasonable fees charged by SECP. Business can perhaps live with bad policies but not with an unstable policy regime. And this goes beyond political stability: the last government completed its five years, but had five finance ministers and eight finance secretaries; three petroleum policies; three governors of the SBP; and any number of changes to the taxation policies through SROs. It is imperative that now the government should ensure policy consistency if we have to achieve a growth rate of 7.5 percent.