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Reconstruction of Pakistan Economy— An Entrepreneur’s View Point

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Investment, production and export are sine quo non of a viable economy. Pakistan has, however, constantly suffered from its inability to achieve this viability—more recently arising out of the nuclear testing in May 1998, followed by the change of government in October 1999 and the 11th September 2001 disaster at the World Trade Centre in New York, which ultimately lead to the war in Afghanistan.

ROLE OF THE IFIs

This situation is further accentuated by International Finance Institutions—IFIs—working for globalisation rather than as a coalition for general economic development of the world. The role of these IFIs, however, is increasingly under scrutiny. The recent Argentinean economic crisis has furthered the view that the IFIs have thrust globalisation blindly rather than promoting a balanced economic development of the world. These IFIs are highly vaulted institutions manned by highly prudent managers. Their prudence, however, has yet to focus on the desperation, helplessness and increase in poverty of the people at large, particularly in the developing world. A third of six billion plus people inhabiting the planet live on barely a dollar a day. The World Bank has recently focused only on international competitiveness as the yardstick for investment in developing countries. A World Bank statement recently published, stipulated “to phase out existing industries which are internationally uncompetitive—sugar, refineries, chemicals—automotives, fertiliser and steel which are imposing high cost on the Pakistan economy”. In this context, arguably, even Pakistan’s main industry, textiles is not internationally competitive, as it needs massive doses of subsidies for export through devaluation of currency, cheaper export finance and duty drawbacks. Without all the above industries, one wonders where the investment, production and export, ensuring increasing employment, would lie!

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The International Monetary Fund, similarly, has promoted high devaluation and low tariffs. This, ironically has led to inflation and increased interest rates. Started by an interim government in the early 90s, the protection generally provided to the local industry has been gradually reduced to 35 percent in '01 from 65 percent during the 90's—earlier, over 100 percent which resulted in attracting foreign direct investment as much as local investment! This will be further reduced this year to at least 25 percent as per the current agreement with IMF—threatening lower to 15 percent. Be it as it may, nowhere in the world has industry developed without adequate protection. India is only now starting to open its markets to the rest of the world, knowing that many of its key industries after years of protection are ready to face foreign competition. Even the developed countries continue to protect sectors vulnerable to competition in the so-called free economy.

Following the Seattle debacle last year, the WTO chose far flung Doha to hold its next meeting on free trade. The question is where exactly is free trade practiced? USA, Europe, India or elsewhere? Indeed, if it really did exist, there would be no need for regional entities such as the EU, NAFTA or any such closed regional markets. The truth is that this is an age of regionalism and protectionism, if not nationalism. The guarding of national interest has been most avidly depicted by the refusal of the United States to lower tariffs on Pakistani textiles. The pressure by the WTO and the IMF on developing countries to remove or lower tariffs thus leaves an impression that they are promoting an agenda for developed countries in the guise of globalisation. Accusations of lack of original thinking is increasingly marring the IMF's reputation. It is felt that it continually prescribes one prescription for all ailing economies while serving none satisfactorily. As such, even in the developed world there have been demands—from George Shultz, William Simon and Walter Wristen—to 'Abolish IMF'.

The WTO, on the other hand, is accused of representing 0.01 percent richest corporations and individuals enabling about 1000 large corporations, contributing 4/5th of the world production. Several multinationals are now more powerful than nation states. In Australia, the ten biggest international multinationals have each annual sales revenue which exceed the Australian Government's tax revenues. The last decade saw a 15 percent increase in wealth (of 70 percent to 85 percent) in the richest countries as against a 2 percent decline in the 20 poorest countries of the world. Further, foreign investors do not come to make money with any socio-economic objectives, which, if any, is incidental. Thus, the policies of the IFIs skew in favour of the developed world and actually discourage further local investment. Intellectual proprietary rights, royalties, technical fees and transfer of prices are in addition to dividends and other payouts leaving hardly anything worthwhile for the host country. On the other hand, the countries which do not rely upon these IFIs, like Cuba and Malaysia, have developed better—faster and smoother—than those that chose to rely on the advice of the IFIs. Pakistan's own experience of 1960s is

that genuine investment came from independent quarters—local entrepreneurs backed by domestic institutions—not foreign investors. Foreign investment followed local investment and not vice versa!

INDIGENOUS BUSINESS ENVIRONMENT

Internally, the business environment has seldom been favourable to investment or entrepreneurship. There has been an inconsistent sense of direction. Rule of law and business buoyancy has been lacking to say the least: snatching of cars and motorcycles in broad daylight have become the norm; which in itself has become a multi-billion rupee business in Karachi alone. Murder and dacoities further scare the businessmen, encouraging the organised flight of capital. Generally, there is a default culture in loan repayment, taxes and utility bills. Smuggling and over/under invoicing is increasingly encouraging the organised sector to opt in favour of the unorganised. Trade is being preferred over industry. Whatever foreign investment is being made, it is generally in simple manufactures, consumer goods, beverages and fast foods. Industry which provides goods and services, earns and saves foreign exchange, creates employment – all leading to self reliance—is devoid of any road map of progress, and, is, in fact, discouraged. Government and business dialogue is at best accommodating. The Government at large continues to consider local businessmen to be merely profiteers rather than developers of local economy and creators of employment. The exercise of nation building is still absent. Accordingly, there has been a flight of capital and consistent brain drain. To cap it all, the general attitude has been to follow the IFIs without realising their impact on the economy. Indigenisation programmes of the engineering industry, for example, are proposed to be revisited at the cost of billions of rupees in investment, hi-tech technology and job opportunities, not to speak of several joint ventures and the technical assistance agreements. Worst affected will be the defence manufactures and their exports that the Government is committed to safeguard the country's frontiers and national security. All these are put in jeopardy just because the government chose to sign an agreement under WTO constraints, without any prior consultations with the private sector.

This, in fact, is the start of the reversal from manufacturing to assembly. The last budget reaffirmed this by allowing assemblies in electronic and electric goods industry at 5 percent custom duty replacing the age-old manufacturing programmes of the country. A highly responsible Government's spokesman further took pride in saying "We want good assembly plants"! And, as if, this was not enough, the local firms were allowed to set up companies abroad—in fact, legalising the flight of capital under the garb of earning foreign exchange for the country at a time when the government is badly in need of inviting foreign capital within the country. And, then we ask why investment is not taking place!

The September 11th attack on the World Trade Center has led to the removal of sanctions and rescheduling of loans and promises of grants and credits.

The real test, however, is, whether it initiates or reinforces investment, production and export (vide annexure). Equally important is what kind of investment climate would emerge in the country given the above circumstances. Despite effort in reviving the economy and promoting foreign direct investment, results remain elusive. The latest report by the State Bank bears testimony to the fact that much more has got to be done in order to revive the economy. The solution lies in the development of hi-tech value added industry even at the “expense” of protection not favoured by the loan giving IFIs: otherwise the end result of the phased out industries, as recommended by the IFIs, could be more damaging to the country’s economy than the nationalisation of the 1970s. Luckily the top administration and the economic team are serious and sincere. Let us hope, they deliver the goods against the severe odds faced by the country.

WHAT TO DO?

The strong arms of a country are strong defence, abundant and cheap food and a strong civil bureaucracy, capable of enforcing law and order and ensuring sound administration. According to a UN report, reinforced by the Harvard University, wherever there is a strong civil bureaucracy, there is a strong economy and vice versa. This includes France, UK, Japan and even India! Pakistan’s bureaucracy has been adjudged as well educated and trained with high experience and expertise. It has its roots among the people. The bureaucrats themselves generally come from middle, if not lower middle class. They are recruited through competitive examinations on merit. And, whenever relied upon, they have delivered the goods quite well. However, one government after another, has damaged the civil bureaucracy. In the process, they have hurt the very sovereignty of the country, not to speak of the socio-economic order. It is high time that wisdom prevails over the whims and subjectivity of all those suffering from this malady to make use of this elite service in the re-building of the economy of the country, with adequate sense of direction from the top. The sooner it is done the better!

Focus on Agriculture

Pakistan is mainly an agrarian economy where agriculture contributes 25 percent of the GDP but caters to 70 percent of the population and the resultant purchasing power. Agriculture must be the first and foremost priority. Historically, when agricultural performance has been good, the whole economy has benefited, even contributing to political solidarity. The recent trends to remove subsidies or price supports to agricultural outputs which exists everywhere in the world, including USA, EU, Japan and India, will have to be carefully evaluated. The stance of the EU and the WTO meeting in Doha on subsidies bears testimony to this need: “Onions must be imported and onions must be exported” free trade slogan, in some quarters, of the government thus, is rather misconceived, to say the least. Emphasis

also will have to be laid on agro-based industry and agro-based export. Further, the Government has to define categorically what kind of investment and technology is wanted and will be protected under all circumstances; otherwise, investment will further shy away. Steel and engineering being the soul of any economy, will have to be re-visited and encouraged. This must include the transport sector with the knowledge that the auto industry has played a leading role in the development of the successful economies; otherwise, the investment worth Rs. 40 billion in basic industry and vending in Pakistan will continue to suffer. In the spirit of the WTO's commitment to a "development" agenda, the government should apply for adequate extensions to the WTO conditions to rehabilitate the industry. Let us hope that it is done to the satisfaction of the industry!

Devaluation

Devaluation has seldom helped investment, production or even export. Pakistan is no exception. According to State Bank figures, in the last decade, the yearly average devaluation was about 11 percent. It has led to an increase in exports at an annual rate of less than 4 percent and imports by an annual average of more than 3 percent, thus leaving a net benefit of just about 1 percent. However, the economic fall-out of this policy have been extremely negative. Inflation has increased at an average of more than 10 percent, expenditure at 16.6 percent and debt servicing at 17.73 percent. Now, when the rupee is finally finding its own level and moving upward, our thinkers must put their heads together and decide whether it is a stronger rupee which will help the economy on the whole or a weaker one. Our neighbour, India, for example, has not suffered from a strong rupee. Its exports have not suffered and, in fact, the foreign direct investment has been encouraged by a stable currency. India's relatively stronger economy is supported by an equitable tax system – income tax rate of 30 percent and sales tax 7–12 percent against 35 to 45 percent and 15 percent respectively, including a 5-6 percent presumptive tax payable, whether income tax is payable or not in Pakistan. The rate of interest in India has been around 10–12 percent as against 14–16 percent in Pakistan with foreign currency reserves of \$ 48 billion in India as against about US\$ 5 billion in Pakistan. India has been a hi-tech value added export led economy comprising steel, engineering, chemicals, and IT as against the simple manufactures – while Pakistan exports comprises yarn and textile made-ups. The Indian economy including agriculture has been highly subsidised. It is because of this concession that smuggling from India is estimated at a cost of Rs. 10 billion in taxes to Pakistan. If at any time Indo-Pakistan trade is to resume this imbalance would have to be rectified; otherwise, Pakistan will be a loser in all respects.

Level Playing Field

Smuggling, which is mainly from India and Afghan Transit Trade has eaten into the vitals of the economy, depriving the government of huge revenues.

Investment in strategic industries in India has been allowed only against foreign currency fixed deposits and commitment to the generation of specific amount of foreign exchange and other such obligations. In Pakistan, it has been at the whim of the government including policies, such as, the import of duty and sales tax free fully built up ‘yellow cabs’ and ‘green tractors’, followed by duty and sales tax free import of knocked down components—CKDs. These measures have hurt industries where plants set up at heavy costs remain idle. The government must reverse these trends as in respect of “engineering procurement and construction contracts” protecting local contractors in complete exclusion of the foreign competition, “including all major industrial and infrastructure projects in all matters of recognised local design engineering and manufacturing organisations” as per a recent direction issued by the Government.

Business and Government Protection

The general default culture in respect of loans, taxes and utilities has ultimately hit investment, production and export. A healthy business environment together with a clear sense of direction, rule of law and clear cut thinking on business, industry and trade issues would help to revive the economy. Chronic deficit finance, trade imbalance and inflation lead to flight of capital and brain drain and can only be contained by industry and not by trade as such. The traditional tariff walls, thus will have to be reconsidered and certain checks and balances to be maintained in the larger interest of the economy as a whole; otherwise, apathy towards investment and more so foreign direct investment will continue.

Industry Vs. Commerce

Pakistan’s experience of combining public and private sector investment and commerce in one ministry has not been a success, as in some other countries. The fact of the matter is, that they are extremely remote culturally from one another. Industry has a parental role—protection—while commerce is trade oriented. Similarly, the private and public sector investment have different socio-economic mandates. The result is that local industry continues to suffer on the whole, thanks largely to the effective lobbying for commerce and trade. Tension between the demands of trade and industry is bound to be further tested in the future. To project the cause of each fairly, a bifurcation of the two ministries is a logical conclusion. Otherwise, investment shall remain shy and so the production and export.

THE NATIONAL INTEREST

In conclusion, Pakistan will have to be guided by its national interests in following any policy emanating from internal and external factors. Internally we will have to be guided by local genius of our own socio-economic fabric. Externally, the

World Bank President, Mr. Wolfensohn, in one of his statements did not agree with the view of globalists—led by Clinton—that “...a truly global market has lifted the lives of billions of people”. Instead, he said that there were “.....searing images of desperation, hopelessness and decline of people who once had hope but will have it no more..... We need local ownership and local participation. Gone are the days when development could be done behind closed doors in Washington or western capitals or any capital for that matter...” It is thus a coalition for development and, as such, globalisation through localisation i.e. globalisation, that is, in the global interest. Let there be no globalisation at the cost of political, social and economic deprivation of people at large. The Noble Laureate, Professor Sen, emphasises that “...globalisation must be dovetailed with national priorities”. One should, therefore, accept that local ownership and involvement must be central to any structuring of the economy by any government in the world, more so in a developing country like Pakistan: it is in self reliance where lies the salvation.

Devaluation—Trade with India

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Comments

Mr Shirazi is a practitioner and belongs to the industrial world. He has battled his way in life as an entrepreneur, not necessarily like the one that belonged to Frank Knight. He has been operating in a protected economy that was not prone to risk and uncertainty. Whatever that may be, he has been a successful man in industry.

His contribution is worthwhile in the sense that he relates the world economy to Pakistan and indicates the iconoclastic views of those whose voices are heard in the world globalisation economy. There has been much that has been protested about globalisation. The view is not cutting much ice with the D-7 countries. The lack of appreciation of the woes of the world is linked with the woes that the developed world is undergoing. Market enhancement for the technologically superior goods of the west seems to be a requirement for them. Shirazi puts up impressive evidence to the contrary.

In the national scene he lays it out, as one should. The culture is one of default but he does not say whether it is willful default or not. The point is that one does not work for the crooked and in the industrial world there are many of them. Those that came in the sector for the purpose of siphoning of resources of this nation cannot be forgiven merely because the presenter belongs to the same class.

The environment has changed because of regressive policies and the earlier entrepreneurs are taking the easy route of going in for trading and not manufacturing. The ills are not ill conceived. They are for real. Vested groups and the government machinery do play havoc and change the balance of industries by their shifts in policy. We are aware of the time and again issuing of various kinds of SROs. The tragedy is that the baby industry syndrome has been taken to far. Industries that have received one kind of benefit want it to continue in perpetuity. Coupled with this he does identify that the MNCs are in consumer goods.

Then he takes a normative route. Shirazi has been pretty vocal at different forum. The system of industrial governance is such that it has allowed industrialists to operate without a human face. The nature of cartels and monopolies speak for themselves. His flight of imagination takes him to fantasyland. The words are encouraging but that will take a lot of doing. The shift that he requires in government policy is desirable but the fact that he does not indicate what the private sector will do in the meantime. How it will respond to what he is seeking. Pakistani industry is victim of greed and not profit. Where a competitive structure is visible the indigenous industry not only survives but also does well. Shirazi does not talk of the competitive or of comparative advantage. He does lament the fact that the government is weak.

Trade blocs are a deterrent to trade and free movement of goods. The example he gives of regressive policies by local MNCs make for interesting analysis. It is something that Naomi Klein has been making in his anti-globalisation effort. That MNCs are dictating terms has become common knowledge. This is now true for the developed countries as well. Whereas there the effort is to blackmail them through employment in the case of LDCs it is simply a case of the economy breaking down. The stakes are much higher in LDCS.

The ills in the economy are primarily due to the industrialists themselves. Government policies do contribute but to what extent one does not know. The basic problem with these presentations is they say what to do but do not say how to do it. The lament goes on.

The recommendations include a whole host of interventions at trying to revitalise the economy. That there is lot between the cup and the lip does not matter. Some of the recommendations are not even useful for the developed countries simply because these cannot be afforded. Certain regressive policies are to be eliminated. The recommendations go to the social areas as well as the management and administrative areas of the government. He goes on to say that Pakistan is not economically or politically a free country.

The liberal policies that he suggests require that the industrialist put their own house in order and not seek dispensations from the government. The protected environment will not be there. That means that the entrepreneurs of this country will have to take on a larger burden.

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