The Pakistan Business Council

FOSTERING ECONOMIC GROWTH

MINIMUM CONSENSUS ON KEY ECONOMIC REFORMS

FEBRUARY 2023

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Pakistan today faces an existential crisis. Its solvency, sovereignty and autonomy are under serious threat due to a combination of commodity headwinds and supply chain disruptions, acerbated by the Ukraine crises, devastating floods and significant political uncertainty. Global recession is impacting demand for its limited basket of exports. Import dependence, especially on fuel and food, remains high. The current account deficit for the FY'23, even after administratively compressing imports, runs at $7-8Bn. All but about $10 Bn of our $100 Bn foreign debts are due for repayment in the next three years and foreign exchange reserves stand at under a month's imports. The tax base remains narrow; public expenditure unchecked; successive governments having failed to address fundamental flaws in the economy. As a result, the people of Pakistan rank at the bottom in most socio-economic measures in South Asia - see Appendix One. It is for their sake primarily that agreement on key reforms is desirable.

Following the pullout of US and NATO forces from Afghanistan, Pakistan's geo-strategic importance has receded and international funding for war on terror has dried up. Even China and other friendly countries which are Pakistan's traditional patrons, are suffering from donor fatigue. Hence, they are hesitant to assist without the comfort of an IMF programme which assures prudent policies. Pakistan's addiction to bail outs has developed over decades. Now, however, after failed attempts at managing without the IMF, talks on reviving the stalled programme have started. IMF's preconditions – market determined exchange rates, revision in price of petrol and diesel and increase in energy tariffs are being implemented belatedly causing inflation in January '23 to clock at 27.6%, the highest in 47 years. This will push more into poverty, which with lay-offs by businesses affected by import restrictions, will threaten street agitation. Additionally, Pakistan faces security risks from a resurgent Tehrik-i-Taliban Pakistan.

A crisis is wasted if some good does not come from it. There is hope that political parties may put the country over party interests and resolve to fix the economy. With this in mind, The Pakistan Business Council (PBC), which is composed of the leading Pakistani and foreign investors in the formal private sector has articulated a set of the most important short to medium term reforms on which, at the very minimum, there should be consensus. This follows PBC's **Charter of Economy** (November 2020) and **Pakistan Economic Reforms Programme** (August 2022).

There is good reason to believe that consistent policies and their continuity benefit the country. Examples of recent successes of policy continuity include the war on terror, the BISP/Ehsaas Programme, expansion in power generation, managing the fallout from the Covid pandemic and moving out of the FATF grey list. All benefited from consensus. Nothing unites Pakistan more than an external security threat. Yet, sadly, the key stakeholders remain divided on economics which impacts the daily life of every citizen and more sharply of those at the bottom of the pyramid. No IMF or other external intervention can help if we all don't resolve to address flaws in the economy.

Perversely, a consensus by default has existed between successive governments on retaining a status quo on key aspects of the economy: taxation, power, state owned enterprises, (de)industrialization, agriculture productivity, a bloated bureaucracy, over-regulation and recurring external account balances. Whilst there is hardly a stakeholder who publicly disputes the need of fundamental reforms, a state of inertia and apathy holds the country and its people back from realizing full potential. It is time for the narrow party interests to take a back seat.

THE KEY REFORMS AGENDA

The key reforms that should at the minimum be part of a cross-party consensus to deal with the immediate crisis and to put the country on a sounder base in the medium to longer term for economic stability are:

<table>
<tr><th>Immediate</th><th>Medium Term Impact</th><th>Longer Term Impact</th></tr>
<tr><td colspan="2">Secure, augment and extend IMF support</td><td></td></tr>
<tr><td colspan="3">Buy time for fundamental reforms by reprofiling debt through assistance from Sovereign Debt Advisors</td></tr>
<tr><td colspan="2">Maintain a narrow exchange rate spread between interbank and open market</td><td></td></tr>
<tr><td colspan="2">Conserve / reduce the use of imported fuel for energy</td><td></td></tr>
<tr><td colspan="2">Cut public expenditure by adopting austerity measures</td><td></td></tr>
<tr><td colspan="3">Widen the tax base to include untaxed wholesale, retail and real estate sectors</td></tr>
<tr><td></td><td colspan="2">Ensure food security and affordability</td></tr>
<tr><td></td><td colspan="2">Provide security of power supplies at a competitive cost</td></tr>
<tr><td></td><td colspan="2">Reduce the burden of SOE losses through restructuring and privatization</td></tr>
<tr><td></td><td colspan="2">Boost exports by broadening the export basket and widening its geographical reach</td></tr>
<tr><td></td><td colspan="2">Make it easier, cheaper and quicker to do business through deregulation, digitization and civil service reforms</td></tr>
<tr><td></td><td colspan="2">Achieve equitable resource distribution by renegotiating the National Finance Award</td></tr>
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Focusing on the near-term reforms is not to deny the importance of longer-term initiatives, important amongst which are population control, managing urbanization, quality of education, skilling people for the knowledge economy, improving productivity, encouraging more women into the paid workforce, affordable health-care, efficient logistics, building climate resilient infrastructure, conservation of water, making internet widely available and affordable, promoting regional trade and empowering local bodies by providing adequate development resources. Foremost, what is required is higher standard of governance and accountability. Most of these important deliverables were covered in PBC's **Charter of Economy** (November 2020) and **Pakistan Economic Reforms Programme** (August 2022). There are also well-articulated socio-economic recommendations of other reputable bodies. This paper however, deals with recommendations to manage the immediate future.

Substantial resources are required to address the aforementioned reforms. These can be only be provided by broadening the tax base, reforming the energy sector, reducing the burden of SOE losses and renegotiating the National Finance Award. Food security, affordability and self-reliance are essential for health and wellbeing, and together with exports and regional trade, these will also help balance the external account.

Immediate Priorities for ensuring Pakistan's Solvency

IMMEDIATE PRIORITIES FOR ENSURING PAKISTAN'S SOLVENCY

Pakistan's external debt servicing obligation for FY23 is USD 23bn, of which USD 6bn has been repaid and USD 4bn rolled over, leaving USD13 Bn yet to be funded. There is further repayment obligation of USD 75bn during FY24-26. Despite a severe import crunch leading to significant unemployment, the current account deficit is running at $7-8 bn and there is a substantial backlog of imports, dividend and other remittances. Whilst the IMF programme is critical to restore confidence of friendly nations to provide assistance, in itself, it will not be sufficient to meet debt obligations unless they are significantly reprofiled. Nor will it provide the space to implement fundamental reforms. Short term rollovers will not suffice. There are therefore four priorities that need to be worked upon:

1. **Priority One** Secure immediate liquidity by expediting/ enhancing the current IMF programme by factoring the impact of floods

   - See recommendations below on managing the external and fiscal accounts with positive impact ranging between $15.7-18.9 Bn on the former and over PKR 1 trillion on the latter.

2. **Priority Two** Buy time for fundamental reforms by reprofiling external debts and by extending the current or negotiating a fresh IMF programme.

   - *Seek reprofiling of debt through advice from sovereign debt advisors. Of the $100 Bn external debt, $75 Bn is payable in FY23-25, which cannot be met by the $3 Bn Fx current reserves and $5 Bn expected from IMF and friendly nations. There is also a $4 Bn backlog of imports and dividend remittances to clear and an import-crunched current account deficit of $7-8 Bn pa to be funded.*

3. **Priority Three** Clearly convey the seriousness of the economic crises to the public instead of giving a "business as usual" impression

   - *Motivate the public to conserve energy through effective communication. The government should lead by example in conservation and by adopting an austerity programme.*

4. **Priority Four** Develop cross-party consensus on at least the key reforms to address the immediate challenges:

   - *This paper sets out a minimum reforms agenda on which cross-party consensus is desirable*

EXTERNAL ACCOUNT •

1. Immediate steps to manage the external account

Exports:

With global recession and compression of demand for goods like textiles, sharpen the focus on export of services. Provide incentive in the form of rebates to services similar to those for export of goods. This would encourage developers who keep their IT earnings abroad to remit via official channels. Expected additional inflow could amount to $2.5 Bn pa.

Remittances/Exchange Rate:

a. Maintain a narrow spread between the informal and the official Fx rate to stem the decline in official remittances and to reduce the source of funding smuggled and under-invoiced goods. At an estimated $350 Mn /month shift back from the informal to the formal sector would have an annual positive impact of $4.2 Bn
b. Millions of $ are leaking from Pakistan into Afghanistan. This needs to stop – see below
c. In the current uncertain political and economic conditions, there is tendency to hoard US$, which like gold has become a store of value. PKR/US$ exchange rate linked PKR bonds should be explored to provide an alternative to hoarding $/gold.

Naya Pakistan Certificates

The fixed rates of return on NPC have recently been revised but after significant lag from changes in global interest rates. To avoid this in the future and to maintain continued attractiveness of NPCs, it is recommended that LIBOR-linked floating rates be announced.

Privatization

Expedite sale of RLNG plants.

Travel for Pilgrimage etc

a. Limit travel for Hajj, Umrah and pilgrimages to Iran, Iraq and Syria, prioritizing those who have never performed a pilgrimage. Estimated saving from 25% cut is $1 Bn pa
b. Restrict issue of air tickets from Pakistan to residents. Non-residents must use their forex savings abroad to buy.

Imports

There is no alternative to limiting imports to essential items: fuel, food, drugs, agricultural inputs, export inputs. However, transparency should be provided to importers of other items to enable them to plan.

China may be approached for a line of credit for items covered by SBP circular on Chapter 84 and 85.

Foreign Use of Credit Cards

Bar non-tax filers from using Pakistan issued credit cards to buy goods/services in foreign currency

2. Key measures to conserve fuel/limit imports

a. Maximize use of Variable Renewable Energy - VRE (hydel, wind, solar), nuclear and indigenous coal instead of expensive imported fuels (FO, RLNG and Imported coal). Complete reliance on indigenous sources would save $4.7 Bn annually but result in daily average shut down of 8 hours (with a seasonal variation of 4-10 hours). If the shutdowns had to be curtailed, it would reduce this saving as follows:

Level of curtailment in daily shutdown through import of fuel	Incremental impact on Import Saving $ Bn	Cumulative impact on import saving $ Bn
No curtailment – total reliance on indigenous sources /VRE resulting in avg of 8 hours of power shutdowns daily	+4.7	4.7
First 25% curtailment in shutdown hours	-1 (via cheapest fuel)	3.7
Following 25% to achieve 50% cut in shutdowns	-1.1	2.6
Subsequent 25% cut to achieve 75% curtailment	-1.1	1.5

b. Charge penal electricity rates based on time-of-use for markets that remain open after 8 pm

c. Limit working days to 4 per week with 1-day work from home instead of a typical 5-6 day workweek. The aforementioned (points 1 & 2) will cut down electricity demand by ~10% (1,594 GwH) while also curtailing petroleum demand by 10-12%.

d. Implement daylight saving by turning back clocks by 1 hour. Alternatively, change the working hours.

e. Consider alternate day use of even and odd numbered cars (but not motorcycles) and encourage car pooling

f. Re-evaluate the renewable energy initiative in view of significant ($3-5 Bn) upfront import outlay on equipment which our external account cannot bear

g. Establish a NCOC type of central body to conduct a public awareness campaign and coordinate the conservation of energy

3. Control leakage of FX to Afghanistan

a. Increase checks on borders, reduce the limit of US$ that travelers crossing into Afghanistan can carry

b. Encourage trade in PKR or on barter; prevent goods from leaving Pakistan without proper export or transit documentation

FISCAL ACCOUNT •

4. Equitably increase tax revenues and cut public expenditure to meet the fiscal target

Revenue:

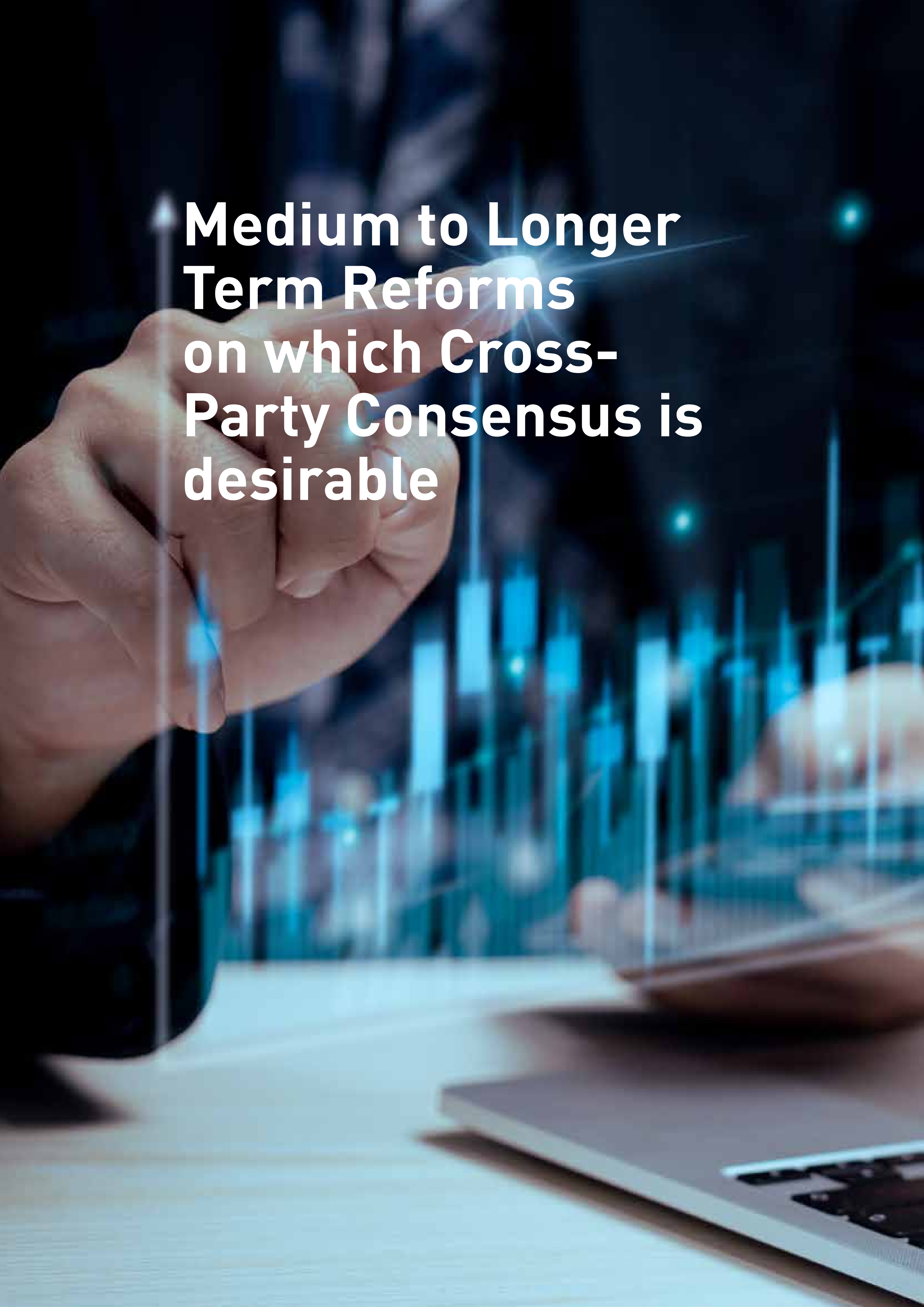
a. Fuel tariffs should be set in line with global rates and commitments made to IMF on PDL should be implemented.
b. Provide direct subsidies to low income users.
c. Tax wholesale/retail with an estimated PKR 234 Bn untaxed potential.
d. Tax real estate which has an estimated PKR 500 Bn untaxed potential.
e. Accelerate the formalization of the tobacco industry. .
f. Ask provinces to levy realistic property taxes to enhance the primary surplus. Property tax in Pakistan at 0.003% of GDP is 1/66th of Bangladesh's at 0.2% of GDP. Every 0.001% of GDP improvement will realize PKR 75 Bn.
g. Win agreement from provinces to share power T&D and gas UFG losses
h. Raise the tax on business class travel by non-tax filers
i. The tax under Clause 7E on deemed rental income needs to be extended to non-tax filers by harvesting the land registration or other ownership data

Expenditure:

a. Trim government expenditure quickly and deeply. Stop replacement of vehicles. Estimated saving PKR 400 Bn
b. Minimize impact on industrial tariffs by removing cross subsidy to residential users. Protect lifeline customers through direct transfers from BISP. Industrial tariffs are already 45% higher than the region.
c. Increase gas tariffs to manage gas circular debt stock of around PKR 1.6trn.
d. Other than in key cities, suspend filling of vacancies for diplomats and trade officials abroad.

ESTIMATED IMPACT ON EXTERNAL AND FISCAL ACCOUNT OF PROPOSALS		
	EXTERNAL ACCOUNT ($ Bn)	FISCAL ACCOUNT (PKR)
Export of services	2.5	
Remittances	4.2	
Naya Pakistan Certificates	0.5	
Sale of RLNG plants	3	
Travel for pilgrimage	1	
Early closure/WFH/Alternate day car use	3	
Reliance on indigenous fuel for power	1.5-4.7	
PDL on diesel		66 FY 23;
10% GST on fuel		200 FY 23
Formalization of the cigarette industry		75
Retail/wholesale		23
Real Estate		50
Property taxes		75
Public expenditure (NHA etc)		400
Energy tariffs		100
TOTAL	**$ 15.7 – 18.9 Bn**	**>PKR 1 Trillion**

Medium to Longer Term Reforms on which Cross-Party Consensus is desirable



FOOD SECURITY AND AFFORDABILITY

Low yield and poor quality are issues that have been confronting the agriculture sector for some time. Now however, these factors have combined with poor forecasting, suspension of regional trade and smuggling to Afghanistan to take a turn for the worse. In a country of vast agriculture resources, recurring shortages of key staples threatens food security and the resultant inflation is putting an unbearable burden on the common person, whilst imports of agricultural products impact the country's balance of trade. An Agriculture Emergency is therefore called for to focus first on addressing the immediate issue of availability and inflation and second on the fundamental flaws within the agriculture value-chain, which if not addressed, can in the worst case threaten food security but if dealt diligently can truly transform Pakistan into the granary of the Middle East and China. In the process, it can uplift a majority of the country's population which resides in rural communities. The national priorities thus are food security, price stability, import substitution, increase in exports, rural prosperity, water conservation, and climate resilience.

Immediate steps to ease the burden of inflation and availability:

- A cross-party recognition that shielding the public from the havoc of inflation by fighting the root causes is a collective responsibility rather than an opportunity to divide for greater political capital. Hunger and malnutrition are a national crisis requiring a united response akin to the pandemic and territorial threats;
- Provinces and the federation must come together to ensure equitable distribution and pricing of essential staples. The political differences currently obstructing cooperation between Sindh and the Center must be overcome in the interest of the people;
- Provinces which have the enforcement capability (and responsibility) to prevent hoarding and price manipulation must exercise it;
- Provinces need to create transparent digital platforms for managing local and provincial inventory and movement of key agricultural outputs which comprise the essential diet of people. These should be integrated with a national platform at the Centre maintained by the Ministry of Food Security;
- No vested interest be allowed to prevail in decisions governing cultivation, export or import of essential crops;

Fundamental Reforms in Agriculture:

- Seeds determine the ability of a plant to withstand pesticide attack, as also the size and quality of the harvest. This is especially true for cotton. Intellectual Property issues have denied the country, seeds of global quality. The Central Cotton Research Institute in Multan which once did some good research has become ineffective. There are now 200 varieties of home-grown cotton seeds but their poor resistance to pests has seen the annual cotton yield drop to less than half of the 15 million bales required by the textile industry. Pakistan is thus forced to import a substantial quantity of its cotton needs. Three leading textile groups are collaborating to introduce a seed variety that should help revive cotton output. Besides yield, the acreage of cotton has also declined as the cultivation of sugar-cane in particular offers better returns. However, sugar is more water intensive and Pakistan is not able to produce sugar of the quality or cost to be globally competitive. Hence subsidies have to be offered by the government to promote exports.

- The agriculture sector is severely under-banked. Only an estimated 18% of farms receive direct loans from banks and with a limited menu of lending products. For example, neither banks nor farmers are satisfied with the practice of placing a charge on the farmer's crop with the farmer's land collateralized as a second security. The farmer's crop is subject to multiple climatic and biological risks that are not adequately mitigated and the bank is unable to easily liquidate the land as collateral. As a result, most lending to farmers is informal and exploitative. New policy and regulatory frameworks are required to allow more capital to flow to the agriculture sector such as through collateralization of the farmer's crop which can bring capital to tenant farmers as well; crop and livestock insurance using modern methods (satellite imaging, weather data, artificial intelligence, etc.) which can improve the farmer's creditworthiness for banks, etc. Collateralization of crops also incentivizes investment in testing and safe and hygienic storage infrastructure which can lead to lower post-harvest losses, grading by quality, and price discovery which are important for value addition and exports. Such storage can enhance food security and quality of agri-commodities for value addition. Encouragement of value addition with links to farmers is another strong driver for financial inclusion and higher farmer profitability.

- Generational fragmentation of land has impacted scale and ability to deploy technology and mechanization to optimize yield and quality. Corporate and co-operative farming are two models that should be explored with adequate safeguards for preserving the livelihoods of the farm communities. Long term leases with profit sharing are another model to consider, especially for introduction of Chinese & other foreign investment into the agri-sector;

- In addition to the aforementioned measure to facilitate use of modern technology, farm equipment rental companies should be encouraged to provide services such as land surveying, land levelling, water course and irrigation systems modeling and upkeep, precision application of fertilizer and seeds, mechanical harvesting, cold chain storage and transportation;

- Pakistan's reservoirs can store only 10% vs. the 40% global norm for water. The current storage capacity is 30 days vs. 120 days considered as a minimum requirement. A $1 Bn potential addition to the economy is estimated for each additional storage of a million acre-feet of water. Twenty-two million more acres could be irrigated in Southern Punjab, Sindh, Southern KP and Eastern Baluchistan. Our canal efficiency is just 33% vs. global average of 90%. Securing supply under the Indus Water Treaty and from the Kabul River are crucial. Ninety percent of the country's water is utilized in agriculture and estimates of the savings potential ranges between 50% to 70%. Tunnel and drip irrigation are two tried and tested options that need to be implemented.

- Pakistan's potential in horticulture is under-exploited. Legal instruments and mechanisms should be developed to enable the enforcement of contract farming agreements between food processing units and farmers. SPS certificates should be issued without hassle to farm-owners for export. Intellectual property rights of seed producers should be enforced. Induct dedicated technical staff for horticulture into provincial extension departments, as requirements for horticulture crops are different than staple food commodities such as wheat and rice. Horticulture commodities should be removed from the ambit of the price control regime. Such restrictions can result in losses to farmers, which discourages them from cultivating horticulture crops, and investing in technology and good agricultural practices (GAP). The State Bank of Pakistan should establish a credit line at concessional rates for establishment of new medium size packing houses, processing units, cold storages, reefer trucks, etc., and for replacing obsolete and inefficient processing machinery with efficient processing lines. The government and the private sector should work to attract large international companies which process food products such as potatoes, citrus, and tomatoes. The priority of new investments should be to introduce off-season fruits and vegetables for all-year processing, bringing new seed varieties of fruits and vegetables and upgrading the cold-chain for the safe transit of produce from farm to the factory gate. Furthermore, the civil aviation and sea port authorities should provide space to the private sector to construct cold storages for fresh produce at the exit terminals.

- Livestock and dairy are primarily subsistence activities in Pakistan, even though, in aggregate, they represent the most significant part of the agriculture sector. The herd size of most farms is small and the absence of scale prevents optimal output. Yields and quality are below global standard, wastage levels are high, yet there is substantial room for significant uplift. The MNC entrants into dairy are contributing to uplift yields and to improve the supply chain but require a determined effort on part of the authorities to curb adulteration. Large corporate dairy farms, benefiting from size, scale and financial and other resources, including genetic intervention provide encouraging models of success. Unlike crops, it is not feasible to provide on-farm dairy technology to small farmers. The "Amul" type dairy cooperative in India needs to be considered, especially in denser population centres. Small dairy farmers are also not able to benefit from direct bank lending. Pakistan has the potential to become a significant supplier of milk and value-added dairy products to China and the Middle East. The provincial food authorities pursue the formal sector with greater vigor than the informal sector, firstly, because it is easier and secondly, due to its headline news value. Yet, the greater benefit to consumers of their actions would be in stemming adulteration, for example of unpacked and unbranded milk sold in milk shops and through home deliveries;

- Pakistan's meat and livestock sector suffers from absence of globally acceptable breed management. Crossbreeding has resulted in a situation that there is little interest in Pakistani meat in international markets.

- Both horticulture and meat exports would benefit from JVs with MNCs that have the knowhow and global marketing reach, like Del Monte in horticulture. There are several models of successful foreign investment in agriculture which can be adapted and adopted. Corn Products Company of the US, (now Rafhan Maize locally) in cultivating maize for both starch and animal feed, Pepsi for promoting growth of quality potatoes for its Lays brand, the Dutch Shaver through the PIA-Shaver JV for developing poultry. There are also excellent examples of companies like K&Ns which have developed the poultry supply chain to address the modern consumer needs. Alliances with Middle Eastern and Chinese companies could boost exports.

- The livestock sector (which includes poultry) has been making a contribution to Pakistan's GDP comparable to the manufacturing sector in recent years. However, the shortage of quality animal feed remains a key area of concern for Pakistan's livestock. Fodder crops and food crop residues make up only a portion of the animal feed available. Feed is a major cost component in dairy and poultry farming. The development of an animal feed industry can contribute to animal health and productivity. A well-thought-out trade-off is required between exporting feed and deploying feed to develop higher value exportable animals and their produce.

- Treatment and prevention of animal disease are a major component of animal health as a means for protection of animal productivity. Disease outbreaks in livestock get exacerbated because of lack of policies to eradicate notifiable diseases in animals, lack of labs for disease diagnostic facilities, and the absence of a robust vaccination regime. Vaccination is often considered a purely private good but, in a country with limited resources, the policy framework can be structured for it to be delivered as a mixed public/private good. Development of disease-free zones is another initiative in this direction.

- Pakistan's coastal potential in significantly under-exploited. Against India's exports of $8 Bn, Pakistan has never achieved more than $450 Mn. Even Bangladesh with a shorter coast line achieves higher exports. The chief impediments to developing higher exports from Pakistan are effective prevention of encroachment by foreign trawlers, upgrading the fishing fleet, cold storage, provision of cheaper power to run the cold stores, compliance with global standards, JVs and other alliances with foreign investors and provision of credit.

- Pakistan needs to implement the Geographical Indications (GI) law promulgated in March 2020. In the absence of this Pakistan risks losing exports of Rice and other horticultural products in international markets.

SECURITY OF POWER SUPPLY AT A COMPETITIVE COST

Pakistan suffers from the highest electricity costs in the region. By penalizing industrial consumers with the cost of inefficiencies and theft, their competitiveness and capacity to create employment and generate exports is impeded. Whilst five export sectors are provided power at rates competitive with comparable countries, the rest of industry, including import substitution sectors and many SMEs, in the value-chain but not direct exporters, continue to be impacted. High tariffs for electricity also reduce the incentive for domestic users to switch out of the less efficient but underpriced gas, reserves of which are depleting rapidly. Tariffs for industry and commerce are also encumbered by cross subsidies to residential and lifeline users. To make matters worse, there is substantial reliance on imported fuel, the transmission system is inadequate to maximize use of indigenous fuel, nor is there a rail link to transport coal from Thar. The grid is also fragile and in need of investment. Salient effects of a sub-optimal power sector on the economy are:

- High import reliance - $6 Bn of the $26 Bn annual imports of fuel are for power;
- Circular debt stands at PKR 2.3 trillion;
- T&D losses at 17.5% amount to PKR 528 Bn pa, of which PKR 165 Bn is above the NEPRA allowance;
- Theft and under-recovery is estimated at PKR 178 Bn pa;
- Industrial tariff in 2021 of 16.5$c/KWh was 85% higher than Bangladesh's at 8.9$c/KWh;
- Cross subsidies in the industrial tariff amount to about PKR 3/KWh or 10% of the rate;
- We heat (and cook) with gas, supplies of which are dwindling, and cool with electricity, for which there is unutilized capacity;
- Demand forecasting is poor – 48% capacity unutilized in 2022;
- Thar with substantial coal reserves is yet to be fully exploited. The rail link with plants reliant on imported coal needs to be built;
- Focus on energy efficiency of appliances and buildings is poor and conservation measures are weak.

The objective of reforms is to reduce import reliance on fuel, make power more competitive by addressing the inefficiencies in transmission and distribution and make transmission more stable and reliable. Opportunities in the immediate and medium term are:

Of immediate impact

- Conserve consumption through penal pricing of power on a time-of-use basis in peak hours
- Given the pressing need to preserve the depleting Fx reserves, enhance reliance on indigenous fuel (Thar coal), hydel, solar, wind and nuclear. A complete switch away from imported fuel at current consumption rate could save $4.7 Bn annually but entail an average of 8 hours of daily power shutdowns
- Complete the transmission line for Thar Block 1 on war footing basis. In the absence of this line, total evacuation from Thar is restricted to 1,600-1,800MW versus available capacity of 2,400MW. This will enable additional cheap electricity from indigenous resources.

Of medium to longer-term impact

- Federal government to restrict its role to removing bottlenecks in power transmission infrastructure and to ensure that the merit order in generation is maintained;
- Exploit full potential of Thar coal mines, build rail connection, initially blend and ultimately replace imported coal with Thar coal. This requires investment of $ 2.2 Bn (Mine $1.5 Bn; Rail link $449 Mn and conversion from Imported to Thar coal $500 Mn) and would yield annual savings of $ 0.9 Bn pa. As work on Thar started sometime back, it may be possible to convince the Chinese government to treat this as an ongoing project;
- Government to explore converting $12 Bn commercial loans under CPEC to longer tenor, concessional cost G-to-G loans
- Any properly justified new capacity addition only be allowed on indigenous coal (if available) and renewables;
- Restore investor confidence by following all GoP commitments to investors in true spirit including tariff regime and MOU terms reached with IPPs;
- Utilize excess generation capacity through marginal pricing to promote industrial use;
- Enhance solar and wind power in line with availability of base load and Fx;
- Upgrade the transmission system post which reliance on expensive RFO & HSD plants will decline allowing them to be phased out. This will also make power supply more stable and reliable;
- Transfer management of government owned GENCOS not due for retirement to technically qualified private sector companies on reward terms linked to performance improvement reward arrangements or through privatization. Facilitate this through adequate protection from NAB and build appropriate safeguards on asset stripping and forced dismissal of employees. Retire all inefficient and costly generation plants;
- Transfer responsibility to fund T&D losses closest to the point of consumption – provinces, cities, local bodies, which may engage the private sector on loss mitigation reward basis;
- Move to multi-seller/multi-buyer arrangements, allowing market dynamics to set the price for both generation and distribution of electricity;
- Phase out country-wide uniform pricing so that the more efficient DISCOs are able to supply at a lower cost to consumers and to enable provinces to use this to attract industry;

- Remove all "cross subsidies" e.g., from industrial / commercial to residential customers – The government can provide targeted cash transfers to lifeline customers via the Ehsaas program;
- Without sovereign guarantees, fast-track additional LNG terminals, storage and transmission to meet the shortfall between demand and supply of gas;
- Consider consolidating the electricity and gas regulators for a holistic regulatory environment;
- Revise the tariff for indigenous gas to stem misuse. Incentivize conversion of domestic cooking and heating from gas to electricity and promote energy efficient buildings;
- Phase the switch of captive generators to grid in line with improvement in reliability of supply and without disrupting their operational feasibility. Potential saving $0.5 Bn pa;

Summary - Potential Impact of Recommendations

Building institutional capacity and improving governance of SOEs will be critical pre-requisites for implementing these solutions

By 2025 By 2028 By 2033

Critical Challenges	Recommendations	Annual Impact (USD Bn)
Sub-Optimal Fuel Mix	1. Blend Thar Coal with Imported Coal Plants (20%)	0.3
	2. Mandate Imported Coal Plants to Run (100%) on Thar Coal [1.5]	1.2
	Sub-Total: Savings in External Account (Forex)	1.5
Surplus Capacity / Unproductive Consumption	1. Savings from Reducing Peak Demand by 1,000 MW	0.4
	2. Diversion of gas from captive to higher efficiency IPPs	0.1 / 0.2 / 0.2
	Sub-Total: Savings in External Account (Forex)	0.9
Generation Curtailment (one-off)	1. Rely only on Indigenous Fuel for Power Supply – Resulting in Loadshedding	4.7
Bleeding DISCOs	1. DISCOs to achieve T&D loss targets set by NEPRA	0.1 / 0.2
	2. Achieving regional benchmarks for T&D loss	0.1
	3. Improve DISCOs recoveries	0.4 / 0.3 / 0.3
	Sub-Total: Savings in External Account & Fiscal Budget	1.4

In 2023 USD 4.7 Bn **By 2025** USD 1.3 Bn **By 2028** USD 1.9 Bn **By 2033** USD 0.6 Bn

Cumulative Annual USD 3.8 Bn

By implementing above recommendations, total annual FX savings would be around ~USD 4 Bn

BROADENING THE TAX BASE AND FORMALIZING THE ECONOMY

Pakistan's Tax to GDP ratio will remain more or less at the current rate as will its ability to invest in human capital – health and education, unless there is political will and capacity/capability in the enforcement machinery to formalize the economy and broaden the tax base. Chasing existing tax payers for more, whilst allowing the informal sector to grow, is akin to killing the goose that lays the golden eggs. The estimate of the potential to tax the under-taxed sectors is as follows:

POTENTIAL TAX REVENUE FROM UNDER-TAXED SECTORS PKR 1,987 BN			
SECTOR	CURRENT TAX REVENUE (PKR Bn)	POTENTIAL TAX REVENUE (PKR Bn)	INCREMENTAL TAX REVENUE (PKR Bn)
TOTAL	**173**	**2,160**	**1,987**
PROVINCIAL	23	775	752
- *Agriculture**	*3*	*375*	*372*
- *Property Taxes**	*20*	*400*	*380*
FEDERAL	150	1,385	1,235
- *Wholesale/Retail***	*43*	*277*	*234*
- *Real Estate***	*107*	*620*	*513*
- *Under-invoicing****	*N/A*	*488*	*488*

**Dr.Ishrat Husain: The News Aug 12, 2022; **PBC/CDPR: Understanding Informality in the Wholesale, Retail and Real Estate Sectors; ***PBC Estimate based on differential between value reported by ITC as exports to Pakistan by China, Singapore, UK and Germany and import values declared in Pakistan from these countries*

The approach to formalization needs to be holistic rather than fragmented and cover the following:

- Check the use of cash. With nearly a third of money in circulation outside the banking system, 80% of the population unbanked and 60% (80 Million people) not included in any financially transparent system, creating the opportunities for financial inclusion, concurrent with disincentives for the use of cash should be major thrusts. These can be achieved through leveraging the growing penetration of smartphones. The money transmission systems now in vogue, still depend on the use of cash and in that respect act as virtual ATM machines which do not serve the purpose of cash-less transactions. Point of Sales (POS) terminals are expensive which is why the number in the country has not grown. POS terminals serve to switch from cash to plastic and do create transactional transparency. The Punjab Government's incentive to reduce GST on some card payments is therefore a step in the right direction which should be replicated. However, with intermediate commissions and charges, the use of cards will remain limited. Digital wallets with vendor QR codes are a better option to displace cash. Discontinuation of the Rs.5,000 note and restrictions on use of cash above a certain limit would also assist. Inter-bank transfer speed has improved and will further improve through Raast and Digital Banks. The Universal Payment Interface (UPI) in India allows money to be transferred across 142 banks, to/from mobile wallets, beneficiaries using the CNIC equivalent and to vendors using QR codes etc. The State Bank can also facilitate a common KYC process for all financial transactions including those on the Stock Exchange and for insurance purposes;

- Address the large undocumented and under-valued parts of the economy – real estate, gold, cash, prize bonds, foreign currency etc., and a fiscal regime that fails to discourage accumulation of wealth in unproductive assets, thus denying the country full potential to invest in productive sectors. Hence Pakistan's savings and investment levels are about half those of its neighbours.

- A 17% GST rate in a poorly documented economy, together with relatively high import and excise duties provide an attractive incentive to evade, the spoils of which are then shared with a notoriously inefficient enforcement and collection machinery. Since provincial GST does not apply on goods, provinces where most of the evasion of federal taxes takes place, have no financial interest to stem it. However, reducing the GST rate has significant negative impact on government revenue in the short term and the IMF conditionalities are unlikely to permit it. Neither is government likely to summon enough political will to challenge much of the trader vote bank which benefits from evasion of the high GST rate. Until rates can be reduced and the collection machinery strengthened, the formal sector will continue to bear the brunt of these levies and the government will be denied taxes to fund social development. Some measures like the requirement of Urdu language labelling on imported finished products need to be supplemented with raids on shops selling those not meeting this condition;

- It is estimated that imports are under invoiced by $5 Billion annually. This hurts the national exchequer and creates an unfair playing field for the formal sector. Agreement to exchange data on the value of imports/exports through Electronic Data Interchange (EDI) with partner countries would help stem under invoicing. It should at the very least be implemented with China;

- The transit treaty with Afghanistan has been misused through diversion of goods to Pakistan. As the treaty has expired, Pakistan can renegotiate in current more regionally favorable environment, to put quantitative and qualitative restrictions on what can transit, insist on letters of credit, charge duty and GST on import which would only be refunded to the Afghan government on exit, track and monitor containers, strengthen inspection of empty containers returning and make physical controls along the border stronger. The civil and military authorities need to be on the same page to do this;

- Front-loaded and unrealistic tax collection targets for an inadequately resourced FBR & provincial revenue authorities forces them to chase existing tax payers and adopt harassment rather than objective assessment as the means to meet these. Until the FBR & the provincial revenue authorities are radically restructured and their capacity to broaden the tax base through use of technology is not addressed, the scope of broadening the tax base will remain limited. Tax collection targets should be set separately for those in and outside the tax base so that its achievement of growing the latter becomes more visible;

- Counterfeiting, especially of food and drugs is a menace that affects the consumers as much as it hurts the government and the formal sector. Weak enforcement of Intellectual Property Rights also puts off foreign investment. One way to check counterfeiting of consumer products is to move the trials to consumer courts and to allow prosecution to be conducted by the lawyers of the hurt parties rather than public prosecutors;

- On a positive note, FATF and Anti Money Laundering laws have made it difficult for transactions to take place outside the banking system. This has effectively cut-off to a major extent the means to fund under invoicing and smuggling and is positive for the formalization of the economy;

- Real Estate has been a traditional repository of “black” money. Whilst there is some progress in stemming the flow into this sector, better collaboration between the Federation and the Provinces in taxation would accelerate its formalization. Fiscal policy also needs to ensure that investment in real estate and gains arising therefrom do not enjoy an unfair advantage over investment and gains in the formal corporate sector.

A large informal economy has the following detrimental effects:

- Weak resource mobilization resulting in under-investment in socio-economic development, impeding productivity. Hence high % of children out of school, stunting, poor health-care, low Human Development Indicators etc
- Poor physical infrastructure, difficult and costly to move people and goods
- Low levels of investment as the undocumented sector lacks access to formal banking
- Exploitation of labour as well as use of child labour
- Irresponsible environmental practices
- Non-compliance with product health and safety standards
- Theft/short payment of utility dues leading to increasing circular debt and reduced investments by utility companies
- Inability of the SME sector to integrate with larger businesses
- Poor gender balance and working conditions
- Exploitation by law enforcing agencies, bureaucrats, money lenders, intermediaries and sometimes criminals
- Increased likelihood of money laundering, reliance on hawala/informal monetary exchange
- Accumulation of undocumented wealth in non-productive assets, especially, unproductive investment in gold and land.

TAXATION REFORMS

Significant changes are required in the structure, talent and technology of the Federal Board of Revenue (FBR) and in fiscal policy to make taxation equitable, broad-based and effective in raising the country's tax to GDP ratio. The key reforms are:

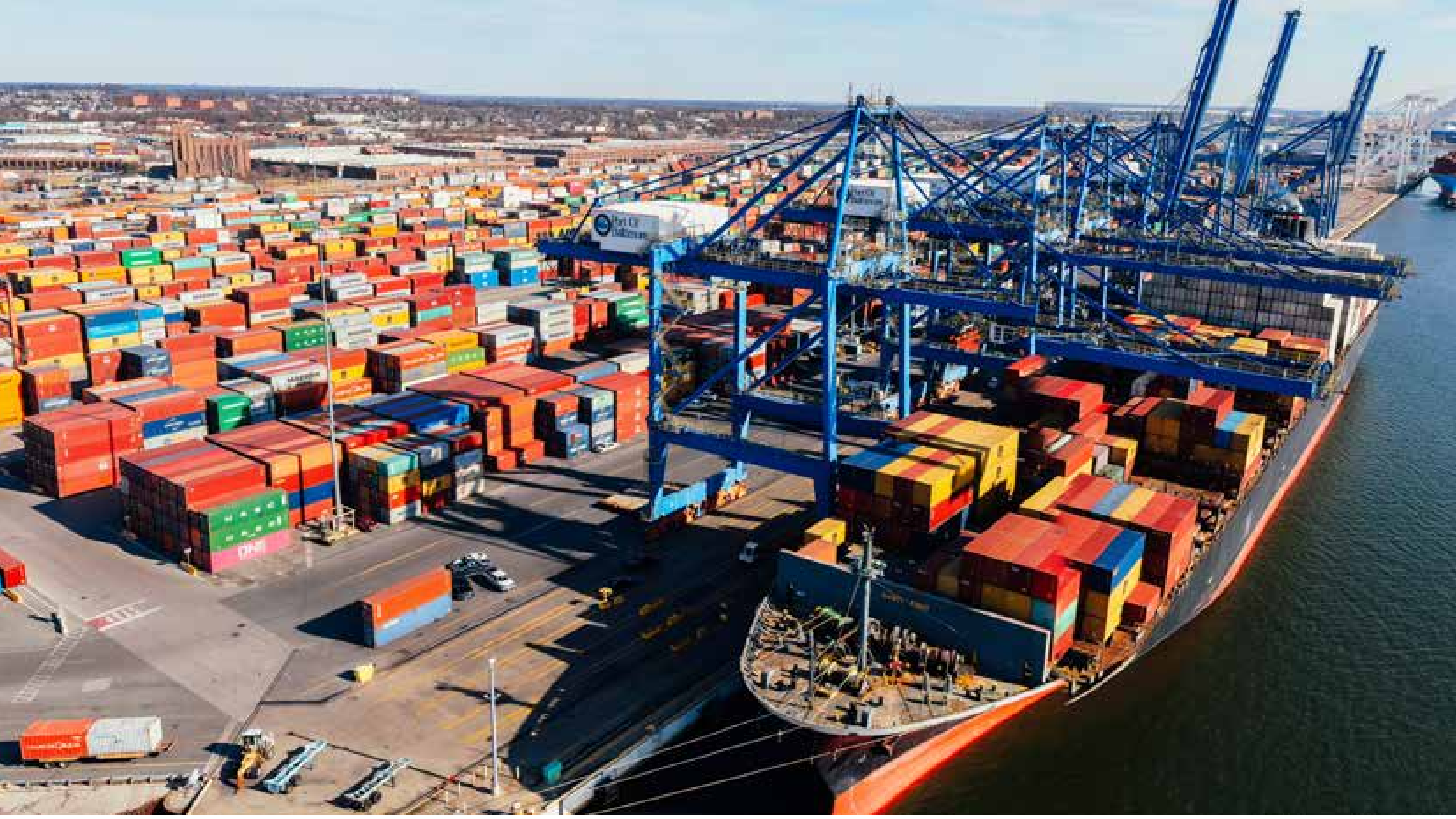
- All income beyond a certain threshold irrespective of source should be taxed. This includes the under-taxed agriculture sector, especially of income from large farms;
- Fiscal policy making should be separated from the collection of taxes;
- An audit function independent of the FBR be established to inspire confidence of tax payers;
- The human resources of FBR should be completely overhauled;
- Training and deployment of technology be given a heightened focus;
- Temporary relief be provided to the FBR from chasing unrealistic tax collection targets until the restructuring is completed;
- Inconsistent and unpredictable fiscal policy, prone to knee-jerk changes and reliance on taxing the already-taxed to meet revenue targets. On the other hand, use of SROs to exempt or provide indefinite relief to certain sectors/tax payers.
- Withdraw the fundamentally flawed turnover-based minimum tax, if necessary, in a phased manner so as not to impact tax revenues;
- Gradually reduce the income and corporate tax rates and remove the disparity between taxation of profit distribution by companies and withdrawal of profit from business by sole traders and Association of Persons;
- Pakistan suffers from one of the most complex tax structures with multiple taxes and authorities for business to deal with. Fragmentation between the federation and the provinces has not helped. Taxes should be unified, returns simplified and the scope for personal interaction be reduced;
- Incentivize capital retention, group formation and investment in plant and machinery;
- A sales tax rate of 17% is high for a poorly documented economy, provides an incentive to evade, creating an unfair advantage for the informal sector. The Sales Tax regime should be in the true VAT mode, and input tax whether at full or reduced rates should be a pass through for businesses;
- Advance and withholding taxes sap the cash flow of businesses and should be reduced gradually;
- Cross adjustments of refunds between Income Tax, Sales Tax , Customs Duty & Excise Duty should be allowed so that refunds if any can be adjusted against tax payables, thus reducing pressures on cashflows;
- Advance/withholding taxes on the consumption by the poor, although theoretically adjustable, are inequitable due to their below taxable threshold income and inability to obtain refunds. This raises the cost of cellular services thus impeding a sector which can play an important role in the formalization of the economy.
- Fiscal policy discourages scale, consolidation, diversification of investment and wider shareholding by taxing inter-company dividends at multiple stages
- Super-tax penalizes successful large businesses and signals benefits of remaining small and under the radar, thus promoting fragmentation, instead of scale and efficiency.
- Tax and other concessions provided to military welfare businesses that result in unfair competition to the rest of the formal sector should be removed
- Cellular telephony, mobile and land-line internet connectivity is over-taxed. This affects the operators' ability to invest in more reliable, higher speed, wider networks. There is good correlation of growth in connectivity with a country's GDP growth.
- Provinces can enhance their income by extending property and agriculture taxes.

RESTRUCTURE AND PRIVATIZE STATE OWNED ENTERPRISES

State Owned Enterprise (SOE) losses cannot be allowed indefinitely to impact government's ability to invest in social development. Either the government should start the restructuring process, or if it does not have resources to do this itself, then it should consider transferring management to qualified experts in the private sector for a prescribed period on a profit and loss improvement arrangement. At a subsequent pre-agreed time, such entities could be privatized. The management agreement can have reasonable safeguards on involuntary reduction of headcount and against asset stripping. This would allow private sector investors to make them viable. It will also reduce the burden of losses estimated at Rs. 200 bn pa as well as the cost of funding Rs 1.74 Trillion of liabilities that have accumulated over the years. Currently neither restructuring nor privatization is happening due to a combination of weak political will and a cumbersome, time-consuming process. The threat of NAB enquiries also prevents courageous decision-making.

If restructuring or management transfer are options, then it would be necessary for the government to provide statutory legitimacy, authority and empowerment for:

a. Removing such units and their management from the purview of the National Accountability Bureau.
b. Exemption from PPRA rules for procurement;
c. Exemption from Public Sector recruitment regulations and give the board the authority, within a prescribed framework of due diligence, to appoint and reward capable people in line with the private sector rates;
d. Remove such entities from the direct control of line ministries;
e. Simplify, without compromising accountability, the process of privatization which can currently take years.



BROADEN THE EXPORT BASKET AND WIDEN ITS GEOGRAPHICAL REACH

(For a more detailed study, please refer to **PBC's Contours of a National Charter for Exports III**)

Without a long-term export policy, underpinned by a well-articulated industrial policy that brings all stakeholder together under the leadership of the Prime Minister, Pakistan's exports are unlikely to grow and diversify in a sustainable manner. Countries like Bangladesh have benefited enormously from oversight of the country's chief executive, especially in resolving inter-ministerial fragmentation of authority. The key building blocks for robust growth of exports are:

- A 5-year National Charter for Exports, owned and monitored by the Prime Minister will give exports the consistent priority that it deserves. This policy should shift the mindset of the bureaucracy from "control" to "empowerment." Long term policy, which brings all stakeholders on a common platform, needs to facilitate planning and encourage investment to build scale and improve competitiveness.

- Exports need to be an integral part of an industrial policy which promotes manufacturing, including sensible import substitution with sunset clauses to promote competitive value. A stand-alone export policy without strong linkages with manufacturing and imports is not sustainable over the long run. A National Industrial Policy would perforce address all elements of manufacturing, including exports and import substitution.

- Export incentives are funded by tax payers and require agreed performance targets and proper accountability. It is recommended that this be done for each sector at least on an annual basis and their continuation or adaptation be contingent on meeting prescribed, medium to long term objectives. Short-term incentives lead to short-term performance. Incentives should be skewed to items for which global demand is growing, for non-traditional goods and services and to promote geographic diversification.

- Shift from retrospective to upfront, prospective investment in promoting the growth of exports. A leap of faith is required on the part of the government to set aside a substantial amount for up-front investment from the Export Development Fund (EDF) for non-core and new markets. With 75% of export reliance on traditional products and with Textiles comprising 60% of exports, of which in turn, 68% are destined for the European and North American markets, Pakistan needs to invest heavily in diversifying both products and destinations. The operators in the non-core sectors are generally small and do not have the means to develop exports. Moreover, the current 10% FX retention allowance for non-core sectors is inadequate in size to fund such development.

- As a matter of principle, all import levies and domestic transaction costs, irrespective of where they are incurred in the supply chain leading up to the final point of export should be refunded to the final exporter, allowing price competitiveness. It is difficult for smaller exporters to operate the existing draw back systems or re-export schemes. A standard refund based on periodically updated costing will make it simpler for them to export. This is especially so where the final exporter is reliant on others in the supply chain to import and process items before adding further value prior to final export.

- Strong brands command premium prices. Pakistani exporters should be allowed to both acquire and to develop brands that they already own. The former is a capital investment, whilst the latter is expensed when incurred. However, the purpose of both is to generate higher exports.

- Marketing and Selling of Pakistani Brands Abroad: Marketing and selling branded goods costs more than selling simple commodities. The present 10% export retention allowance does not adequately cover the cost of establishing a brand, registering the products with supermarket chains, paying for shelf rentals etc. These costs are high in the early years of market entry. It is recommended that such costs incurred abroad may be allowed at actuals, subject to audit or other verification.

- State Sponsored National Brand Building Programme: Pakistan could learn valuable lessons from the Turkish “TURQUALITY” Programme through which the Turkish government has been funding the development of 10 worldwide Turkish brands. A “PAKQUALITY” initiative should be promoted under the PPP model to ensure that Pakistani brands also become regional / global icons.

- Pakistan exporters are required to realize export proceeds within a short time period. This does not permit the warehousing of products, for subsequent sale on a “just in time” basis, which is increasingly demanded by foreign buyers unwilling to carry inventory on their own books. Larger exporters should be permitted to warehouse inventory abroad. This is all the more essential to serve online sales portals, such as Amazon, which will not allow access to foreign suppliers unless they are shipping promptly from a domestic point. This would entail longer time periods for remittance of export proceeds.

- The five core export sectors are offered energy at a rate presently competitive with comparable countries. Competitive tariff continuity should be assured to allow businesses confidence to invest. Also, in principle, all exports (not just the five core sectors) should be entitled to energy at a cost which is globally competitive. This will help to broaden the export basket. Where industries produce a mix of exported and domestically marketed products, a rebate should be offered on the quantity exported to render the input cost of energy to a globally competitive level.

- Banks are reluctant to lend to SMEs due to higher risk. SMEs on the other hand are unable to take risks associated with credit to foreign buyers. A vendor financing and export house model would promote greater integration of the SMEs into the export chain. Japan and Korea developed their exports through the export house model with companies like Mitsubishi and Mitsui offering a model and learning opportunity.

- Commercial banks need to manage their risks as their primary responsibility is to safeguard their shareholder's interest. Development is not a shareholder business; it is a stakeholder business with the state having a major interest in managing its trade balance. Developing export markets involves risks as most foreign buyers will not provide letters of credit, especially to SMEs who lack negotiation power. The EXIM Bank owned by the government should be capitalized and made operational to help exporters to address the riskier markets in Africa, Central Asia and Latin America. The past failure of DFI's like the IDBP, PICIC etc., is in itself not a sufficient reason to avoid setting up a well-resourced and governed DFIs. Instead, learnings should be taken from the past mistakes. The risk premium for exports to Africa and Central Asia may initially be met from the Export Development Fund to which all exporters contribute a percentage of exports.

- A quarter of Vietnam's exports are generated by Samsung alone whilst many other Japanese, Chinese, South Korean, Taiwanese and US investors account for a sizeable percentage of its exports. Pakistan has not attracted foreign investment into exports, even in the agriculture sector where there could be potential. Instead, a liberal FDI policy has attracted many FMCGs which reap the demographic dividend from a rising middle class but do not export or create import substitution. A differentiated FDI policy which factors impact on the external account is recommended for fresh foreign investment. Existing foreign companies operating in Pakistan should be encouraged to export into their global value chains

- The Apparel (Value-added sector) exports from Pakistan cover the bottom 20% of the global universe of apparel, leaving 80% of apparel demand unaddressed. This is where countries like Vietnam and Bangladesh have moved with speed. Bulk of Pakistan's exports are majorly cotton based, whilst global demand is shifting to man-made fibres, which are also ideal for the emerging technical textiles. The per unit price commanded by Pakistan apparel exports is between 11-50% of Vietnam's and 20-33% of Bangladesh's. Hence there is significant scope to change the cotton/man-made fibre mix and to go up the value chain. The main onus of this is on the current large players who need to invest in capacity and capability including skills. There is little that the government can do other than providing a long-term policy framework.

- Travel Advisories limit the number of foreign buyers travelling to Pakistan. The government can help by advocating a differentiated approach for larger cities where most of the industry is located. Also, it could subsidize the first few year's costs of running Pakistan-based buying offices for larger buyers. These could potentially be located near major airports to assure further security. In the meantime, it needs a fast visa approval process with an added challenge that many buyers or their merchandizing & inspection teams are Indian and Bangladeshi nationals.

- There is no WHO approved pharmaceutical manufacturing facility in Pakistan. This is a major impediment to exports. Pharmaceutical companies contribute to a Central Research Fund. Companies may be allowed to draw on this fund in relation to their contribution in the previous years to meet the costs of drug registration abroad and to establishing WHO certified facilities. Additionally, those meeting a prescribed export performance realization may be given a 1% rebate. Pharma exports amounted to $269 million in FY'22 as compared to carpet exports which generated $83 Mn of exports in the same period. Yet the pharmaceuticals sector is not one of the five major focus sectors for exports whilst carpets is.

- Footwear, Leather, Furniture, Cutlery, Sports suffer from design and skill deficiencies which can be addressed through a combination of FDI, technical agreements and training by establishing or improving dedicated design centres. There is also scope to boost export of horticulture, meat and fisheries – see the section on Food Security.

- Unlike export of goods which attract rebates, export of services is not similarly incentivized. Rebates would also encourage full remittance of export proceeds. It is estimated that annually $2.5 Bn of exports are made by freelance software developers but this sum is not remitted back to Pakistan. IT and IT enabled service companies lack immovable collateral for bank borrowing. Their work-in-progress and receivables should form the basis of bank lending. Equipment required to develop software and operate call centres and back-office services should be permitted to be imported free of duty and GST. Cluster development through co-location of software developers in IT Parks would bring additional benefits of collaborative working. A concerted effort should be made to develop skills in the emerging sectors of IT such as Artificial Intelligence, Data Analytics and Robotics. Instead of merely churning out graduates, time and money would be better spent in specialist skill building. It is estimated that each $1 Bn of software exports entails 25,000 additional specialists, whilst the number of back-office workers required for that level of incremental exports is 50,000. Public Private Partnerships can develop appropriate training programmes. There is also significant demand for trained IT resources especially in countries with ageing populations.

- Economic Diplomacy to Promote Exports (a joint effort by the Ministries of Foreign Affairs, Commerce, Investment and Industries)
  - Pakistan's foreign policy should consist primarily of economic diplomacy. Pakistan should not belong to any camp and its leaders must exercise diplomacy in public statements. Punching above our weight causes offence and leads to marginalization of Pakistan.
  - The priority and training of our diplomats must include the promotion of trade and investment. There should be close coordination between the relevant ministries and the private sector. Focus of inward investment should be on export-oriented and technology intensive industries as well as sectors for which investors in Pakistan lack capital or risk appetite.
  - Focus economic diplomacy to negotiate market access, at a minimum to achieve parity with key global sourcing competitor countries. Whilst prescribed goods from Pakistan currently are allowed entry into the EU duty free under the GSP+ facility and Textiles have parity access in the USA with countries like Bangladesh, exports from Pakistan suffer from higher duties into Japan, Canada and Australia, relative to Bangladesh. EU's GSP+ will expire in 2023. It is vital that Pakistan lobbies in Brussels to retain duty free access. Similarly, Pakistan needs to consider ongoing lobbying in Washington to obtain preferential access into the USA. Vietnam is a good model to emulate for market access. Through a plethora of trade agreements, Vietnam has opened up key markets to goods and improved its ability to competitively add value to import of materials. An example of Bangladesh's success in economic diplomacy is securing duty-free access for 97% of export lines into China with which it to date has no Free Trade Agreement. By contrast, Pakistan which signed an FTA with China in 2006, currently has duty-free access to just 45% of export lines, which will grow to 75% by 2030.
  - Pakistan's representation in markets of potential growth such as Africa and Central Asia must be enhanced and made more effective. India's trade agreements and its in-country trade representation in Africa is far superior to Pakistan's and its exports far exceed ours.
  - Travel to Pakistan by foreign business visitors should be facilitated. The visa system does not always work efficiently. Likewise, our diplomats must work to obtain more favourable travel advisories, without which nationals of some countries are denied cover by their company's insurance policies.

DEREGULATE AND IMPLEMENT CIVIL SERVICE REFORMS TO MAKE IT EASIER, CHEAPER AND QUICKER TO DO BUSINESS

Having inherited a highly regulated regime from its erstwhile colonial masters, Pakistan has been slow to move from a "controlling" to an "empowering" mindset. In part this is due to a large bureaucracy at multiple layers – local, provincial and federal and a small base of rule-abiding businesses in the formal sector. Regulations are complex, often duplicating, requiring paper-based applications and snail-mail response. Some like Section 452 of the Companies Act 2017 are also framed with a mindset of suspicion of the corporate sector. Section 452 requires officers in companies to declare their interests in companies abroad, no matter how small, even those already declared to the FBR. Such disclosure serves no investor value.

The World Bank's Regulatory Guillotine exercise has unlocked significant benefits for countries that have deregulated. The Pakistan Modernization of Regulations Initiative (PMRI) modeled on the World Bank's programme aims to:

- Identify and reduce overlap between local, provincial and federal regulations
- Simplify by making requirements more risk and consequence based
- Digitize and automate the application and processing and make progress fully transparent
- Set time limits for decisions and implementation
- Create virtual one-windows by integrating multiple data and departments

It is important that industry consultation is conducted through field surveys to identify sector-specific issues. Furthermore, global benchmarking of regulatory environment with countries that fare significantly better than Pakistan would provide useful models to emulate. A mindset-change from *"Why control and regulate?"* to *"How to enable and empower?"* is a key success factor. To facilitate it, delayering of bureaucracy would be required.

An excellent example of deregulation is the Pakistan Single Window initiative which significantly reduces the number or interfaces in processing inward and outward movement of goods, digitizes and makes progress visible, thus reducing cost and making it easier to do business.

Civil Service Reforms

The effectiveness of civil service is a product of the quality of its resources, which in turn is dependent on the effectiveness of recruitment, training, structure, performance evaluation and promotion processes and rewards. There are flaws in virtually all these factors. A bloated bureaucracy, charged to implement regulations based on a colonial control mindset, targeted at the relatively small formal law-abiding sector, raises the cost and makes it difficult to do business. Red-tape also slows down decision-making and results in harassment of the public. This is acerbated by threat of National Accountability Bureau investigations, leading to near-paralysis in key ministries. Civil service reforms require strong commitment and determined implementation, which may not be possible in a single tenure of a government. Nor are results linear. Hence, they need to be approached with a sense of realism. One reality is that political parties that form governments lack deep insight or knowledge of specialist areas, which they try to overcome through technocrat Advisors with limited political influence. Parliaments are also composed primarily of representatives from rural/ agriculture/feudal background and have limited knowledge of the economy or global affairs. The few urban representatives that come with a business background are mostly from the informal sector. Bureaucracy on the other hand has decades of knowledge on how to "work the system" and resist change. Here are the key facets that need to change:

- Refine the screening process of applicants to improve the quality of intake;
- Factor domain knowledge in the selection and placement criteria. The balance between generalists and functional experts is missing;
- Create additional posts for specialists and tailor the training to their domains. In the absence of specialist knowledge, the civil service hires but lacks the ability to evaluate the quality of work done by expensive consultants;
- Form expertise clusters such as: financial and economic, social, technical, etc., to ensure that officers have the right background to be effective;
- Separate the provincial and federal civil services to stop the transfer to specialist federal ministries such as the Board of Investment or Ministry of Commerce at Grade 21. Currently, the Provincial Administrative Service has a significant choke-hold on the bureaucracy as they get to jump to the federal and overtake career diplomats, commerce and finance people.
- Introduce an objective and transparent performance evaluation system based on agreed KPIs. The current confidential report system hides rather than revealing scope for individual improvement;
- Replace standard across-the-board annual increments by a differentiated salary review based on merit and performance;
- 95% of the 640,000 employees in federal government are below grade 17. This means we have too many clerks and assistants who by virtue of long service earn more than the equivalent in the private sector. They also slow down the movement of files and of decision-making. On the other hand, it is impossible to hire grade 22 specialists at government salaries. This imbalance needs to be corrected;
- Monetize the perks into a consolidated salary and benchmark it with the private sector;
- Address the void created by the absence of empowered, devolved and fully resourced local government where public services are required to be delivered;
- Put in place an early retirement system for non-performing civil servants;
- Civil service pensions now exceed current aggregate annual cost of salaries. The growth of pensions needs to be arrested by switching to defined contribution basis, as in the private sector and now in KP.

RENEGOTIATE THE NATIONAL FINANCE AWARD (NFA)

The current NFA cannot sustain the federal government as is clearly evident from the 2021/22 Budget below:

	PKR Trillion
Tax Collection Target	5.8
Distribution to provinces	-3.3
Balance with the federation	2.5
Non-tax revenue	2.0
Available with the federation	4.5
Debt servicing cost	-3.0
Defence budget	-1.4
Balance with the federation	0.1
PSDP	-0.9
Pensions	-0.48
Civil Service expenditure	-0.48
Subsidies	-0.68
Grants	-1.2
Federal Deficit PKR	-3.64 Tr

Whilst the federation incurs an unsustainable fiscal deficit, provinces have a reduced incentive to raise taxes. In most years they also record a budget surplus.

It is recommended that the NFA be renegotiated to enable the federation to manage its fiscal account and provinces be incentive to both raise taxes and adopt more cost-efficient spending. It is estimated that Rs 750 Bn additional revenue can be raised by provinces through agriculture and property taxes, against just Rs 23 Bn currently.

Appendix One

THE NEED TO CHANGE

We believe that notwithstanding the many immediate and urgent challenges facing the economy, the foremost socio-economic need of Pakistan is the creation of livelihoods for the 2 million people that reach the age of employment every year. This is closely followed by the need for significantly higher investments in human capital, notably in healthcare and education. In both of these, Pakistan lags South Asia, which in turn compares poorly vs other countries. The Covid pandemic has starkly revealed the gaps in our healthcare. Even prior to the Pandemic, 40% of children suffered from stunting and 44% of kids in ages 5-16 did not attend school – the Pandemic has only worsened a bad situation. The BISP/Ehsaas Programme provided a useful safety-net during the lockdown but clearly there is room to strengthen and deepen it further. Whilst uplifting the socio-economic well-being of people is primarily the responsibility of governments – both federal and provincial, the private sector cannot abdicate its role in creating livelihoods, especially for women and in improving the lives of people by offering affordable and better-quality goods and services and by becoming more responsible towards the environment. No business can thrive indefinitely in a failing economy.

Pakistan is the "sick-man" of South Asia. We lag behind in virtually every

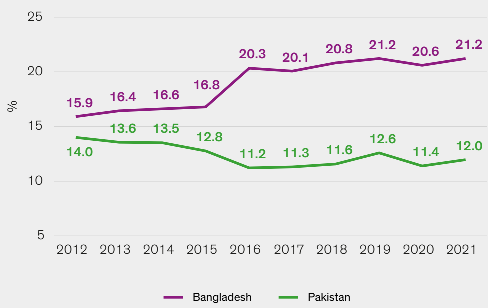
Pakistan lags South Asia in key socio-economic indicators

Measures	Pakistan's Rank	Pakistan	Bangladesh	India	Sri Lanka
Rank in Global Health Security Index (of 195)	4th	130	95	66	105
Malnourished Children	4th	36.7%	30.2%	30.9%	16%
Life Expectancy (yrs)	4th	67.4	72.9	69.9	77.1
Primary School Attendance	4th	62%	86%	95%	90%
Upper Secondary School Attendance	4th	33%	48%	64%	73%
Adult Literacy	4th	58%	74.9%	74.4%	92.4%
Human Development Index (of 188)	4th	154	133	131	72
Quality of Life Index (of 111)	4th	93	77	73	43

Source: The World Bank/ UNICEF

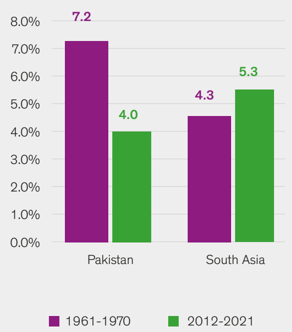
Pakistan has prematurely deindustrialized

Manufacturing as % of GDP: Pakistan vs Bangladesh



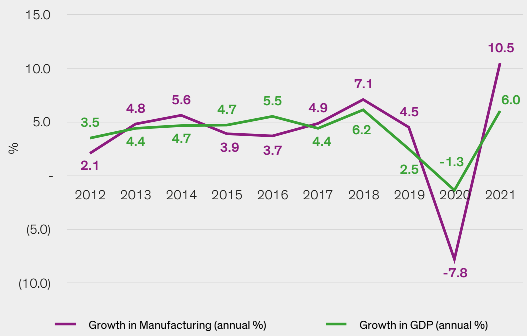
Pakistan's Long-Term Growth Rate has almost halved

Ten Year Moving Average GDP Growth



Growth of Manufacturing and GDP are Correlated

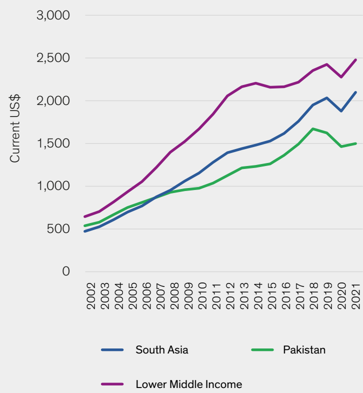
GDP & Manufacturing Correlation



Source: The World Bank

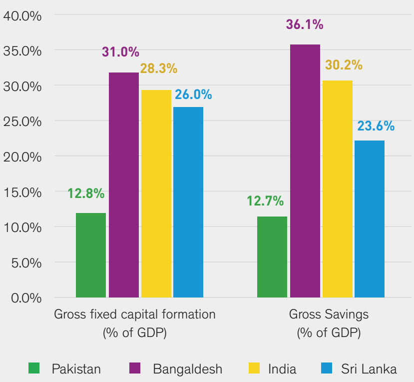
Pakistan's Per-Capita Earnings have Improved the Least

GNI per capita, Atlas method



socio-economic indicator. Our per-capita earning, which once exceeded China, India, Bangladesh and Sri Lanka, has eroded to just 12% of China's and is now 30% lower than India and Bangladesh's. The long-term GDP growth rate has halved to just over 4%, grossly below the 6-7% required to generate badly needed jobs. The country has prematurely de-industrialized with declining manufacturing, stagnant exports and growing import reliance. The latter, even for items of daily use. Poorly negotiated trade agreements and disparity in market access vs. Bangladesh has further impacted the balance of trade. Trade in South Asia is the least integrated with the world and Pakistan is constrained by sanctions on Iran and trade constraints with and through Afghanistan. As a result of recurring external account crisis, Pakistan has since independence, been in IMF progammes for more years than out of it. Investment is half the rate of South Asia. Private sector is crowded out by the government from bank credit and SME funding is well below South Asian levels. The country has been slow to switch from revenue seeking import tariffs, which are one of the highest in Asia, creating an anti-export bias. Industry carries a disproportionate tax burden. High tax rates, in a largely undocumented economy and a complex taxation system create incentives to informalize the economy. This despite efforts to digitize and reduce the cash in circulation. Smuggling, counterfeiting, under-invoicing, misdeclaration of imports, adulteration, grey production and misuse of the Afghan Transit Treaty severely impact tax revenues and create an unfavourable playing field for the formal sector. The corporate sector

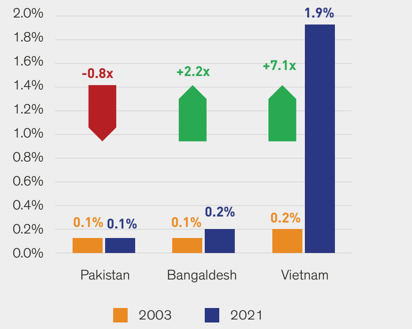
Pakistan lags South Asia in savings and investment - 2021



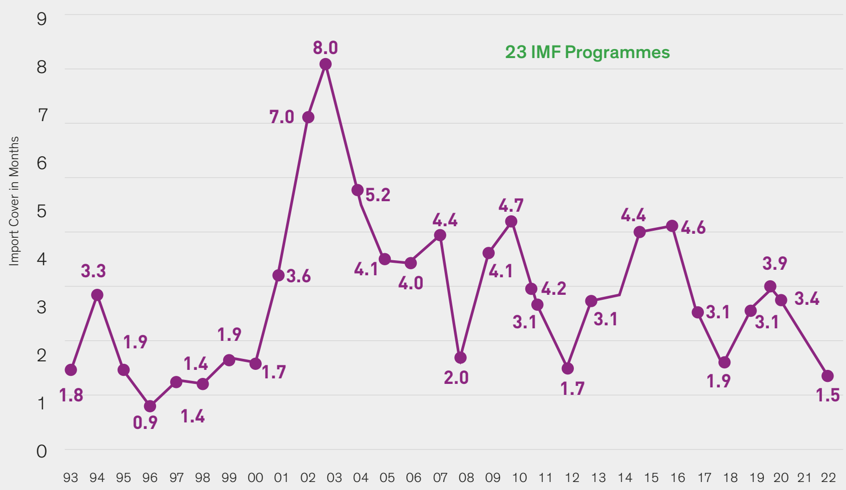
Source: The World Bank

Share of World Exports has declined

% Share of World Exports



Recurring external account crisis and IMF programmes



Source: The World Bank/SBP

Narrow Product and Regional Diversification of Exports

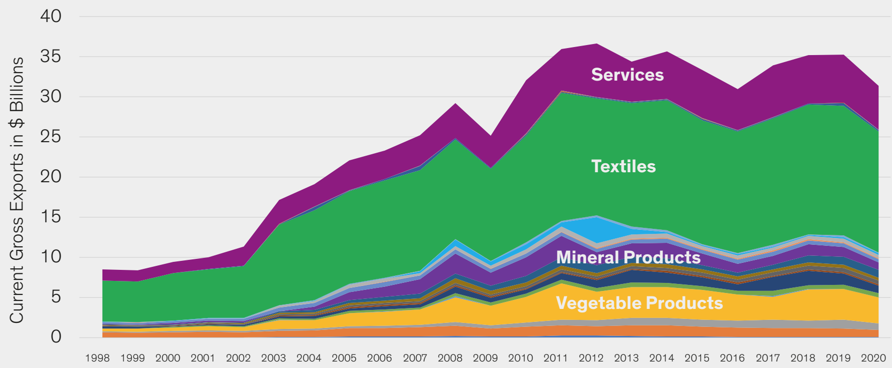
Source: ITC Trade Map

is also encumbered by over-regulation, framed with a controlling and suspicious, rather than an empowering, pro-growth, mindset. The competitiveness of industry is impacted by one of the highest electricity tariffs in the world, along with labour laws which have not kept up with the changes in Pakistan's competitor countries. Successive governments have frittered away the country's gas reserves by mispricing it to domestic users. We are also running out of water. Most industrial areas around large cities are choked, lack basic utilities, which business is forced to procure at additional cost. Poor rail network, an ageing truck fleet and slow port handling impact cost, speed and reliability of logistics.

With neither cost, nor ease of doing business helping and in the absence of consistent policies, some businesses have been provided indefinite protection which reduces the incentive for them to become competitive. Large-scale investment is primarily directed into sovereign-guaranteed, fixed-return projects. Furthermore, past actions of the National Accountability Bureau (NAB) are unlikely to sustain private sector interest in Public Private Partnerships, which repeated governments have cited as a panacea to our utilities and transportation gaps. Without meaningful reforms in the NAB law, bureaucracy too will remain paralyzed.

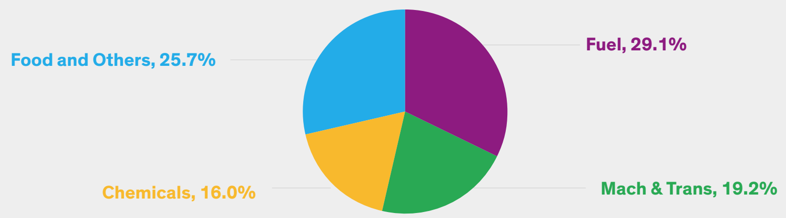
Whilst Vietnam attracted foreign investment into export-oriented industries, Pakistan's foreign direct investment has largely been in quick pay-back, low-technology, consumer goods for the domestic market. With western and Japanese companies actively pursuing a China + supply chain strategy, Pakistan stands out for its failure

Export Mix has not Diversified



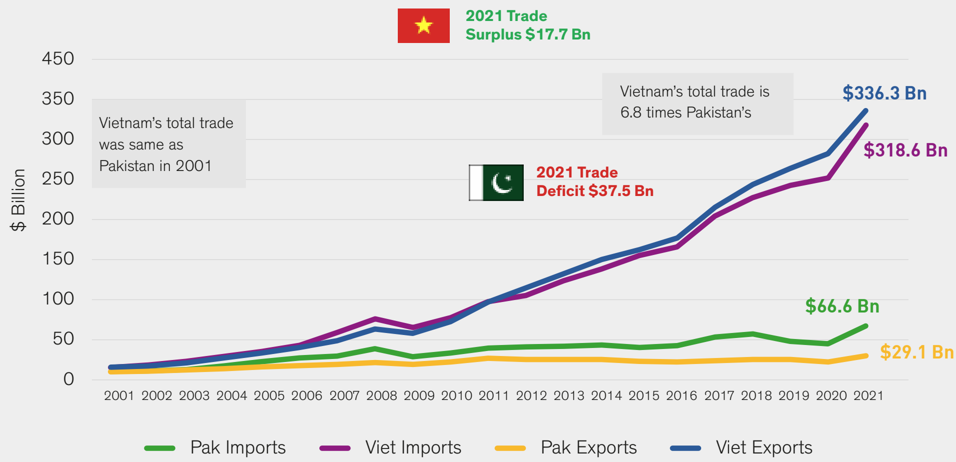
Source: OEC; The World Bank

More than 65% of Imports are Unavoidable in the Near Term



Source: Calculated from PBS Import Data for FY22

Pakistan and Vietnam: two contrasting strategies (and vastly different results)



Source: The World Bank

FDI: Vietnam export focused; Pakistan consumption driven

Vietnam

Samsung alone accounts for 25% of Vietnam's Exports

SAMSUNG LG SUMITOMO ELECTRIC

Pakistan

Unilever P&G Nestle L'ORÉAL Coca-Cola PEPSI to attract any significant investments from any company relocating from China. Our exports are narrowly focused - 61% reliant on Textiles of which 74% directed to Europe and the USA. With the Green Party in power in the EU parliament, continuity of or extension of EU's GSP+ programme is at a risk. Access to the US could also become contingent on social and environmental objectives. Our textile exports are still cotton-based when global demand is shifting to man-made fibres. Export of services is not incentivized in the same way as goods are. Neither government, nor industry have made concerted attempts to improve productivity whilst India, Bangladesh and Sri Lanka made significant progress to supplement their low-wage advantage through higher productivity. Gender inclusion remans poor. Pakistan lacks globally recognized product standards and certification systems. Indeed, post the 18th Amendment, there are five different provincial standards for food items. Also, the focus of the provincial food authorities is primarily on the formal sector, whilst the informal sector escapes scrutiny. We have also failed to prepare our workforce for the knowledge economy, relying on remittances by a largely manual workforce in the Middle East.

In none of the five major crops does Pakistan's per acre yield exceed 50% of the global best. Agriculture output is marred by fragmentation of land holdings; forced reliance on exploitative middle-men; gaps in affordability and availability of mechanization and modern techniques, including land levelling, precision application of seeds, fertilizers and insecticides; poor seed quality especially of cotton; wasteful use of water; outdated harvesting techniques; and weak cold

Vietnam's 10 Key Export Commodities in 2018

Phones and their parts
US$49.1 billion

Textile & garments
US$30.5 billion

Computers, electrical products
US$29.3 billion

Fishery products
US$8.8 billion

Footwear
US$16.2 billion

Wooden products
US$6.3 billion

Vehicles and their parts
US$8.0 billion

Iron and steel
US$4.5 billion

Cameras, video cameras, and parts
US$5.2 billion

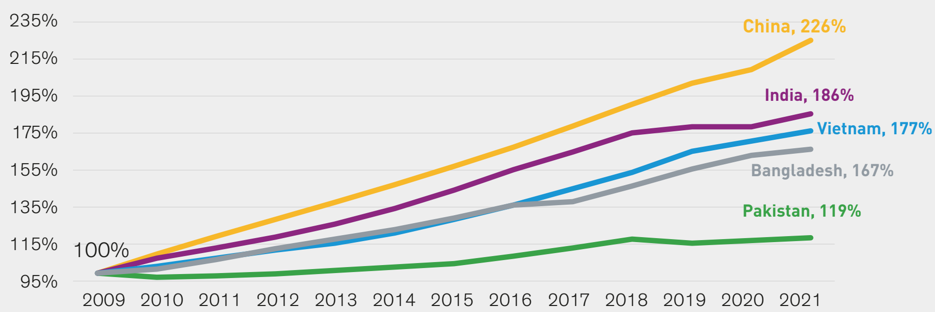
Machinery, instruments, accessories
US$16.5 billion

Vietnam's Trade Agreements

- China
- ASEAN
- US
- RCEP
- Japan
- CP Trans Pacific Partnership
- EU (ratification pending)

Lowest increase in productivity

Cummulative Growth on 2009 Base



Source: ILO
Annual growth rate of output per worker (GDP constant 2017 international $ at PPP) (%)

Farm productivity: Substantial room to improve

2021			
Output	Pakistan	Best in the world	Pakistan as % of Best
Wheat (t/ha)	3.0	10.1 (Ireland)	30
Cotton (kg/ha)	566	2,032.0 (China)	28
Sugar cane (t/ha)	70.3	115.8 (Peru)	61
Maize (t/ha)	6.4	30.3 (Saint Vincent and the Grenadines)	21
Rice (t/ha)	4.0	10.2 (Egypt)	39

Source: FAO-UN; United States Department of Agriculture
t/ha = tons per hectare
kg/ha = kilograms per hectare

Cotton Production	2004 Mn 480 lb bales	2022 Mn 480 Lb bales	% Change
India	19	27.5	44.7
Pakistan	11.1	6.2	-44.1

Source: United States Department of Agriculture chain and logistics resulting in high post-harvest waste. To make matters worse, guaranteed support price for sugarcane has disincentivized cultivation of cotton, denying the textile industry opportunity to add value and for the country to earn foreign exchange from exports. Livestock and dairy are largely run on subsistence basis and quality and yield are poor. The potential of horticulture is also under-exploited. It is a pity that the agriculture sector which can potentially uplift the largest section of the country's population and help arrest uncontrolled urbanization has not received the focus it deserves. Additionally, poor management of supplies threaten food security and cause inflation which hurt the poor most.

The losses of State-Owned Enterprises cannot continue to be absorbed by a fiscally stressed economy. Currently neither being restructured nor privatized. CPEC investment needs to move from power to logistics, manufacturing and agriculture. The dream of attracting Chinese private sector remains, a dream. SEZs have yet to take off into "plug and play industrial zones", liberated from bureaucratic constraints and the slow dispute settlement procedures that apply elsewhere in Pakistan.

Food Inflation Y-O-Y December 2022

Urban		Rural	
Commodities	% Change	Commodities	% Change
Onions	415.0	Onions	463.5
Tea	63.8	Gram Whole	61.2
Wheat	57.3	Wheat	58.6
Eggs	54.4	Tea	58.1
Gram Whole	53.2	Eggs	57.8

Source: PBS

SOE Footprint and Losses

Number of SOEs
204

Total Loss in 2016/17
Rs. 191.5 Bn

Largest Contributors to losses

Discos
Rs. 148 Bn

Roads and Highways
Rs. 134 Bn

Railways
Rs. 40 Bn

Aviation
Rs. 40 Bn

Appendix Two

ABOUT THE PBC

The PBC is a private sector business policy advocacy forum composed of Pakistan's largest businesses / groups including multinationals that have a significant investment in and a long-term commitment to the growth of Pakistan. Members turnover represents every ninth Rupee of Pakistan's GDP and together the members contribute 25% of tax revenues and 40% of exports. More information about the PBC, its members and its activities can be found on our website **www.pbc.org.pk**

International Industries Ltd.
Ismail Industries Limited
Jazz
JS BANK
Jubilee General Insurance
K&N's
KE
KHAADI
KSB
LIBERTY
LOTTE
LUCKY CEMENT
MACPAC FILMS
MAHMOOD GROUP
Martin Dow
MASOOD ROOMI
mayfair The little joys of life
MEGA MEGA CONGLOMERATE
National Foods since 1970
NAVEENA GROUP
Nestlé Good food, Good life
NIMIR
OLP
Packages Limited
pakarab fertilizers limited
PEPSICO
PM
PSL PAKISTAN SERVICES LTD.
PSX PAKISTAN STOCK EXCHANGE LIMITED
ptcl
reckitt
SAIF GROUP
Sapphire
Servis
Shan
SICPA
SIEMENS
Soneri Bank
SOORTY
SPEL Synthetic Products Enterprises Limited
Standard Chartered
systems
TAPAL
TATA PAKISTAN
TCS WE MOVE YOU
Tetra Pak PROTECTS WHAT'S GOOD
TG
TOYOTA INDUS MOTOR COMPANY LTD
TPL
TTE
Tufail
UBL where you come first
Unilever

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