

The background features a dynamic arrangement of orange and green splatters and dots of varying sizes. A large, semi-transparent white semi-circle is positioned on the right side, partially overlapping the green splatters. The text is overlaid on this semi-circle.

# New Vision for Economic Transformation Resource allocation and productive structures

Economic Advisory Group  
1 December 2021



# Background

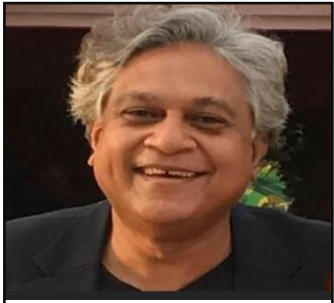
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- What is Economic Advisory Group (EAG)?
- Who are we?
- Why we formed Economic Advisory Group?
- How we function and what are our objectives?
- What motivated us to write this document?

# Economic Advisory Group (EAG)

<https://primeinstitute.org/economic-advisory-group-eag/>

Economic Advisory Group is an independent platform of individuals drawn from economics, policy and private sector. EAG deliberates on Pakistan's economic policies regularly and shares its views with the public and the government. It was formed in January 2021 under the auspices of an independent think tank PRIME Institute which serves as its secretariat.



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# This presentation

*Acknowledge the need to move away from 'the old ways' of doing policy*

- Countries become what they make
- What is needed for transformation
- Pakistan: the barriers to transformation
- Rethinking Policy
- Policy Reforms

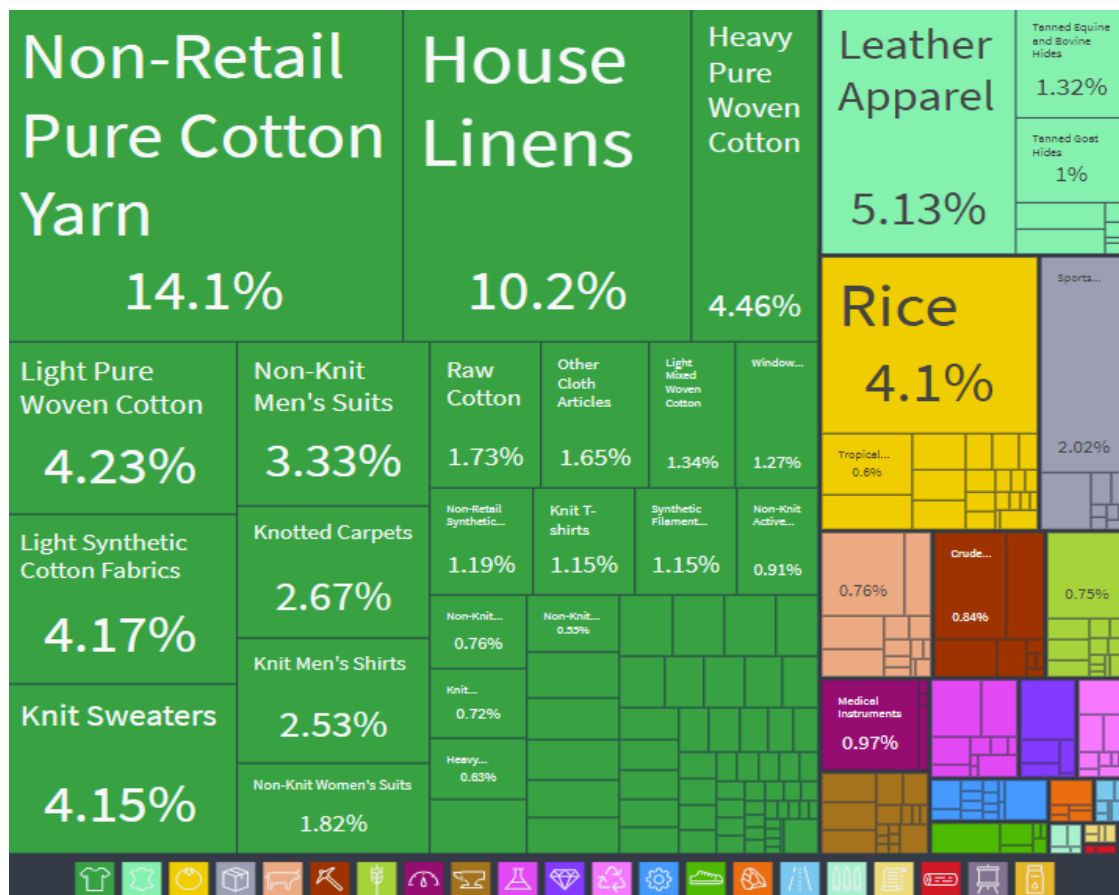




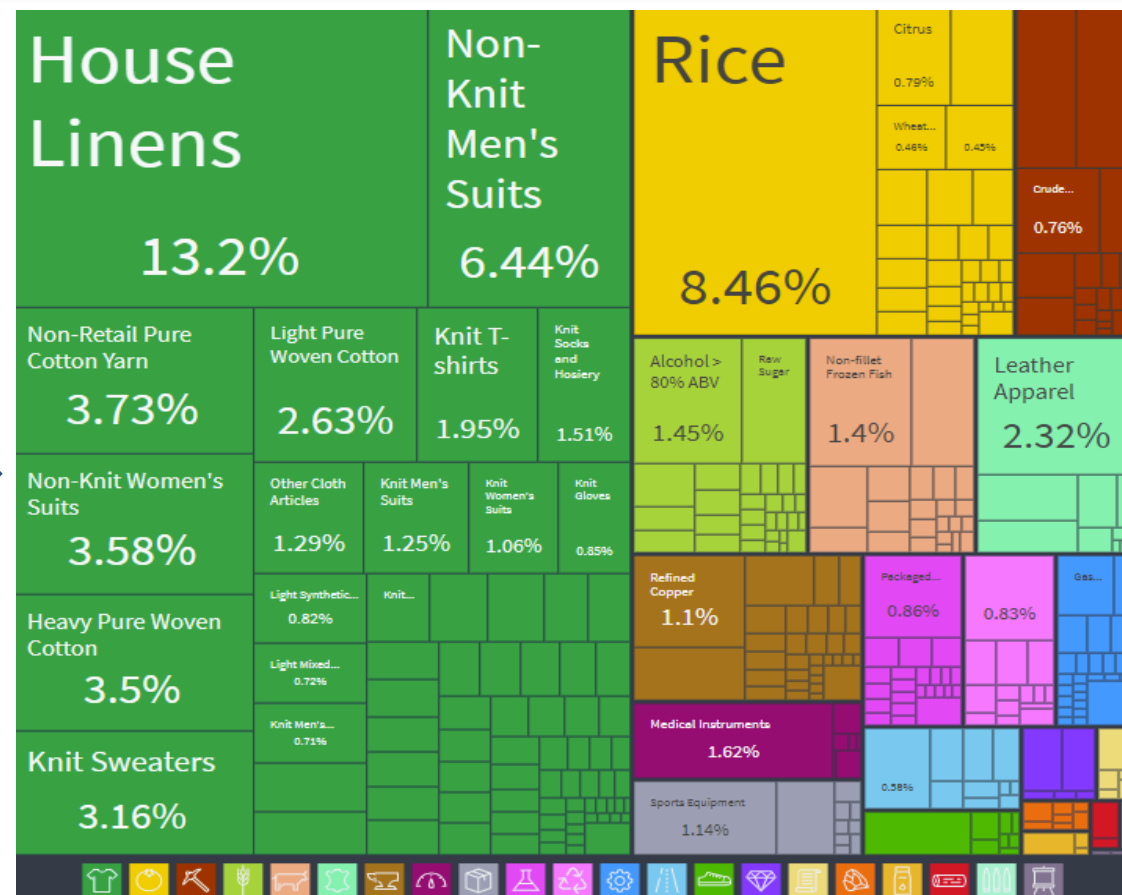
# Executive Summary

- Pakistan's economy is ossified in terms of **sectoral make up, productive structures, and resource allocation**
- Evidence shows **world economy has transformed** immensely and the **pace of change** is only accelerating
- Policy framework must move away from sustaining existing structures to incentivizing moving up the **economic complexity ladder**
- **Acquisition of capabilities through effective allocation of resources** will automatically ensure sustained growth
- Recommend replacing old fashioned industrial policy of sectoral support and government picking winners **with incentivizing value seeking & productive behaviors** among economic agents

# Pakistan export basket

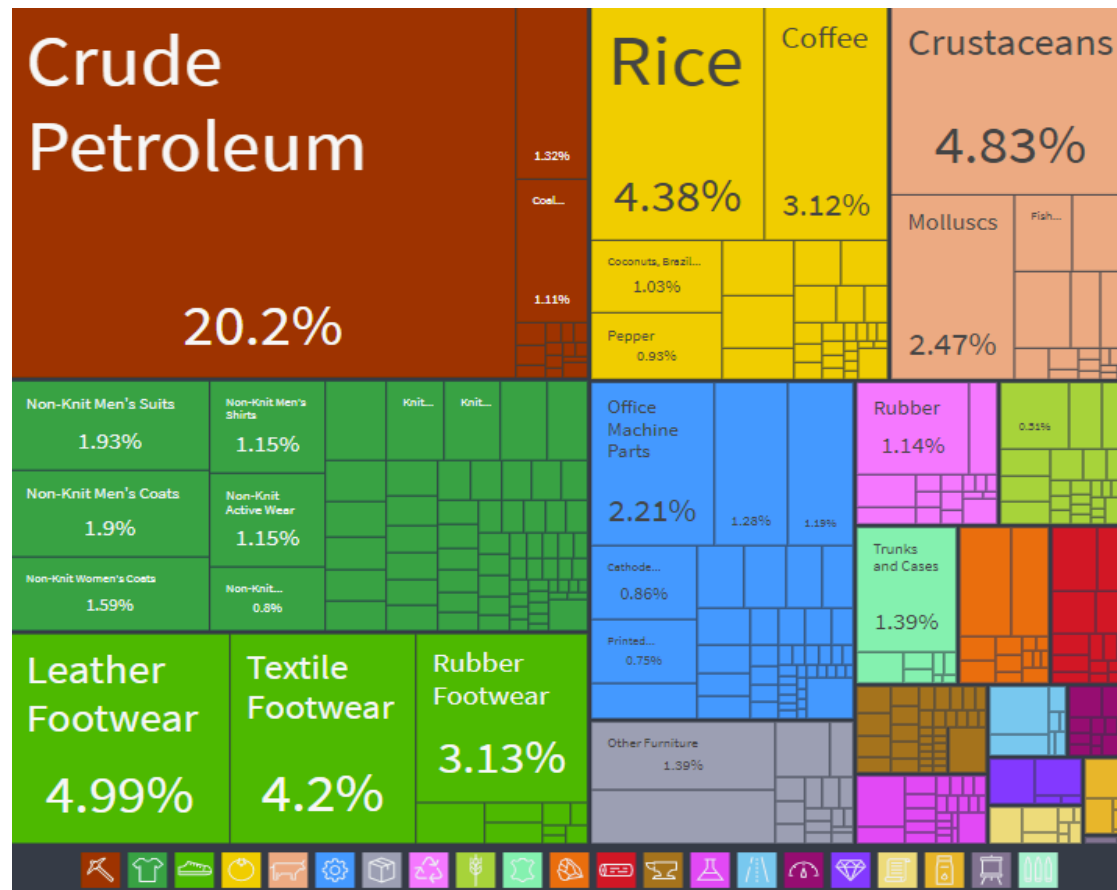


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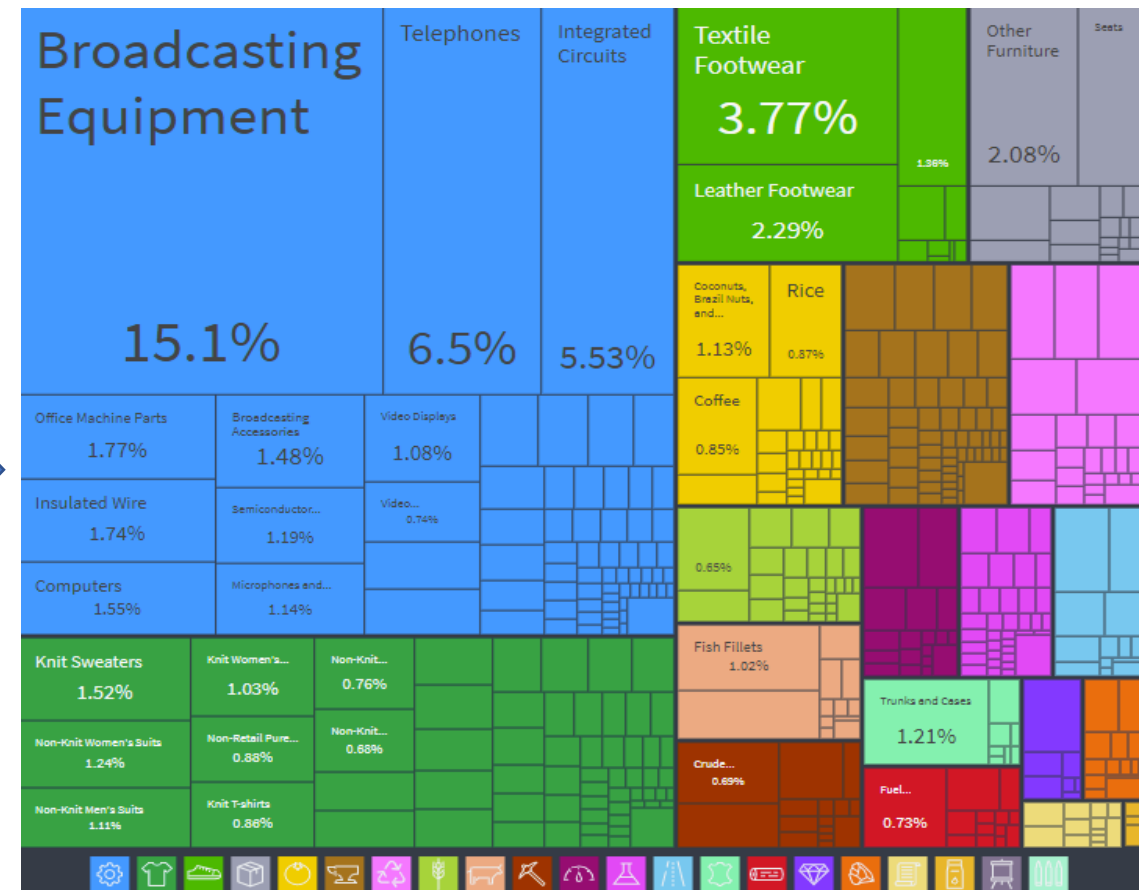


2019

# Vietnam export basket



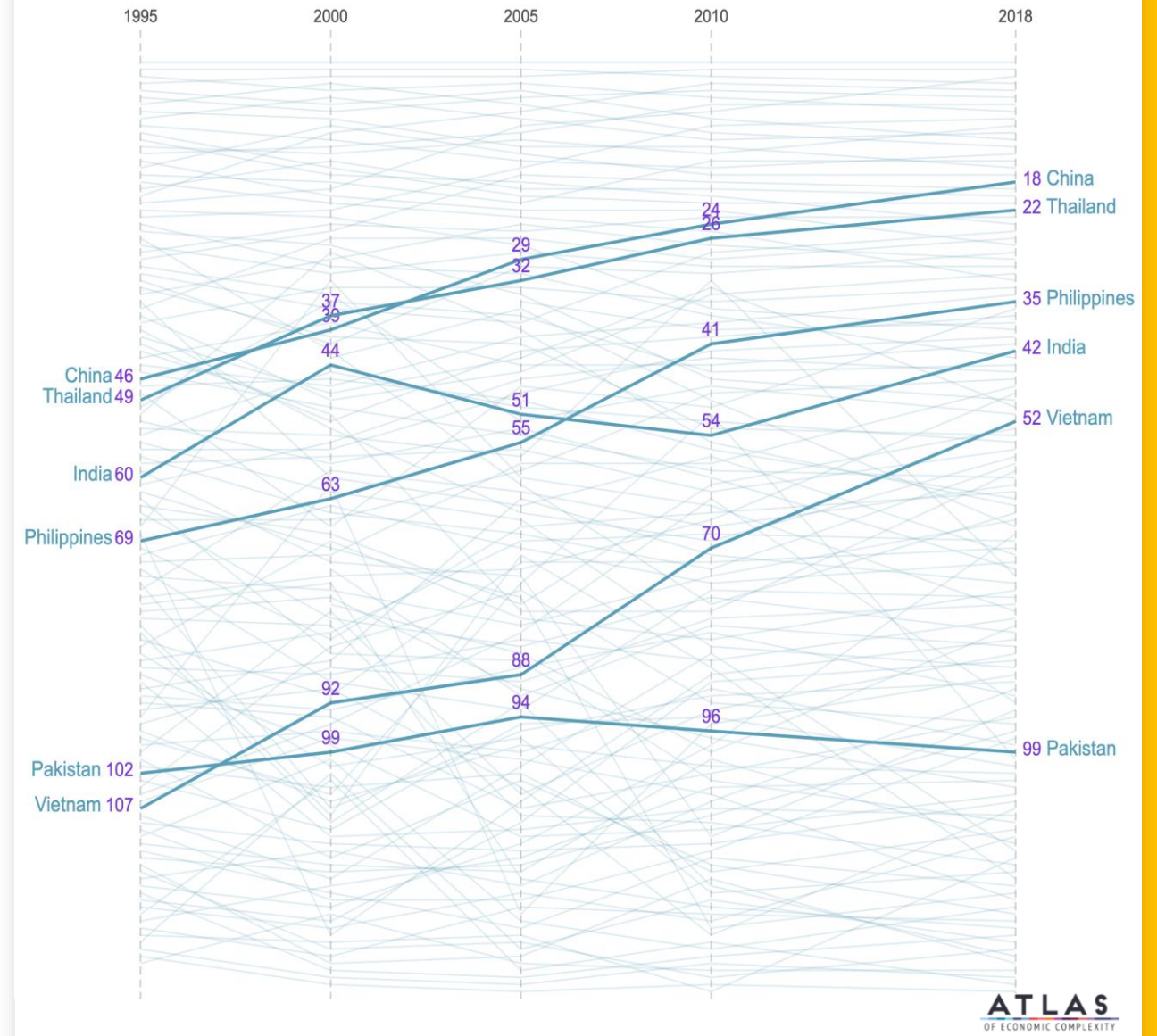
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2019

# The missing transformation

- Pakistan added 21 new products to its export basket since 2003
- However, these only contributed \$2 per capita to the value of our exports
- Whereas top performers like Thailand and Vietnam added 34 and 48 new products, contributing \$213 and \$1020 per capita to the value of their exports, respectively





# Relation to growth

- There's strong correlation between income per capita and increasing sophistication (higher ECI ranking)
- Where there is a deviation from level of measured sophistication and per capita income, it serves as a predictor of future growth potential
- Level of sophistication (or ECI ranking) five times more accurate predictor of growth than the Global Competitiveness Index of the World Economic Forum
- Successful countries moved up Economic Complexity Index (ECI) ranking by both diversifying and making their products less ubiquitous/more exclusive

# Countries become what they make

## Pakistan

Sizing of Dots

World Trade ▾

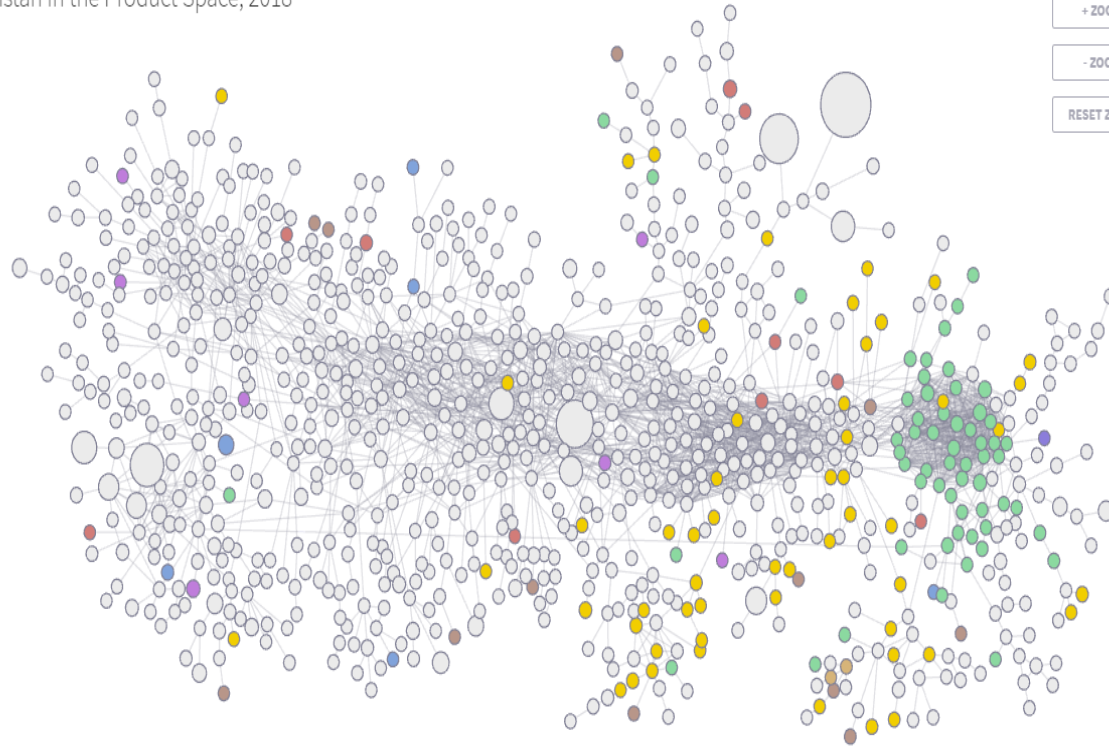
Pakistan in the Product Space, 2018

Analyze Further

+ ZOOM

- ZOOM

RESET ZOOM



PRODUCT SECTORS

**ATLAS**  
OF ECONOMIC COMPLEXITY

## Vietnam

Sizing of Dots

World Trade ▾

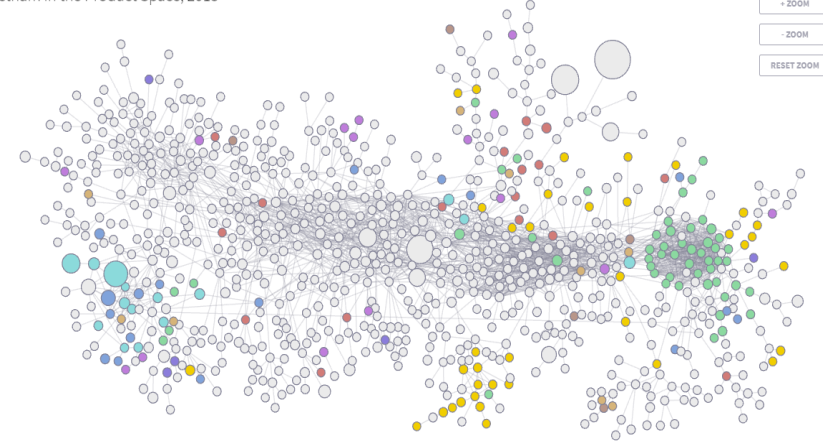
Vietnam in the Product Space, 2018

Analyze Further

+ ZOOM

- ZOOM

RESET ZOOM



PRODUCT SECTORS

**ATLAS**  
OF ECONOMIC COMPLEXITY

## Thailand

Sizing of Dots

World Trade ▾

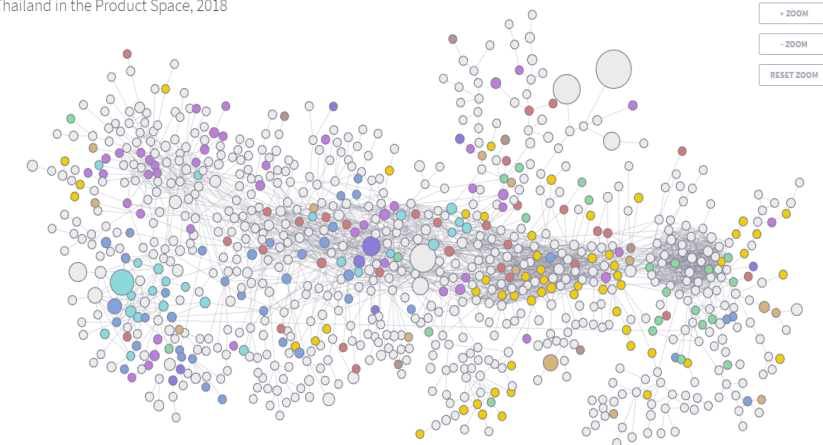
Thailand in the Product Space, 2018

Analyze Further

+ ZOOM

- ZOOM

RESET ZOOM

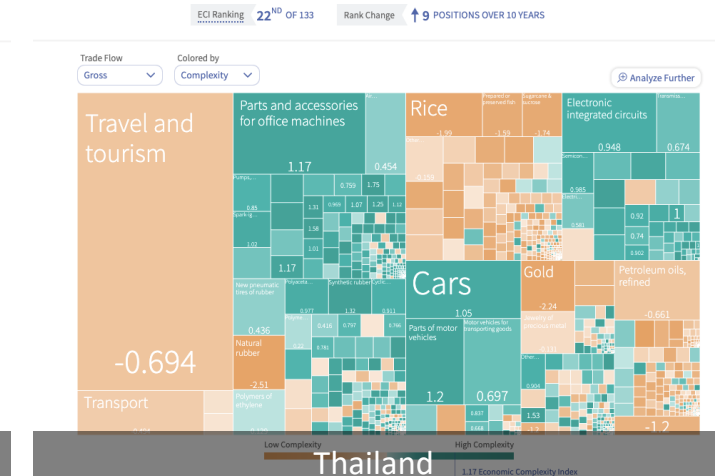
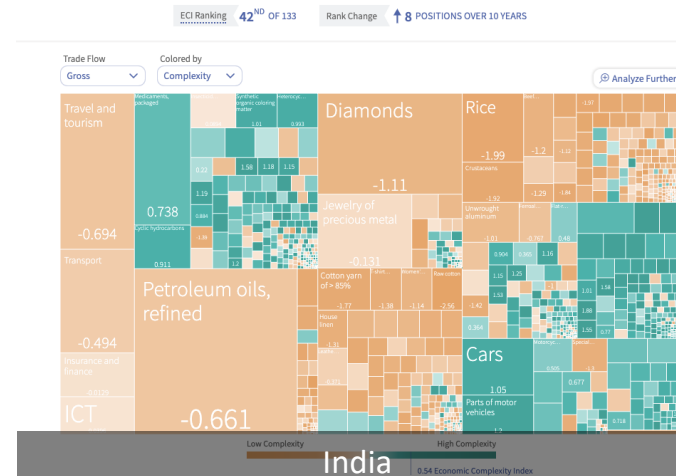
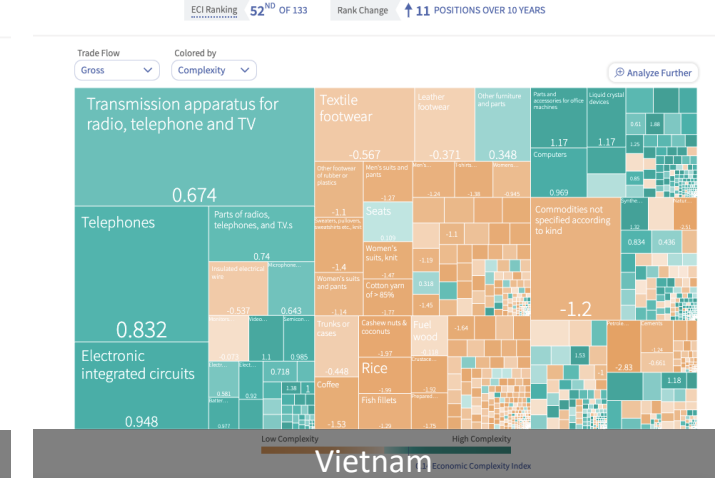
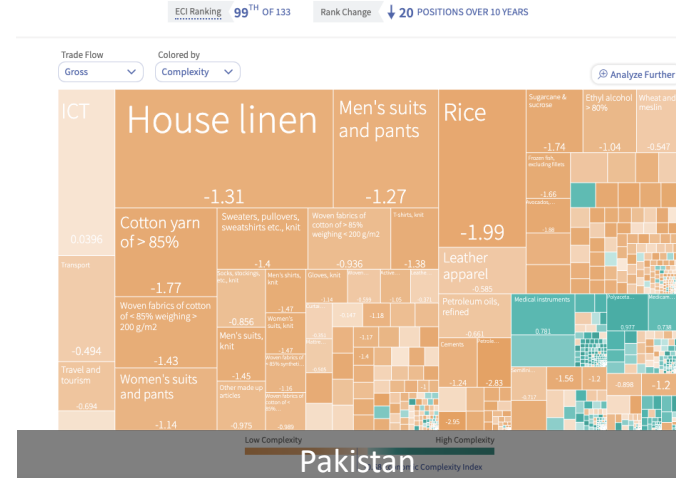


PRODUCT SECTORS

**ATLAS**  
OF ECONOMIC COMPLEXITY

# Pakistan: Transformation towards complex products has not begun

- Pakistan: low complexity products e.g. Textiles and Agriculture
- Vietnam and Thailand: high and moderate complexity products e.g. Electronics, Textiles, Services etc.
- Process of diversifying knowhow to produce a broader and increasingly more complex is accelerating, and growth can therefore be driven by a more complex set of goods and services



# What is needed for transformation?

- The flexibility for resources to move from one activity to another

*“in dealing with actual economies, the **barriers** (for resources to move) may be **more important than the frontier.**”*

– Franklin Fisher, MIT Prof







# International Experience

- [Meza et al. \(2019\)](#) show that 41% of the increase in **Mexico's** productivity between 2003 and 2012 was because of improvement in allocative efficiency
- Improvement in allocative efficiency was an important part of productivity growth during **Chile's** decade-long period of growth following the debt crisis of early 1980s ([Chen and Irrazabal, 2015](#))
- [Hsieh and Klenow \(2009\)](#) show that, by eliminating misallocations, productivity in the manufacturing sector can increase by 100-128% in **India** and by 86-110% in **China**

# Barriers: The Fatal Conceit

*“many studies and anecdotes detail how corruption, (bad) regulation, or direct government involvement **distort the allocation of resources from their most efficient use**, especially in poorer economies.”*

- Restuccia and Rogerson (2017)

# Barriers: Market Failures

- Market failures can also act as a barrier to resources moving to more productive activities
- The lack of integration with regional and global markets mean that businesses may fail to reach scale and, as a result, remain stuck in a low productivity trap
- Investment in human resource and research & development
- Implementing standardization of regulations to comply with requirements of foreign markets
- Providing adequate social security to the masses and protecting the environment

# Conceptualising the idea!

- What is required for economic transformation is **continuous reallocation of resources** towards more productive activities
  - i.e. producing more sophisticated products requiring higher capabilities
- And what is required for resources to get reallocated is:
  - The **incentive structure to keep evolving**
  - And the **willingness** on part **of policymakers** to let inefficient businesses die out
- Both **bad policies** and **market failures** can contribute towards keeping the incentive structure 'static' and, as a result, **prevent economic transformation**







Source: DAWN

# The old ways

## Example: **Sugar Industry**

- Fixing support price to incentivise farmers
- Then allowing sugar mills to operate as local monopolies

*“... cane grown in a reserved area shall not be purchased by a purchasing agent or by any person other than the occupier of the factory ...”*

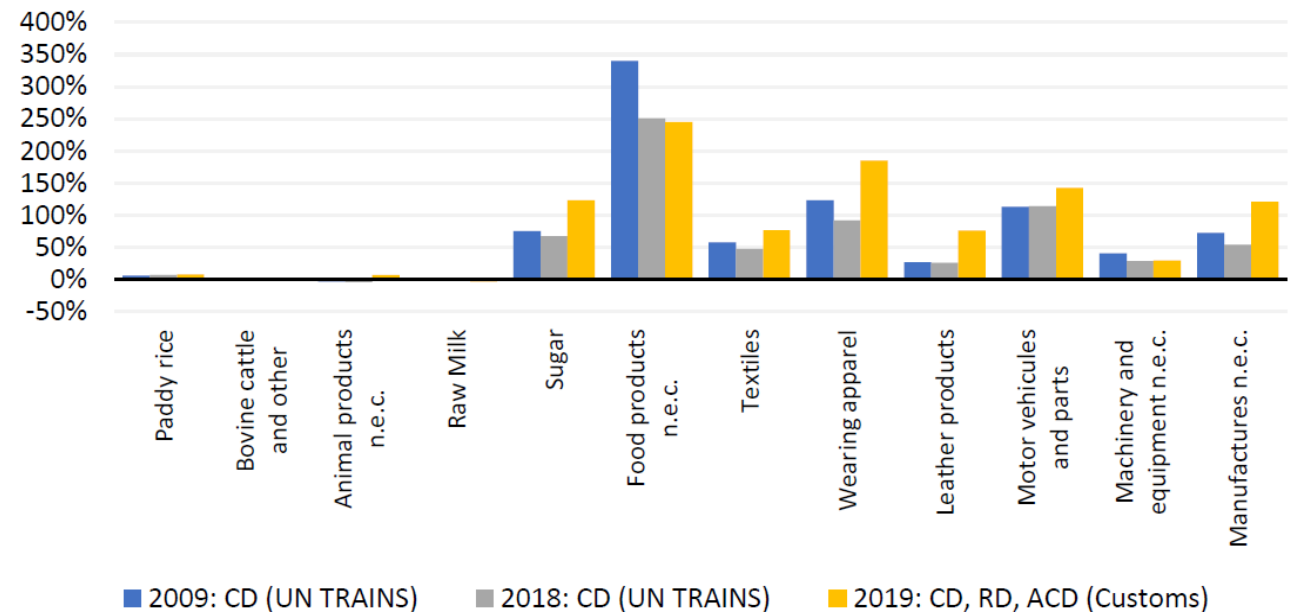
– Punjab Sugar Factories Control Act 1950
- Finally, engaging in import/export restrictions to sustain the whole enterprise

# The old ways

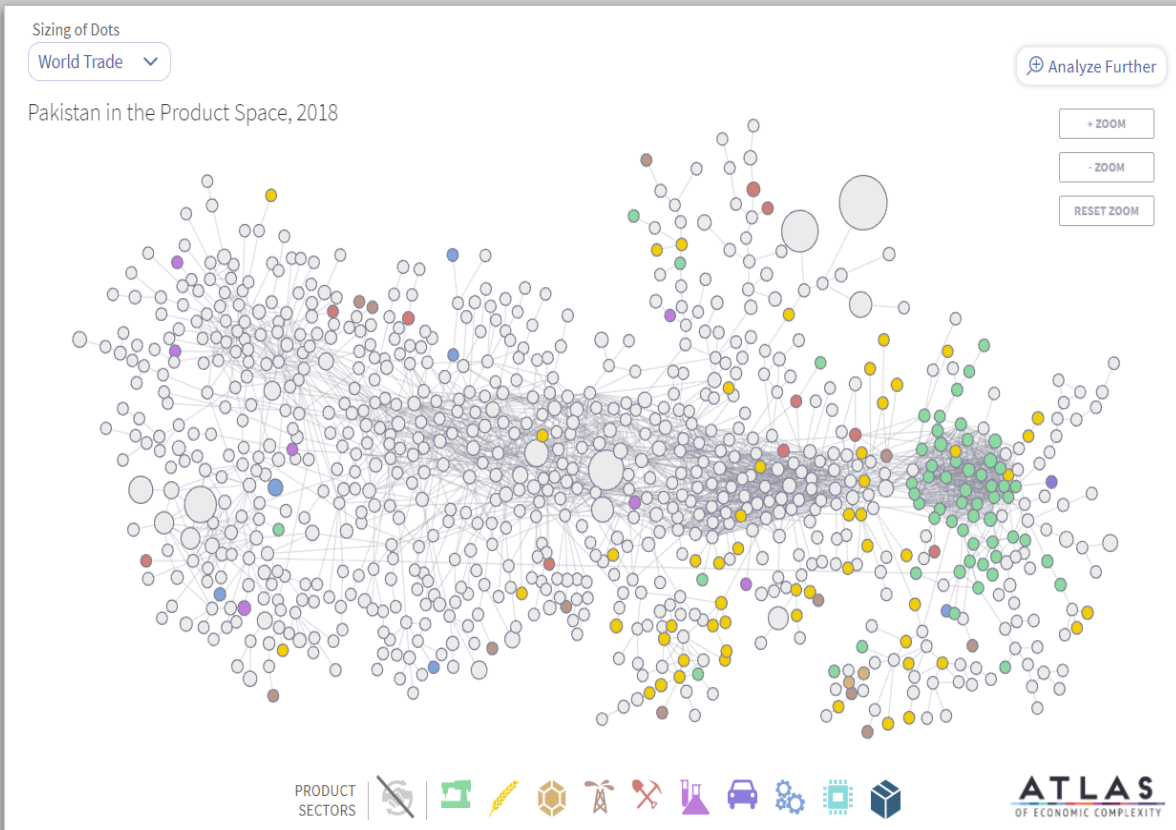
Similar examples can be found everywhere:

- Effective rate of protection for **food-processing** has been over 200%
- Using tariff and non-tariff barriers to protect the **auto sector**
- Giving subsidies to incentivise manufacturing of **textile products**
- Guaranteeing profit margins of **OMCs**

Figure 7: Effective rate of protection in Pakistan, selected sectors



Source: World Bank



Sectors	Effective Rate of Protection (2019)
Dairy Products	165%
Sugar	123%
Food products n.e.c.	245%
Beverages and tobacco products	167%
Textiles	77%
Wearing apparel	185%
Leather products	77%
Wood products	76%
Petroleum, coal products	79%
Motor vehicles and parts	143%

The old  
ways:

- **Product space** has remained concentrated in sectors **which enjoy protection**
- **No reason** why resources should **get reallocated** to new and more-complex products



# Rethinking Policy

- Incentivising one type of activity can often disincentivise another
- '*Crony capitalism*' starts with lobbying for more resources but ends with depriving the country of economic transformation
- Policy mistakes from picking winners are costly, and stick around for much longer



# Rethinking Policy

- Market failures are pervasive and often prevent transformation
- Good governance and 'right' institutions are critical to stimulate capability-building and sustained growth
- Policy design must aim at overcoming these barriers, without stopping the incentive structure from evolving
- Key is to catalyze the private sector's own self-discovery process





# The way ahead

- Move **away from incentivising sectors/products**
- **Towards incentivising:**
  - Higher standards
  - Product sophistication/brand development
  - Market penetration & integration with value chains
  - Human/skill development
- **Overcome the limited scale** of the domestic market by integrating with regional and global markets.
- Develop **insurance products for small farmers** and protect the vulnerable through direct cash transfers, **instead of fixing prices**



# Rethinking Policy

Ideas for Reform

# Reform Proposals

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- Our proposals touch upon multiple aspects of the economy
- However, all proposals are geared towards reducing misallocation and building capabilities
- We organize our proposals under four broad themes:
  - a. Integrate with regional and global markets*
  - b. Revisit pricing regimes*
  - c. Invest in youth and women*
  - d. Industrial strategy*





# Integrate with regional and global markets

## Motivation

- Important to overcome limited purchasing power of domestic market and achieve economies of scale
- Benefit from learning externalities by participating in global value chains

## Key Suggestions

- Actively engage with regional trading blocs with the aim to join these
- Redesign existing schemes to incentivize export of new products and/or to new markets
- Reduce custom and regulatory duties, and replace these with a uniform tariff across all sectors and product categories





# Revisit Pricing Regime

## Motivation

- In a market economy, prices are central to allocating resources across the economy
- However, both ill conceived government interventions and limited competition can distort pricing system

## Key Suggestions

- Liberalise the support-price regimes which currently govern crops such as wheat, sugar cane etc.
- In its place, introduce crop insurance for small farmers to protect them from adverse shocks
- Revisit laws which govern relevant stakeholders along the supply chain to
  - i. decrease barriers to competition
  - ii. strengthen bargaining power of weaker stakeholders
- Do away with trade restrictions and, instead, use strategic reserves to tackle concerns around food security



# Invest in youth and women

## Motivation

- There is a need to revamp education system with special focus on strengthening vocational education
- Resources are flowing towards higher education even when not needed e.g. mushrooming of universities

## Key Suggestions

- Introduce and mainstream TVET pathways, starting from schooling and going all the way to higher education
- Fast track initiatives to recognize and strengthen the skill-set of workers operating in the 'informal' sector e.g. *ustad-shagird* networks
- Embed digital, data science and industry 4.0 related skills in the *Single National Curriculum* at the primary and secondary level
- Modernize TVET workshops/institutes to teach digital and other 21st century skills





# Industrial strategy

## Motivation

- Sectoral policies and unconditional subsidies have incentivized resources to stay where they are
- Also, vulnerable to capture by lobby-groups
- The experience of SEZs has also been far from impressive

## Key Suggestions

- Replace sectoral policies with a system of incentives that reward entrepreneurial endeavor irrespective of sector
- Reorient focus from SEZs towards improving land-use within cities i.e. zoning regulations
- Must simplify tax code (automating tax-administration is essential but not enough)





# Industrial strategy

## Key Suggestions (continued)

- Work with relevant departments at the national and sub-national level to reduce compliance costs for businesses
- Work with the judiciary to reduce contract enforcement costs for businesses, and other necessary legal reforms
- Address the rigidities in the labour market
- Focus on public investment reform, which is important as the private sector is not interested in going to vast parts of Pakistan
- Strengthen credit bureaus and enforcement laws for movable/immovable assets to reduce credit frictions





Thank You!