DEMOCRACY REPORTING INTERNATIONAL | TABADLAB

Date:
December 28, 2020

Policy Brief

Industrial Opportunities Created During Covid-19

Danyal Adam Khan

Summary

- The disruption to global supply chains has created a unique set of **opportunities for markets such as Bangladesh, Cambodia, Vietnam and Pakistan** to tap into business deals with the western world as they look to diversify their supply chains.
- The **manufacturing sector in Pakistan** has significant unrealized potential as a source of employment and tax revenues. The sector provides **60% of tax revenue, 17% of job opportunities and contributes 14% to GDP.**
- Covid-19 hit Pakistan at a difficult time when the economy was already experiencing stress. The **manufacturing sector has been contracting for many years, with 10.2% decline** in 2019-20 alone.
- Initiatives taken by the government such as **SBP's Rozgar Scheme** and subsidies granted to the construction sector have proven helpful, but SMEs have been hit hard by Covid-19 which largely operate outside the formal economy.
- The **pandemic provides an opportunity** for the public and private sector to reform and grow in a manner which can help post-Covid-19 economic recovery, as witnessed with increased PPE exports.
- Pakistan's vision for economic expansion requires **industrial growth to be at the front and center of public policy.** The way forward must include identification of priority sectors for exports, improving Pakistan's export competitiveness, import substitution, fast-tracking Special Economic Zones (SEZs), improving Ease of Doing Business and prioritising support to SMEs.

Identifying the Problem

China is the factory for the world. It exported USD 2.5 trillion worth of goods around the globe, representing almost 13% of overall global exports. China was the single largest supplier of goods to the United States in 2019, at almost 18.1% of its total imports[1] . As the Covid-19 pandemic erupted and the world's factory went into a lockdown, companies in the United States, Canada, Europe, and Australia were hit with a supply chain calamity.

The interconnectedness of world markets that had been the pride of globalization, revealed its most vulnerable side, much as it had during the 2008 financial crisis. While China's exports to the world have steadily recovered from a low of USD 185.15 million in March 2020 to USD 268.07 million in November 2020[2], the world has been forced to rethink its supply chain and diversify outside of China. The Covid-19 pandemic may present long term opportunities for countries like Bangladesh, Cambodia, Vietnam and Pakistan to tap into business deals with the western world as they look to diversify. Pakistan needs to position itself in a manner that it is able to take advantage of emerging opportunities. In the absence of concerted efforts to improve Pakistan's competitiveness, this may not be realized. Currently, Pakistan ranks low on the World Competitiveness Index (110/140) having slipped 3 notches in the last year; on the Ease of Doing Business Index, Pakistan ranks 108 out of 190.

The focus of this policy brief is the manufacturing sector, its current status, how it has been impacted by the Covid-19 pandemic and what needs to be done to improve the sector's performance.

Manufacturing Sector in Pakistan - Why it is Important?

The manufacturing sector provides employment opportunities to about 17% of the total labour force of the country, and its share in the GDP is only around 14%. However, it generates a whopping 60% of the government's tax revenue[3]. This makes manufacturing and industry an absolutely vital and strategic sector. A manufacturing boom can not only meet local demand, reduce the dependence on imports, flip the current account deficit by increasing the volume of exports but it can also address the fiscal deficit.

Investing in the industrial framework of Pakistan can provide the labour force an opportunity to expand, build capacity and actively contribute to the economy. In particular, SMEs that are focused on manufacturing can contribute to a more equitable distribution of wealth and opportunity, adding to the long-term socioeconomic development of the country.

Pakistan's vision for economic expansion, currently underpinned by Chine Pakistan Economic Corridor (CPEC), requires industrial growth to be at the front and centre of public policy. This will mean not just protecting the sector from the impacts of Covid-19, but actively seeking opportunities to expand in new directions. CPEC provides a window for the structural shift of the economy towards industrialisation and especially high tech manufacturing. Timely and intelligent investments at this stage can result in an improved return on Pakistan's debt-financed development, along with a transfer of knowledge and capacity-building.

The Manufacturing Sector & Covid-19

The Covid-19 pandemic has led to unprecedented economic downturns in many parts of the world. For Pakistan, the virus happened to hit at a time when the country was already experiencing a significant financial slump. In the first three quarters of FY19-20, the Pakistani rupee had already depreciated by 3.9%, causing the imports of raw materials to become considerably more expensive. As per the IMF, Pakistan's real GDP was expected to have contracted by 0.4% in FY20, serving as a good indicator for the drop in productivity. Some key factors adversely impacting the manufacturing sector are listed below:

1. Rupee devaluation and disruption of global supply chains have caused the cost of imports to skyrocket
2. Inflation, at 8.9% in October 2020, had peaked to 14.6% in January 2020[4] and caused disposable income and aggregate demand to decline sharply
3. High interest rates prior to the pandemic that sought to contain inflation had served to discourage new investments
4. Covid-19 lockdowns have impacted SMEs in particular and caused downsizing or closures, with unemployment at 9.56%

More specifically, a majority of manufacturing businesses were unprepared to handle an unexpected situation such as Covid-19. Almost all major sectors—steel, cement, construction, automobiles, pharmaceuticals, chemicals, textiles, paper and board—have taken a hit in 2020, particularly those relying on imported raw materials. Delayed shipments, a devalued rupee and expensive imports were met with fledgling demand at home and abroad. Most of Pakistan's primary export partners—China, US, UK, Afghanistan and Germany—have been dealing with severe Covid-related recessions of their own. This has disrupted the market for Pakistani exports, which fell sharply by a record 47% to $957 million in Apr'20[5] before making a recovery to $2 billion in Oct'20[6].

Large Scale Manufacturing (LSM), which makes up 80% of the sector, has been on a downward trajectory for many years. Factors such as power shortages, low-price international competition and weak frameworks for support and regulation have been the primary causes. Furthermore, a 2.6% contraction for LSMs in the 2018-19 financial year has ballooned into a devastating 10.2% shrinkage in 2019-20[7]. On a month-on-month basis, certain LSM sectors such as paper and board, rubber products, food, beverages and pharmaceuticals have managed positive growth in some months of 2020. However, data from the Pakistani Bureau of Statistics shows that twelve of the fifteen major industries shrank in FY19-20. The automobile sector alone contributed to the huge contraction in LSM, shrinking by 36.5% in the first three quarters of FY 19-20 as compared to the preceding year[8].

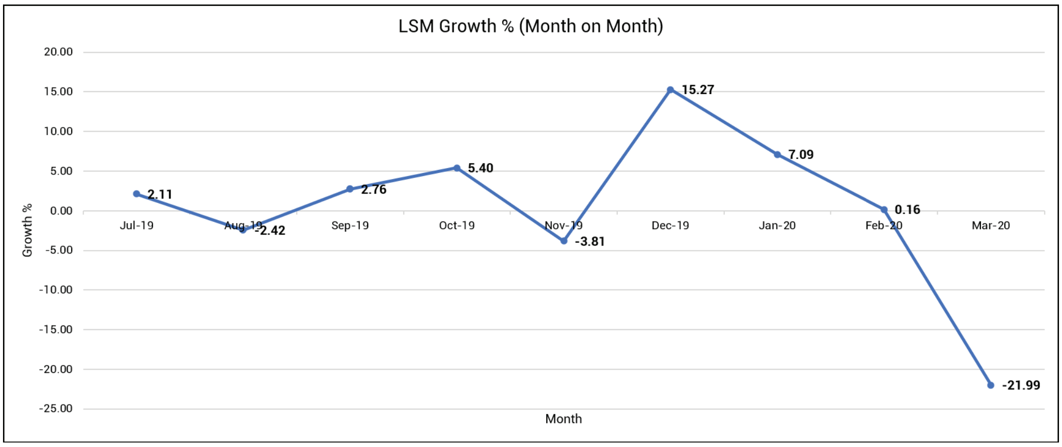

Figure 1: Source: Pakistan Bureau of Statistics

The Public Policy Response So Far

Initiatives like the Rozgar Scheme launched by the State Bank of Pakistan (SBP) have allowed 2,958 businesses to receive Rs. 238.2 billion by November 2020 in low-cost loans aimed at covering wage expense during Covid-19[11]. Similarly, loan repayments have been deferred and credit limits have been expanded, including for SMEs. In particular, the federal government has announced considerable incentives for the construction industry, such as amnesty schemes, tax exemptions and subsidies worth Rs. 30 billion for programmes like the Naya Pakistan Housing Scheme. Although these are also aimed towards associated sectors such as cement and steel, as well as many export-oriented industries, it is still the SMEs that seem to be worst-impacted—in particular, due to the early lockdowns that were later lifted in phases through April and May.

Opportunities

Where the pandemic has caused substantial economic disruptions, it has also brought significant opportunities to the fore. Companies in multiple sectors have focused on altering their processes, products and business models to adapt to prevalent conditions. Of particular note has been the sudden boom in manufacturing Covid-19 related products such as PPEs, sanitizers and medical equipment. Whereas Pakistan already has a significant industry attached to surgical instruments which was growing by 9.56% in the first half of FY19-20[9], businesses had received USD 100 million worth of orders by the time the government allowed export in July 2020. Not only has this industry met local demand but has somewhat boosted exports, eyeing USD 500 million by the end of the year[10]. In addition to surgical equipments, there are also emerging or existing opportunities in IT related industry, medical devices, light engineering. The world's food supply chain also offers great potential for export oriented businesses, particularly the halal meat market.

This goes to show the role that the manufacturing sector can play in the post-Covid-19 economic recovery. The rise of Global South markets, in particular, such as Vietnam, Cambodia and Bangladesh shows us how an economic turnaround through industrialization is possible.

Recommendations

While the growth rate for Pakistani industries has been predicted to remain negative for the financial year[12], it is critical that policymakers adopt the following steps to reverse the distress caused by the pandemic on businesses, trade, and investment opportunities and position to exploit long-term opportunities emerging from the current scenario:

1 Creation of National Industrial Policy:

The country requires an updated, wide-lens industrial policy that takes the entire manufacturing landscape into account rather than individual sectors. A deliberate push towards prioritizing the production and export of selected goods, which offer a competitive edge to Pakistan in the global arena, must be informed by a cohesive picture of how the country sees its economic future. Industrial growth cannot be expected to take place as a mechanical process without macro-level interventions by the government and relevant institutions like the PIDC. Linkages with technical training institutions must also be actively considered by policymakers.

2 Identify Priority Export Oriented Sectors

In keeping with the expected demands from US, EU, Canada and Austria, countries primarily reliant on China for supply chain currently, Pakistan should on priority identify key sectors that may benefit from export-oriented growth and support the same with an integrated set of policies.

3 Import Substitution for Consumer Goods

The disruption to global supply chains and increased cost of imports due to the Covid-19 crisis offers Pakistan a unique window for import substitution, particularly for industries not heavily reliant on imported raw materials. The skyrocketing prices of foreign products imply that Pakistani consumers might be willing to switch to cheaper, locally-manufactured alternatives. This will entail providing incentives to businesses producing consumer goods such as electronics, and easier to substitute than capital goods while also having a tariff structure that supports import substitution. The government can play a huge role by prioritising the purchase of high-quality locally-manufactured goods in key industries.

4 Targeted Growth for SEZs

With the second phase of CPEC is targeted towards industrial cooperation, the completion of SEZs must be fast-tracked by their relevant authorities in order to stimulate economic activity that has stalled during Covid-19. These zones have been lacking the necessary facilities to operationalize and attract either domestic or foreign investors; a reality that will only change once tangible progress is seen to be made. Another way to enable targeted growth through SEZs is the allocation of specific sectors to zones and providing the necessary ecosystems for each. Furthermore, in order to disburse the benefits of SEZs more equitably: a) elite capture of the zones should be discouraged, and b) backward linkages should be established to localize supply chains.

Recommendations

5 Digitalization, EODB and Access to Information

A lack of Ease of Doing Business has been a longstanding problem in Pakistani industrial development and will seriously hamper efforts to boost manufacturing if not addressed. Covid-19 has forced the public and private sector all over the world to rethink their processes, and it is absolutely essential for Pakistani policymakers to follow suit. A serious push towards digitalization and one-window operations at key institutions like SECP, FBR and NBP can remove hurdles associated with registration, taxation and regulations. In particular, potential local and foreign entrepreneurs must have easy access to information regarding how to navigate the intimidating labyrinth of business regulations in Pakistan.

6 Bringing SMEs into the Banking Network

The facilities and incentives announced by the government and SBP have been ostensibly targeted towards the manufacturing sector and SMEs, most of the benefit seems to have been derived by larger market players. SMEs and the informal sector have not been able to utilize the relief provided by the SBP as SMEs have not been fully assimilated into the banking network. The most equitable and widespread benefit can be achieved when policies are actively geared towards prioritizing small and medium enterprises instead of a few large corporations.

Endnotes

[1]'The People's Republic of China'. Office of the United States Trade Representative. https://ustr.gov/countries-regions/china-mongolia-taiwan/peoples-republic-china

[2]'Value of monthly exports from China from November 2017 to November 2020'. Statista. https://www.statista.com/statistics/271616/monthly-value-of-exports-from-china/#:~:text=In%20November%202020%2C%20Chinese%20exports,period%20of%20the%20previous%20year

[3]'Economic Impact of Covid-19 on Pakistan'. Institute of Cost and Management Accountants of Pakistan. https://www.icmap.com.pk/images/covid19/EconomicImpact_of_COVID19_on_Pakistant.pdf

[4]'Inflation Snapshot'. State Bank of Pakistan. https://www.sbp.org.pk/ecodata/MPM-New.pdf

[5]'Exports Fall by a Massive 47.24% in April 2020'. Jehangir Nasir, Pro Pakistani, May 2020. https://propakistani.pk/2020/05/06/exports-fall-by-a-massive-47-24-in-april-2020/

[6]'Pakistan's exports crossed $2 billion in October'. The Nation, Nov 2020. https://nation.com.pk/03-Nov-2020/pakistan-s-exports-crossed-dollar-2-billion-in-october

[7]LSM sector shrinks 10.2% in last fiscal year'. Shahbaz Rana, The Express Tribune, Aug 2020. https://tribune.com.pk/story/2259240/lsm-sector-shrinks-102-in-last-fiscal-year

[8]'Pakistan Economic Survey 2019-20'. Ministry of Finance, Jun 2020. http://www.finance.gov.pk/survey/chapter_20/03_Manufacturing_and_Mining.pdf

[9]'Surgical goods, medical instruments exports surge 9.56pc'. The Nation, Jan 2020. https://nation.com.pk/28-Jan-2020/surgical-goods-medical-instruments-exports-surge-9-56pc

[10]'Pakistani manufacturers hope to earn $2 billion by exporting PPEs, hand sanitizers'. Khurshid Ahmed, Arab News, Jul 2020. https://arab.news/2bbwb

[11]'Coronavirus – The Situation in Pakistan'. Flanders Investment & Trade, Nov 2020. https://www.flandersinvestmentandtrade.com/export/nieuws/coronavirus-situation-pakistan

[12]'Pakistani manufacturers hope to earn $2 billion by exporting PPEs, hand sanitizers'. Khurshid Ahmed, Arab News, Jul 2020. https://arab.news/2bbwb

UKaid
from the British people

This material has been developed by Tabadlab in partnership with DRI. It has been funded by UK aid from the UK government; however, the views expressed do not necessarily reflect the UK government's official policies.