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# PRIME Analytical Reports

*Unlocking Business Potential for Growth*

**Issue: 11, Vol: 1**

**June 2016**

# Engine of Growth:

# An Analysis of Pakistan’s Industrial Performance

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# Engine of Growth:

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## Introduction

Industrial growth has been inconsistent in Pakistan. It has gone from 11 percent on average in 1960s to as low as 3 percent on average during the first half of 2010s. These aggregate numbers masks considerable inter-decadal volatility in industrial growth. Despite such trends, industrial sector remains an important correlate of economic growth. The GDP growth rate for the FY2015-16 was 4.71 percent despite a negative growth rate of 0.19 for the agriculture sector. This rather impressive growth rate in GDP was propelled mainly by 6.58 percent growth in industrial sector.

Industrial sector is also leading in employing new entrants to the labor force. From 2014 and 2015, it has provided new jobs to 1.12 million workers[1]. Transport/Communication, Wholesale/Retail and others have provided jobs to 9,000 workers while employment in agriculture sector has reduced by 30,000 workers[2].

Currently, industrial sector has become even more important for Pakistan's growth aspirations especially if viewed against the backdrop of CPEC investment and improved energy supply. The recent development update of the Pakistani economy by the World Bank also bears out this view.

The purpose of this report is to un-ravel industrial growth in Pakistan by identifying which sub-sectors and industries have been at the forefront of industrial growth. Such an analysis can guide businesses to mobilize their investment in those sub-sectors and industries. The analysis is supplemented by the policy analysis for industrial strategy prevalent in Pakistan and how it incentivizes industrial growth. The investment pattern of the industrial sector is also presented at a disaggregated level along with gauging the trend in the industrial productivity.

### *This Report*

1. Charts recent trends in industrial growth of Pakistan
2. Highlights incentives and analyzes industrial stratregy of Pakistan
3. Examines domestic and foreign investment in Pakistan's industries
4. Measures industrial productivity in Pakistan

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[1] Based on Author's calculation from PBS data.
[2] Ibid.

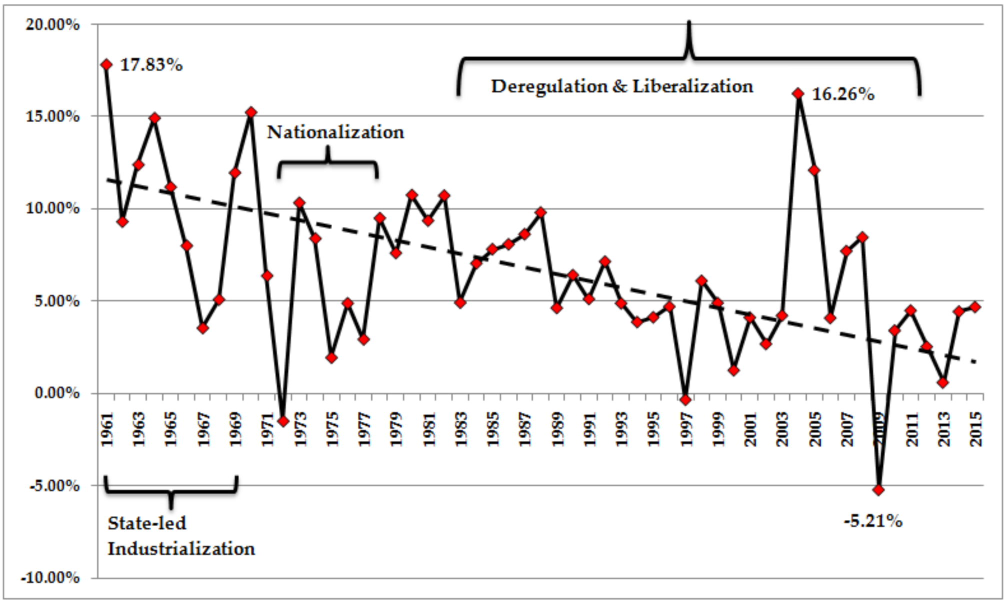
# 1. Industrial Growth in Pakistan

As mentioned above, industrial growth has been irregular in Pakistan. This erratic pattern of industrial growth is exhibited in Figure 1. The downward trend in industrial growth is quite visible from the figure. On close examination, the decreasing trend is clear for each decade as well. The only instances where Pakistan has managed to maintain positive trend in industrial growth consecutively for five and three years is between 1984-1988 and 1968-1971 respectively. For most of its history and barring the two periods just mentioned, it has only posted positive trend in industrial growth for no more than two years on six different occasions.

On the negative side, industrial growth has gone from positive in one year and negative in the preceding year 16 times as shown in Figure 2[3].

Interestingly Pakistan has failed to surpass its highest industrial growth of 17.84 percent in 1961 during the ensuing five decades.

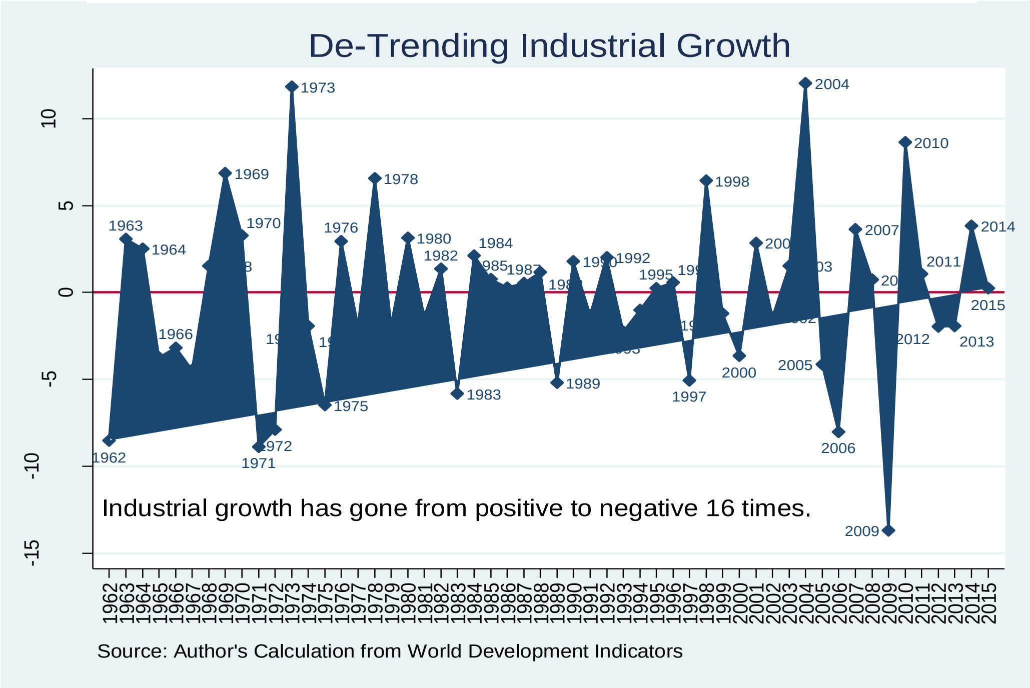
**Figure 1: Industrial growth – Highs and Lows**




Source: World Development Indicators

[3] Calculated as number of spikes from positive to negative.

**Figure 2: Hidden Trends of Industrial Growth**




Source: World Development Indicators

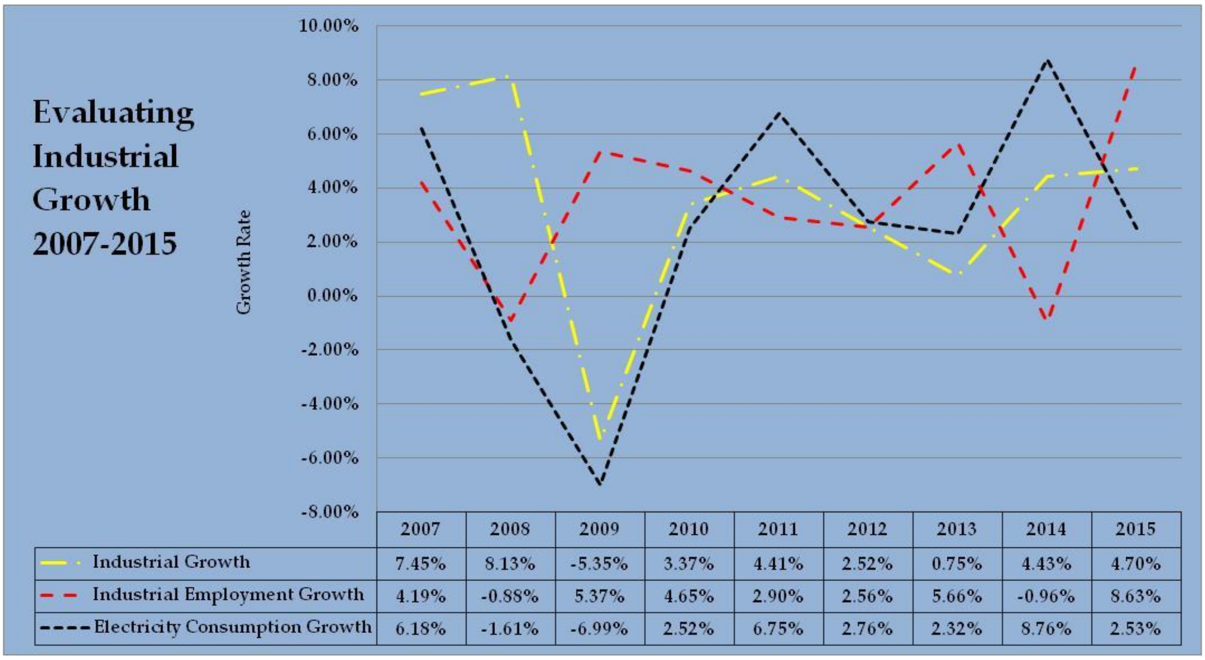
Industrial growth can also be assessed by tracking growth in industrial employment and electricity consumption by industrial sector. The rationale for using these two metrics is that they represent industrial activity. The trend of the three indicators is somewhat in line. However, industrial growth and electricity consumption growth move rather more closely. On the other hand, growth in industrial employment appears less variable relative to industrial growth and energy consumption growth by industrial sector. Growth rate in industrial employment varies by 3 percent on average, while industrial growth and industrial energy consumption growth varies by 4 percent and 5 percent on average[4]. This implies that growth in industrial activity may not be as inconsistent as Figure 1 presents.

*"Large-scale manufacturing sector has grown considerably during last fiscal year"*

A.Q. Khalil
Karachi-based entrepreneur

[4] This is calculated as the standard deviation of each indicator.

**Figure 3: Industrial Growth – Some Comparisons**




| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|---|
| Industrial Growth | 7.45% | 8.13% | -5.35% | 3.37% | 4.41% | 2.52% | 0.75% | 4.43% | 4.70% |
| Industrial Employment Growth | 4.19% | -0.88% | 5.37% | 4.65% | 2.90% | 2.56% | 5.66% | -0.96% | 8.63% |
| Electricity Consumption Growth | 6.18% | -1.61% | -6.99% | 2.52% | 6.75% | 2.76% | 2.32% | 8.76% | 2.53% |

Source: Author's Calculation based on data from WDI and PBS

## 1.1 Industrial Growth – A Decomposition Analysis

This sub-section applies Shapley Decomposition to decompose industrial growth into sub-sectors which are mining, manufacturing, electricity generation/distribution and construction. Such decomposition highlights the relative contribution of each sub-sector to the industrial growth. Table 1 presents the results of this decomposition.

**Industrial sector has grown by 3.70 percent on average during the last 11 years.**

On average, during the last 11 years, industrial sector has grown by 3.70 percent. Out of this, manufacturing sector has contributed 2.37 percent, implying that it has been responsible for almost two-thirds of industrial growth. Contrarily, despite varying volume in the overall industrial sector, mining, electricity generation/distribution, and construction have contributed almost the same to the average industrial growth.

**Table 1: Shapley Decomposition of Industrial sector growth**

| Year | Industrial Growth | Mining | Manufacturing | Electricity | Construction |
|---|---|---|---|---|---|
| 2006-2007 | 7.45 | 1.11 | 5.73 | -0.84 | 1.43 |
| 2007-2008 | 8.13 | 0.47 | 3.91 | 1.97 | 1.78 |
| 2008-2009 | -4.63 | -0.38 | -2.08 | -0.87 | -1.3 |
| 2009-2010 | 3.37 | 0.42 | 0.89 | 1.06 | 1 |
| 2010-2011 | 4.41 | -0.66 | 1.58 | 4.56 | -1.07 |
| 2011-2012 | 2.52 | 0.71 | 1.31 | 0.16 | 0.34 |
| 2012-2013 | 0.75 | 0.55 | 3.05 | -2.97 | 0.12 |
| 2013-2014 | 4.43 | 0.2 | 3.63 | -0.06 | 0.66 |
| 2014-2015 | 4.7 | 0.55 | 2.53 | 0.92 | 0.7 |
| 2015-2016 | 6.58 | 0.93 | 3.18 | 0.99 | 1.47 |
| **Average** | **3.70** | **0.39** | **2.37** | **0.49** | **0.51** |

Source: Author's Calculation based on data from Pakistan Economic Survey

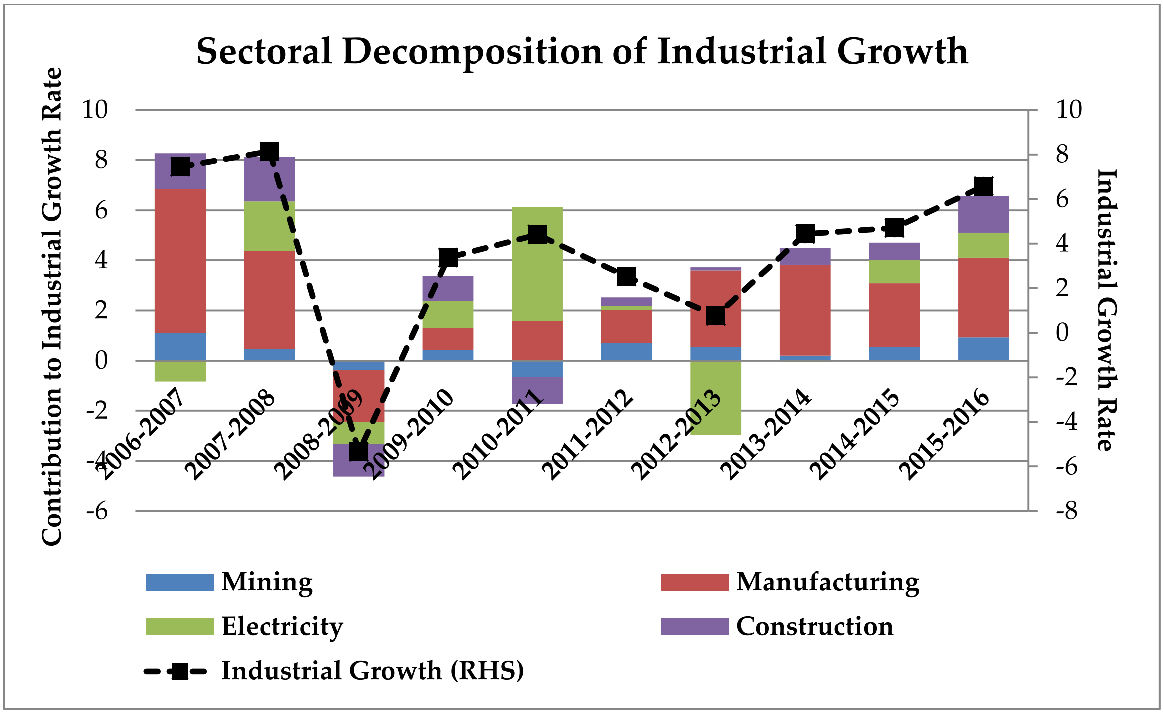
Figure 4 illustrates the results of Table 1. It shows that contribution by electricity sector has pulled industrial growth in 2010-2011. Electricity sector's contribution has turned positive after being a negative drag on industrial growth in 2012-2013 and 2013-2014. In recent years, construction sector's contribution to industrial growth has also increased. For example, in 2014-15, contribution of construction was 15 percent of total industrial growth. This has increased to 22 percent of industrial growth between 2015-2016. This may encourage more investment in industries related to construction. For example, Mohammad Ali Tabba, Chairman All Pakistan Cement Manufacturers claimed the cement industry is going to invest from $700 million to $1 billion in the industry[5].

Manufacturing sector is still the major contributor to industrial growth and should be the focus for improved industrial performance. Asim A. Chishti, Business Development Coordinator at international Finance Corporation (IFC) stated that "more efforts are

[5] Khan, A. Cement industry to invest $1billion. Pakistan Observer, 14th April, 2016.

required to strengthen and promote manufacturing sector to ensure speedy development and job creation".[6]

**Figure 4: Industrial Growth Decomposition – Major Players**




Source: Author's Calculation using data from Pakistan Economic Survey

Furthering disaggregating industrial growth at the manufacturing sector level reveals that Large Scale manufacturing has contributed more than two-thirds on average to manufacturing growth rate for the last 11 years. This is no wonder since during last 3 years; about 124 large scale manufacturing units have been set up in the country[7]. Karachi based entrepreneur A.Q. Khalil seconded this view that LSM has grown considerably during the last fiscal year.[8]

Interestingly, while share of LSM has varied during the period under consideration the share by Small and Medium scale manufacturing has consistently increased. Table 2 presents the results of Shapley decomposition for manufacturing sector and Figure 5 graphically presents the same results.

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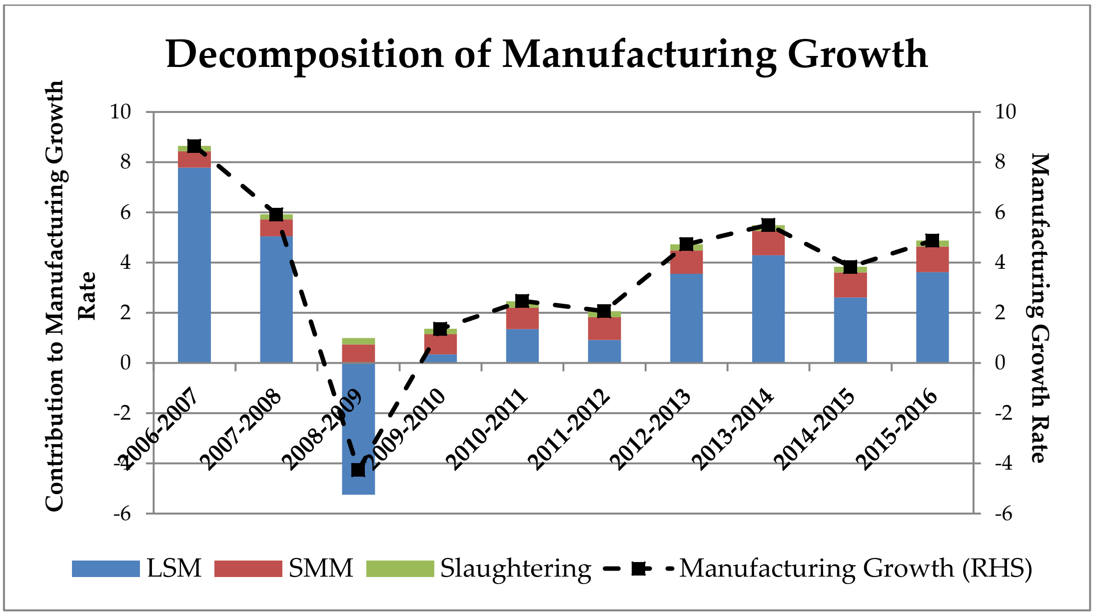
[6] Manufacturing sector key to development. Pakistan Observer, 9th Jan, 2016.
[7] Zain, A. 124 manufacturing units set up in Pakistan since 2013. Daily Pakistan, 22nd May, 2016
[8] Akhter, S. Business community say politics in focus. The News, 4th June, 2016.

**Table 2: Decomposing Manufacturing Growth**

| Year | Manufacturing Growth | LSM | SMM | Slaughtering |
|---|---|---|---|---|
| **2006-2007** | 8.65 | 7.78 | 0.66 | 0.21 |
| **2007-2008** | 5.92 | 5.05 | 0.67 | 0.2 |
| **2008-2009** | -4.27 | -5.25 | 0.74 | 0.25 |
| **2009-2010** | 1.36 | 0.34 | 0.81 | 0.21 |
| **2010-2011** | 2.47 | 1.35 | 0.86 | 0.25 |
| **2011-2012** | 2.06 | 0.92 | 0.9 | 0.25 |
| **2012-2013** | 4.73 | 3.55 | 0.93 | 0.25 |
| **2013-2014** | 5.5 | 4.3 | 0.96 | 0.23 |
| **2014-2015** | 3.83 | 2.61 | 0.99 | 0.23 |
| **2015-2016** | 4.88 | 3.62 | 1.02 | 0.24 |
| **Average** | 3.51 | 2.43 | 0.85 | 0.23 |

Source: Author's calculation using data from Pakistan Economic Survey

**Figure 5: Manufacturing Sector Growth – Major Players**




Source: Author's Calculation using data from Pakistan Economic Survey

Large scale manufacturing sector in turn has grown on account of improved performance of some specific industries such as Automobiles, Chemicals, Fertilizers, Non-metallic mineral production, coke & petroleum, iron & steel products and Pharmaceutical. The growth in production of these industries is presented in Table 3.

**Table 3: Growth in Production of Selected LSM Industries – Last Four Fiscal Years**

| | FY2012-13 | FY2013-14 | FY2014-15 | FY2015-16 | Average |
|---|---|---|---|---|---|
| **Textile** | 0.91 | 1.45 | 0.97 | 0.62 | 0.99 |
| **Food, Beverages & Tobacco** | 7.43 | 8.24 | -0.93 | 3.66 | 4.6 |
| **Coke & Petroleum** | 13.32 | 7.49 | 5.47 | 2.4 | 7.17 |
| **Pharmaceuticals** | 6.61 | -0.37 | 6.84 | 7.21 | 5.07 |
| **Chemicals** | -0.66 | 6.74 | 6.67 | 10.01 | 5.69 |
| **Automobiles** | -11.95 | 0.35 | 17.06 | 23.43 | 7.2 |
| **Iron and Steel Products** | 13.24 | 3.38 | 35.63 | -7.48 | 11.19 |
| **Fertilizers** | -5.03 | 21.64 | 0.95 | 15.92 | 8.37 |
| **Electronics** | 2.38 | 7.02 | 8.51 | -9.98 | 1.98 |
| **Paper & Board** | 17.61 | 9.30 | -5.74 | -2.9 | 4.56 |
| **Non-metallic Mineral Products** | 6.07 | 0.19 | 2.71 | 10.23 | 4.8 |

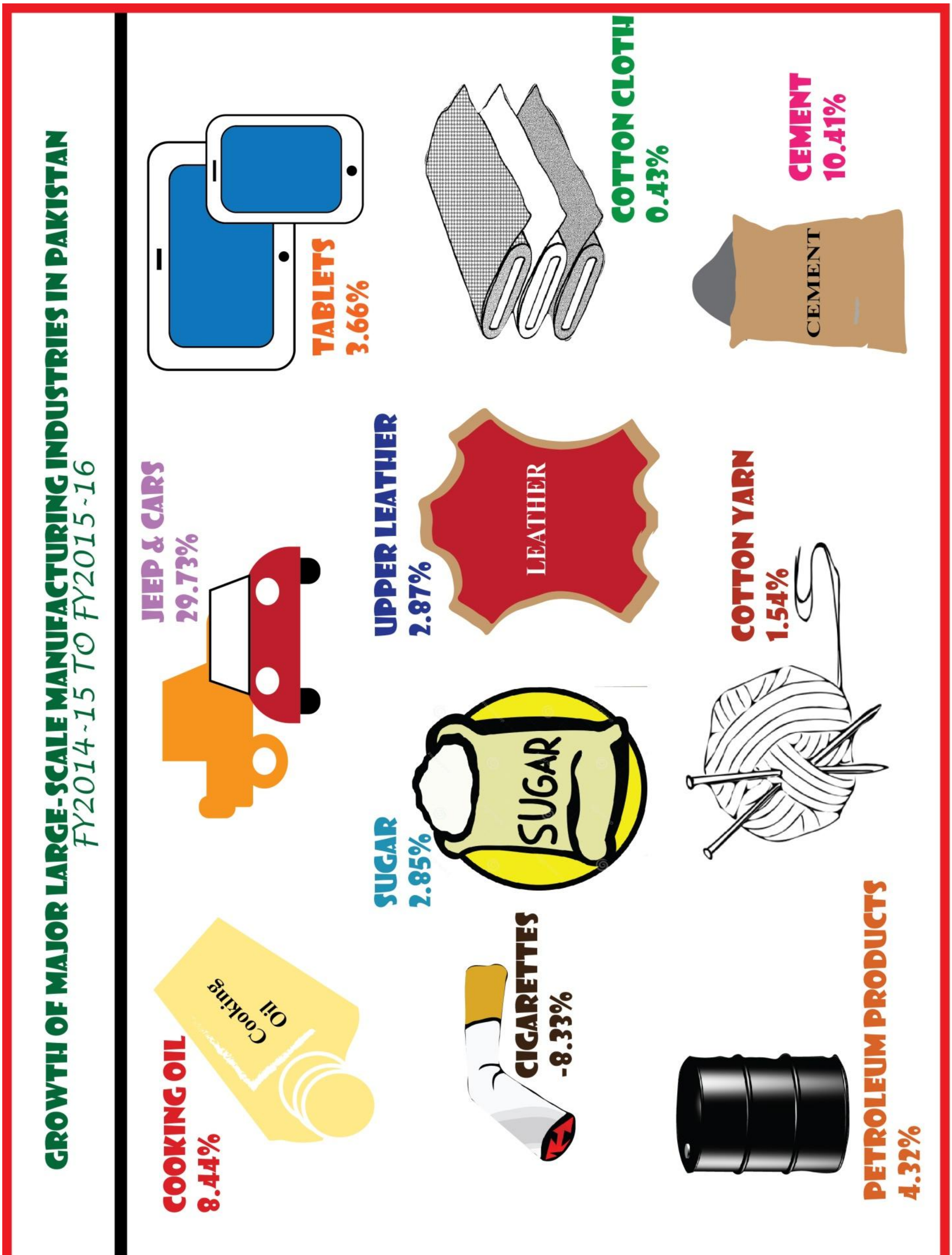
Source: Pakistan Economic Survey, Various Issues

Interestingly, in any fiscal year covered in Table 3, no more than 2 industries have registered negative growth. Similarly, despite varying growth rates, most of the industries have recorded positive growth during the last four years.

**124 LSM units have been set up during the last 3 years.**

Some of the industries have also posted positive growth throughout the last four years like food, beverages & tobacco, fertilizers, non-metallic mineral products, and textile. In case of latter, the growth rates, although positive, have hovered close to 1 percent. This indicates that textile industry has been running at sub-par level.

It can be expected that given the prospective increase in energy supply through CPEC energy projects and higher investment that corresponds to CPEC, these industries will carry this momentum ahead.




Source: Pakistan Economic Survey, 2015-16

## 2. Incentives to Industrial Growth – A Policy Analysis

Governments both at the federal and provincial levels have set-up incentive structures to promote industrialization. Each province in Pakistan lays down an industrial strategy around industries in which it has a comparative advantage. As per its Industrial Policy 2016, KPK government "will encourage setting up industries in the province based on its rich natural resource endowment and traditional industries, most notably construction, tobacco, and farming industries". Along with provision of basic infrastructural facilities like water and energy, additional incentives are also accorded. In KPK industrial policy 2016, these incentives are presented in Table 5 along with their budgetary requirements.

**Table 4: KPK Industrial Policy – Incentives**

| | Proposed incentive | Rate | Estimated Budget requirement (Rs. in millions) | | |
|---|---|---|---|---|---|
| | | | **2016-17** | **2017-18** | **2018-19** |
| **1** | Government shall bear 5 % mark up on financing for five years for new/expansion projects availed up to June 2017. | 5% | 500 | 1600 | 2500 |
| **2** | Government shall finance 25 % of the cost of property (plots) acquired for setting up industrial units up to December 2017 viz Early Bird investments to expedite the industrialization process. | 25% | To be borne by KP-EZDMC from its own resources | | |
| **3** | Government of KPK shall bear 25 % of the electricity bill maximum up to 3 years from the start of commercial production for all new units, which are unique in nature and 1st of its kind in KPK. | 25% | 360 | 550 | 750 |
| **4** | Government of KPK shall subsidize 25 percent of the transport cost from Karachi to industrial site against import of plant & machinery for setting up new units. This subsidy shall be available for all new capital goods/plant and machinery reached into SEZ for installation. | 25% | 330 | 550 | 750 |
| **5** | For women entrepreneurs, the government of KPK shall finance 25 % of the equity investments subject to maximum of PKR 3 million per investor. | 25% | 500 | 500 | 500 |

Source: Government of KPK

As an example of incentive structures are also in place the price of land in Sundar industrial Estate is reduced from Rs. 5 million per acre to Rs. 3.5 million per acre. The Capital Value Tax (CVT) is also reduced from the flat rate of Rs. 100 per square feet to 2 percent only. Currently, three industrial estates have just been given Special Economic Zones (SEZs) status. These SEZs are" Quaid-e-Azam Apparel Park located at M-2 (Lahore-Islamabad Motorway) at the distance of 2 kilometers from Shiekhupura interchange, M3 industrial city located on Trade Corridor of Pakistan along Motorway M-3 near Sahianwala interchange, and 225-acre Value Addition City situated 20 km from Faisalabad and 1.5 km off Sheikhupura-Faisalabad highway[9]". These zones will enjoy a 10-year long tax holiday and one time duty free on import of capital good in the zones.

Once completed by 2018-19, CEO Punjab Board of Investment and Trade (PBIT) Ms. Amna Cheema claims that these "newly-declared SEZs are estimated to have a turnover of more than Rs.1 Trillion to the country's economy and guarantee over 2 million jobs"[10]. Additionally, Hattar industrial estate in KPK is also given Special Zone Status along with a 10-year tax break and one time duty free import[11]. Such incentives for economic zones specified for export promotion also exist. These specific economic zones are called Export Processing Economic Zones and are managed by Export Processing Zones Authority (See Box 1 for incentives accorded to such export processing zones).

*"Newly-declared SEZs are estimated to have a turnover of more than Rs.1 trillion to the country's economy and guarantee over 2 million jobs"*

*Ms. Amna Cheema*

*CEO Punjab Board of Investment*

These incentives are supported by the Investment Policy 2013. The Investment Policy operational was framed in 2013. According to this policy and Special Economic Zone Act 2012, incentives and exemption are in place for "Zone enterprises" and "Zone Developers" (See Box 2 for these incentives and exemptions).

**Box: 1 Economic Zones - Incentives and Exemptions**

1. Zone developers and zone enterprises to have duty free import of capital goods for established, maintenance of zones and projects therein.
2. Income tax exemption for zone developers and zone enterprises for a period of ten years.
3. All utilities and infrastructure till zero point of the zone.
4. Captive power generation allowed to zone developers, and excess can be sold.
5. One-window-facilities by Board of Investment.
6. Dry port facilities.
7. Security arrangements by the provincial government.

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[9] Three industrial estates in Punjab given SEZ status. Dawn, 11th June, 2016.
[10] Ibid.
[11] Hattar given special economic zone status. The News, 11th June, 2016.

Despite such lofty incentives and exemptions, the performance of economic zones-led industrialization has somewhat underperformed. One reason for this has been frequent withdrawal in incentives and exemptions afforded initially. Such pre-mature withdrawal of incentives resulted in the closure of 1,145 industrial units out of 1,848 in 2002-03[12]. In addition, economics zones face infrastructural impediments. As laid down in SEZ Act 2012, SEZs are to be established by the Government of Pakistan. This requires the government to provide as well as maintain the infrastructure, which it normally fails to.

The same is also true for logistics. Naheed Memom Chairperson of Sindh Board of investment claims that three newly approved SEZs of Khairpur, Bin Qasim and Konrangi are without gas and electricity[13]. While logistic services like road network to ports and dry ports are placed, these roads are not maintained adding to the worries of industries. Contrarily, the relatively successful performance of the industrial area of Islamabad like I-9 and I-10 is on account of better road connection to markets in Rawalpindi and Islamabad.

**Box 2: Export Processing Special Zones – Incentives in Pakistan**

1. Developed land on competitive rates for 30 years
2. Duty-free import of machinery, equipment and materials
3. Freedom from national import regulations
4. Exchange control regulations of Pakistan not applicable
5. Repatriation of capital and profits
6. No sales tax on input goods including electricity/gas bills
7. Duty-free vehicles allowed under certain conditions
8. Domestic market available to the extent of 20%. Exceptions may be available
9. Presumptive tax @ 1%
10. Only EPZA is authorized to collect Presumptive Tax at the time of export of goods which would be final tax liability
11. Obsolete/old machinery can be sold in domestic market of Pakistan after payment of applicable duties & taxes
12. Defective goods/waste can be sold in domestic market after payment of applicable duties, maximum up-to 3% of total value
13. EPZ units allowed to supply goods to Custom manufacturing bonds

If these impediments remain in place, the upcoming economic zones may also fall to the same fate. As of now, there are an estimated 77 economic zones in Pakistan. With 26 more coming under the CPEC banner, there can be an over-supply of economic zones. This can further deteriorate the performance of SEZs as scant resources of the government are stretched over increasing number of established industrial zones. One way to address this is

[12] Causes of industrial failure and its implication in NWFP, Quaterly Science Vision Vol. 8 (3 & 4).

[13] Three special economic zones in Sindh without power, gas. Pakistan Today, 9th June, 2016.

by promoting, marketing, and establishing private sector led economic zones. Responding to their profits, the developers will ensure that zones are successful and productive.

**Box 3: Federal Budget 2016-17 – Prospects for Industrial Growth**

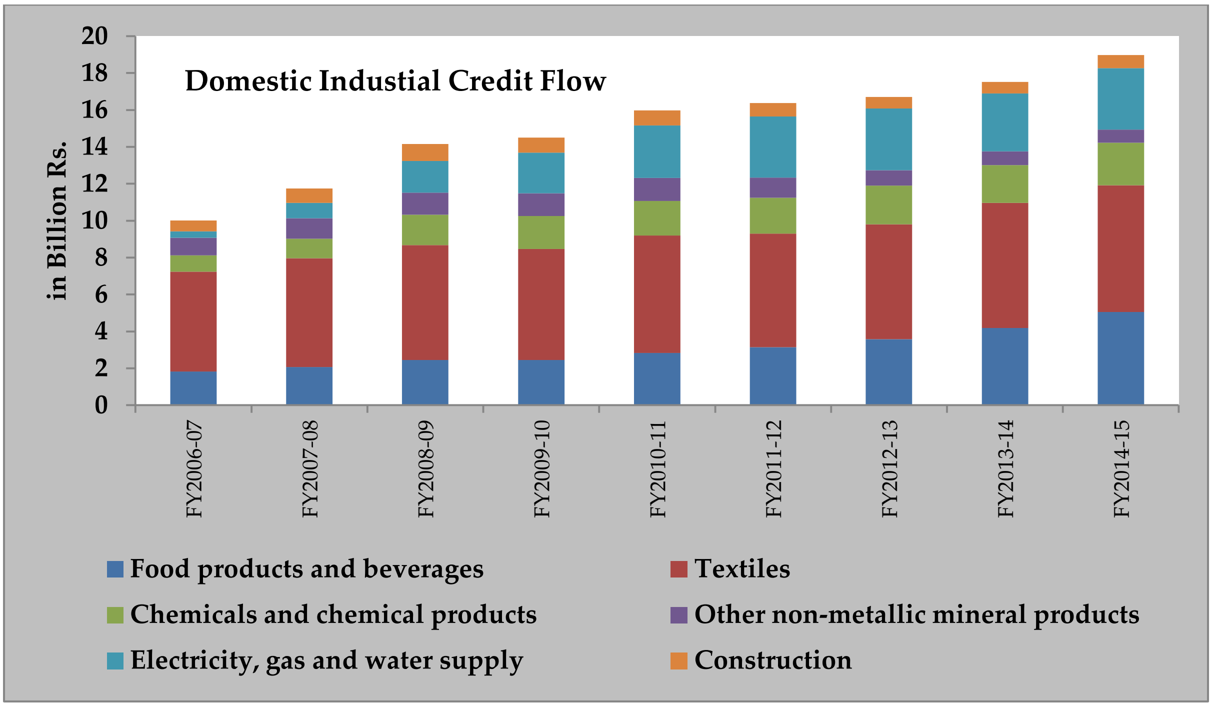
The Federal Budget 2016-17 has announced some measures of relief for industrial sector. However, out of the 9 measures that the Finance Minister mentioned in his budget speech, apart from one measure no new measure is installed. In most of the cases, either the time limit for that scheme is increased or the requirements are relaxed for that scheme. In case of reduction in corporate tax to 31 percent, it is one of the highest in the world. In short, industrial package enshrined in the budget is more like a continuation of the status quo. This view is also shared by the representatives of the American Business Council of Pakistan. The measures announced for the industrial sector are as follows:

1. Zero-rating for export oriented sector – textile, carpets, leather, sports, and surgical goods.
2. The turnover threshold for sales tax exemption for cottage industry has been raised from Rs. 5 million to 10 million.
3. Reduction of corporate tax rate to 31%
4. Tax credit at 1 percent on the tax payable for a period of ten years that is allowed for every 50 employees for any industrial undertaking to be set up before June, 2018 is increased to 2 percent and time limit for industrial units to be set up is also increased to June 2019.
5. Tax credit at 2.5 percent of tax payable for those manufacturers that makes over 90 percent sales to registered persons.
6. 100 percent tax credit for industry set up with 70 percent fresh equity. This tax credit is available for five years from the start of commercial production,
7. Custom duty reduced from 5 percent to 3 percent on 2000 items of machinery and raw materials. This proposal will help industrial sector to the tune of Rs. 18 billion.
8. Regulatory duty on import of bead wire which is used in tyres manufacturing is exempted.
9. Equity requirement for expansion of existing plant or new plant is reduced to 70 percent for enjoying tax credit at 100 percent on the tax payable on plant extension or new plant.
10. Period of exemption to investment in green field industrial undertakings has increased to 30th June, 2019.

## 3. Industrial Investment – Recent Trends

This section analyzes the trend of industrial investment in Pakistan. Both domestic and foreign investment is studied. In case of domestic investment, domestic outstanding credit is used as a proxy. It is observed that five industries constitute about more than 80 percent of domestic credit. By these estimates, textile industry makes the largest chunk of the investment followed by food products and beverages and finally electricity, gas & water supply. Figure 6 shows the breakdown of domestic industrial credit.

**Figure 6: Domestic Industrial Credit**




Source: SBP

The overall trend in domestic credit has been sluggish as shown in Figure 7. Part of the reason behind low levels of domestic credit is higher financing of fiscal deficit by domestic sources, most dominantly commercially banks. For fiscal year 2016-17, 81 percent of fiscal deficit is financed by domestic sources up from 66 percent for fiscal year 2014-15. Resultantly, banking credit to private sector has reduced. Mr. Ibrahim Qureshi, President All Pakistan Business Association claimed that banking credit to private sector has gone down from 67 percent of total credit disbursed in 2004 to 37 percent in 2014. He further stated that mere reduction in interest rate won't increase credit unless permanent reforms like improving tax machinery, stopping capital flight, and curbing speculation are in place.[14]

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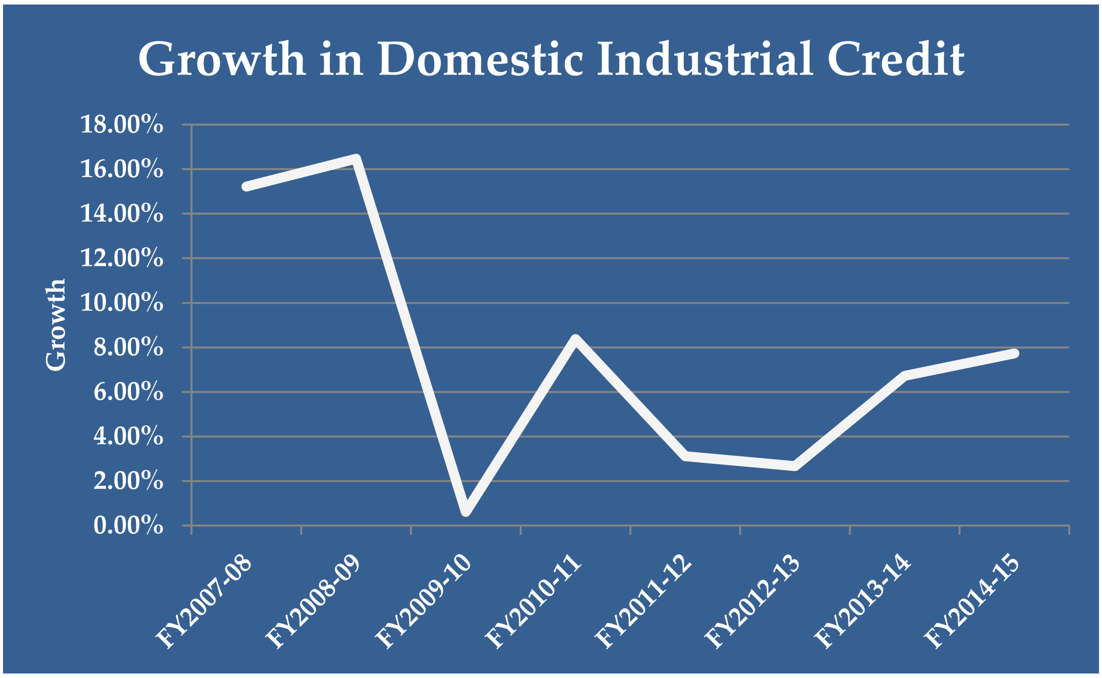
[14] APBF backs SBP policy rate cut. Pakistan Observer, 24th May, 2016.

**Figure 7: Industrial Credit - Growth**




Source: SBP

Foreign direct investment, on the contrary, is a bit more diverse than domestic. It is concentrated in seven industries, which are food, oil & gas exploration, communication, power sector, trade services, construction, and financial business. These sectors constitute almost 80 percent of total foreign direct investment coming into Pakistan. The breakdown of industrial foreign direct investment has undergone change as shown in Figure 8.

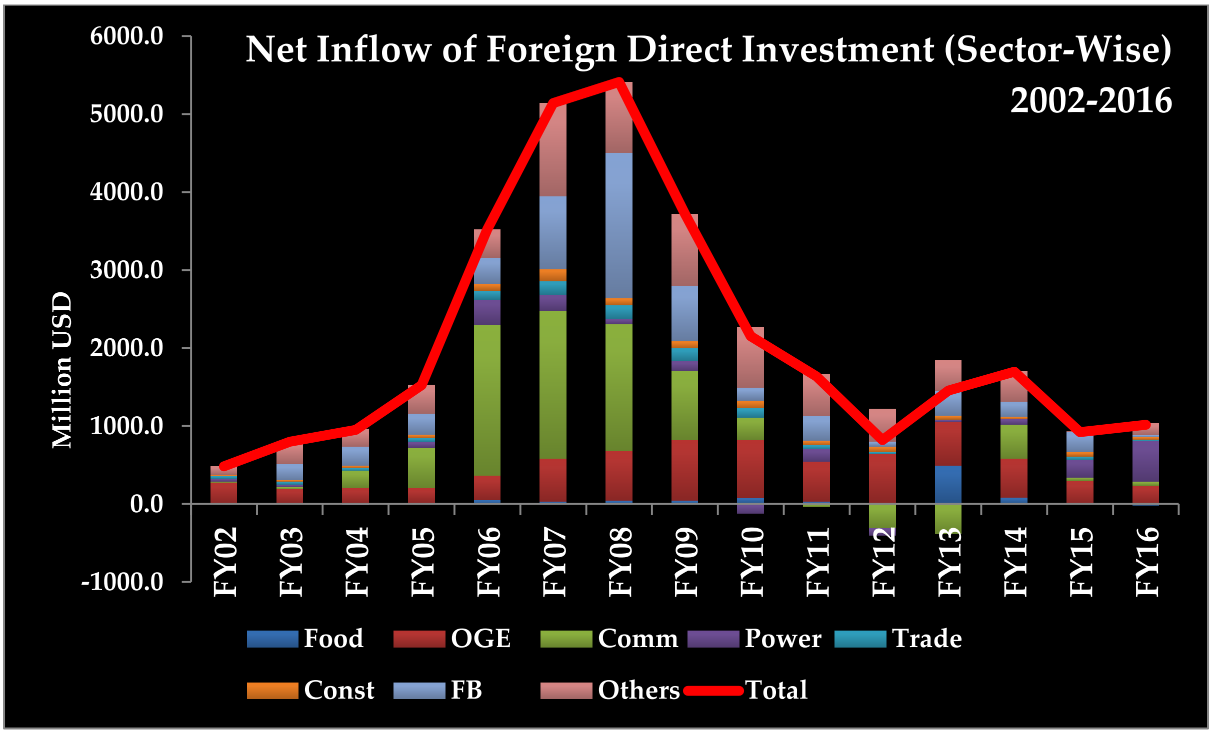
**"Germany is interested in investing into Pakistan's power sector."**

**Ms. Isa Lepel**
**German Ambassador to Pakistan**

During mid-2000s, industrial foreign investment was dominated in a large part by communication, oil & gas exploration, and financial business. This domination has now receded completely. Industrial foreign investment is now headlined mostly by power sector. This trend of higher power sector industrial investment will remain true in the coming years as well owing to CPEC investment which is in private sector IPP mode. Therefore, increasing number of countries are showing interest in Pakistan's energy sector. Ms Isa Lepel, who is German Ambassador to Pakistan, has highlighted Germany's interest to invest in Pakistan's energy sector.[15] Figure 9 charts the trend of the top four industries by foreign direct investment flows.

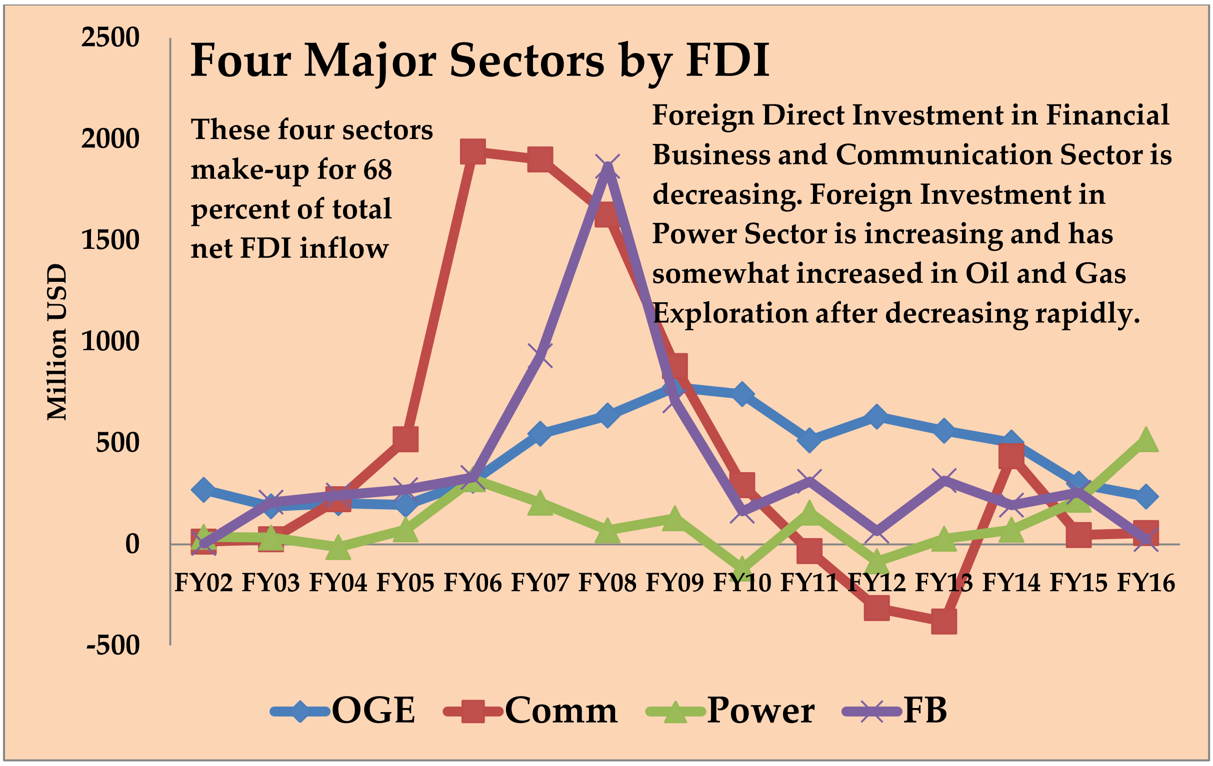
[15]Pakistan offers a liberal regime for foreign investment. Radio Pakistan, 11th June, 2016.

**Figure 8: Foreign Direct Investment – A Breakdown[16]**




Source: SBP

**Figure 9: Trends of Four Major Industries by FDI**



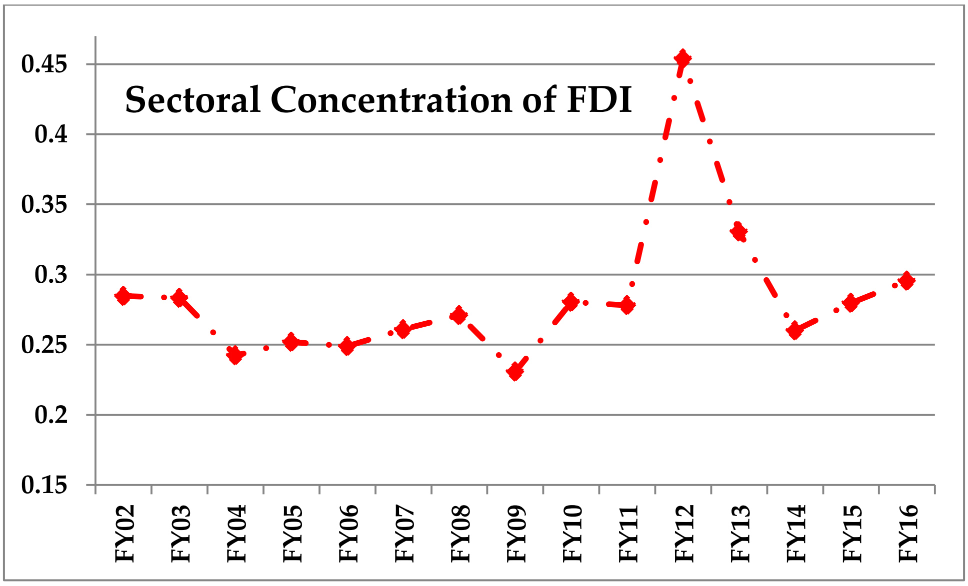

Source: SBP

[16] OGE = Oil & Gas exploration; Comm = Communication; FB = Financial Business; Const = Construction

As for the overall trend, industrial foreign investment is decreasing in line with domestic credit pattern. However, on year-on-year basis, slight improvement is visible for FY2016. Comparing domestic industrial credit and foreign industrial investment reveals some interesting patterns. Firstly, only food, construction sector and power sector are among the top recipients of both domestic credit and foreign investment. This trend for power sector may expand as public investment is expected to pick up drastically in the sector. Minister for Water and Power, Mr. Khawaja Asif has recently claimed that government has lined up $58 billion worth of investment for the power sector till 2022[17]. Secondly, while foreign industrial investment is on a downhill propensity, domestic industrial credit is sluggish. Thirdly, while a change is observed in the structure of industrial foreign investment, the breakdown of domestic credit flow remains somewhat the same.

Finally, both domestic and foreign industrial investment seems quite limited to a few sectors. Figure 10 shows this by plotting the average of top three sectors by industrial foreign investment. Here again the rising concentration in sectoral FDI is expected to increase with more CPEC power sector investment.

**Figure 10: Increasing Concentration**




Source: Author's calculation using data from SBP

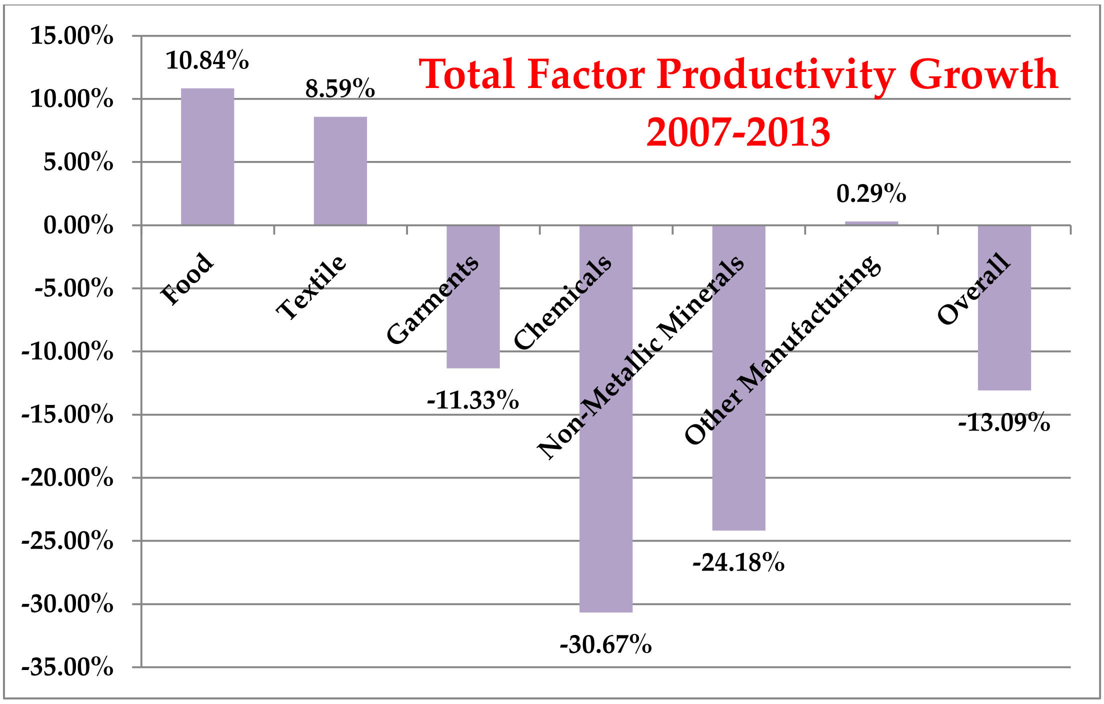
## 4. Industrial Productivity

This section estimates the industrial productivity in Pakistan for selected industries[18] and for the country as a whole. Two rounds of enterprise survey compiled by the World Bank for

[17] Pakistan eyes $58 billion investment in power sector till 2022. India Times, 10th June, 2016.
[18] The selection is based on those industries for which consistent data is available.

2007 and 2013 are used[19]. The results of the estimation are presented in Figure 11 which shows the annual growth in industrial productivity.

**Figure 11: Industrial Productivity**




Source: Author's calculation using World Bank Enterprise Survey

Only two industries for which total factor productivity is calculated have reported positive growth in productivity. Food industry has witnessed an annual growth in productivity at almost 11 percent. Productivity in textile industry has also grown by 8.59 percent. For other industries like garments, chemicals, and non-metallic minerals, productivity has reduced by 11.33 percent, 30.67 percent, and 24.18 percent respectively.

The overall productivity has also gone down by 13 percent per year in the industrial sector. This negative outlook could be explained by lack of innovation due to the limited extent of market. Innovation requires large investments which can only be profitable if the scale of operations are large enough. Factors like power crisis, poor security stance, large unskilled labor force, and lack of access to credit stalls business expansion.

Government's practice to accord preferential treatment to few sectors hampers fair play. In the past, government has granted exemptions to certain sectors like exemptions of import duty on purchase of capital and machinery. While these policies are congenial to businesses, their limited scope to only few hand-picked industries by the government obstructs competition. This promotes inefficiencies and reduces productivity. The business-friendly exemptions should be provided across the board for all business endeavors. Finally, taxes

[19] These are the only two available surveys for Pakistan.

also hamper productivity. High taxes, for example, discourage businesses not to innovate and reduce costs. For example, IT companies are required to register with SECP for exporting IT services. This qualifies them to pay high taxes which hamper their profits. Resultantly, such sectors remain in the informal side of the economy. The ensuing restricted extent of operation does not give them incentives not to innovate and increase productivity. Dairy industry is one such example. Diary sector remains largely an informal part of the economy where investment in innovation and productivity does not take place. For example, packaged milk remains only at 6 percent of total milk consumption. Government has recently slapped a 10 percent sales tax[20] on packaged milk which already covers a limited extent of the milk market as mentioned above. In this way, it is denting even that part of the dairy industry that innovates and is productive. Such measures can potentially discourage innovation.

## Conclusion

There is a buzz in the industrial sector of Pakistan on the back of improved energy provision and CPEC investment. This is evident from the 6.58 percent industrial growth for FY2015-16 which is about 2 percentage points higher than the previous year's. There is a need to clearly delineate sub-sectors and industries that are placed at the forefront of industrial activity. This report has attempted to address this by decomposing industrial growth.

The results have revealed that large scale manufacturing is the main contributor to manufacturing sector growth. Manufacturing growth in turn determines industrial growth in a large part. Based on the analysis, the report has mapped the performance of the major large scale manufacturing industries of Pakistan. Industries like iron & steel products, fertilizers, coke & petroleum, chemicals, pharmaceutical, and non-metallic mineral products have posted high average growth rates for the last years. These industries should be incentivized through pro-business measures.

Several pro-business measures have been introduced in economic zones in Pakistan. While many exemptions and incentives have been granted to industries in these zones, frequent withdrawal of such exemptions are also observed in few instances. This, coupled with the fact that infrastructural and logistical impediments also exist, economic zones in Pakistan have mostly failed to realize their true potential. The report has highlighted that the newly approved and upcoming CPEC SEZs may actually add up to the list of failed SEZs.

The over-reliance on few industries is observed in both domestic credit and foreign direct investment. However, the breakdown of foreign direct investment has undergone a change. After having dominated by communication sector and financial business, foreign direct investment is increasing headlined by power sector and oil & gas exploration. Domestic credit, on the other hand, has witnessed a rather same structure.

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[20]Bilal, A. A milking tax. The News, 12th June, 2016.

Finally, the report has highlighted that policies by the government in favor of few industries hinder competition which reduces productivity. Hence, there is a need to ensure fair play through across the board business-friendly policies.

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