

# Private investment still elusive

THERE is a need to downsize the government by means of its steady withdrawal, especially that of the federal government, from many of the functional responsibilities that it has taken upon itself. The functions so relinquished should either be organized by the private sector or should be hived off to lower formations of government by reducing the multiplicity of agencies engaged in similar activities.

In particular, the government continues to devote a disproportionate share of its resources to activities that would be more efficiently looked after by the private sector. All this, combined with endemic governance problems, has resulted in accumulated losses of public sector enterprises crossing Rs. 400 billion with an annual addition of almost 1.5 per cent of GDP to this number.

It was assumed that lower interest rates (the average rate on lending having come down by close to six percentage points since June 2001) would provide a stimulus to both production and consumption and hence counter the recessionary symptoms in the economy. Commercial enterprises were expected to borrow at low interest rates to expand productive activities while consumers were expected to be lured by bank credit on easy terms to buy consumer goods like motor cars, motorcycles, air conditioners, freezers, etc. There were increases on both counts, although much more prominent in the case of the latter.

A disturbing feature of the improved availability of credit and higher industrial growth this year is that whereas in theory, deregulation and liberalization should result in investment in sectors in which we have a comparative advantage, in our case,

it has led to investments in the manufacture/assembly of motor cars and motorcycles (growth in excess of 45 per cent over last year), refrigerators (23 per cent), TVs (59 per cent), polyester, sugar (14 per cent) — in none of which we have comparative advantage.

For far too long have exports been viewed more from the point of view of their importance to our balance of payments than in terms of their role in economic growth. With GDP expected to grow by five per cent and export growth for the year estimated at around 21 per cent, if exports had not increased at this pace, GDP growth would have been below 4.7 per cent.

Unfortunately, this budget has not done enough to support exports. There are essentially the worn-out, hackneyed, promises that customs clearance of goods would be ensured within 48 hours, that GST refunds would be processed on a timely basis, that the effectiveness of the duty and tax remission on export scheme will be improved and that private enterprises would be subjected to a gruelling sales tax audit only once a year. The quantum of benefits expected to accrue will depend on the manner and effectiveness of these measures.

That exports continue to be limited to a few items and that some of the 'increase' in exports was, in fact, money held abroad by resident Pakistanis remitted in the garb of exports are another matter and not the subject of discussion here.

What will be the impact of the budget on the environment for private investment? Apart from the perennial questions of political instability, poor law and order and the chequered history of policy consistency and predictability, the institutional reforms required to create an enabling environment for private investment are yet to be fully spelled out and implemented.

The expectation that as the government reduces its role in

the economy, private domestic and foreign investors would step in and revive investment in the real economy has proved to be misplaced. This hoped-for outcome has actually not come to pass. The government has been left waiting for private investment. It has made desperate attempts with poor results to shift the responsibility for investment from public agencies to private enterprises. The gaps in investment programmes left by the fiscal retrenchment have not been filled by the private sector. Private investment has so far remained subdued at 8.5 per cent of GDP compared with 9.2 per cent throughout the 1990s. As a result, the economy has not returned on a growth path on a steady and sustainable basis, as had been promised after the much publicized structural adjustment programmes.

The whole premise underlying the stabilization programme was that consumption would be cut and taxes increased and the resulting increase in domestic savings would bring about a macroeconomic balance. There has been niggardly achievement on this front. On the contrary, the drastic scaling down of public sector investment has deepened the cut-back in industrial production since demand in many sectors continues to be sluggish.

Lower interest rates, though a welcome development, alone cannot change the environment for industrial growth. Banks have been reluctant to extend more credit because of lack of credit seekers wanting to invest in bankable projects. A better, though somewhat extreme, example of this phenomenon is Japan, where short-term interest rates have been zero for some time but the economy is in recession and facing a credit crunch. We know that banks are today flushed with funds. But the paradox is that bankers want to lend to high quality borrowers who are not looking for credit, but are denying credit to those who need it but are perceived as risky cus-

tomers. Hence, the banking system appears to have become a sophisticated post office for transferring household savings to government at lower interest rates.

Moreover, a moot question remaining unanswered is that with interest rates on deposit having fallen below the rate of inflation, as is the case currently, why would people place their money in the banking system?

It will, admittedly, take time to remove the structural problems that constrain investment — that of lack of an adequately diversified portfolio of skills and a narrow export base, but there are several other irritants that need to be removed speedily to facilitate private investment. Other than subdued domestic and international demand, the regulatory environment and the predatory behaviour of government agencies and functionaries continue to discourage private sector investment.

The cost of doing business is high in Pakistan. One-fifth of the time of entrepreneurs is taken up in dealing with different government departments and agencies. The cost to register a business is 44 per cent of the per capita income, compared to zero per cent in New Zealand, one per cent in the US and UK and four per cent in Norway. Contract enforcement takes a year compared to less than 100 days in New Zealand, Australia, Norway and the UK, while the cost of enforcement is 46 per cent of per capita income compared to one per cent in the US, UK and Canada and eight per cent in Australia.

Finally, a major hurdle to growth is the legal system and the dysfunctional and outdated bureaucratic mechanisms which not only cause delays because of the emphasis on procedures rather than on substance but are also unable to respond quickly to the demands of rapidly changing international trading systems.

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