From Swimming in Sand to High and Sustainable Growth

A roadmap to reduce distortions in the allocation of resources and talent in the Pakistani economy

Pakistan's
Country Economic Memorandum

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Abbreviations and Acronyms

AD	Aggregate demand
AOP	Association of Persons
APO	Asian Productivity Organization
AWD	Alternate Wetting and Drying
BBRI	Better Business Regulation Initiative
BBS	Bangladesh Bureau of Statistics
BOI	Board of Investment
BOP	Balance of Payments
CCP	Competition Commission of Pakistan
CEO	Chief Executive Officer
CMI	Census of Manufacturing Industries
CRA	Corporate Rehabilitation Act
DDT	Duty Drawback of Taxes
DLTL	Drawback of Local Taxes and Levies
DTRE	Duty Tax Remission for Exporters
EAP	East Asia and Pacific
EDD	Exporters Dynamics Database
EFF	Extended Fund Facility
EFS	Export Finance Scheme
EMDE	Emerging Markets and Developing Economies
EOBI	Employees Old Age Benefits
ETD	Economic Transformation Database
EWRF	Electronic Warehouse Receipt Financing
FBR	Federal Board of Revenue
FDI	Foreign Direct Investment
FETI	Female Exclusive Training Institute
FGCC	Faisalabad Garment City Company
FLFP	Female labor force participation
FP	Färe-Primont
FTA	Free Trade Agreement
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GGDC	Groningen Growth and Development Center
GHG	Greenhouse Gas
GSMA	Gender Survey of Mobile Access
GST	General Sales Tax
GVC	Global Value Chain
HBW	Home-Based Work
HGF	High-Growth Firms
HIES	Household Integrated Economic Survey
HS	Harmonized System
ICT	Information and Communications Technology

IFC	International Finance Corporation
ILO	International Labor Organization
IMF	International Monetary Fund
IO	Input-Output
IQR	Interquartile Range
IT	Information Technology
JDSC	Jobs Group JD Standard Code
KLEMS	Capital, Labor, Energy, Materials and Purchased Services
KP	Khyber Pakhtunkhwa
LFP	Labor Force Participation
LFS	Labor Force Survey
LMIC s	Low and Middle-Income Countries
LFP	Labor force participation
LSMS	Living Standard Measurement Survey
LTFF	Long-Term Financing Facility
MFN	Most-Favored Nation
MME	Multi-Model Ensemble
MOC	Ministry of Commerce
MOF	Ministry of Finance
MoIP	Ministry of Industries and Production
MoITT	Ministry of Information Technology and Telecommunication
MUB	Manufacturing Under Bond
NTM	Non-Tariff Measure
NTB	National Information Technology Board
NTD	Non-Traditional Destinations
OECD	Organisation for Economic Cooperation and Development
PBC	Pakistan Business Council
PBS	Pakistan Bureau of Statistics
PCT	Patent Cooperation Treaty
PKR	Pakistani Rupee
PLF	Publicly Listed Firms
PPF	Production Possibilities Frontier
PPML	Poisson Pseudo Maximum Likelihood
PPP	Purchasing Power Parity
PSC	Private Sector Credit
PSLM	Pakistan Social and Living Standards Measurement Survey
PWT	Penn World Table
R&D	Research and Development
RER	Real Exchange Rate
ROA	Return on Assets
ROE	Return on Equity
SAFTA	South Asian Free Trade Agreement
SAR	South Asia
SBP	State Bank of Pakistan
SCD	Systematic Country Diagnostic
SDP	Size-Dependent Policies
SECP	Securities and Exchange Commission of Pakistan

SOE	State-Owned Enterprise
SP	Sole Proprietorship
SRO	Statutory Regulatory Order
SSP	Shared Socioeconomic Pathways
T&D	Transmission and Distribution
TDAP	Trade Authority of Pakistan
TERF	Temporary Economic Refinance Facility
TEVTA	Technical Education & Vocational Training Authority
TFP	Total Factor Productivity
TFPQ	Total Quantity-based Productivity
TFPR	Total Revenue-based Productivity
UNCTAD	United Nations Conference on Trade and Development
WAP	Working Age Population
WDI	World Development Indicators (World Bank)
WEF	World Economic Forum
WGI	World Governance Indicators
WIPO	World Intellectual Property Organization
WITS	World Integrated Trade Solution
WTO	World Trade Organization
WVS	World Value Survey

Executive Summary

Over the past two decades, Pakistan's per capita GDP growth has been low. Periods of relatively fast growth have been interrupted by the accumulation of external vulnerabilities that tend to result in balance of payments crises, leading to abrupt halts to growth. A model of growth that is driven by consumption and government expenditure rather than by investment and exports is at the core of Pakistan's growth challenge. As identified in 2019 in Pakistan@100: Shaping the Future (2019) report, to become an upper middle-income country by its centenary in 2047, Pakistan needs to accelerate and sustain growth at 6 to 8 percent per year. Three years later and hit by the disruptive effects of the COVID-19 pandemic, Pakistan has diverged further from that outlined path. Thus, achieving the objective of reaching upper-middle-income status by 2047 will require returning to a path of sustained and focused structural reforms.

This report looks at how Pakistan can achieve this path of higher and sustained economic growth. It builds on the analysis and stakeholder discussions conducted as part of the Pakistan@100: Shaping the Future (2019), the Pakistan Systematic Country Diagnostic: Leveling the Playing Field (2020), and the Creating Markets in Pakistan: Country Private Sector Diagnostic (2021), as well as on a wealth of local and international analysis.

The premise of this report is that Pakistan's growth is stunted by its inability to allocate all of its talent and resources to the most productive uses. Underlying that inability are various distortions, either introduced by policy decisions, or unaddressed by them. Distortions can take many forms. Some examples are taxes, subsidies, size dependent industrial policies, trade restrictions or gender norms (Figure E.1). Taken altogether, these distortions create powerful incentives for firms and households to allocate resources in ways that are socially suboptimal, while also discouraging innovation and productivity upgrading.

Distortions affect the way land and capital are allocated. For example, distortions in the form of differences in direct tax rates tend to make it more profitable to invest in real estate relative to manufacturing or tradable services. And because the size of the tradable sector tends to be associated with growth, this reduces growth potential. Within tradables, high import duties make it more profitable for firms to sell domestically rather than exporting. For example, in Pakistan, a 10 percent import duty on a given product increases profits of selling domestically relative to exporting by 40 percent on average. Firms that decide to embark upon export-oriented manufacturing despite these adverse incentives face a further distortion: if they want to innovate, they miss out on export subsidies. It is 80 percent more likely for a potential exporter that decides to export a traditional product (e.g., apparel) to be eligible for an export subsidy, than for one that decides to innovate and export a new product. This is because export subsidy schemes target mostly well-established, unsophisticated export products and can provide up to a 30 to 35 percent boost in profits.[1] In agriculture, for example, subsidies and support prices for specific crops coupled with additional subsidies on key inputs (e.g., water) induce farmers to allocate land to sugarcane rather than diversifying into other crops that would fetch better prices internationally, or that embed less water.

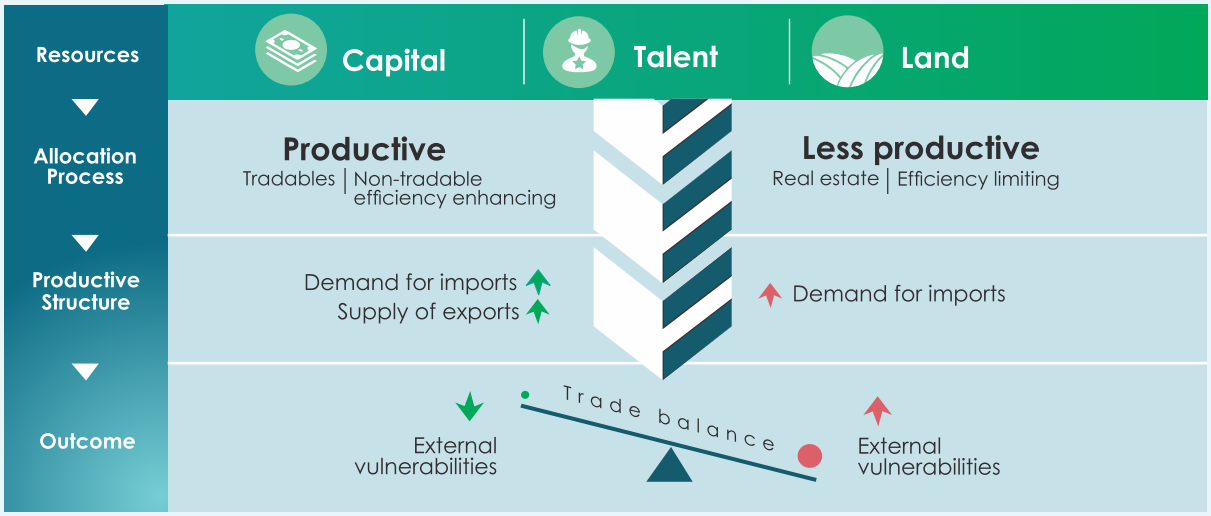
Talent is also misallocated because of distortions. While females in Pakistan have made strides in terms of educational attainment, gender norms often mean that this accumulated human capital is underused because females do not participate to their potential in the labor force. But those who are willing to participate face a coordination problem. Consider first the demand side, in the case of manufacturing. The share of females in total manufacturing employment is only about 4 percent. It therefore may not pay off for firms to make the necessary investments to accommodate female workers (e.g., dedicated spaces in plants, restrooms, transport, etc.) if female employment does not reach a certain level. From the supply side, females might not be willing to work in a factory without dedicated spaces for females (or where there is not a critical

[1] Export subsidies, known as DDT or DLTL have rates of 1, 2, or 4 percent of export values, for a set of eligible products (mostly well-established, traditional, and low-sophistication products). As a share of value added, these incentives can reach up to 30-35 percent in some sectors. See Box 0.5

mass of women working), and then decide to not work at all. The distortion here is related to a market or coordination failure that is in turn associated with a gender norm, and unaddressed by policies (e.g., mandatory dedicated spaces for female workers).

Figure E.1:

PAKISTAN'S GROWTH CHALLENGE: Swimming Out of Quicksand

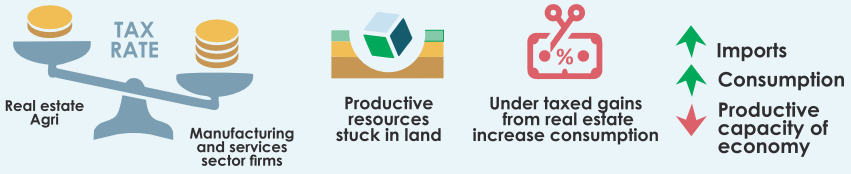


Why is Pakistan stuck in a cycle of repeated external crises?

Distortions have led to a misallocation of resources

Policy induced

1. Under taxation of real estate leads to productive resources being diverted toward a non-tradable sector



Policy induced

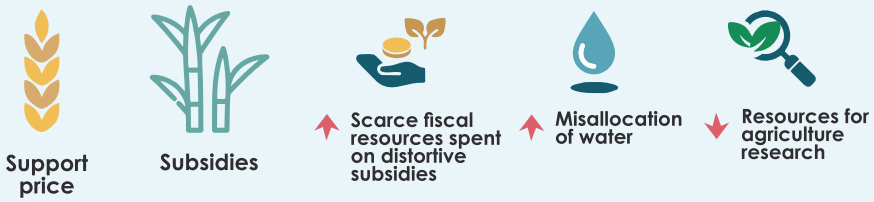
2. Cascading import duties result in 'export substitution'

Norm induced

3. Gender norms limit female labor force participation

Policy induced

4. Subsidies and support prices for certain crops limit diversification in agriculture



This report looks at Pakistan's performance across

...and the impact of distortions on resource allocation in these three areas, and hence Pakistan's overall growth performance

This report focuses on how Pakistan has performed in three areas that are at the core of the growth process: productivity, growth of firms and investment, and female labor force participation. It presents new evidence on firms' productivity dynamics across different sectors of the economy, the patterns of firms' growth and investment, and the allocation of female talent. It focuses on how the decisions of firms- farms- or individuals are shaped by some crucial distortions that exist in Pakistan and proposes several policy reforms or interventions to eliminate or reduce the extent to which these distortions lead to resource and talent misallocation. It is structured into seven standalone chapters (or policy notes) that summarize analyses conducted in seven background papers. The main findings of these chapters are summarized below.

The first section focuses on productivity dynamics across sectors, and its main drivers.

Aggregate productivity in Pakistan has been stagnant or declining during the past decade, mostly driven by firms and farms becoming less productive over time. The COVID-19 pandemic exacerbated the decline in firms' productivity, with a contraction of 23 percent in 2020.[2] Productivity declines are seen across different types of firms located in different parts of the country, though stronger contractions can be identified for family-owned firms. In the agriculture sector, focusing on Pakistan's main crops, while yields have grown over the past decades, this has been due to a more intensive use of inputs. At the same time, total factor productivity has been falling for most crops, although, in this case, with provincial heterogeneity: Punjab and Sindh have been relatively good performers, compared with Khyber Pakhtunkhwa (KP) or Balochistan.

Allocative efficiency gains – visible in the reallocation of resources away from low productivity and into high productivity firms – have not been strong enough to compensate for declining within-firm productivity. Among studied firms, some allocative efficiency gains were observed, although these were modest. In agriculture, the analysis of farms in Punjab shows instead systematic allocative efficiency losses over the period, with resources flowing from high to low productivity farms. The empirical analysis in the report is complemented with a theoretically grounded quantification of distortions that shows that the aggregate productivity gains of eliminating distortions stand at 30 percent, with about 18 percent due to the improved allocation of resources and 12 percent due to the entry of more firms into productive activities.

A substantial portion of firms' productivity decline is related to Pakistan's inward turn.

On the export side, the report unveils a significant productivity premium for exporters that is linked both to the selection of better performers into export markets and to learning by exporting. However, during the period of analysis the share of exporting firms in the economy fell, as did the share of exports in the total sales of those firms that continued to export. The export-productivity link points to the importance of export promotion, but the results of an impact evaluation of one of the most important export promotion policies in Pakistan: the Duty Drawback of Taxes (an export enhancement, or subsidy scheme) show a small positive impact overall and a high cost/benefit ratio. It also shows that the scheme induced the reallocation of exports toward products that were eligible for high-subsidy rates, and that also happened to be well-established and low sophistication products. Thus, the scheme exacerbated the limited diversification that the export bundle has shown over the past two decades.

On the import side, high import duties, particularly on intermediates have negatively affected firms' productivity, as well as sales and wages. While much of the world embraced the global value chain (GVC) 'revolution', Pakistan increased its trade costs instead. Import duties, for example, increased from 15 percent on average in FY10 to a maximum of 21.3 percent in FY20, implying higher costs of importing intermediates and capital equipment. Between 2012 and 2020, all sectors in manufacturing experienced increases in import duties on their relevant intermediates. New evidence presented in Chapter 3 shows that increases in import duties in upstream sectors have reduced the productivity, sales, and wages of firms downstream. A 1 percent increase in upstream duties is associated with a 0.6 percent decline in productivity downstream, a 0.5 percent reduction in sales, and a 0.6 percent reduction in wages. Results also show that schemes that

[2] Available data do not allow to check whether there was a rebound in 2021. However, it is likely that this was the case.

provide exemptions on duties paid by exporters on imported intermediates have not been fully effective in insulating them from import duty distortions because they have not been accessed by all exporters. Smaller exporters find it cumbersome to file for duty exemptions because of administrative burdens and lengthy processes that act as a fixed cost and disproportionately affect small firms. Thus, the negative productivity effects of upstream import duties on firms downstream are the largest for small exporters, but negligible for large ones.

The last chapter in the section turns its attention to productivity in a key sector from the point of view of employment, poverty reduction and export orientation: agriculture.

The farm and district- level analyses for the agriculture sector show that climate change poses a threat to Pakistan's agricultural productivity.

Crop productivity in Pakistan is highly susceptible to elevated temperatures and rainfall variations, putting the crop segment at severe risk due to climate change. Crops tend to be negatively affected by higher maximum temperatures (wheat and sugarcane, in particular). On the other hand, higher minimum temperatures negatively affect wheat and rice, while they benefit sugarcane yields. More abundant precipitations and humidity tend to negatively affect yields across all crops (the link between precipitation and sugarcane being the only exception), and wind negatively affects rice and sugarcane yields. These estimates, coupled with the experience of the devastating impact of extreme climate events on agriculture output and yields, and the fact that climate change will make extreme temperatures more common, point to the importance of investing in technologies that contribute to adaptation to climate change.

The second section turns its attention to the challenge of private investment, the role of FDI, and the links between investment and firms' growth in Pakistan

Part of the decline in productivity is associated with low investment rates, particularly in tradable and productive sectors, which leads to limited growth of firms. Private investment rates in Pakistan declined from an average of 14 percent of GDP in the 2000s, to 11.1 percent in the 2010s. Foreign direct investment (FDI) did not contribute to boosting investment either, as it has remained below 1 percent of GDP over the past decade. In manufacturing, once depreciation of worn-out capital is netted out, investment rates as a share of value added were at 9 percent country-wide, according to the latest Census of Manufacturing Industries, but can be as low as 1 and 3 percent in Balochistan and KP, and 11 and 8 percent in Punjab and Sindh.

Pakistani firms are smaller in size than in most comparator countries, and struggle to grow. Large productive firms in low- and middle-income countries tend to be more innovative, export more, provide more training to their workers, and are more likely to use internationally competitive technologies and standards. However, Pakistan shows lower-than-average proportions of very large firms. In the export sector, this is especially apparent. International evidence shows that 'export superstars' are the ones driving export growth and diversification. However, on average, exporters in Pakistan are small. For example, an average Pakistani merchandise exporter ships US$1.4 million worth of merchandise a year, while the average Bangladeshi merchandise exporter ships US$3.8 million. For knowledge-intensive services, the typical Pakistani exporter is about two thirds the size of the typical merchandise exporter. However, economies of scale in knowledge intensive services are likely not to be as important for competitiveness as in merchandise. Relatedly, firms' growth patterns are less dynamic in Pakistan than elsewhere. In Pakistan firms struggle to grow large as they grow old. A young, formal firm in Pakistan that has been in operation for 10 to 15 years is about the same size as a firm that has been in operation for more than 40 years. Instead, in better functioning markets, evidence shows an 'up-or-out' dynamic. Firms either grow or exit. In Pakistan, and again focusing on exporting firms, the results show that the probability of a small exporter becoming large within a five-year period is lower than observed in comparators such as Egypt, Bangladesh, or China. Limited growth of firms is in part related to the fact that Pakistan relies extensively on size-dependent policies, which create incentives

for firms to stay small, de jure or de facto, and also because the Government of Pakistan actively borrows from the banking sector, crowding out private sector investment, and therefore firms' growth.[3]

Part of the borrowing of the Government that crowds out private investment is used to support firms that may be unviable without state support. Pakistan exhibits a relatively large share of firms known as 'zombies', that is, firms that are loss-making for at least three consecutive years (in 2016, Pakistan had the highest share of zombie firms among comparator countries). State-owned enterprises (SOEs) and family-owned domestic firms are more likely to be zombie firms, according to this definition, and to display low investment rates. Compared with non-family-owned domestic firms, state-owned and family-owned firms realize 6.7 and 3.9 percentage points lower profits than comparable non-family-owned private domestic firms. The fact that these zombie firms survive, rather than being liquidated and releasing resources to more productive and profitable firms, is indicative of distortions related to soft-budget constraints (e.g.: government assistance to SOEs), subsidies, weak competition, and inadequate insolvency regimes. In the case of SOEs, a large portion of them operate in upstream sectors such as transport, financial or energy, which implies that their inefficiencies spillover the rest of the economy through input-output linkages.

High profitability, however, is not necessarily associated with high productivity but instead with high protection. Firms in sectors protected from import competition realize higher financial returns than those operating in low protection environments, for a comparable level of productivity. Indeed, an increase in import duties by 1 percentage point increases profit margins by 4 percent on average.[4] These firms operating in protected sectors also display lower export as a share of their revenues and employees, compared with those operating in more open sectors. This is consistent with the fact that import duties implicitly act as export taxes, by providing a relative profit boost to domestic sales.

To increase investment rates and bring in large firms that could add dynamism to markets, the country could leverage its untapped FDI potential – estimated at US$2.8 billion annually. Pakistan's untapped FDI potential is estimated at around US$2.8 billion per year. Tapping that potential would lead to more than doubling current inflow levels. This estimated untapped potential FDI does not imply a ceiling but rather what would be expected given Pakistan's characteristics, and average policies and implementation capacity. However, attracting export oriented, or efficiency enhancing FDI will require active policies to reduce trade costs, streamline the regulatory environment, and reduce policy uncertainty. Currently, the type of FDI in Pakistan is mostly inward oriented, with limited productivity spillovers to the rest of the economy. Evidence presented in Chapter 6 shows that in Pakistan there are positive but limited productivity spillovers from FDI in upstream sectors. These spillovers are associated to FDI in efficiency enhancing upstream services, and accrue disproportionally to less advanced firms, suggestive of a process of learning. There is no evidence of horizontal FDI spillovers.

The final section moves the focus away from firms and farms onto individuals and examines how talent is being allocated. It focuses specifically on female labor force participation.

Fast and sustained growth requires tapping into all of Pakistan's talent and allocating it to its best use. However, Pakistan displays far lower female labor force participation (FLFP) rates than expected for a country at its level of development. In 2019, there were only two countries in the lower-to-middle per capita GDP range and nine overall with lower FLFP rates than Pakistan. In addition, for those women who do participate in paid employment, constraints limit their set of employment options. Altogether, this leads to a misallocation of talent.

Pakistan can accrue GDP gains ranging between 5 and 23 percent by closing the female employment gap relative to its peers, depending on the extent of implementation of complementary labor market policies. Chapter 7 presents new analysis on female employment and GDP gains for Pakistan if the country were to close its female employment gap relative to Bangladesh and a hypothetical country representing an

[3] Pakistan's banks' exposure to sovereign debt measured as the ratio of banks' sovereign debt holdings to total assets was above 40 percent in 2021, the highest across all countries analyzed (source: Fitch Connect, IMF Financial Soundness Indicators, Monetary and Financial Statistics, and World Economic Outlook databases).

[4] This is consistent with the typical manufacturing sector's share of value added in output being one third, and the profit share of value added being in turn two thirds.

average for lower middle-income countries.[5] About 7.3 million new jobs would be created if Pakistan were to close its female employment gap with Bangladesh, and the share of working age women in employment would increase from its 2018 level of 22 percent to 34 percent.

In Pakistan, educational attainment and FLFP show a U-shaped relationship, which largely disappears when soft connectivity improves. Working age women who lack formal education or who have very high levels of education are more likely to participate in the labor market, while medium levels of educational attainment are associated with lower FLFP. Poverty trumps gender norms associated with low FLFP (as poor households tend to also have low educational attainment), while these gender norms affect fewer households with higher incomes where women's educational attainment tends to be higher. For intermediate levels, supply and demand constraints are at play constraining FLFP. On the supply side, gender norms are likely more binding than at higher levels of educational attainment. On the demand side, jobs for women at these levels of education might not be available (not only because of possible biases in hiring, but also because of additional costs that employers face in the form of segregated spaces, restrooms, or provision of safe transport).[6] Connectivity helps increase options for female employment because it reduces the costs of working remotely, helps expand certain services sectors, improves education tools at schools and in homes, and increases exposure to a more diverse set of views. Indeed, the results in Chapter 7 show that improved connectivity, in the form of high internet penetration at the district level is particularly beneficial for women with medium levels of education. Overall, FLFP in Pakistan is constrained by both demand and supply side factors and a multi-pronged policy approach that looks at both factors is needed to bring about change.

Based on these results, this report outlines a transformative reform agenda that could offer substantial payoffs to Pakistan, and that focuses on improving the way resources and talent are allocated. The reform agenda has been made even more relevant by the global conditions that Pakistan's economy currently faces. The aftermath of the COVID-19 pandemic has triggered supply chain disruptions that have increased costs of production and fueled inflation in developed and developing countries alike. Central Banks in advanced economies have responded by tightening monetary policies, thus tightening global financial conditions, and incentivizing a flight to quality that will likely increase the bar in terms of attracting investment. The war in Ukraine has added still more pressure through increased commodity prices that increase inflation and fiscal and external vulnerabilities. In this context, a reform agenda that reduces distortions to improve resource allocation and productivity upgrading is of paramount importance.

The proposed reform agenda needs to be implemented in a sequenced manner to internalize Pakistan's complex political economy.

The distortions in place in Pakistan are to a large extent the result of powerful 'insiders', albeit limited in number, who influence the policy-making process to maximize their own benefits.[7] In agriculture, for example, these are large landowners that benefit from subsidy schemes or underpriced inputs for a narrow set of crops (e.g.: sugar or wheat). In domestic-oriented manufacturing, these are large businesses that secure import protection, often at effective rates above 100 percent. In export-oriented manufacturing, these are large exporters of well-established products, such as textiles and apparel, that receive a disproportionate share of export subsidies, including Drawback of Local Taxes and Levies (DLTL), Export Finance Scheme (EFS) and Long-Term Financing Facility (LTFF), and in some cases also subsidized energy. In services, these are financial institutions that finance large portions of relatively low-risk government debt, or real estate related sectors that face a reduced tax burden relative to other sectors of the economy.

Distortions are often at the expense of a larger group of outsiders, and fundamentally, at the expense of fast and sustained growth. 'Outsiders', in this context can be largely defined as those not benefiting from

[5] Bangladesh was chosen for the analysis as both Pakistan and Bangladesh are at a similar level of development, display similarities in the employment patterns for men and share cultural preferences and norms that result in fewer women seeking employment in specific sectors, such as the services sector.

[6] In manufacturing, for example, female employment is extremely low. The latest Census of Manufacturing Industries conducted in 2015/16 shows female employment was only 4 percent of total employment. Visits to manufacturing establishments during the preparation of this report revealed that it is the more sophisticated firms that have active interventions to increase FLFP, including the provision of safe and dedicated transport, dedicated space in the plant and in some cases even childcare

[7] For a more detailed discussion on insider-outsider dynamics in the political economy of reforms in Pakistan, see World Bank, 2020: Pakistan Systematic Country Diagnostic.

preferential conditions that these distortions introduce for the insiders. These are, for example, consumers that pay higher prices due to high import protection, subsistence agriculture farmers that do not benefit from high procurement prices or subsidies on output or inputs, micro or small enterprises that are de facto excluded from subsidy schemes or tax exemptions because of the complexity of the schemes (e.g. the Duty and Tax Remission for Exporters, DTRE), those enterprises (existing or potential ones) that are de jure excluded because they export non-traditional products (e.g. in the cases of DDT and DLTL that mainly focus on traditional export products), or females that face disproportionate costs to participate, inter alia, in the labor force.

These insider-outsider dynamics make reforms to level the playing field extremely challenging, requiring both strong political leadership and civil society. A three-step approach is proposed, that starts with reforms to level the playing field through the removal or reduction of distortions, followed by interventions to support growth in the context of a more level playing field. Finally, to ensure the sustainability of these changes, there is a need for increased evidence-based policy-making and greater transparency, so that the civil society has the elements needed to demand efficiency-enhancing reforms. This Executive Summary presents key recommendations while the full set of recommendations and their proposed prioritization can be found in the Overview as well as in each of the chapters.

First, remove distortions to improve aggregate productivity through a better allocation of resources, by focusing on:

- **Tax policy:** Widen the tax net, harmonizing tax rates across sectors, to ensure a level-playing field and facilitate the reallocation of resources from non-productive non-tradables (e.g. real estate) and into more productive sectors (tradable or efficiency enhancing non-tradables).

- **Trade policy:** Gradually reduce the anti-export bias of trade policy by reducing import duties, to facilitate the reallocation of resources, from domestic to outward oriented activities.

- **Export schemes:** Expand eligibility of export subsidies to favor export growth and diversification.

- **Size-dependent policies:** Re-consider size dependent industrial policies, to reduce incentives for firms to stay small de jure or de facto.

- **Agriculture subsidies:** Gradually phase out subsidies and price support in the agriculture sector, to facilitate a market-based allocation of land, labor and equipment based on comparative advantage, and re-allocate the created fiscal space toward investment in climate smart technologies and infrastructure for crops and livestock, and agriculture extension services and research.

- **Working conditions for women:** Enact gender unbiased hiring policies, enforce existing legislation on work-place harassment, and consider wage subsidies to boost female employment at intermediate skills levels, to improve the allocation of talent in Pakistan.

- **Female transport:** Invest in safe, dedicated transport and improved soft connectivity to facilitate remote work, to boost female labor force participation and productivity more generally.

Second, to ensure maximum positive impact of the alleviation of distortions, consider the following complementary reforms.

- **Fiscal space:** Crowd in, rather than crowd out private investment by increasing the tax base and the efficiency of spending (including SOE reform ranging from improved governance and management to privatization in areas in which firms are not viable and state involvement unrequired), to reduce the borrowing needs of the consolidated government thereby releasing resources for the private sector

to borrow and grow.

- **Credit:** Reallocate subsidized financing for exporters away from working capital (the Export Finance Scheme) and into investment and innovation focused financing (the Long-Term Financing Facility).

- **Managerial practices:** Re-allocate funds away from current unconditional subsidies to exporters, into support on a cost-share basis aiming at upgrading firms' managerial practices, with a focus on those with export potential, and subjecting interventions to impact evaluations, to assess impact and possibilities of their scaling up.

- **Business climate:** Reduce regulatory complexity, harmonize the general sales tax (GST) across provinces, and business licensing and registration processes to reduce costs of doing business.

- **Investment framework:** Harmonize investment laws to attract more foreign direct investment.

- **Insolvency regime:** Upgrade insolvency laws to reduce the costs of liquidating unviable firms.

Third, subject all interventions that entail the use of public funds to rigorous impact evaluations, and create a dynamic loop from evidence to policy making. Engage academia to link to the public sector and make data on direct support to firms or individuals as transparent as possible.

- **Costing of expenditures**: Mandate by law that all tax expenditure and subsidy proposals are properly costed before reaching decision-making stage and make the results of the costing public.

- **Feasibility Analysis in PSDP Process**: Encourage the participation of academia in the consideration of Public Sector Development Program (PSDP) from Central and Provincial Development Working Party (CDWP), to ensure a rigorous assessment of project feasibility.

- **Impact evaluations in large PSDP projects & Export Development Fund (EDF)**: Mandate by law impact evaluations of PSDP projects as well as EDF allocations that incur in substantial expenditures of public funds and make the results public.

- **Academia-Public sector links**: To accomplish these recommendations, involve the Academia. Create linkages between academia and the public sector and invest in impact evaluation capabilities. Start by building capacity in this area within the Pakistan Institute of Development Economics, while expanding the network of linkages to other universities and think tanks across the country.