

Booming exports via SMEs

This is a summary of the key findings of the report, 'Enhancing Exports & Strengthening SMEs', presented to the sub-group of the Economic Advisory Council (EAC) on 'Competitiveness and Exports' in 2018. The approach and recommendations if implemented, could help accelerate growth of Pakistan's exports and its SME sector, in turn supporting employment generation and overcoming the chronic balance of payments problem towards more sustainable economic growth.



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Growth in exports is linked primarily to the performance of the country's manufacturing sector. The Government of Pakistan is keen to pursue a broad-based, inclusive strategy to enhance exports and at the same time strengthen Small Medium Enterprises (SMEs) while generating employment and growth.

Prioritise firms that can generate growth: These objectives can be best achieved by expansion of industries that a) are export oriented (or can potentially become), b) have higher labour to capital ratio, c) are energy efficiency, and d) have a high concentration of SMEs. Several industries have these qualities and include sectors such as garments, light engineering/electrical (i.e. auto parts and components, pumps, fans, motors, surgical instruments, cutlery, etc.) and sports and leisure goods. These sectors must be prioritized as part of any strategy aimed at reviving the manufacturing sector achieving the above-mentioned targets of promoting SMEs for broad based development objectives.

Focus on medium sized enterprises: To promote exports via SMEs, policy focus should predominantly be on medium-sized enterprises (as opposed to small ones) as they are more responsive to government policies around deregulation, improving access to finance, skills training, etc. Small enterprises usually operate outside the regulatory framework making it very difficult to reach through the formal system. Such firms are also less dynamic as they are more focused on survival than expansion and growth. Emphasis on medium enterprises, that are generally better resourced, faster growing, more productive and likely to export, will also benefit smaller enterprises. Small firms connected to larger firms in the cluster are more likely to be subcontracted and through that process be driven to growth and movement up the technology ladder.

Create new industrial hubs: It is also critical to shift manufacturing, largely concentrated in Karachi and central Punjab, towards other parts of Pakistan for broad based development. This can be achieved by identifying and supporting economic activities (such as fisheries and agribusiness/horticulture) and SMEs in sectors and areas important in other regions of the country.

Revive east-west trade corridors: Improving trade with Afghanistan can also enhance exports while having a wide and geographically dispersed impact. Historically Afghanistan has been a major trading partner for the north-west region of Pakistan with Peshawar as the transit hub of regional trade. Realizing this potential for expanding trade with Afghanistan will not only enhance



Pakistan's exports, but also generate employment and promote development of SMEs in KP. Government will need to implement practicable export procedures, along with investing in logistical infrastructure at the border, including developing a modern truck port and custom clearing facility.

Policy direction

However, export growth is not only reliant on industrial expansion, a critical first step, but also on removing key determinants hampering competitiveness of Pakistani exports. An overvalued exchange rate, transportation delays, and high input costs can cause exporting firms significant loss in profitability. The regulatory burden of such factors is especially excessive for SMEs, not only in the form of direct costs as it raises the cost of production, but also indirectly in terms of time spent by entrepreneurs on dealing with these obstacles rather than on managing production, introducing innovations and finding new markets. Hence, measures must focus on reducing the regulatory burden for export-oriented SMEs.

As long as Pakistani exporters are encumbered by such constraints, it will remain difficult for them to compete in world markets due to the gaps in competitiveness with more developed exporting countries. Some suggestions to strengthen SMEs and enhance exports include particular steps in the immediate and medium-term.

- **Strengthening SMEs** will entail the longer-term goal of institutional reform, oriented towards SME-focused skills training, improving SMEs' access to markets, and promoting industrial clusters. These steps must come under a National SME policy to ensure regulations to register an SME business are simplified and consistent. The immediate concerns of reducing regulatory burden on SMEs and improving access to finance (especially through digitisation) needs urgent treatment. In the longer-term, policies should encourage industries (fisheries, horticulture etc.) outside traditional manufacturing sectors and emphasize regional trade.
- **Enhancing exports** requires a stable exchange rate regime, reliable access to power and gas at competitive prices, rationalization of tariffs and the SRO regime and providing exporters access to intermediate goods and raw materials at world prices. Efficient customs procedures (via single window strategy) and border management (via business-friendly custom clearance units) are also necessary for Pakistan to improve its trade competitiveness, as is the reform of the regulatory compliance regime. Longer term measures can focus on improving productivity, integration in Global Value Chains and leveraging CPEC.