PRAC
POLICY RESEARCH
& ADVISORY COUNCIL

KARACHI CHAMBER OF
COMMERCE & INDUSTRY

STATE OF INVESTMENT IN PAKISTAN

Recommendations:

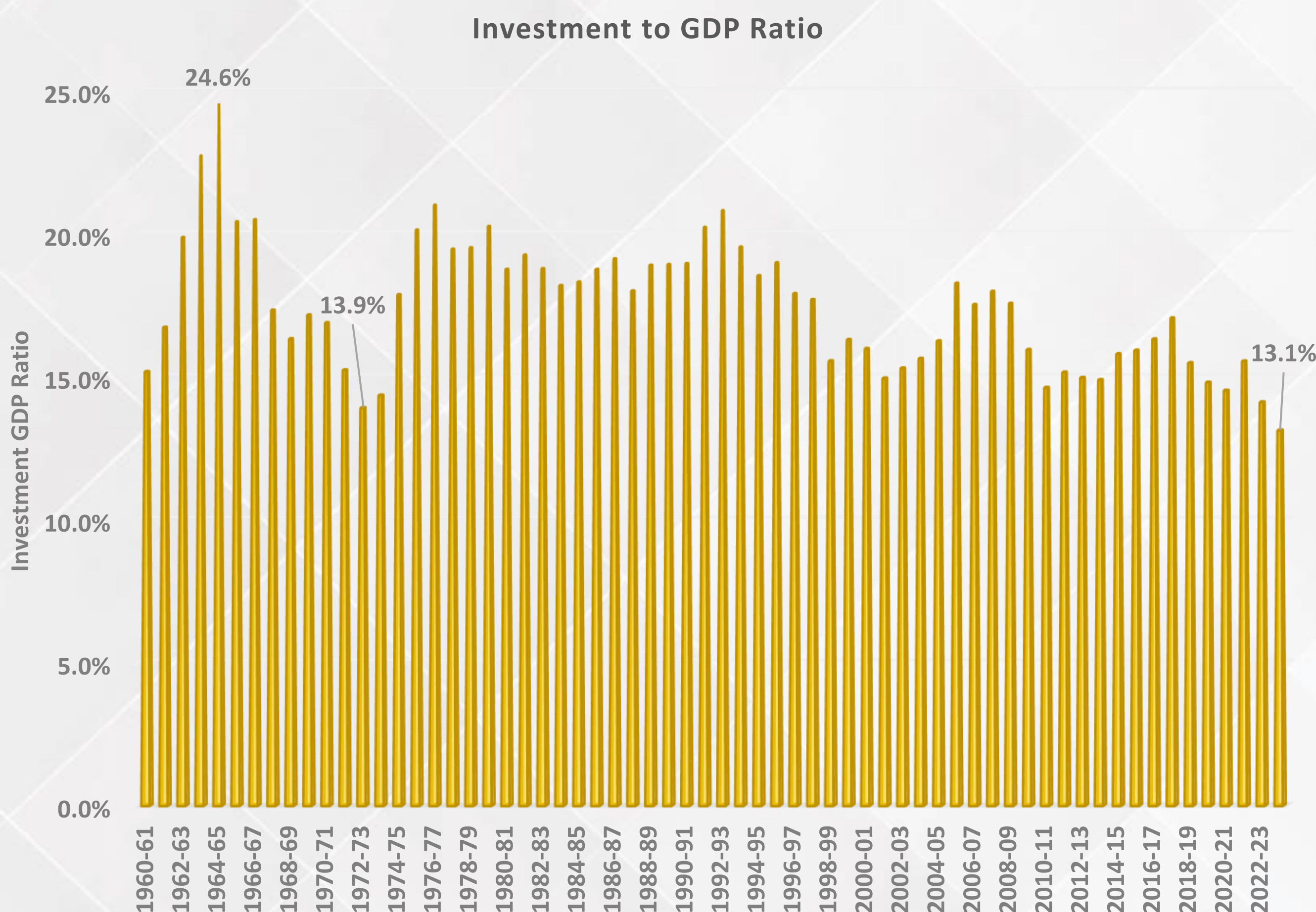
- **Real Economy**: Shift capital from real estate to manufacturing by raising taxes on the real estate sector and promoting Public-Private Partnerships (PPP) to develop critical infrastructure such as railways, roads, highways, warehouses, and ports.
- **Cost of Borrowing**: Lower borrowing costs for manufacturing firms to reduce financial burdens. The State Bank of Pakistan (SBP) should mandate commercial banks to allocate a fixed percentage of credit to large-scale industries, SMEs, and cottage industries.
- **Corporate Tax**: Gradually reduce the Corporate Income Tax (CIT) to 25% for the manufacturing sector, benefiting both foreign and domestic investors. Revive the Export Finance Scheme and reduce taxes on SMEs and Associations of Persons (AOPs).
- **SME Focus**: Implement the SME policy with harmonized definitions. The SBP should increase SME financing and encourage diverse financing options to boost growth.
- **Consistent Policy:** A consistent policy is a crucial factor affecting investment inflows. All policies should be long-term and should have political consensus across parties.
- **Performance-Based Incentives**: Tie industrial incentives to sectoral performance, including production efficiency, technological upgrades, and export success.
- **Efficient Import Substitution:** Raise the investment-to-GDP ratio from 13.1% to 20% by prioritizing sectors like petrochemicals, engineering, minerals, chemicals, leather, food processing, and IT services. Implement an industrial policy focused on efficient import substitution.
- **Promote Exports:** Focus on industry-centric strategies to increase value addition, improve production efficiency, promote technology adoption, and address investment needs.
- **Reduce Input Cost:** Over the next decade, reduce input costs and enhance export competitiveness by liberalizing tariffs on raw materials and intermediate goods. Lower the average tariff from 9.03% to 5% and facilitate duty-free access for industries.
- **Sector-Specific Investment**: Address the lack of sector-specific investment policies to restore industrial competitiveness. Prioritize investment in petrochemicals, light and heavy engineering, minerals, chemicals, and agro-food processing.
- **Private Investment through CPEC**: Leverage the China-Pakistan Economic Corridor (CPEC) to attract private investment. Establish joint venture mechanisms to facilitate collaboration between local and Chinese investors under CPEC, encouraging relocation of export-based Chinese Industry.

1.0 Introduction

Pakistan is grappling with a significant savings and investment challenge, worsened by persistent fiscal deficits that have squeezed the private sector and hindered productivity growth. The country's recurring economic crises can largely be attributed to the government's failure—and reluctance—to broaden the tax base. Consequently, investment in the formal economy, as a percentage of gross domestic product (GDP), is approaching historic lows. To overcome the current crisis, Pakistan's policymakers must encourage the flow of private capital into key sectors like infrastructure. Persisting with incentives for informal investments in areas like real estate has been disastrous. Pakistan must now foster an environment that encourages citizens to invest in the country's long-term development, rather than in unproductive, speculative assets. This shift would not only help formalize the economy but also attract the long-term investments necessary for sustainable economic growth and improved productivity.

Investment as a percentage of GDP in FY24 stands at only 13.1 percent, the lowest in the last 64 years. The highest was recorded in FY65 with an investment-to-GDP ratio of 24.6 percent

Figure:1 Historical Trend Investment to GDP Ratio % (Current Prices)

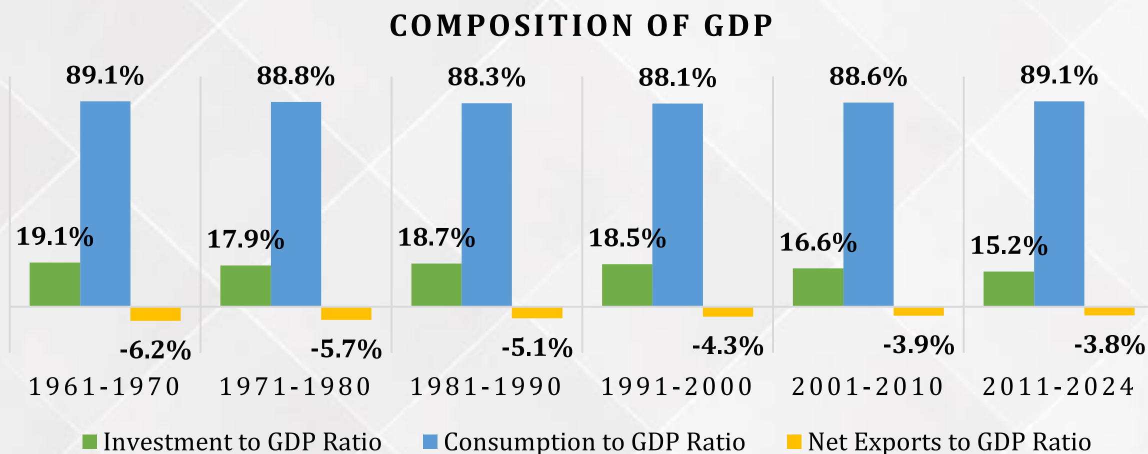


Source: PBS

2.0 Composition of GDP

Pakistan's economy has always been driven by consumption. The contribution of consumption to GDP has remained around 89 percent in every period, whereas the contribution of investment to GDP has been recorded in between 15 to 19 percent. A decade-wise analysis shows that the 1960s recorded the highest average investment-to-GDP ratio, followed by the 1980s and 1990s, with averages of 18.7% and 18.5%, respectively. However, since 2011, the investment-to-GDP ratio has seen a significant decline, averaging just 15.2%—a concerning trend for the country's long-term economic growth.

Figure:2 Composition of GDP (Current Prices)

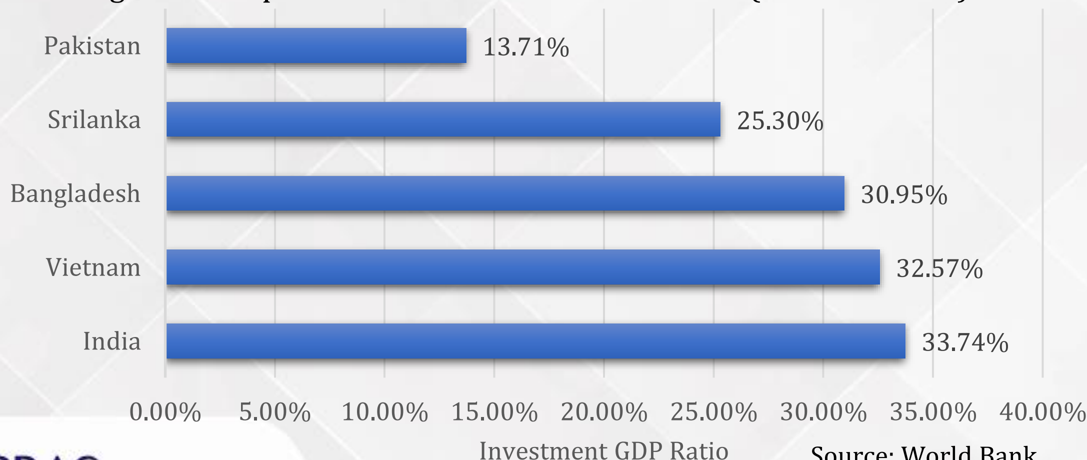


Source: PBS

3.0 Regional Comparison Investment to GDP Ratio

A regional comparison highlights a troubling position for Pakistan. According to the World Bank, in 2023, Pakistan recorded the lowest investment-to-GDP ratio among its peer countries. The South Asian average stood at 31.8%, with India, Bangladesh, and Vietnam reporting significantly higher ratios of 33.74%, 30.95%, and 32.75%, respectively. This underscores Pakistan's considerable lag in investment relative to its regional counterparts, raising concerns about its economic competitiveness in the region.

Figure: 3 Regional Comparison of Investment to GDP Ratio (Current Prices)

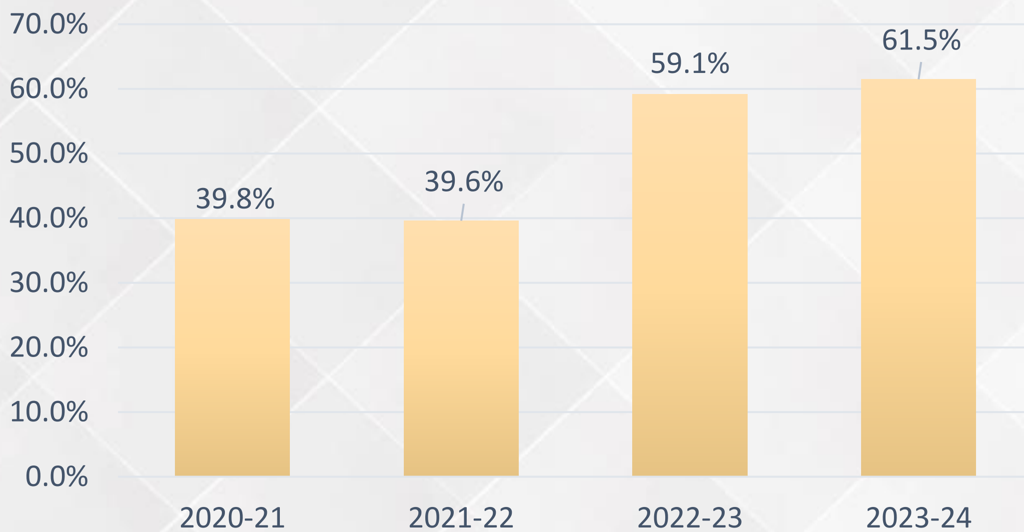


Source: World Bank

4.0 Debt Servicing and Private Sector Credit

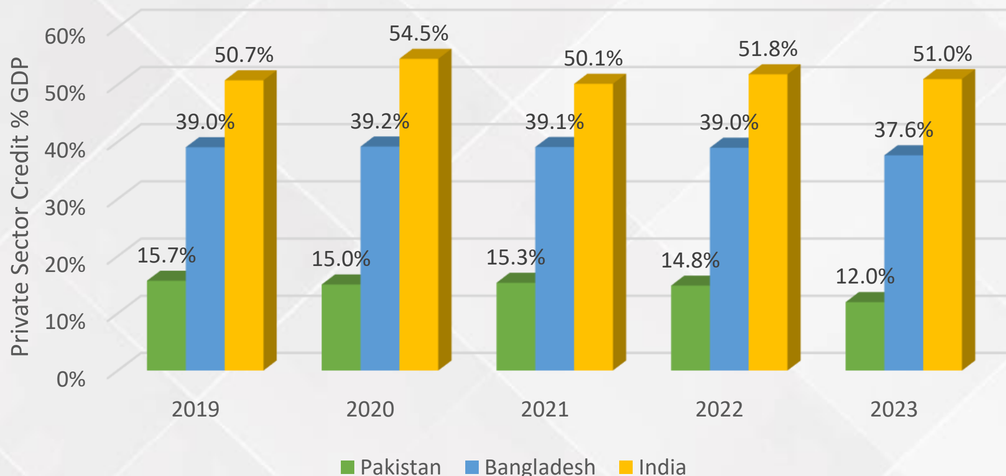
A large portion of investment in Pakistan is driven by public sector spending. However, recurring economic crises have diminished the government's capacity to fund this investment, with over 60 percent of federal fiscal resources now dedicated to debt servicing, and most of the rest going toward covering current expenditures. Consequently, Pakistan's ability to pursue large-scale infrastructure projects without external borrowing is severely limited. This challenge is further worsened by the lack of incentives for formal economic activity, which reduces the capital available within the formal economy, particularly for infrastructure development.

Figure: 4 Debt Servicing (Mark-Up Payments) as % of Total Revenue



Source: SBP

Figure:5 Regional Comparison Private Sector Credit % of GDP

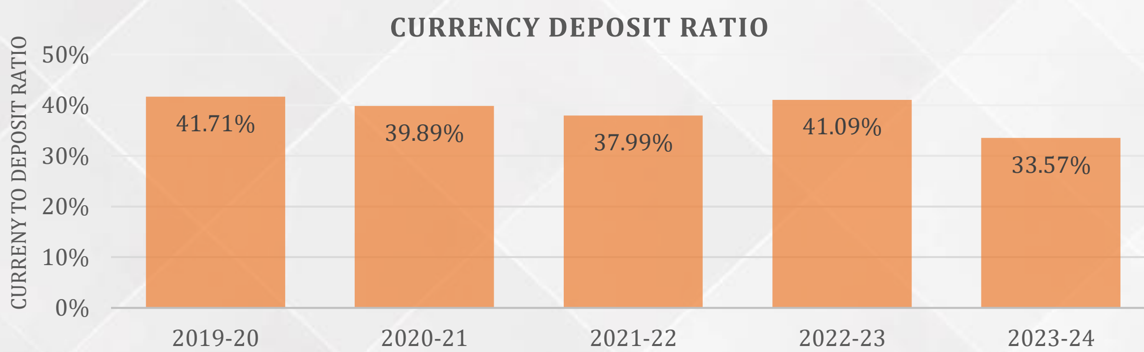


Source: World Bank

5.0 Informal Sector

Pakistan's low investment-to-GDP ratio is largely attributed to its low savings rate. However, this is not due to a lack of willingness among households to save. Instead, many households save outside the formal financial system. With limited financial inclusion and an increasing volume of currency in circulation, a significant portion of savings is channeled into the informal sector, often invested in real estate, gold, livestock, or simply held as cash. This results in a vast pool of capital that remains inaccessible to the formal financial system, depriving it of funds that could otherwise be used for more productive investments. The high currency-in-circulation-to-deposit ratio further indicates that a large amount of cash is being held outside the formal economy.

Figure: 6 Currency in Circulation to Bank Deposit Ratio

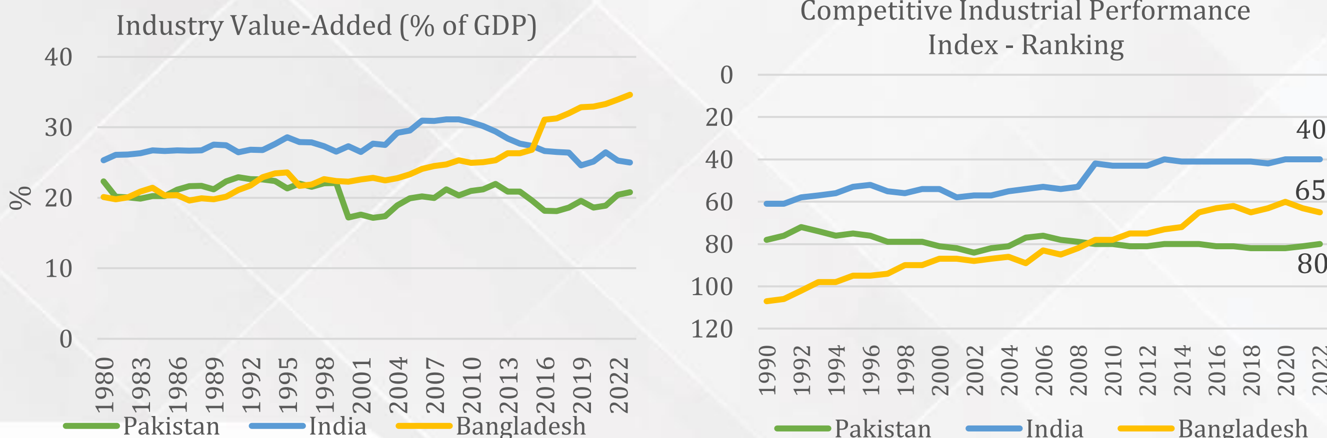


Source: SBP

6.0 Eroding Industrial Competitiveness

Pakistan has experienced significant de-industrialization over the past several decades, with no effective policy intervention to halt or reverse this trend. Over the last 40 years, the industry's share of GDP has declined by an average of 0.6% annually, dropping from 22.3% in 1980 to 20.8% in 2023. Pakistan's ranking on the Competitive Industrial Performance Index (CIP) has also worsened, falling from 78th in 1990 to 80th in 2022 out of 153 countries. In a regional context, Pakistan's CIP ranking is the lowest, with India and Bangladesh ranking 40th and 65th, respectively

Figure: 7 Pakistan's Industrial Sector Competitiveness vs. Regional Countries

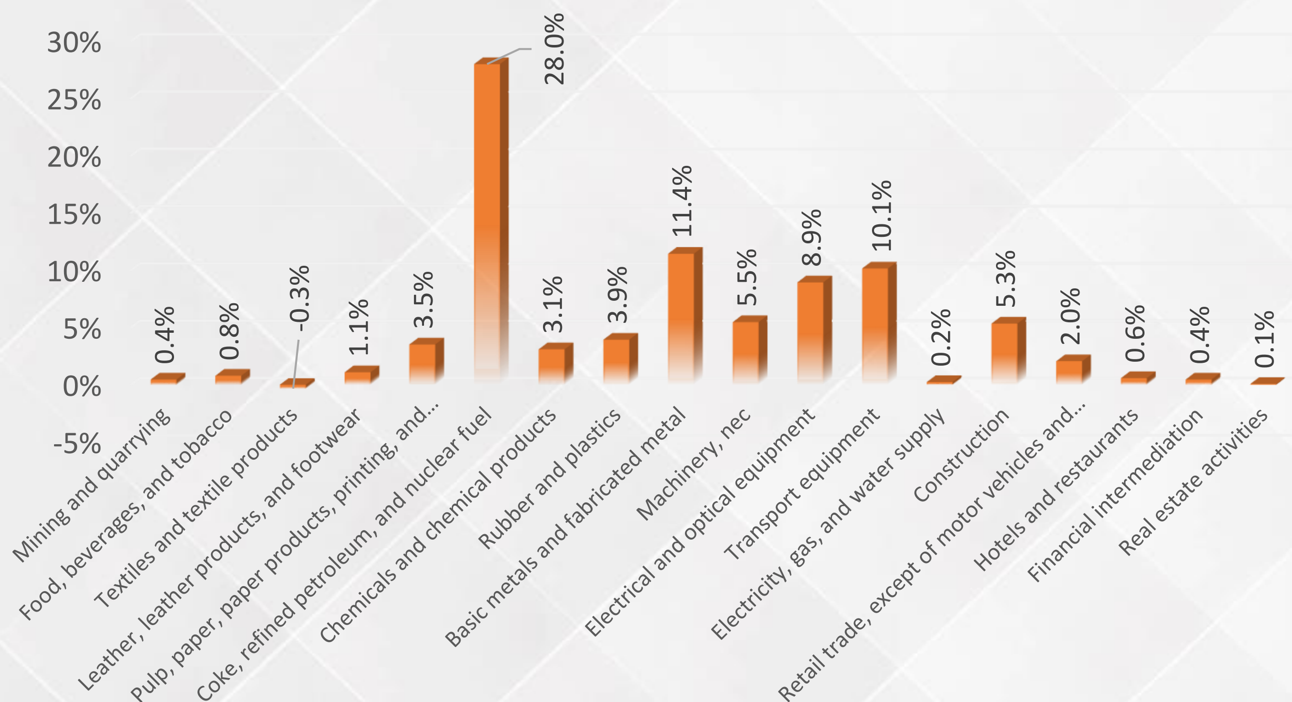


Source: World Bank & UNIDO

7.0 Sectoral Tax to GDP Ratio

The sectoral tax-to-output ratio highlights resource allocation, incentive structures, and profitable industries in Pakistan. As shown below, the booming real estate sector has the lowest tax-to-output ratio among sectors. In contrast, petroleum has the highest, followed by basic metals, transport equipment, electrical machinery, and construction. Sectors with the potential to drive manufacturing growth are facing relatively higher taxes, hindering their development.

Figure: 8 Pakistan's Sectoral Tax to GDP Ratio (2018-22)



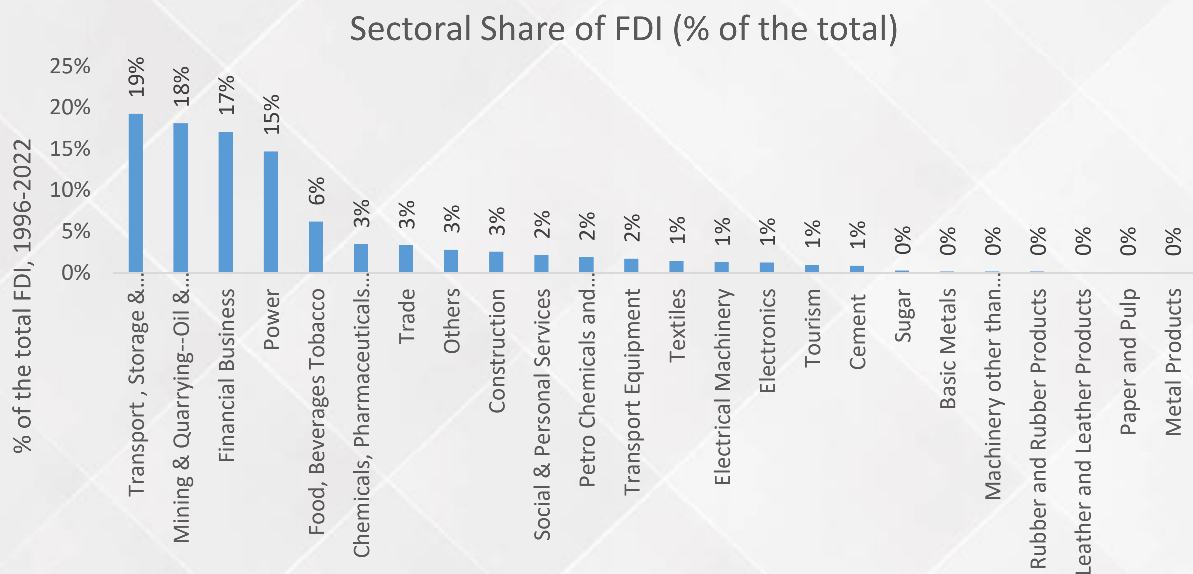
Source: Input-Output Tables (2018-22), Asian Development Bank

8.0 CPEC and Foreign Direct Investment

Pakistan's FDI-seeking approach has been untargeted and too general and needs to be revamped into a more nuanced, two-tiered policy. The current strategy is liberally allowing inward FDI seeking domestic market opportunities without prioritizing high-priority areas such as the export sector, advanced manufacturing, value-added agriculture, and electronics. CPEC has afforded Pakistan a unique opportunity to galvanize private investment and FDI and transform its economy. China is now the largest source of inward FDI in Pakistan cumulatively since 2015, accounting for over 30 percent of the total, with an investment value of US$ 7.2 billion.

However, despite China's high volume of inward FDI during CPEC Phase I, Pakistan has attracted a relatively modest share of around 5 percent of China's outward FDI in BRI countries since 2015, with power generation and infrastructure projects accounting for a large share. The investment interest and momentum from CPEC Phase I does not appear to have carried over into Phase II as yet, or into the manufacturing sector. So far Pakistan also does not appear to have been able to leverage CPEC to catalyze domestic private investment successfully, non-CPEC Chinese investment or attract non-China FDI.

Figure: 9 Share of Foreign Direct Investment in Various Sectors, 1996-2022



Source: SBP

Conclusion

The reforms discussed would help alleviate Pakistan's investment crisis. Reforms would stimulate domestic investments and boost industrial production, thereby increasing exports. Rationalizing taxes would enhance industrial competitiveness, create jobs, and promote long-term economic growth. While these measures are not exhaustive, they can significantly impact resolving Pakistan's stagnant economic development.

(Reforms/Recommendations can be seen on the front page)

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