By the Editor

Hi all!

Soon, we have INFER 2015 coming up and I will take this space to urge you all to register. Get a holistic experience of finance and economics. Who knows? You might even win!

Godspeed!

Midhat Waris

Assistant Editor

This month, Ceteris Paribus brings to you some interesting news items from around the globe. From promising policies on entrepreneurship in Pakistan to prosperity challenges, this issue is informative yet interesting.

Happy Reading!

Zahra Sohail

News Snapshot

- According to IMF, the world economy will grow by 3.5% this year and by 3.8% in 2016.
- GDP growth in China slowed down to 7% in the first quarter of 2015.
- Unemployment rate in UK drops down to record lowest since July 2008, confirmed by official figures.
- Rolls Royce’s first order from Emirates worth £6.1 bn is the largest order to date.
- FedEx is all set to acquire TNT, its Dutch Rival for €4.4 bn offering 33% premium on TNT’s share price.
- Royal Dutch Shell to buy BG Group offering a 55% share premium making it the largest deal of 2015.

“Inflation is the one form of taxation that can be imposed without legislation.”

— Milton Friedman
Entrepreneurship in Pakistan

Written by: Anil Saleem and Talha Nadeem

Entrepreneurship has long been acknowledged as a driving force which propels successful economies. However, the study of entrepreneurship within the discipline of economics did not receive much systematic attention until the twentieth century. Among the pioneering works that set the stage for future research was Schumpeter's (1934) attempt to formally define the entrepreneur, including his motivation and role in the context of economic development. According to Schumpeter, the entrepreneur was able to combine existing resources in new ways, and these new combinations led to creative destruction and the creation of new products, processes and/or markets. Thus, the entrepreneur was cast in the role of an innovator.

This conceptualization was at odds with Knight (1921), who laid greater emphasis on the entrepreneur's ability and willingness to take on uncertainty in the pursuit of profits. The element of risk-taking which was central to Knight's theory was downplayed by Schumpeter, who held that those who provided capital to entrepreneurs were the ones bearing risk.

Meanwhile, Baumol (1990) challenged the narrative that entrepreneurs universally engage in productive activities, or that economies thrive in conjunction with a rise in entrepreneurial spirits.

Instead, Baumol stated that entrepreneurs always exist, and whether they engage in productive pursuits or destructive activities - such as rent-seeking - depends on how the rules of the game and payoff mechanisms are set up in a society.

**Importance of entrepreneurship in the context of growth**

There has been an explosion of interest in entrepreneurship in the backdrop of events like the financial crisis of 2008, the subsequent slowdown in growth rates for economies across the globe and the battle to counter resulting unemployment pressures. Rasool, Gulzar and Naseer (2012) find that policymakers have increasingly laid more emphasis on entrepreneurship as a means of promoting growth. If such growth leads to significant job creation, then a plausible consequence is a reduction in prevailing unemployment. According to Haque (2007), rising entrepreneurial activity tends to occur in tandem with higher growth rates, which in turn creates more opportunities to find employment.

With Pakistan's GDP growth hovering under 5% in 2014-15 and unemployment rate in the 6% region according to the Pakistan Employment Trends 2013 report, there is room for a stimulus to the economy, and entrepreneurship can facilitate that boost. Start-ups that successfully scale up can contribute to GDP growth and reduce unemployment via job creation. They can also be sources of potential tax revenue for the government.

**Impact of innovation and R&D**

In the context of entrepreneurship, innovation enhancements are often more imperative than infrastructure investments. Government appreciations for research and development (R&D) will certainly boost innovations, which will eventually catalyse the growth of an economy - this is called knowledge spill-over effect. In the Global Innovation Index, Pakistan has been ranked at 134th position. According to 'Invest to Innovate' report 2014, recently few corporate organizations have lent support to the innovative start-ups in the country, by funding NGOs and educational institutes to enhance these start-ups.

Besides this, the poor educational standard of Pakistan has been one of the causes for lack of innovation. In the Global competitiveness report of 2011, Pakistan earned 3.3 points for quality of education - which was the least amongst South Asian countries. The net result is...
constricted and imitative knowledge spill-over, due to lack of market depth and a dearth of research institutes, think tanks and universities. By contrast, in developed nations it is common practice for research conducted by universities and research institutes to be funded by private firms with the aim of fostering innovation.

**Competitiveness**

Porter's Diamond model succinctly portrays the methodology to increase the competitiveness amongst national and international firms. Since the government policies are beneficent for the large firms, which have enlarged the competitiveness of the local producers in the international markets - because of rent seeking. The efficiency-driven economies will attract more opportunity based entrepreneurs, efficiency is another term used for competitiveness - this can be achieved by fostering growth and technology based entrepreneurs, expanding the scope of employment in the society. But according to the Enterprise survey report 2007, Pakistani firms has less technological machineries or efficiency in the region. Moreover, entry and exit barriers have further deteriorated the national competitiveness of the firms, however the firms are internationally competitive in few government supported commodities - exhibited in Global Competitive report, 2014. The protection and subsidies provided by the government to large industries are mostly at the cost of innovation. Those government expenses can be utilize to foster the innovation and research culture in every educational institute, and certainly enable them to take a risk on new ideas and initiatives.

**Policy Recommendations**

Improved access to finance: Evans and Jovanovic (1989) estimate that entrepreneurs are in most cases limited to using less than 1.5 times their wealth in order to finance their ventures, and such binding liquidity constraints result in lower than optimal funding for start-ups. The Prime Minister's Youth Business Loans Scheme appears to have been a step in the right direction, with loans to the tune of Rs. 4 billion disbursed thus far since its launch in 2013 (Jabri, 2015). It would be prudent to continue this scheme and extend its outreach, granted that systematic monitoring and evaluation exercises are also undertaken to determine whether the intended goal of promoting entrepreneurship is being achieved.

Provision of mentoring for young entrepreneurs: The inclination to spur youth entrepreneurship makes sense when one considers that around two-thirds of the country's population is under the age of 30. However, it may be argued that those entrepreneurs who take the plunge earlier on in life without amassing wealth are 'risky' entrepreneurs, compared to 'safe' entrepreneurs who accumulate wealth before turning to entrepreneurship later in their careers (Vereshchagina and Hopenhayn, 2009). Such risks can be mitigated by the provision of mentors for young entrepreneurs. To some extent, there are already some independent mentors accessible through formal or informal channels, but there is little evidence to show that this access is distributed evenly across regions and urban/rural areas of Pakistan.

Attracting the ablest individuals towards entrepreneurship: Poschke (2013) determines that the least and the most able individuals, in terms of schooling, are likelier to become entrepreneurs and persist with their choice, implying a U-shaped relationship between education and entrepreneurship. In terms of policy, measures to subsidize entry into entrepreneurship could be directed at individuals who have several years of schooling and are more productive compared to least schooled individuals. Poschke's research indicates that the latter have a greater tendency to abandon one failed business in favour of another, while the most able individuals have a greater tendency to build enduring, sustainable businesses.

Tapping into the potential of female entrepreneurs: According to the Global Entrepreneurship Monitor (GEM) Pakistan 2010 report, the country's female established business owner (EBO) rate, 0.82, was the lowest among all 59 countries surveyed. Although this had risen to 1.60 according to the GEM Pakistan 2012 report, the EBO for males was still 3 times the EBO for females, indicating significant gender disparity (Mian and Qureshi, 2012). Thus, there is a need to determine what factors are holding females back from becoming business owners in the long run. Qualitative research could be funded in this regard, and clues could be found from the experience of other 'factor-driven' economies (as classified by the GEM) which have similar or higher female EBO rates in comparison to men, including Angola, Ethiopia, Ghana, and Nigeria.
Promoting linkages with academia: It is heartening to note that many universities in Pakistan have set up incubators and introduced entrepreneurship programs and courses as part of curriculum offerings. On the other hand, the volume of research papers on the topic of entrepreneurship is still sparse compared to themes such as poverty, health, education, financial sector, GDP growth etc. One possible policy intervention is to set aside funds to incentivize researchers pursuing entrepreneurship as their area of focus. Universities and colleges offering degrees specifically centred on entrepreneurship are also advised to keep track of their graduates’ progress, with applied components of the curriculum giving hands-on experience to students and preparing them to launch their start-ups at the completion of the program.

Developing entrepreneurship clusters: Similar to the concept of industrial zones, the government can set up entrepreneurship clusters which bring together like-minded individuals/start-ups and foster a community-like environment for discourse, collaboration and the exchange of ideas. Such clusters have proven potential to create synergy and also attract the attention of venture capital and investors, with the most notable global examples being Silicon Valley in the United States and Silicon Wadi in Israel. While these are examples of high-tech hubs, they could be adapted to meet local needs. For example, a cluster for start-ups focused on innovations in agriculture or alternative energy could be set up.

Despite the numerous obstacles, however, success stories of Pakistani entrepreneurs are testimony to the prospects available for forward-thinking, visionary risk-takers in the local space. It is the responsibility of the country’s policy-makers and stakeholders in the entrepreneurial ecosystem to create an enabling environment where failure is mitigated and promising start-ups are nurtured, for the collective benefit of both the entrepreneurs and the economy at large.

Dr. Jean-Joseph Boillot, who visited IBA for EconomiCon 2015, found the policy paper to be very promising.
Inflation, in simple words, can be referred to as the rise in general price level in an economy. Inflation in Pakistan seemed to have settled down during the 90’s. The year 2004 brought along an unwanted trend of increasing inflation in the economy while in the year 2008 inflation in Pakistan hit the 20% mark (20.3%) for the first time since 1973. However, we have seen declining inflation since then.

Recently inflation has been as low as 2.49% recorded in March 2015, due to decline in transport cost as oil prices have gone down. The picture gets clearer when core inflation is also taken into account, which is calculated by excluding oil and food prices in the country, and was 5.9% for the month of February. In Pakistan’s case oil and food prices are the main cause of inflation. Hence, low inflation would not be sustained for much longer.

To keep the low income groups happy, the government has been selling wheat and flour at utility stores at a very cheap price, but this is not the solution to stabilize or decrease inflation. Pakistani government has also allowed import of various raw materials through road from neighbouring countries but that is just a subsidiary solution and would not solve problems like inflation.

Political instability has kept Pakistan at the start of the economic growth rat race; although it’s high time the country gets some sort of opportunity to actually run the race, let alone finish it. Encouraging capital accumulation and attracting foreigners to invest in Pakistan is seen as a rather tacky and mainstream approach to development and progress. Multinationals or even local firms set up by “outside world invaders” would hinder the government’s influence on business control. This would minimize their traditional implementation of certain profit scheming or as some say, “tax evasive” policies to a level quite below the government’s liking. However this is at the opportunity cost of the nation’s economic growth and prosperity as well as a convenient negligence by the government of the Oath of Office. Remittance and aid itself are not sufficient to revolutionize this semi-industrialized economy. What will have a long lasting impact is the commencement of much-needed investment in human capital, a far-sighted approach toward foreign firms with open arms and the clichéd yet relevant factor: a decreased rate of corruption. Even the domestic industry has suffered. Agriculture sector provides raw materials to many major industries but government has not provided them enough subsidy, due to this agriculture industry has struggled to match its supply with demands. Hence, the cost of raw material rose and consequently cost of product of the industries rose as well.

Although prices of oil have gone down by a significant account recently, this fall in prices is due to external factors and Pakistani government is taking the credit for it. As soon as Saudi Arabia stops giving discount to USA to demote the use of Shale gas and also to discourage the world from purchasing oil from Russia, the oil prices will rise again.

Domestic production at a lesser cost will not only make the availability of goods much easier but aggregate supply will also increase, and domestic industry will get developed which would further result in lower price and hence could be controlled, if not decreased.

I believe that for Pakistan’s economy, inflation can be bad if it crosses the six per cent mark, and can be extremely harmful if it crosses the double digit level. Several supply and demand factors could be responsible for this surge in inflation. Supply-side shocks can cause large fluctuations in food and oil prices, effects of which on overall inflation can be so excessive that these cannot be countered through demand management.

In Pakistan, monetary and fiscal policies, exchange rate stability and energy management should be the target policy. Otherwise, the country will not only lose quality in products but also experience a drop in quality of human capital.
“It has been more profitable for us to bind together in the wrong direction than to be alone in the right one. Those who have followed the assertive idiot rather than the introspective wise person have passed us some of their genes. This is apparent from a social pathology: psychopaths rally followers.”

This time round, we pick a book quoted to be “Elegant, startling, and universal in its applications”. 'The Black Swan: The Impact of the Highly Improbable' is a book by Nassim Nicholas Taleb which changed and revolutionized the way we look at the world.

The writer is witty, entertaining and keeps one engaged throughout the book. “He has a polymathic command of subjects ranging from cognitive science to business to probability theory”, according to Goodreads.

Ever seen a black swan? The high improbability of finding a black swan resonates throughout the book. A black swan is a highly improbable event with three principal characteristics: It is unpredictable, carries a massive impact and, after the fact, we concoct an explanation that makes it appear less random, and more predictable, than it was.

We, as human beings, always converge our focal point towards things already known. Failure to take into consideration what we don’t know allows us to overlook opportunities and underestimate the dangers that exist. We are also not open to the idea of rewarding those who can imagine or predict the impossible.

While we keep a myopic view, the world continues to change and transform right before our eyes. Taleb, in this book, explains how to deal with black swans and how to turn them into an advantage.

Highlighting his views on people who follow trends and patterns, Taleb says:

“If you hear a "prominent" economist using the word 'equilibrium,' or 'normal distribution,' do not argue with him; just ignore him, or try to put a rat down his shirt.”
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Pakistan-India Trade - Challenges and cycles

Past trends and Cycles

Without discussing the past trends and cycles in trade between the two nations, it is impractical to jump towards recent challenges and cycles. It must be noted that immediately after partition, India devalued its currency whereas Pakistan refused to do so which meant that Pakistan's exports would be costly for India. India at that time was a major importer of Pakistan's raw Jute and it immediately stopped trade with Pakistan in retaliation. Trade started after 18 months but on a smaller scale.

Historically, the situation was different especially until 1965 when India constituted 70% of Pakistan's trade. The 1965 war changed conditions drastically. India tried to change the situation by granting Pakistan the Most Favored Nation (MFN) status in 1996. The idea was to generate incentives for peace for Pakistan by increasing its share of India’s trade. The bilateral trade in 1996 stood at US $180 million. This is quite a small amount in terms of the potential for trade however Pakistan has not yet given MFN status to India as Pakistan may face challenges because giving MFN status means reducing most of the tariff and non-tariff barriers against Indian imports that would have a bad impact on the Pakistan's domestic industry.

There are trade opportunities between the two nations in which Pakistan can provide India with relatively cheaper stones and precious metals that can be refined in India and sold as jewelry however this is more beneficial for India as they will have the profits of the value-added final product.

Since then trade between the two nations has seen ups and downs. Trade is halted whenever the relations between the two nations are in a slump due to border skirmishes, war, and disputes. Kashmir is a bone of contention between the two nations since inception. Both the major wars in 1965 and 1971 stopped trade completely and it never recovered to its former position. In 1999, Kargil battle opened the doors of conflict between the two nations once again. Indian involvement in Baluchistan and now in Afghanistan has worsened the relations. These are also the reasons behind the cautious perspective of military establishment in Pakistan towards opening up trade with India.

The urban upper class in Pakistan is attracted towards India however the lack of visa facility and absence of display centers in each other country acts as a major constraints in investment and trade. Also the problems that are caused by customs requirements are a hindrance in trade.

Challenges

Is Pakistan really at a disadvantage in the Trade with India?

Although there is much potential for trade between the two nations but it may benefit one country over the other due to the industry dynamics that have evolved over the period.

It can be seen that India has protected its domestic industry to a great extent and opened its economy in 1990 whereas Pakistan had opened its economy quite earlier. This is why the domestic industry in India is stronger as compared to Pakistan's domestic economy. Opening up trade with India at a large scale will benefit India more as compared to Pakistan since Pakistan's domestic producers may face declining demand as they are less competitive. Producers in India have the advantage of having lower manufacturing costs due to subsidized power and cheap labor. Thus, allowing Indian goods into Pakistani markets would surely destroy the local industrial and agriculture sectors. Indian-made cars, motorcycles and electronics are much cheaper than their Pakistani counterparts. The same can be said for the Indian pharmaceutical sector, where the price of drugs is much lower than that in Pakistan.

Secondly, both India and Pakistan have similar weather conditions which implies that the two nations produce and have expertise in similar products and commodities. India's main exports to Pakistan include sugar, and chemicals, while its imports include mineral fuels, among others. Sugar and chemicals are produced in Pakistan as well. This means that there is a lack of double coincidence of wants until there is shortage of commodities in either of the two nations. The need for trade in staple food only arises when there are major crop failures or shortages due to floods and natural disasters. Pakistan already produces these products and removal of tariff and non-tariff barriers by Pakistan will lead to serious implications for the Pakistan's market as people prefer cheaper products and commodities. It will reduce the demand for local production and
harm Pakistan’s industry and firms. Indian producers enjoy cheap power, fertilizers and seeds. Under free trade, Indian goods would flood Pakistani markets primarily because of low prices, destroying the local industry and trade within a few months, and leaving millions of people unemployed.

Adam Smith’s theory states that free trade eliminates inefficiency and most economists approve this theory but this has not really worked well for Pakistan that has signed 6 Free Trade Agreements (FTA’s). Also Pakistan’s FTA with China has proved to be unfavorable for Pakistan’s trade balance with China. Many industries have lost market shares globally and this loss in competitiveness warrants attention for industries, which were close to global benchmark competitiveness, and would have either retained or acquired it if some protection was given.

Trade liberalization must be based on industrial competitiveness and factor in Non-Tariff Barrier (NTB) costs. Tariff concessions should be empirically negotiated and NTBs rationalized through processes, transportation costs cannot be minimized without an undeterred political will. Both the size and distance in question makes trade between India and Pakistan desirable. The distance between buyers and sellers depends on route facilitation. The only open land route for trade is between Lahore and Amritsar. Exporters in Karachi or Kunri access India through Punjab. It’s clear that free trade cannot be beneficial unless all routes are opened, distances are optimal and transportation costs are feasible.

Sindh shares a border with Rajasthan. Khokhrapar railway station was built 105 years ago however this station stopped working after the 1965 war. In 2006, Thar Express was launched but closed in a year. There was a time when a huge chunk of exports from Pakistan to India and imports from India took place via this border. The Sindh and Rajasthan route can be extended to Gujarat. Sindh contributes one-third of Pakistan’s GDP and one-fourth of the country’s population lives in this province. Gujarat is only five per cent of India’s population, but it contributes 16 per cent of total industry output and 22 per cent of the exports.

**Pakistan’s trade with India**

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports (US $ million)</th>
<th>Imports (US $ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>326.7</td>
<td>1115.0</td>
</tr>
<tr>
<td>2007</td>
<td>291.7</td>
<td>1266.2</td>
</tr>
<tr>
<td>2008</td>
<td>354.6</td>
<td>1691.5</td>
</tr>
<tr>
<td>2009</td>
<td>253.3</td>
<td>1080.4</td>
</tr>
<tr>
<td>2010</td>
<td>275</td>
<td>1599.9</td>
</tr>
<tr>
<td>2011</td>
<td>272.9</td>
<td>1607.3</td>
</tr>
<tr>
<td>2012</td>
<td>348</td>
<td>1572.6</td>
</tr>
<tr>
<td>2013</td>
<td>402.7</td>
<td>1874.1</td>
</tr>
<tr>
<td>Total</td>
<td>2506.9</td>
<td>11767.0</td>
</tr>
</tbody>
</table>

The recent trade pattern with India clearly highlights that if Pakistan grants the MFN status to India, its trade balance with India may worsen as the imports from India will increase when tariffs are removed however Pakistan’s exports will only increase by a lesser amount.

Pakistan is however planning to grant India NDMA (nondiscriminatory market access) which will result in reduction of sensitive list to 100 by Pakistan that will benefit trade while keeping in consideration, the protection of domestic industry. Such measures are taken by the recent pro-business government.

**Conclusion**

I believe that trade between the two nations can benefit both the nations provided that Pakistan protects its strategic industries. Although globalization argument is in favor of granting MFN status to India but allowing complete free trade would be devastating for the Pakistan’s economy. This is why I think that it is a better option for Pakistan to give India NDMA (nondiscriminatory market access) instead of MFN status. Giving NDMA status to India means abolition of the negative list, which includes 1,209 tradeable items between the two countries. This will enhance economic growth and competition in domestic markets leading to efficiency.

Written by: Syed Murtaza Nadeem