PAKISTAN'S EXPORT COMPETITIVENESS IN GLOBAL MARKETS[*]

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Pakistan's export competitiveness has to be examined in the broader context of integration of developing countries into global markets, the opportunities and benefits it presents and the challenges we face in deriving maximum benefits.

This paper aims to address the following four questions:-

(1) Why should Pakistan integrate itself into global markets? Why can't we rely on our own domestic market of 145 million people?

(2) If we decide to integrate, this will involve opening up our economy to products from other countries and deprotect our industry. Won't this lead to de-industrialization of Pakistan?

(3) Pakistan has a weak, narrow and inefficient industrial base. How can our industry compete with countries such as China, India, Thailand etc.?

(4) What are the competitive advantages of Pakistan upon which we can build and accelerate our export growth?

I will take up each of these questions at some length in this paper and conclude by outlining the agenda for future action.

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(1) Integration into Global markets

During the last fifty years, the volume of world exports has risen twenty fold and volume of world manufactured exports almost forty fold. World output growth, on the other hand, has grown only seven fold. By 2001, world trade accounted for 24 percent of World Gross Product. If we look at the last three decades, merchandise exports of developing countries (DCs) have grown at an average rate of 12 percent per annum. Manufactured exports accounted for 70 percent of DCs exports at the end of the 1990s and 30 percent of world manufactured exports. These global markets therefore presents an excellent avenue for developing countries to participate in the benefits of a buoyant trading environment.

Today, the global exports amount to US$ 6.4 trillion and the entire national income or GDP of Pakistan is only $ 64 billion or 1% of world exports. It does not take more than simple arithmetic to realize that if we had maintained the average growth rate of developing country exports i.e. 12 percent annually in the 1990s where we would have been today. Had we simply maintained our historical share of 0.22 percent in the world markets we would have exported merchandise goods worth $ 17.5 billion this year. Our economic growth rate would have been much higher than the 3.5 to 4 percent with which we were stuck during the last decade. Employment generation and poverty reduction would not have haunted as grave issues as they do today. In my view, integration into global markets offers the best potential for Pakistan to achieve rapid growth and poverty reduction compared to reliance on domestic markets. Enhancing the share in the ever enlarging pie of world markets puts us on fast track which is hard to achieve by relying on our domestic economy as the engine for growth. It also permits the realization of greater economies of scale and scope which then benefits domestic consumers in form of lower prices.

If we depend on domestic markets we won't be able to generate the foreign exchange needed for imports to provide raw materials, components, machinery, equipment to our industry and pay for petroleum products to keep our transport, railways, electricity and other economic activities running. Even if we keep on borrowing from external creditors we won't have sufficient foreign currency to repay them. Thus those who look inward for growth and poverty reduction are sadly mistaken and suffer from romantic idealism rather than practical realities.

De Industrialization of Pakistan

The second reservation to trade liberalization and integration is that by deprotecting our industry we will lead the country towards de industrialization. This reasoning is flawed both analytically as well as empirically. Closer integration into the global trading system through greater liberalization and openness is expected to increase the share of international trade in domestic economic activity. This happens because the size of the traded goods sector expands relative to the rest of the economy and by shifting resources from protected Import substitution industries to export oriented industries. Such a reallocation of resources according to comparative advantage yields significant efficiency gains and welfare benefits. Exposure to world competition provides enterprises with greater access to information and technology and leads to more vigorous efforts to acquire new skills and capabilities. Export-oriented economies enjoy better capabilities than inward-looking ones.

Fifty years ago, South Korea elected to trade with the world and open up its economy while North Korea chose the path of protectionism and closing the economy to the outside world. Today per capita income (in PPP terms) in South Korea was $ 19,400 while in North Korea it is $ 1,000. Industrial growth rate in S. Korea was 22 percent and only 1 percent in North Korea. S. Korean population has 23 million telephone lines and 9 million cellular phones while North Korea only 1.1 million lines. Many such examples can be given – Myanmar vs Thailand, Cuba vs other Caribbean countries. In all cases where the countries have opened themselves up to international trade, industrialization and development have followed.

There are no grounds to believe that, in the long run, the standards of living of population of any country will improve if the country is protected from the rest of the world. Pakistan has successfully moved from the stage of a primary commodity exporter to labor-intensive manufacture exporter. The share of manufactured exports in total exports today is more than 85 percent and within manufactured exports there is a clear direction towards value-added exports. This export expansion has helped Pakistan to change its economic structure.

Agriculture's share has declined, as should happen in any emerging economy, to 25 percent from 50 percent while Industry has gone up to 25 percent from almost a miniscule base. Thus there is no evidence that liberalization and opening up of the economy leads to de-industrialization. This is more of a rhetorical statement by anti-globalization movement rather than a fact. The next stage for Pakistan's industrial path is that of upgrading industrial activity towards more technology and skill-intensive activity. Participation in international production networks can create some impetus to development by broadening the range of sectors in which Pakistan can base its industrialization efforts. It is no longer necessary to master entire production chains and to organize them within single firms. We can focus on mastering just one facet of production and a limited subset of all the activities involved in making the final products. This is likely to entail large savings in learning costs and can allow small and medium enterprises (SMEs) domestic companies establish linkages with large multinational corporations (MNCs). Given relative factor endowments, we may begin by creating competency in the more labor-intensive components of complex products, gradually progressing to more skill and technology intensive activities. But this is a path which we will have to tread for sustainable export competitiveness.

Competition with other developing countries

There is a genuine concern among many quarters that Pakistan will not be able to compete with the giant size economies of China and India because they possess economies of scale and are endowed with superior technological and human resource base. As the trading relations with India are laden with emotions this paper will focus its attention on China only. It is a fact that the fear about China is not only prevalent in Pakistan but among all developing countries. There is no doubt that China has been the most aggressive among the DCs to penetrate global markets and become the fifth largest exporter of the world. But we should not forget that China is also one of the fastest growing economy in the world with per capita incomes doubling every ten years and the real effective purchasing power rising significantly every year. China is a large market which absorbs more than $ 250 billion of merchandise exports from all over the world every year and the bulk of it from the Asian countries. Our share in China's market is less than 0.2 percent. As close ally and friend there is no reason as to why we cannot increase this share to at least 1%. This will translate into $ 2.5 billion of additional exports and an assured growth of 15-20 percent every year. In six years time we will be able to double the value of exports to China to $ 5 billion annually. There are two ways to follow this route.

China is encouraging foreign direct investment and Joint Ventures for establishing a commercial presence. The direct import content of exports by foreign joint ventures (FJVs) in China is high, estimated at some 50 percent and intra-firm trade accounts for as much as 30 percent of import of FJVs. The ownership structure of these enterprises and the high import content of their manufacturing have contributed significantly to strengthening the trade links between China and the East Asian economies. Foreign direct investment (FDI) from investors in East Asia uses China as an export platform for the western markets and that their home countries provide the inputs needed in such operations. Removal of subsidies, reduction of tariffs and non tariff barriers and elimination of preferential treatment will exert considerable pressure on the State-owned enterprises to improve efficiency and competitiveness.

Pakistan can create a window of opportunity by establishing joint ventures with these enterprises. The main suppliers of textiles to China are Taiwan (25% of China's textile imports), Korea and Japan (about 20% of each). The relocation to China of clothing plants from Japan, Korea and Taiwan has contributed to China's imports of textiles from these economies. If Pakistani export houses can provide high quality and lower priced textiles to these clothing plants our exports can partially replace those from Japan, Korea and Taiwan which are likely to become high cost suppliers of these goods.

Unlike clothing, textile industry China was characterized by obsolete machines, low quality products and excess labor. It was dominated by loss making State owned enterprises (SOEs) with low labor productivity. In 1998, about 40 percent of SOEs were on the verge of bankruptcy. The performance of SOEs will further deteriorate as a result of significant reductions in tariffs and the reduction or removal of subsidies following accession. The short to medium term impact of accession could favor a rapid growth in import of textiles. The high ratio of textile imports to domestic production (22 percent) signifies the dependence of clothing exports on imported textiles. About 55 percent of China's exported apparel is made from imported fabric. There is no reason as to why Pakistan cannot capture a large share of these imports.

Empirical studies made by US International Trade Center (USITC) have also concluded that China will lose its competitive advantage in outergarments, textiles and cotton fabrics while it will have strong performance in sectors with high technology intensity. The changes in the composition and direction of China's imports and exports have important implications for other economies. Pakistan can take advantage of this opportunity by aggressive marketing of its products and engaging the SOEs in long term relationship as partners. China's market can thus be accessed directly and indirectly through intra-firm sales, production sharing arrangements, licensing, brand name outsourcing and strategic alliances for marketing, design or technology transfer.

Pakistan's Comparative advantage

Low wages do not necessarily give a competitive advantage when labor productivity is also low. It is the unit labor cost which is critical to competitive advantage. Pakistan's low unit labor costs in textiles is the main source of its static competitive advantage at present. But static advantage is of little consequence in a rapidly changing global economic environment and it is dynamic comparative advantage which should be taken into account. This leads us to the question: what are the fastest growing products in the global market?

Table 1 shows the trend growth rates for the period 1980-98 of the 20 most dynamic products in world trade. Most of these products fall into four categories:

A) Electronic and electrical goods (SITC 75, 76, 77)

B) Textiles and clothing (SITC 61, 65, 84)

C) Finished products from industries that require high technological complexity (SITC 5, 87)

D) Primary commodities including silk, non-alcoholic beverages and cereals (SITC 261, 111, 648)

In general, these market dynamic manufactures show smaller variations around their trend values than less dynamic manufacturing and primary commodities. They can thus be identified as the drivers for increasing market share in world markets.

The main exports experiencing highest growth rates with a high share concentrated in DCs are computers and office equipment; telecom; video and audio equipment and semiconductors and clothing. All these products involve labor-intensive processes, which suggests that the increased importance of global production sharing has been a crucial determinant of the growth of their exports.

The most striking finding is that the higher the skill and technology content of exports, the faster is the growth rate of exports of DCs compared to growth in world trade. The lesson is that upgrading of exports should involve replacing imported skill and technology intensive parts and components with domestically value added content of output and exports something which has begun to take place in automobile industry in Pakistan but is much less visible in other high tech sectors.

Pakistan can today and in near term safely compete for products which have low technology and high labor intensity. Among the twenty top products on market dynamic considerations Pakistan has the scope of enhancing its share on textiles and clothing including leather, and primary commodities. With a very low import intensity, adequate domestic production of raw materials at low cost, abundant supply of labor at competitive costs, the textile and clothing industry has Revealed Comparative advantage (RCA) greater than one and a Domestic Resource Coefficient (DRC) of less than one. These indicators show that Pakistan has the wherewithal to face competition in the world markets. The other policy indicator of export competitiveness i.e. Real effective exchange rate also shows the strength of Pakistani exports in relation to its competitors in third country markets. The removal of quota will eliminate the quota rents being collected by some of the exporters in Pakistan further improving the price competitiveness of our products. The recent investment of almost $ 2 billion in acquisition of new state of the art machinery and equipment will replace the obsolete technology and upgrade the quality improving the productivity of Pakistani textiles.

Lower transport and communication costs and reduced trade and regulatory barriers have facilitated production sharing which is generally concentrated in labor-intensive activities. Production sharing allows firms to exploit the comparative advantage specific to the production of particular components, including scale economies and differences in labor-costs across countries. Firms determine the location of the production of components according to their own factor intensity and costs rather than the average factor intensity and cost of the end-product.

Where international production networks are organized on the basis of subcontracting, the lead firm usually concentrates on Research and Development, design, finance, logistics and marketing but is not always involved in production activities. Pakistan can be the production platform for those labor intensive processes in high and medium technology sectors in the overall context of an international or regional network. This applies both to merchandise exports as well as services.

Policy Implications

By 2005, DCs would be able to earn an additional $ 700 billion from annual exports of a number of low technology labor intensive products if protectionist barriers are dismantled. This amounts to about 35 percent of the total export earnings or 60 percent of earnings from manufactured exports that the

DCs registered in 2000. The question we have to ask ourselves: what are the policy implications for capturing a higher share of these rising export earnings?

First, we must realize that although differences in absolute costs and considerations of competitive advantage are important determinants of the extent to which developing countries can penetrate international market in different products but it is the market access by advanced economies (ACs) which is equally important. The present restrictive environment confers enormous power to the ACs to block the entry and sustained expansion of DC exports into their economies. This is, in itself, a topic which will take a whole day seminar and I will therefore desist from exploring the question of market access by ACs. Suffice to say that it is the most critical issue to be resolved.

Second, it is also relevant to know as to how rapidly the markets for labor intensive manufactures will expand in the ACs i.e. to what extent incomes and purchasing power of the population in the US, European Union and Japan will rise. If the growth in these economies remains lack luster then it will be futile to expect much gains from world trade.

Third, the middle income countries particularly newly industrializing economies (NIEs) should be moving out of labor intensive manufactures and creating space for low income economies as Pakistan. Asean countries and East Asian NIEs will be the ones to watch carefully as they can expect to face greater competition for their light manufactured exports.

Fourth, it would also be interesting to observe as to what extent China and India whose skill mix and factor endowments are sufficiently well developed will allow rapid upgradation in a number of technology intensive sectors. This will allow them to exit from traditional labor intensive sectors and provide space for countries such as Pakistan in labor-intensive products.

During the last several years Pakistan has taken a number of measures to reduce anti-export bias and improve its policies and governance towards promotion of exports. For example,

?? Restriction on import and export of cotton and sales tax on imported cotton removed.

?? Duty drawback is allowed on exports.

?? Tariff on import of plant, machinery and equipment has been reduced to 5 percent.

?? Tariff rates on import of raw materials reduced to 5 and 10 percent.

?? Bank financing available for investment under Textile Vision.

?? Export refinance rates reduced to 3.5 percent.

?? Exchange rate has remained stable.

?? Domestic interest rates are all time low in the history of Pakistan.

?? Aggressive and pro-active measures being pursued to revive sick industries.

?? Export earning retention ratio raised to 35 percent for export of services.

?? Credit Guarantee Agency established to reduce shipment risks.

?? Dollar financing allowed to exporters

?? Long term Corporate bonds allowed to be floated through capital market

As the competition for market shares among the DCs is intensifying it is essential for Pakistan to develop a carefully managed strategy for integration and enhancing market shares aimed at accelerating industrialization and growth. This strategy will differ from simple minded reliance on static comparative advantage driven by market forces. Market forces do not automatically generate the incentives needed to alter the pace and pattern of integration into the global economy or overcome the impediments to a more dynamic interaction between trade and growth. Adjustment to new set of incentives is not instantaneous, rather it is time consuming process requiring investment in physical and human capital. A judicious combination of currency adjustments and domestic taxes may help to absorb the shocks to vulnerable industries without causing serious distortions in resource allocation or violating the commitments that the country has made in the accession to the WTO. This calls for a considerable role for policy and strategy but not market-distorting interventions as happened in the past.

The main plank of the strategy should be to concentrate its production and exports on dynamic products with respect to their global demand potential and productivity potential. Pakistan will and should remain engaged in the low-skill, labor intensive dynamic products such as textiles, leather products etc. Within textiles the main thrust will be to move towards high value added products gradually raising the level of technology, upgrading the skills and improving the quality and consistency across huge volumes of a single item. But as we have observed trade in skill and technology intensive manufacturing has been increasing much faster than that in labor-intensive and resource based manufacturing. This shift will not be so easily possible due to the constraints on availability of right human resources and skills in the country.

Pakistan has a low proportion of well trained University graduates in science and technology and even a lower proportion of technicians per million inhabitants relative to countries such as China and India. The recent moves to increase the financing for universities and science and technology institutions to produce PhDs domestically are welcome initiatives. But the industry in Pakistan has to invest in Research and Development (R&D) by pooling their resources and challenging the scientists to find solutions to the problems faced by the industry. The linkage between local scientific institutions and the industry is weak and has to be strengthened. Unless some significant progress is made in the fields of science and technology we should be realistic and tamper our expectations as far as trade in skill and technology intensive products is concerned.

AGENDA FOR THE FUTURE

The agenda for a strong public-private partnership for sustaining and enhancing Pakistan's export competitiveness in the global markets should focus on the following areas:-

(1) Measures to increase labor productivity through education, on-the-job training, skill upgradation and dissemination of new knowledge and techniques. This will translate into higher value added and low unit labor cost.

(2) Measures to attract foreign investors for export oriented joint ventures in Pakistan and establish joint ventures in countries such as China. Foreign partners have played a role in production relocation in clothing sector through outsourcing. Brand-name merchandisers and large retailers of standardized products are the ones to be targeted. Foreign joint ventures can provide marketing, design, logistics, financing while the production can be handled by domestic firms. This will require greater transparency and disclosure by Pakistani firms aspiring for joint venture relationships.

(3) Measures to improve physical and financial infrastructure including cutting down long delays in shipments, clearances, cargo space, handling etc. at the ports and airports. Reliable and low cost supplies of power, water, gas telecommunications etc. should be assured for export industries. Long term financing and hedging products need to be developed by the financial institutions.

(4) Measures to ensure compliance with environmental standards and labor standards agreed under international codes and agreements. Pakistani exporters have been adopting a wait and see attitude so far

but they should equip themselves to become fully compliant with these requirements of the advanced economies buyers and governments. Worldwide Responsible Apparel Production (WRAP) and Apparel Industry Initiatives (AIP) are some of the global movements likely to affect trade in textile and clothing sector.

(5) Measures to diversify the export base by moving to develop engineering goods and chemicals industry. As steel and auto industry are beginning to look efficient other downstream and upstream industries should be established. Within textile sector clothing and value added products should be expanded as the economics of conversion makes it obvious. One lb. of cotton converted into finished fabric fetches $ 1.61 on the world market while the same amount of cotton converted into woven garments raises the earnings to $ 4.17. Increased demand of blended fibrics world over calls for investment in this sector. Domestic costs of manufacturing synthetic fibers and yarn should be aligned to international prices by exploiting scale economies and rationalizing plant sizes.

(6) Measures to simplify the tax and tariff regime for exporters. The recent episodes of delays in the sales tax refund regime have left bad taste both for the Government as well as the exporters. A more simplified procedure without involving any prior financial outlays by the exporters should be developed to overcome this long standing

problem. This will free up the exporters' time to focus on marketing and product development rather than spending their energies in chasing the sale tax refunds.

(7) Measures to improve the organization and management of export firms. Most of the firms are family owned and managed by a close circle of family members and associates. This lack of professionalism in the organization and management limits both expansion in the size of the firm but also results in poor organization of functions and tasks contributing to low productivity. There is an urgent need to bring in professional managers and skilled manpower to operate these industries and thus lead to higher overall productivity.

(8) Measures to integrate the export-oriented Small and Medium enterprises (SME) into an organized production network for exports. The SMEs in Pakistan are playing a key role in production of exports but in a haphazard manner creating problems of perceived quality, delivery slippages, reliability and deviations from specifications. Their technological base is also rudimentary and the specialized level of technical, administrative and financial expertise leaves much to be desired. The formal sector, through strategic alliances, subcontracting, outsourcing can bring the SMEs into the production network and lead to overall productivity gains.

CONCLUSION

The above analysis has demonstrated that it is in the larger economic interest of Pakistan to integrate into the global markets and derive maximum benefits offered by these new opportunities. It is also clear that the fears about deindustrialization resulting from integration and liberalization are unfounded and misplaced. The competition from countries such as China, while fierce and real, can be managed to Pakistan's advantage. Pakistan enjoys competitive advantage in several products which are fast growing in the global markets and have high demand potential. But Pakistan's export competitiveness cannot be left to the whims of market forces alone but managed strategically. The agenda for action facing Pakistan is substantial but a constructive public-private partnership can help achieve the goal. The biggest challenge facing Pakistan is a change in the attitude, behavior and mindset of both the government officials as well as private businessmen – from an adversarial to trusting relationship.

Acknowledgement

The author has drawn freely from the UNCTAD's Trade and Development Report.

TABLE - I

EXPORT VALUE GROWTH AND SHARE IN TOTAL EXPORTS
OF THE 20 MOST MARKET-DYNAMIC PRODUCTS, 1980-1998

(Per cent)

SITC code	Product group	Average annual export value growth 1980-1998
776	Transistors and semiconducts	16.3
752	Computers	15.0
759	Parts of computers and office machines	14.6
871	Optical instruments	14.1
553	Perfumery and cosmetics	13.3
261	Silk	13.2
846	Knitted undergarments	13.1
893	Plastic articles	13.1
771	Electric power machinery	12.9
898	Musical instruments and records	12.6
612	Leather manufactures	12.4
111	Non-alcoholic beverages	12.2
872	Medical instruments	12.1
773	Electricity distribution equipment	12.0
764	Telecommunications equipment, and parts	11.9
844	Textile undergarments	11.9
048	Cereal preparations	11.9
655	Knitted fabrics	11.7
541	Pharmaceutical products	11.6
778	Electrical machinery	11.5
	20 most dynamic products	12.9
	Memo item:	
	World exports	8.4
	Developing country exports	11.3

Source: UNCTAD

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