Export Performance of Pakistan: Role of Structural Factors

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1. Overview

Pakistan’s export performance has remained weak over the past two decades. According to World Bank, Pakistan’s export share in world exports declined from 0.18 percent to 0.13 percent. In the same period, unlike contraction in Pakistan’s export share, shares of its competitors’ in world exports have depicted substantial increase. Specifically, Bangladesh’s share in world exports increased from 0.06 percent to 0.19 percent, India’s from 0.61 percent to 1.65 percent, and Vietnam’s from 0.14 percent to 1.17 percent.

As detailed by SBP in its annual report for FY2014-15, Pakistan’s exports are mainly comprising of resource-based items such as cotton, rice, and hides and skins over the past many decades. This element highlights the existence of product cycles of exportable goods that have surpassed their comparatively beneficial age. Consequently, marginal but unsustainable gains in exports receipts are generated either due to favorable international prices or elevated surplus in domestic production. The last major spur in exports growth of Pakistan in FY2010-11 was due to high international price of cotton. However, as the price normalized in the next year, the growth in exports turned negative.

Similarly, despite some quantum boost in exports to the European Union amid the Generalized System of Preferences (GSP) Plus status since January 2014, decline in international commodity prices and slowdown in global trade prompted exports growth to plunge sharply and turn negative in FY2015-16, even surpassing the plunge in global exports. In particular, exports from Pakistan declined by 13 percent in FY2015-16; the highest decline recorded in a single year since FY1981-82 (Figure 1).

Figure 1: Pakistan’s Export Performance

![Graph showing Pakistan and World export performance]

* covers around 83% of total exports
Source: International Monetary Fund (IMF) and Pakistan Bureau of Statistics (PBS)

Unlike Pakistan, most of its regional neighbors and competitors were able to transform their export base from primary commodities to high value added items during the last two decades. For example, compared to an increase of 16 percentage point in the share of manufactured exports in Pakistan’s total exports, similar share

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1 For further details, see Special Section 3, titled “What has caused stagnation in Pakistan’s exports?” SBP’s Annual Report on the State of Pakistan’s Economy 2014-15.
2 Global trade has declined by 12% during the last two years.
of regional competitors has on average increased by 43 percentage points over the past two decades. Indeed, structural reforms aimed at export promotion, such as efforts for product and market diversification, focus on education and research etc., have played a key role in making a difference in these economies.

Since the above facts relate Pakistan’s export potential to favorable international prices, degree of global demand, and export promotion through structural reforms, role of other contemporary factors lose significance in inducing higher demand for exports. While addressing the global cyclical factors is beyond the capacity of a small open economy like Pakistan, it is the structural reforms that need the immediate attention.

Hence, in this backdrop, following analysis is an extension of SBP’s earlier analysis about the dire state of Pakistan’s export sector and presents the list of some of the important structural factors that could be responsible for holding back the export growth in Pakistan, particularly when compared to its competitors. Also, we attempt to decompose the export growth of Pakistan in recent years into global effect and other structural effects using Constant Market Share Analysis and compare it with country’s immediate neighbors and trade competitors.

2. Structural factors affecting Pakistan’s export growth

i. Cost of Doing Business

Cost of setting up new business and running of existing facilities has gone up in Pakistan, particularly in the last ten years. Exporters in Pakistan are facing stringent competition from Bangladesh, India and Vietnam. Indeed, this trend is supported by latest statistics released by World Bank (Figure 2). It could be observed that, albeit having higher levels, unlike most of the peers and competitors where cost of business has substantially reduced in recent years, businesses in Pakistan and Turkey have seen no major relief.

Specifically in Pakistan, this cost would be mostly associated with higher inflation and interest rates in recent past along with the adverse security situation in the country. Moreover, rising energy prices in Pakistan witnessed during the past ten years have also contributed to this increase in cost of doing business.

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3 Currently, the share of manufactured exports in Pakistan’s total exports stands at 76%, whereas the same share is equal to average 87% in case of regional economies. (Source: WDI-World Bank).


5 See Annexure in the end for further details.

6 During 2009-14, average inflation in Pakistan stood at 10.6% against 5.0% in its regional competitors. In recent years, average inflation in Pakistan is hovering close to its competitors, i.e. around 3.0%.

7 According to consumer and wholesale price statistics, respectively, administered prices of electricity increased 127% and 173% percent since FY2007-08.
ii. **Availability of Electricity**

Frequent electricity outages are another important structural obstacle in promoting exports from Pakistan during the last decade. When compared to peers/competitors, these outages have translated into substantial output losses for different sectors of the Pakistan’s economy, including the export sector (Figure 3). Although the government efforts to ensure uninterrupted electricity supply to industrial sector have led to a modest improvement in the recent years, there is still a lot of space for improvement. Power projects under the China-Pakistan Economic Corridor (CPEC) will further help in reducing Pakistan’s energy woes in coming years and would help in restoring country’s export competitiveness.

iii. **Women Participation in Labor Force**

Over the past decade, role of female participation in the labor market has significantly increased around the world. Particularly in low and middle income economies, their participation in manufacturing sector is playing an important role for supporting the firms by increasing the pool of labor, which also supports achieving potential levels of manufacturing capacity. Pakistan, despite having half of its working age population consists of female, has the lowest female participation rate in labor force when compared to regional and other peer countries. As highlighted by World Bank (2016), unlike its other South Asian neighbors, lack of female participation in Pakistan’s textile sector is one of the major obstacles which are keeping its growth below potential.

iv. **Foreign Direct Investment (FDI) and Technological Advancement**

Pakistan, with high ratio of young population, tends to have low level of savings than overall investments in the economy. To finance this gap, the country is consistently dependent on external financial flows in order to avoid pressures in the external sector. FDI inflows are generally considered as one of the stable source of external financing. Uninterrupted flows under FDI, particularly in the value

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8 Compared to 12% percent decline in Electricity generation during FY2007-08 to FY2012-13, the same has showed an increase of 25% during FY2013-14 to FY2015-16. (Source: SBP Statistical Bulletins).

9 In South Asia, the average ratio of female participation stands at 35% of total labor force. The same ratio is equivalent to 22% in Pakistan (World Bank-WDI).


11 Mean age of population in Pakistan stands around 22.5 years during 1991-2013. (For details, see Chapter 7: Social Sector, SBP’s Annual Report on the State of Pakistan’s Economy 2015-16). Also, statistics suggest that on average Investments – as % of GDP – had remained 3 percentage points higher than savings in Pakistan during the last decade. (For details, see Ali, A. 2016. Savings and Investments in Pakistan. *SBP Staff Notes*, 01/16, January 2016).
added sectors, also help in improving the export revenues through technological transfers and advancements in labor skills. With average 0.4 percent of FDI-to-GDP ratio in the last five years, Pakistan is considerably lagging behind its peers/competitors for attracting FDI flows (Figure 4).

Secondly, the overall environment of the country has not been conducive enough to attract any inflow of FDI in exportable sectors. This is despite the presence of some sizable setups providing opportunities for economies of scale amid rising domestic demand from the growing middle class. Leather and its products, pharmaceuticals, sports goods, transportation, dairy and textiles are some of the sectors having the potential for attracting foreign investment to spur country’s exports.

v. **Spending on Education and Research**

In this era of globalization, those countries having skilled and educated labor force perform better in terms of competitiveness than those having large proportion made-up of unskilled force along with lower education levels. Experience of East Asian economies is one relevant example. In this regard, Pakistan is even behind its regional competitors. For instance, during last decade, the average public spending on education stands at 3.1 percent of GDP in South Asian countries compared to 2.4 percent in Pakistan.

Similarly, countries that have successfully notched up from low income to middle/high income economies, like most of the East Asian economies, invested heavily in research and development. As a result, they were able to achieve high and sustainable economic growth, and generated higher levels of high value added exportable surplus with economies of scale. With average 0.3 percent of GDP, research and development expenditure in Pakistan is considerably low when compared to regional and other peer group countries. Specifically, according to latest figures, South Asian countries on average spend 0.7 percent, while low and middle income economies spend 1.3 percent of GDP on research and development (Source: WDI-World Bank).

vi. **Tariffs on Imports**

While higher tariff rates could help in curbing unnecessary imports, tariff on imported raw materials could impact the country’s export performance. With increasing importance of global value chains at different stages of production, share of exports made up of imported inputs have also increased, and Pakistan is no exception. Estimates suggest that around 20 percent to 30 percent of imported inputs have been used at different stages of production in Pakistan. Despite such significant importance of imported inputs in production,

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12 For example, textile and clothing being the major export sectors in Pakistan remained unable to attract any major FDI as their share in total inward FDI stocks stands at 1% only. In contrast, same sectors in Bangladesh and Cambodia, two main competitors of Pakistan in textile and clothing chains, attracted significant FDI in the past decade. Specifically, stock of inward FDI (as % of total FDI) in these sectors stands at 22% in Bangladesh and 25% in Cambodia.

13 The median adult literacy rate in Vietnam, Singapore, Turkey and Malaysia in the last 15 years is 92%, whereas literacy in Pakistan stood at 58%. (Source: WDI-World Bank).

applied tariff rates are relatively high in Pakistan when compared to its peers/competitors (Figure 5).\textsuperscript{15} Given the import intensity of exports is rather significant in Pakistan; high tariff rates could seriously damage the country’s export competitiveness in the international markets.\textsuperscript{16}

vii. Market Diversification

According to IMF’s direction of trade statistics, Pakistan has slightly diversified its destinations over the last decade. The prominence of the US and European markets in Pakistan’s exports has reduced by about 9 percentage points (from 45 percent in 2006 to 36 percent in 2015). However, Pakistan appears to be still under-exporting to the large and fast growing emerging economies of the world (Figure 6). Specifically, Pakistan’s exports to Germany, Japan, Hong Kong, Brazil, Russia, and India are below what could be expected based on their share in world imports. Besides the US and the European markets, with which the country is currently trading under the GSP-Plus status, Pakistan trades heavily with members of the Gulf Cooperation Council (GCC).

viii. Product Diversification

Similar to diversification in export markets, product diversification is helpful in reducing the vulnerability of the country’s export portfolio to extreme volatility in export prices. The statistics suggest that Pakistan’s product diversification is better than Bangladesh, while it lags behind the other regional economies and competitors. In fact, number of exported items by Pakistan actually decreased during the last five years, whereas of its competitors’ showed expansion in this period.\textsuperscript{17} However, as mentioned earlier, the real problem emerges from Pakistan’s chronic reliance on resource-based exports (Figure 7). Availability of cotton, rice and hides and skins largely determines the country’s export growth in a given year. Particularly, in case of textile exports – country’s major export sector - the gradual upgrading from low to high value added items is although encouraging, the volumes are still very low when compared to countries like Bangladesh and Cambodia.

\textsuperscript{15} For instance, as per SBP Annual Report on the State of the Economy 2014-15, import of raw materials like polymers of ethylene and, propylene have to face 5 percent tariff in Pakistan, whereas in Vietnam and Cambodia, these items are allowed to import at zero tariff, pp. 122.


\textsuperscript{17} According to ITC statistics, there was a reduction of 169 products in total list of exported products by Pakistan during 2011-15. In contrast, Bangladesh, Sri Lanka, Cambodia and Turkey witnessed an addition of 267, 508, 330 and 55 products in their total list of export products in the same period, respectively.
Moreover, steady transition in Chinese economy towards services provides opportunities for emerging economies to expand their export base, particularly those consists of labor-intensive production. Being a major export partner, Pakistan could also take advantage of this potential opportunity through timely investment in increasing its educated and skilled labor force which will be capable of meeting new challenges.

ix. Access to Finance

Financial inclusion in Pakistan is rudimentary as compared with countries that enacted export led growth models. Even the country’s regional competitors have performed better in most of the matters related to access to finance (Table 1).

<table>
<thead>
<tr>
<th>Table 1: Access to Finance Indicators</th>
<th>Borrowers from commercial banks (per 1,000 adults)</th>
<th>Depositors with commercial banks (per 1,000 adults)</th>
<th>Commercial bank branches (per 100,000 adults)</th>
<th>Firms using banks to finance working capital (% of Firms)</th>
<th>Domestic credit to private sector by banks (% of GDP)</th>
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<tbody>
<tr>
<td>Bangladesh</td>
<td>74</td>
<td>565</td>
<td>8</td>
<td>30</td>
<td>41</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>-</td>
<td>-</td>
<td>19</td>
<td>41</td>
<td>38</td>
</tr>
<tr>
<td>India</td>
<td>-</td>
<td>-</td>
<td>14</td>
<td>36</td>
<td>51</td>
</tr>
<tr>
<td>China</td>
<td>342</td>
<td>19</td>
<td>8</td>
<td>22 (2012)</td>
<td>100</td>
</tr>
<tr>
<td>Turkey</td>
<td>842</td>
<td>1,030</td>
<td>19</td>
<td>42</td>
<td>69</td>
</tr>
<tr>
<td>Pakistan</td>
<td>22</td>
<td>336</td>
<td>10</td>
<td>9</td>
<td>16</td>
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Source: IMF and WDI-World Bank

3. Concluding Remarks

Besides the aforementioned factors, there are other structural issues related to taxation, labor policy, institutional developments, and firm-specific factors which are responsible for sluggish export performance of Pakistan. World Economic Forum – a Swiss nonprofit foundation – has recently published its annual report, entitled: The Global Competitiveness Report 2016-2017. According to the report, currently Pakistan ranks at 122 out of 138 analyzed countries (1=best) based on several indicators used for measuring the country’s global competitiveness.\(^{18}\) Although Pakistan’s ranking has moderately improved in recent years, it is still considerably lagging behind its regional and other competitors in the past ten years (Figure 8).

The detailed GCI data reveals that, during 2007-13, largely the deteriorations in performances of macroeconomic environment, infrastructure and institutions were responsible for overall decline in Pakistan’s GCI rank. In contrast, during the last three years, Pakistan’s overall GCI rank has showed gradual improvement. This amelioration, however, is largely contributed by an improvement in the ranking of macroeconomic environment. The improvement in other important pillars such as health, labor, infrastructure and institutions though remained marginal.

\(^{18}\) For each country, these indicators are grouped into 12 main categories or pillars to make a composite Global Competitiveness Index (GCI).
Overall, the analysis both at macro and micro levels indicate that the non-price factors played a major role in determining the export performance of Pakistan in the last decade. As highlighted, despite the stability in the domestic macroeconomic environment and improvement in security conditions in the past couple of years, the global economic conditions remained unfavorable. This has exposed the vulnerability of our exports to global shocks and highlights the resolution of aforementioned structural bottlenecks built over the past decades. The removal of such structural bottlenecks is not only necessary for consolidating the gains achieved from recent macroeconomic stability but also essential for the sustainability of country’s balance of payments position and for its medium-term growth trajectory.
Annexure: Update on Decomposition of Export Growth using Constant Market Share Analysis

Global trade has showed lackluster performance since the global financial crisis of 2007-08. In fact, it has declined by 12 percent during the last two years. The spillover effects of this trend could be seen in both advanced and emerging economies alike. Number of reasons has been identified for this slowdown such as, the transformation of Chinese economy towards more inclusive growth, decline in the role of global value chains, protectionist policies and general decline in private investment across the globe. (For details, see IMF - World Economic Outlook, October 2016).

Pakistan’s external sector, particularly the trend in exports has been a cause of concern for policy makers over the years. While the trend is generally on decline since FY2003-04, it has gathered pace during the past few years. Surely the recent slowdown in global trade volumes played a major role in driving the country’s recent export performance; nevertheless, when compared to performance of regional and other peer competitors in the same period, weak growth in exports from Pakistan is quite obvious (Figure A1). To further extricate the factors that supposed to be responsible for export growth in these countries, we employed a Constant Market Share Analysis (CMSA) technique.\textsuperscript{19} The CMSA essentially decomposes growth of actual exports during a specified period into four parts, viz. the world trade effect, commodity composition effect, market diversification effect and a competitiveness effect.\textsuperscript{20}

Table A1 presents the decomposition of export growth from CMSA technique for selected countries during the period 2009-15. It could be observed that unlike other countries, export growth in Pakistan and Turkey was solely driven by global trade effect during 2009-15. In the same period, the impact of commodity and market diversification had remained marginal in both countries while they lost their market share due to eroding export competitiveness. Countries like Vietnam, Bangladesh and Cambodia, however, significantly gained from improvement in export competitiveness in recent past. In fact, their gain from competitiveness was such large that it offset the loss they faced through inadequate commodity and market diversification.


\textsuperscript{20} Competitiveness effect includes the impact of trade policy, changes in real exchange rate, tariff structure, structural reforms, etc.