

Special Section 3: What has Caused Stagnation in Pakistan's Exports

Stagnation in export revenues have been a consistent source of concern for Pakistan's economy during the previous two decades. Characterized by marginal gains in value; stagnant quantum; and a fall in global market share, the dismal export performance has repeatedly challenged the sustainability of economic growth spurts that Pakistan occasionally enjoyed.¹ While energy constraints are cited as the most binding constraint, factors like real PKR appreciation, recession in advanced economies and snags in tax machinery, have surely put domestic exporters in a tight spot. We can hardly deny presence of all these constraints, but their perceived impact on export performance is perhaps overemphasized: Pakistan's inability to export to its potential is too chronic to be linked up with these contemporary issues. In our view, this inability mainly reflects impediments at structural, institutional and entrepreneurial levels that never really allowed exports to hold ground. In this section, we will discuss these impediments for different sectors, and how similar issues were addressed by other countries in the region.

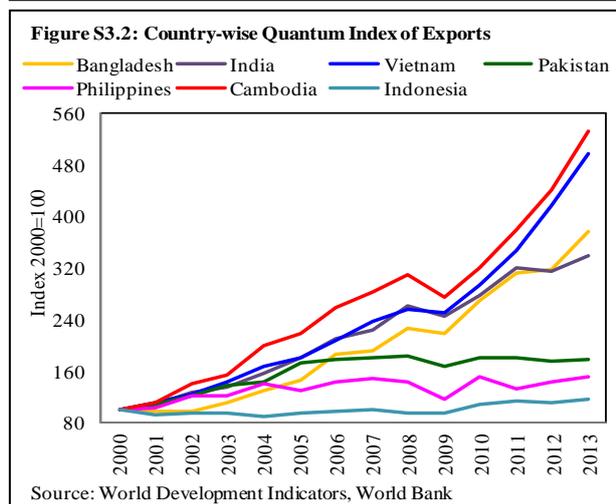
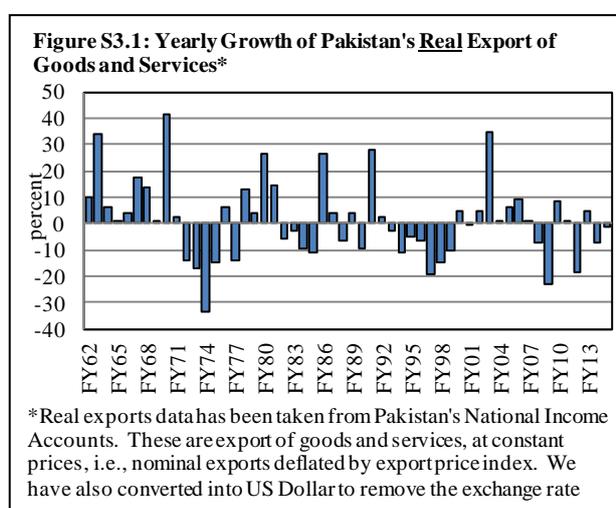
A closer look at the export performance:

Technically speaking, Pakistan's exports never really took off: since 1970s, the growth in real export of goods and services has been patchy and volatile (**Figure S3.1**). This volatility primarily represents the inconsistency in our trade policies, and the fact that Pakistan's exports have always been, and still are, very much resource-based; the availability of key commodities (like cotton and rice) largely determines the magnitude of exportable surplus in a certain year.

Last 10 years have been particularly disturbing. This period marked the beginning of a more competitive global trade regime, in which developing countries were allowed to export to advanced countries without any quota restrictions.² Some countries gained and consolidated their exports, whereas others could not brace up for the challenge. Pakistan was amongst the latter category. As shown in **Figure S3.2**, India, Bangladesh, Cambodia and Vietnam quadrupled their exports, whereas Pakistan, Indonesia and Philippines could barely manage existing volumes.

Why a real long-term growth is not visible?

Before answering this, it is important to lay out certain stylized facts about Pakistan's exports, especially with reference to overall activity in different sectors of the economy.



¹ Whenever the economy experienced demand-driven boosts, macro economic imbalances emerged in the form of higher imports; and large current account deficits. Since FX is the most (or perhaps the only) binding constraint on Pakistan's economic growth, demand compression policies had to be implemented, to take the economy back to its (stagnant) potential.

² The Multi-Fiber Agreement (MFA) governed the textiles and garments trade up till 2004, under which quotas were imposed on developing countries to export to developed countries like the US, Japan and the EU.

Some Stylized Facts on Pakistan's Exports:

- (i) Manufacturing is the most export-oriented sector of the economy (**Table S3.1**). However, due to rising domestic demand and a stiff competition in the export market, share of exports in manufacturing GDP has posted a decline in recent years;³
- (ii) On the flip side, manufactured products constitute nearly 60 percent of Pakistan's total exports, and this share has remained intact over the previous few years. Therefore, overall export performance still depends mostly on manufacturing activity in the country;
- (iii) The export share in livestock and services sectors has consistently been the least. These two sectors have the highest share in Pakistan's GDP (70 percent, combined), but are most inward-oriented;⁴
- (iv) Fishing has the highest export-orientation among all sectors, as nearly half of the produce is sent out to other countries especially in the Asia Pacific;⁵
- (v) Within livestock, meat is the major FX earner with around 74 thousand MT exported in FY15; but this represents only 2 percent of estimated production during the year.⁶ Bigger disappointment is the dairy sector, as Pakistan remains a net importer of dairy products despite being the 4th largest milk producing country in the world;
- (vi) Within services sector, transport and telecommunications constitute the bulk of exports; however, these are only 6 percent of respective sectoral GDPs. Financial sector has been a better performer with exports-to-GDP ratio of 12 percent;⁷
- (vii) In overall terms, nearly 87 percent of the country's value addition is absorbed domestically. Compared to other countries with similar population – like Indonesia and Bangladesh, Pakistan

Table S3.1: Ratio of Sector-wise Exports to Sector-wise GDP

| percent | FY07 | FY08 | FY09 | FY10 | FY11 | FY12 | FY13 | FY14 | FY15 |
|-----------------------------|------|------|------|------|------|------|------|------|------|
| Agriculture | 7.3 | 8.7 | 8.9 | 9.3 | 9.8 | 9.7 | 9.8 | 9.2 | 8.0 |
| Crops | 12.9 | 15.1 | 15.1 | 17.0 | 16.9 | 20.5 | 19.3 | 16.8 | 15.4 |
| Livestock | 2.5 | 2.7 | 2.4 | 2.7 | 3.0 | 2.7 | 2.9 | 3.1 | 2.4 |
| Fishing | 26.7 | 28.2 | 33.5 | 28.6 | 40.7 | 45.4 | 42.4 | 47.6 | 38.3 |
| Industry | 47.8 | 42.6 | 44.3 | 44.2 | 44.6 | 38.6 | 40.8 | 40.6 | 38.1 |
| Mining | 19.1 | 28.1 | 17.5 | 21.5 | 27.2 | 15.8 | 4.5 | 14.3 | 12.3 |
| Manufacturing | 67.3 | 56.8 | 62.5 | 61.4 | 60.9 | 55.0 | 59.8 | 57.7 | 55.9 |
| Services | 5.1 | 3.9 | 4.6 | 5.6 | 5.3 | 4.3 | 5.6 | 4.3 | 4.2 |
| Total goods* | 26.7 | 25.3 | 25.1 | 25.3 | 25.4 | 23.4 | 24.0 | 23.5 | 22.2 |
| Goods & services | 14.6 | 13.7 | 13.6 | 14.4 | 14.8 | 13.2 | 14.0 | 13.1 | 11.6 |

Notes: Export of agriculture includes all food items plus raw cotton, plus raw hides and skin. Raw cotton has been added in crop sub-sector, whereas raw hides and skin has been added in the livestock sub-sector. All dairy products and meat have been included in livestock exports. Mining exports include all mineral products that come under HS codes 25 to 27. However, cement has been excluded from this list, and has been added in manufacturing exports. *Goods exports divided by commodity producing GDP (i.e., agriculture plus industry). Source: Goods data has been taken from PBS, whereas services export data has been extracted from the balance of payments, compiled by SBP.

is surely producing a smaller exportable surplus.⁸

³ Manufacturing exports are calculated as total exports, minus food items, live animals, raw cotton and mining products (HS codes 25 to 27). For other details, see Notes in **Table S3.1**. This definition synchronizes with the one used by the World Bank in computing World Development Indicators.

⁴ For instance, wholesale and retail trade is the single most important component of services sector GDP, with a share of 35 percent. This segment by definition is to capture trade activity in the domestic market.

⁵ Ten years back, EU countries were the major buyers of Pakistani seafood, but today their share is negligible.

⁶ According to Economic Survey 2014-15, total meat production is estimated at 3.7 million MT.

⁷ Financial sector exports from Pakistan mainly include insurance charges for export/import; commission charged by banks on SCRA related transactions by non-residents; fee/commission charged by banks on profit/dividend repatriations by multi-nationals; etc.

⁸ For countries with smaller population like Vietnam, Cambodia, Thailand, etc., promoting export is a national strategy to boost overall economic growth. For very big countries like China and India, it is relatively easy for firms to attain economies of scale, which makes them compatible in the global market. The share of export of goods and services of

Anti-Export Bias: The Legacy of Import Substitution

If we closely analyze Pakistan's trade and industrial policies over the past four decades, it becomes clear that the incentive structures laid out in the country's trade policies, had always favored import-substitution industries. This favor was not completely out of place: East Asian countries too had adopted import substitution policies throughout 1950s and 60s. However, import substitution policy in East Asia did not produce the anti-export bias like it did in Pakistan (and many other countries).⁹ While exporting sectors in East Asian countries were provided with offsetting incentives like duty exemptions, free-trade zones, institutional support, etc.; in case of Pakistan, these sectors were forced to pay higher import price for inputs than the prevailing international prices.¹⁰

To reduce this bias, successive governments took measures to boost exports, but those were limited in comparison to incentives for import substitution activity.^{11,12} Even when the government introduced comprehensive tariff reforms under the 'New Trade Policy', and announced export promotion measures in 1980s, the anti-export bias remained strong.^{13,14} More importantly, private investments that took place after the IFI-financed reforms during 1988-93, also had limited export orientation:¹⁵ new entrants in cement, sugar, automobiles and electronics sectors were eyeing to substitute imports, and the investment in thermal generation was also to cater growing domestic needs.

Unfortunately, the realization to put in place an export-led growth strategy is yet to be visible in policy-making circles.¹⁶ Although tariff structure has largely been rationalized over the liberalization phase, there are exemptions given to certain sectors (especially raw materials), which signify a tinge of policy bias towards import competing industries.^{17,18}

Indonesia, Bangladesh and Nigeria is 25 percent, 20 percent and 16 percent, respectively. However, Pakistan fares well with Brazil that has an export share of only 11 percent in its GDP (this low share mainly represents a huge dependence of resource-rich Brazil on primary commodities, for both its exports as well as GDP).

⁹ Source: Leipziger, M. Danny and Thomas, Vinod (1993). "The Lessons of East Asia: An Overview of Country Experience." The World Bank, Washington DC.

¹⁰ As Hassan (2013) puts it: "The anti-export bias in policy was reinforced by an industrial strategy that favored manufacturing based on processing domestic raw materials. Export development based on imported inputs was strongly discriminated against by generally high import duties....the spurts of export growth that materialized in the 1960s and 1980s were, to a large extent, supported artificially by indirect subsidies to the textile sector, which kept the domestic price of cotton well below the international price and thus encouraged relative low value-added textile products, notable cotton yarn." Source: Hasan, Parvez (2013). "Failed Economic Promise: Lessons from Pakistan's Development Experience" in "Pakistan Moving the Economy Forward by Lahore School of Economics. May, 2013.

¹¹ For instance, the government devalued the PKR in 1973, and eventually delinked it from the US Dollar; reduced import tariffs; switched to negative list regime in 1983; and announced facilities to import raw material and capital goods to produce exportable items.

¹² Khan, M. Z. (1999). Liberalization and Economic Crisis in Pakistan: Volume 9, in *Rising to the Challenge in Asia: A Study of Financial Markets* (pp. 1-35). Manila, Philippines: Asian Development Bank.

¹³ The reduction in bias achieved via cuts in import tariffs, was more than offset by imposition of import surcharges and elimination of compensatory rebates in 1986. (Source: Khan H. Ashfaq (1998). "The Experience of Trade Liberalization in Pakistan". The Pakistan Development Review. part II (Winter 1998) pp 37:4 , 661-685).

¹⁴ Export promotion measures included opening up of rice and cotton export to the private sector; provision of FX for marketing of goods abroad; linking income tax concession on export earnings to the value-added content; and the introduction of value-added criterion in the allocation of textile export quotas.

¹⁵ Reforms in the industrial sector included deregulation, de-control, privatization, tariff reductions, regulation of foreign investments, and abolishment of investment licensing.

¹⁶ Not only did the protectionist regime suppress investment in export-oriented industries, it also made protected industries inherently inefficient. As a result, when these sectors were exposed to international competition following the trade liberalization measures, it was hard for them to re-position themselves to compete effectively in the global market.

¹⁷ In its recent trade policy review for Pakistan, the WTO noted: "Despite cautious liberalization, overall tariff levels remain high, which weakens productivity growth and constitutes an impediment to efficient resource allocation and the integration of Pakistan into global value chains. In addition, the use of ad hoc trade policy instruments under SROs remains common and severely undermines the predictability of the trade regime; it also supports a culture of rent-seeking." (Source: WTO, WT/TPR/S/311, Trade Policy Review, Report by the Secretariat, on Pakistan. February, 2015).

Export Enhancing Measures Lack Coherence

While the overall industrial strategy remained fixated on domestic market, export enhancement measures lacked clarity and were not supplemented by other policies. Recall what East Asian economies did to promote exports: at first, they adopted policies to help core sectors develop from low value-added to high value-added products; side by side, they also identified other (secondary) sectors to progress over the medium-term. Secondly, to achieve policy targets, these sectors were provided strategic incentives: cheap credit; supportive tariff structure; technological improvement via capital import; and collaborations with multi-nationals. Education sector was also taken on board so as to develop a workforce that could work in those chosen sectors. So effectively, export expansion was the one-point agenda that set the long-term direction for all sets of policies in the area of industry; finance; education; and commerce. This focused strategy has been missing in case of Pakistan.¹⁹

Pakistan has focused mainly on incentives like rebates, subsidized credit, duty drawbacks, R&D fund allocation, etc., that used to get announced in the Annual Trade Policy. However, little attention has been paid on improving the quality of human capital. Not only the quantity and quality of education remained low but technical and vocational education could also not flourish.²⁰ Similarly, a lack of policy clarity towards achieving technological advancement in SME sector, has also cost the economy dearly. In the last decade, governments had been setting overly ambitious export targets at various levels, but without an articulated strategy in terms of a practical policy action.²¹ These targets have been set keeping in view an overwhelming list of desirable outcomes like enhancing efficiency; ensuring lower cost of inputs; increase productivity; introduce innovative technology; etc; but it was never worked out as to how to achieve these outcomes, and what specific time-bound measures were needed.

Missing Export Culture of Multinationals

In the previous couple of decades, global trade of goods and services has been dominated by the presence of global value chains.²² The importance of multi-national enterprises (MNEs) in promoting export culture in host countries, can be gauged from the fact that these enterprises are contributing

¹⁸ For instance, import of important raw materials like polymers of ethylene and, propylene (HS codes 3901 and 3902) have to face 5 percent tariff in Pakistan, whereas in Vietnam and Cambodia, these items are allowed to import at zero tariff. These two polymers (plastic material) are used in a wide range of industries like automobiles, toys, plastic furniture, etc., and together, their import cost over US\$ 1 billion every year to Pakistan. Similarly, polyester staple fiber, which is the major raw-material for producing synthetic textiles, also has to face 6 percent tariff; this item is also allowed by Vietnam and Cambodia at zero tariff.

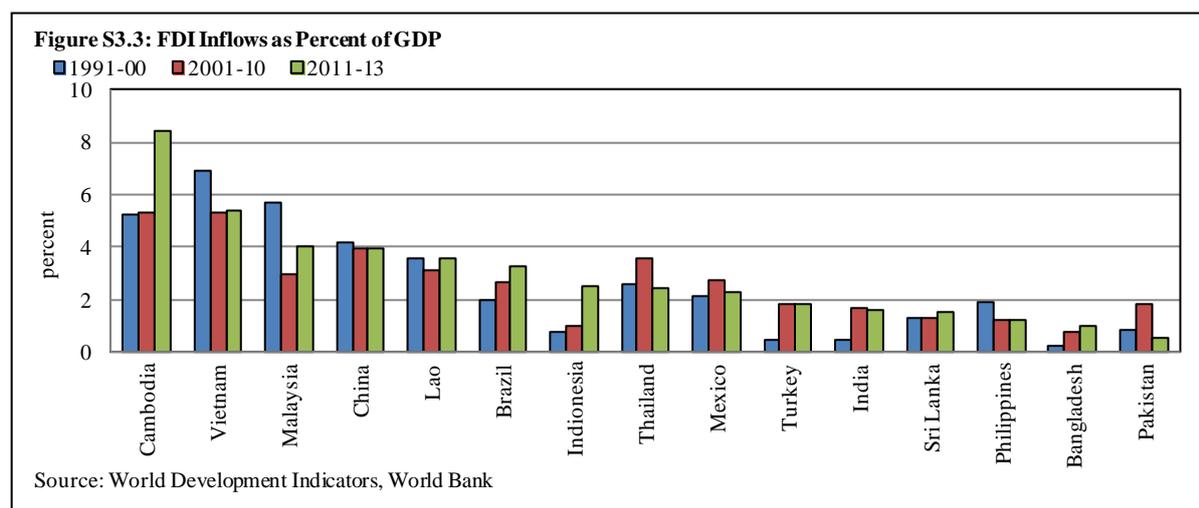
¹⁹ It may be argued that East Asian economies are small in size and export was the *only* growth strategy available; *that* exclusive attention to exports was not needed for Pakistan. True, but then this makes Pakistan's overall trade policy, inherently inconsistent. Specifically, concerns over export sluggishness emerged only because of recurring BoP crises in the country: our imports far exceed exports, and when debt financing is not available (FDI has remained low), our reserves deplete. So if imports were not pumping up, the need to boost exports would not be there. But here comes the role of the trade policy: instead of phased and planned liberalization, Pakistan reduced import tariffs for consumer and capital goods simultaneously. Making things more challenging, the free trade agreement with China was rectified in 2006, which also induced an influx of cheap imports into the country, hurting local industries. As a result of this unbalanced policy – i.e., liberal imports without a national export strategy, neither did exports increase, nor could the domestic industry develop; the outcome was increased penetration of imports into the economy and frequent FX crises.

²⁰ McCartney, Matthew (2014). "A Comparative Study of the Textiles Industry in Pakistan". The Lahore Journal of Economics, Volume 19, Special Edition, September 2014.

²¹ For instance, the government had announced the Export Plan Pakistan back in 2007 that set a target of taking exports to \$40-45 billion by FY13; Similarly, Strategic Trade Policy Framework (2012-15) was announced in 2012, which projected exports to total \$95 billion by during FY13 –FY15 (\$32 billion every year). And more recently, the Vision 2025 aims to increase Pakistan's annual exports to US\$ 150 billion by 2025.

²² Global value chains refer to internationalization of business operations across multiple locations, in order to increase efficiency, lower costs, and speedier production. Supported by advances in information, communication and transport technologies, these global value chains enable the corporates to gain competitiveness, and also add employment opportunities in participating countries. Source: "Global Value Chains in a Changing World" Edited by Deborah K. Elms and Patrick Low. World Trade Organization Publications, 2013.

nearly 80 percent of world's exports.²³ Unfortunately, Pakistan's has never been able to attract export-oriented FDI, the way many East Asian and Latin American countries did. Instead, the FDI that came into Pakistan was, to a large extent, focused towards capturing the domestic market (e.g., IPPs, cement, chemicals, automobiles and pharmaceuticals). This was a logical outcome of kind of policies that Pakistan had adopted for industrialization.²⁴ However, what is more worrisome is that Pakistan could not even benefit from indirect impact on export growth, as FDI remained concentrated in few sectors and volumes remained too low to make a significant impact on the country's technological capabilities.²⁵



Here, it is important to recall that the export success of East Asian countries was driven primarily by investments by Japanese investors in the newly industrialized countries (NIEs)²⁶ and ASEAN-4.²⁷ Chinese manufacturing sector has also taken leaps with the help of FDI from Japan and NIEs, and today over half of China's exports originate from foreign invested enterprises.²⁸ The recent export boom in Vietnam and Cambodia, is also FDI-led. As shown in **Figure S3.3**, South Asia has never been on the radar of foreign investors.

No Legal Cover for Product Innovation and Identification

Pakistan does not have an adequate legal mechanism to protect and enforce the intellectual property rights, including copyright, patents, industrial designs, trademarks, and geographical indications.²⁹

²³ Source: World Economic Forum, "Foreign Direct Investment as a Key Driver for Trade, Growth and Prosperity: The Case for a Multilateral Agreement on Investment". Published by World Economic Forum, Geneva, Switzerland, 2013.

²⁴ As noted by Hamdani (2013), "FDI has been mainly market seeking and so, its benefits of technology transfer have not flowed directly into the export industries....A general failure of the foreign manufacturing affiliates operating in Pakistan in all industries has been their reluctance to develop an export-oriented approach, even within the global network of their parent companies." Source: Hamdani, Khalil (2013). "Benefiting from Foreign Direct Investment" in "Pakistan, Moving the Economy Forward", by Lahore School of Economics, pp 327.

²⁵ FDI promotes exports via following channels: (i) capital expansions; (ii) technology transfers and product innovation; (iii) facilitating access to new and large foreign markets, (d) training the local workforce and improving technical and management skills.

²⁶ NIEs include Korea, Singapore, Taiwan and Hong Kong

²⁷ ASEAN-4 countries include Indonesia, Malaysia, Philippines and Thailand.

²⁸ Source: China Statistical Yearbook 2014, by National Bureau of Statistics of China.

²⁹ Intellectual property rights systems provide the institutional framework to promote two economic goals. First, patent and copyright laws grant certain exclusive rights to the developers and creators of intellectual property, encouraging intellectual creative activity and promoting the effective use of resources in the development of new technologies and the discovery of new knowledge, thereby enhancing the intellectual infrastructure for economic development. Second, marks and indications of goods and services, such as trademarks and geographical indications, enable businesses to maintain public trust and promote fair competition. Source: Ministry of Economy, Trade and Industry, Japan (<http://www.meti.go.jp/english/report/data/g400112e.html>).

This insufficient legislation is directly hurting export growth in some sectors, and is also discouraging private sector to undertake costly research and development activity in the country. Export growth in three industries is suffering the most: cotton textiles; basmati rice; and computer software.

In case of cotton, the absence of intellectual property rights (IPRs) has kept companies away from spending on developing superior varieties of cotton seeds.³⁰ More specifically, Plant Breeders' Rights Act (PBRA) is waiting to get enacted in the country for last 11 years, which would grant patents to seed developers.³¹ Understandably, this insufficient legislation has also deterred foreign companies to enter the Pakistani market.³² As a result, most of the seeds available in the market are of low quality.³³ Not surprisingly, therefore, cotton yield has remained suppressed in Pakistan that has effectively placed a lid on textile export growth.³⁴ It is important to recall here that introduction of high-quality seeds have significantly contributed to yield gains in India and other countries over the last decade.³⁵

Basmati export is another casualty of lack of IPRs. Pakistani authorities have been unable to claim Geographical Indication (GI) for local basmati, simply because there is no legal framework for GI in Pakistan.^{36,37} In place of GI, there is only Intellectual Property Organization – IPO Pakistan; however, trademarks registered under IPO are not recognized abroad. India, on the other hand, had enacted the Geographical Indications of Goods (Registration and Protection) Act, 1999, with effect from September 2003.³⁸ Under this Act, India's state-owned Agricultural and Processed Food Products Export Development Authority (APEDA) had filed the application for GI for basmati five years ago,³⁹ though the case is under litigation, it will completely wipe out Pakistan's chances to excel in basmati exports if approved.⁴⁰

³⁰ Since the Seed Act 1976 did not allow introducing new seeds by the private sector, it remained silent on the IPRs.

³¹ Also missing from the picture are the quality controls: a number of firms sell fake/adulterated varieties of genetically modified seeds, which have consistently failed to enhance cotton yield.

³² The other side of this picture is even worse: the government is still to decide whether to allow foreign companies like Monsanto and Syngenta to introduce their genetically modified seeds in Pakistan; no field trials have been conducted as yet to assess their effectiveness and repercussions. It is important to recall here that these seeds have significantly contributed to yield gains in India and other countries over the last decade.

³³ Presently, there are around 750 companies in Pakistan that deal with cotton seeds. Compared to the requirement of 40,000 MT *certified* cotton seeds in the country, only 4,630 MT are available every year. Furthermore, only 13 percent of the seeds available in Pakistani market are certified; this compares quite poorly to the availability of 98 percent certified seeds in the Indian market. Germination in cotton seeds has a success rate of only 50 percent, compared to 95 percent in India.

³⁴ It is encouraging to note that necessary amendments in the Seed Act 1976 have been approved by the Parliament in July 2015; these amendments authorize the private sector to produce basic seed and its varieties.

³⁵ Source: (i) Choudhary, B., and K. Gaur. 2010. *Bt Cotton in India: A Country Profile*. ISAAA Series of Biotech Crop Profiles. Ithaca, NY, US: International Service for the Acquisition of Agri-biotech Applications; and (ii) a more detailed description of peer-reviewed studies on the impact of Bt cotton has been presented in *BT Cotton In India: A Status Report (Second Edition) 2009*, by Asia-Pacific Consortium on Agricultural Biotechnology.

³⁶ Geographical indication (GI) is a name or sign used on certain products which corresponds to a specific geographical location or origin (e.g. a town, region, or country). The use of a GI effectively act as a certification that the product possesses certain qualities due to its geographical origin.

³⁷ Pakistan has not been able to enact a GI law in the country despite the fact that a large number of products qualify for getting such protection like *Peshawarai chappal*, *Multani halva*, *Kasuri methi*, and *Hala's ajrak*, among others. WTO members need to give protection to GIs under the TRIPs agreement; however, unless Pakistan provides GI protection to its goods by its law, we could not obtain GI protection for our goods in other countries that have the GI law.

³⁸ A number of products were granted GI tag like *Darjeeling tea*, *Mysore silk* and *Kashmir Pashmina*, which meant that none other than those registered as authorized users (or at least those residing inside the geographic territory) are allowed to use the popular product name.

³⁹ APEDA had applied to include Punjab, Haryana, Delhi, Himachal Pradesh, Uttarakhand, and parts of Uttar Pradesh and occupied Jammu & Kashmir, as basmati growing regions.

⁴⁰ APEDA has challenged the inclusion of Madhya Pradesh among Basmati growing regions, whereas Basmati Growers Association of Pakistan has also appealed against this registration in the Intellectual Property Appeal Board (IPAB). Earlier, Pakistan's Trademark Registry had accepted application of Punjab-based Basmati Growers Association to register Basmati as a trademark. However, this was challenged by APEDA, and the case is still pending in Sindh High Court. Pakistan's Rice Exporters Association of Pakistan (REAP) is also contesting against the decision for not including Sindh in basmati growing regions.

In case of the Information and Computer Technology (ICT) industry, incomplete and outdated legal framework has restricted both local and foreign investment. More specifically, several laws await promulgation including “Data Protection Act”, “Confidentiality Law” and “Privacy Law”. Pakistani companies face severe competition when they have to compete against companies from countries that provide legal cover to protection and security of data in accordance with international requirements. Similarly, Pakistan’s Patent Ordinance 2000 does not include “Software Registration”, which raises concern amongst our IT programmers, data processors and researchers about the security of their innovations, source codes and programs.

Hard to control the informal sectors

Another reason for a dismal export performance is the presence of informal players in potential sectors. For instance, Pakistan’s dairy sector is predominantly comprised of informal production and processing, and under current set up, it is hard for the government to take effective measures to increase dairy exports.⁴¹ Most of the milk animals in the national herd are raised and bred by subsistent farmers with limited knowledge, and to some extent, interest in enhancing productivity.⁴² In addition, due to scattered production, it is hard to control the entire value chain.⁴³ Therefore Pakistan, despite being the 4th largest milk producer in the world, has not been able to enjoy benefits from its comparative advantage.

Pakistan’s Image as Supplier of Quality Products

In some sectors, Pakistan has not been able to build a rapport of being a quality supplier, e.g., horticulture; more specifically, fruit exports. It appears that the entire fruit supply chain is in dilapidated state, right from the picking of fruits from trees and on-farm transportation, down to packaging, grading, farm-to-market transportation and wholesaling. Serious deterioration of fruit quality happens at every step.⁴⁴ Although many large exporters and processors have certifications required for exports, but these certifications only ensure food safety and operations – not the quality itself.⁴⁵

Quality Certifications are Costly

To be able to sell goods and services in the international market, local firms need to comply with technical regulations and standards.⁴⁶ Non-compliance to these standards can act as an important

⁴¹ Nearly 95 percent of the country’s milk production takes place in the informal sector. Similarly, only 3 percent of the total milk production is processed in the formal sector (Source: “Enhancing Dairy Sector Export Competitiveness” by Trade Related Technical Assistance Program (TRTA II) of International Trade Center, 2013).

⁴² Wastage of milk during transportation and calving, low productivity in majority of farm animals due to inherent weaknesses and inappropriate feed, lack of interest in majority of farmers’ community to adopt best breeding and milking practices, limited investment in the value added industry etc. are the main factors that restrict exports.

⁴³ For example the products extracted from milk, in most instances, are produced at one place, processed at another, packed at a third place by a vendor and sold by a separate distribution system.

⁴⁴ Source: Policy Reforms to Enhance Competitiveness and Exports of Horticulture (Kinnow and Mango), by Trade Related Technical Assistance Program TRTA II, Funded by the European Union. (Web link: <http://trtapakistan.org/7297AF63-383B-460B-B5A8-D8E660FE3065/FinalDownload/DownloadId-850B22F631050157B829D9C3068A655D/7297AF63-383B-460B-B5A8-D8E660FE3065/wp-content/uploads/2013/10/Mango-and-Kinnow.pdf>).

⁴⁵ The Plant Protection and Quarantine Department is the government institution in Pakistan, which is responsible for overseeing whether the export of fruits is in accordance with the International Plant Protection Convention rules, to which Pakistan is a signatory. Typically this department does not disqualify export consignments on grounds of size and shape of the fruit; stage of ripening process; packaging; etc., especially if it meets other phytosanitary requirements (e.g., absence of fruit flies). (Source: same as in footnote 44).

⁴⁶ These standards and technical regulations address a wide range of issues – from labour conditions, health and safety issues, and quality management systems, to environmental and social concerns. Within the WTO regime, all member countries are signatories to two important agreement related to standards and technical regulations: (i) Technical Barriers to Trade, which recognizes the importance of international standards and conformity assessment systems in improving efficiency of production and facilitating international trade; and (ii) Sanitary and Phytosanitary Measures, which allows

barrier to export, as this can lead either to an outright ban on the export of certain products, or imposition of cost-intensive compliance requirements.⁴⁷ Pakistan has faced outright bans on export of some products (like surgical equipments and seafood) in the past due to non-compliance of international standards.⁴⁸ Furthermore, many firms in the SME sector are not able to export as quality certifications are quite expensive.

For instance, surgical goods industry faces strict compliance requirements, especially the costly CE marking.⁴⁹ Similarly, fan exporters need to acquire UL certification of safety standards, if they want to penetrate in the North American markets.⁵⁰ However, the certification process costs nearly a million Rupees per product, and therefore, only a couple of large firms in Pakistan are reported to have this certification.⁵¹

Another problem related with certification is unawareness among exporters. For instance, in case of meat exports (both raw and processed), nearly all firms have acquired Halaal certification, which is necessary for exporting to the Middle-Eastern countries that account for more than 85 percent of Pakistan's exports. However, the compliance status for European and North American countries is dismal: less than 15 percent firms comply with HACCP and BRC standards, required to export to these countries.⁵² More worryingly, most exporting firms are not even aware of Traceability certification, which is an essential requirement for accessing the European meat market.⁵³ This basically reflects the limited vision of our exporters who are probably not even considering exporting their products in these high-end markets.

Components are not standardized in SMEs

SMEs contribute nearly 30 percent of Pakistan's GDP and 25 percent of export of manufactured goods.⁵⁴ Most of items that SMEs export include light engineering products like fans, surgical instruments and sports goods. This problem of quality control is most challenging in case of electric fans: despite a huge vendor base around the fan production clusters in Gujrat and Gujranwala, nearly half of the fan manufacturers are dissatisfied with quality and availability of inputs.⁵⁵ A major issue is the non-standardization of these parts, which does not allow them to export a consistent quality

WTO members to restrict international trade based on regulations to ensure food safety, and to prevent the spread of diseases among animals and plants.

⁴⁷ Significant costs arise from testing, labeling, laboratory testing, and certification of products and processes, which sometimes requires the adjustment of production facilities to comply with the requirements. Small and medium enterprises are particularly discouraged from exporting, as quality certifications and other requirements entail heavy costs.

⁴⁸ For instance, In March 2009, Food and Drug Administration of the US refused entry to several items of surgical equipment and a number of other export items from Pakistan, because production did not conform to applicable requirements. Similarly, fisheries exports to the EU were put on hold in 2007, due to non-compliance with EU regulations on health and safety (the ban was lifted in 2013). In the year 2014, more than 220 consignments of fruits from Pakistan were restricted access to or withdrawn from the markets in the EU. (Source: "Assessment and Analysis of Certification Requirements in Selected Export Sectors of Pakistan", prepared by the National Productivity Organization (NPO) and European Union (EU) funded Trade Related Technical Assistance (TRTA II) Program, implemented by UNIDO in association with ITC and WIPO).

⁴⁹ Officially, "CE" is an abbreviation of *Conformité Européenne*, meaning "European Conformity". The CE marking is the manufacturer's declaration that the product meets the requirements of the applicable EC directives.

⁵⁰ Presently, Pakistan exports electric fans to Bangladesh, Iraq, Yemen, UAE, Saudi Arabia, Afghanistan, Sudan and Jordan.

⁵¹ Source: "Assessment and Analysis of Certification Requirements in Selected Export Sectors of Pakistan", prepared by the National Productivity Organization (NPO) and European Union (EU) funded Trade Related Technical Assistance (TRTA II) Program, implemented by UNIDO in association with ITC and WIPO.

⁵² Source: same as footnote 45.

⁵³ The importers of raw and processed meat in the Middle East and Southeast Asia require two certifications: Halal Certification and HACCP. Potential buyers in Europe and the UK require HACCP and traceability certifications, followed by BRC and FSSC 22000.

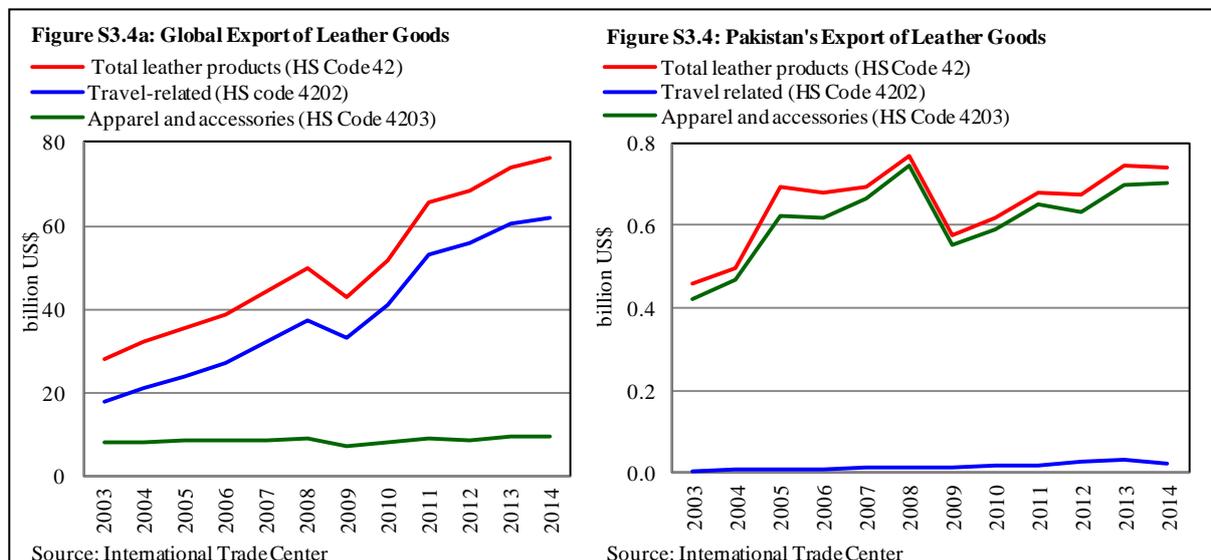
⁵⁴ Source: International Finance Corporation, World Bank "Islamic Banking Opportunities across Small and Medium Enterprises" 2014.

⁵⁵ Munir, Kamal and Khan, Usman (2011). "Fan Industry in Gujrat and Gujranwala: An SME Cluster Study". A Research Study by LUMS under the SME Cluster Survey Project of State Bank of Pakistan 2010-11.

product.⁵⁶ Therefore, to produce high quality fans, large firms rely on imported raw materials like electrical steel sheets, copper enameled wire, ball bearing, PVC, etc. Since price of these imported components is determined by global demand and supply, firms that use these components have to put up with price fluctuations.

Stuck with old-fashioned products

A rather glaring failure of Pakistan's export sector is the demand-supply mismatch: Pakistani exporters are stuck with products that are losing value or appeal in the global market. For instance, Pakistan's textile industry is heavily cotton-oriented (70 percent), whereas globally, the demand for cotton-based textiles is losing ground. Presently, cotton constitutes only 33 percent of global apparel consumption;⁵⁷ its place has largely been taken by the use of synthetic fibers with a 60 percent share.⁵⁸ There are multiple reasons why synthetic textiles could not flourish in Pakistan. At first, there is no downstream petrochemical industry in the country, which makes it dependent on imported polyester staple fibers (PSF), filaments, synthetic yarns and fabric.⁵⁹ Secondly, the use of synthetic fiber in textiles industry has also been obstructed by heavy protection to this sector over the years.⁶⁰



Another example of product mismatch is leather goods export. Global market for these products is changing rapidly, as the demand for leather garments is fading away and consumers are drifting towards *leather-like* materials including leatherette and faux leather, which are produced using synthetic fibers.⁶¹ However, the overall use of leather has not declined. In place of garments, leather is now being used mostly in travel-related items like trunks, handbags, suitcases, camera cases, etc. As shown in **Figure S3.4**, global export of leather garments has stagnated in the last 10 years, and its

⁵⁶ Within fan clusters in Gujrat and Gujranwala, there are about 700 specialized vendors that produce different components including castings, fan guards, stands, rods, enameled copper wire, fan bodies, bush gears, shafts, etc. Level of vertical integration is quite low, as production processes are technically divisible. Therefore, every vendor produces only one or two of the components required by fan assemblers. Source:

⁵⁷ This is in comparison to 60 percent in 1960 and 50 percent in 1980 (Source: FAO).

⁵⁸ Other fibers include wool (2.1 percent), flax (1.0 percent) and cellulosic fibers (3.9 percent).

⁵⁹ Countries that have an indigenous petrochemical industry have a natural advantage in the export of synthetic textiles over others. For instance, China, Vietnam, Indonesia, and India are among the top-10 exporters of man-made fiber apparel in the US market. Of these countries, China, India and Indonesia are among world's largest producer of man-made fibers.

⁶⁰ More specifically, the import of polyester staple fiber had remained heavily protected, with tariff rates of 25 percent throughout the quota regime, which discouraged its use in textile manufacturing. Pakistani quotas for women clothing and children wear remained largely unutilized, as these require mixed fibers. Even today, it takes 6 percent tariff to import PSF into Pakistan, whereas for Vietnam and Bangladesh, this import is free of tariff.

⁶¹ And as mentioned before, Pakistan is not into producing synthetic textiles.

share in total leather goods export has been reduced to only 12 percent. Pakistani exporters seem oblivious to this trend. Garments still constitute 93 percent of our total leather goods exports, whereas export of travel goods export is virtually non-existent.⁶²

Resource Availability

Pakistan has done little to increase the availability of materials used in export manufacturing. Two sectors that have suffered the most are textiles and leather: both the industries complain of insufficient availability of the right quantity and quality of their key raw material, i.e., long-staple cotton and hides/skins.

The problem with leather exports mainly represents the demand-supply gap arising from the export of live animals; the industry also complains of wide-scale smuggling to Afghanistan and Iran. Even the available livestock cannot be optimally utilized by leather industry, as inadequate practices of slaughtering in the country reduce the quality of hides and skins to low grades.⁶³ Damages are also done during collection and preservation phases. In fact, there are many factors which affect the quality of leather at pre-slaughtering stage: it is estimated that around 20-25 percent of the hides and skins are affected by pre-slaughtering damages, like skin-cuts, rashes, diseases, injuries, etc.⁶⁴

Similarly, in the textiles sector, there exists a huge concentration within the garment sector in products, which *can* be produced using local cotton.⁶⁵ Pakistan produces short-to-medium staple cotton that is most suited for the production of low-count (rough textured) yarn. This kind of yarn is largely used in producing bed-wear, tents, canvas, towels, tarpaulin, etc. Among wearing items, coarse yarn works mainly for producing denim, chinos, polo shirts and kind of T-shirts that are sold at discount stores like Wal-Mart. However, for most wearing apparels, customers prefer fine thread counts for a softer feel. Pakistan has to import long-staple cotton (and high-count yarns) from Egypt, China and the US, to produce finished apparel products.

Lack of investment in human resources

For large firms that supply to international brands directly, investing in labor quality to comply with international standards, is a must. However for other firms, investing in labor is a risky task, because labor retention is uncertain, and training entails huge cost. Absence of proper training facilities is also causing problems for small industries. For instance, surgical goods industry depends on vocational trainings in public institutes to find skilled labor for production. They cannot provide in-house training to young labor, as they would run afoul of international labor laws to which Pakistan is a signatory.⁶⁶ However, these institutes are not able to deliver desired quality of labor due to lack of facilities.

⁶² Although Pakistan's share in leather garment exports has increased, it is still to make a niche in the fast-paced travel goods market, which has achieved a worth of US\$ 62 billion.

⁶³ The grading system is the method via which manufacturers present their pricing structures to retail dealers. In Pakistan, leather garments are made mostly from low grade & medium grade leather. If the quality falls below low grade, it may result in rejection from the buyer.

⁶⁴ Source: "Leather Sector Analysis" by "Pakistan Institute of Trade and Development (PITAD), September 2012.

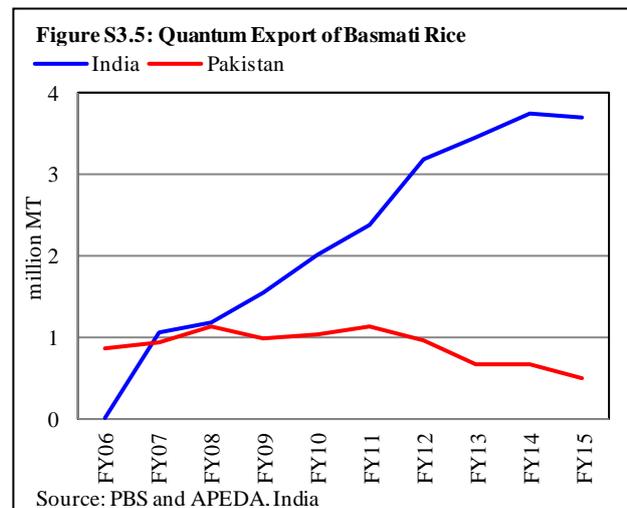
⁶⁵ Since garment firms in Pakistan produce similar products (lack of product diversification), they undercut each other to secure export orders.

⁶⁶ Like other industries in Sialkot, surgical instrument industry is also highly labor-intensive. Traditionally, this industry used to work on apprentice system (known as *ustaad-shaagird*), as per which young labor used to work for some 5 to 7 years in a manufacturing unit, to acquire skill-set for producing surgical instruments. However, with the gradual phasing out of child labor from the country, this system has collapsed and there is a severe dearth of trained and skilled labor force. It was earlier planned that instead of working in hazardous conditions of manufacturing unit, children would be given training in public institutes like Sialkot Surgical Training Institute, to keep skilled labor in the pipeline. However, this did not happen due to lack of facilities available in these institutes.

Not Many Brands of our Own

Isn't this unfortunate that millions of consumers worldwide are using/consuming Pakistani products without even realizing it? This is primarily because most Pakistani firms are supplying to established global brands; consumers only see the label, not the origin of the product. This business strategy put supplying firms in a disadvantageous position, as consumers remain loyal to brands no matter where they source their supplies from. Therefore, it is the suppliers who face the brunt if any conflict of interest between vendors and brands arise. For instance, when Walt Disney Company blacklisted products from Pakistan, vendors who were earlier supplying to the company could not sell their products independently, but consumers continued to buy Walt Disney products which were sourced from other countries.⁶⁷ Similarly, when big apparel and home stores including Nike, JC Penny, Target, Sears, etc., insisted large apparel firms to install production units outside Pakistan to reduce suppliers' risk, local firms had no other option but to comply: many Pakistani apparel manufacturers had to add capacities outside Pakistan, especially Bangladesh.

Typically, firms do not invest in brands because it entails high retail expense, including; distributor networks and commission; shelving charges; registration brand listing in hypermarkets abroad. What they do not realize is that cost of *not* investing in branding is also huge. In case of basmati rice, private sector has not been able to counter branding and marketing techniques of their (Indian) competitors. With few exceptions, business strategy of Pakistani basmati exporters had most of the time been to supply unbranded rice in bulk. Anecdotal evidence suggests that in some cases, the importing countries re-packaged and labeled Pakistani rice for onward shipments, and in other, Pakistani exporters themselves were packaging their shipments in importers' brand name. As a result, well-established Indian brands with a strong distribution and marketing network, managed to quadruple their exports in just ten years, beating out Pakistani competitors by a wide margin (**Figure S3.5**).



Snags in tax machinery

Delay in refunds and duty drawbacks is one of the most commonly cited issue from Pakistani exporters. Export rebate is given to the exporters to facilitate the export sectors, by paying back custom duty, sales tax and excise duty etc., which exporters pay on imported raw materials, against the claims of the exporters. Textiles, leather, carpet, sports goods and surgical instrument industries are prime beneficiaries of this facility. However, the refund process is painfully slow, which results in huge volume of refunds stuck with the revenue authorities. As per industry's claims, over Rs 200 billion refunds are presently pending, which adversely hit cash flow of exporting firms.

Roadmap to Enhance Exports

The two-most important concerns that had plagued export growth in the previous few years were energy shortages and the country security perception. As mentioned before, both these indicators have started showing signs of improvement. As noted in **Chapter 7**, the ongoing operation against militants all across the country has brought desirable results, and the country's image abroad has also

⁶⁷ Walt Disney dropped Pakistan from its list of "Permitted Sourcing Countries" from April 1, 2014, on the grounds of "poor governance standards". Products of Disney brand are being produced by thousands of independent vendors working in numerous manufacturing facilities around the world including Bangladesh, China and India.

started to improve. On the energy front, new investments are in pipeline for enhancing power generation and transmission capacity. In the meantime, the government has exempted industrial sector from power load shedding during FY15. Nonetheless, a reliable supply of uninterrupted energy would remain essential for promoting investment in the country.

While energy related reforms are being taken, it is time to move on to addressing other structural issues that never allowed exports to grow. This requires strong commitment, a comprehensive strategy, and the needed operational and financial support from the government. Solutions are neither easy, nor quick. The whole idea is to set the economy in a right direction; clear the bottlenecks; facilitate the processes; improve the skill set; and take the economy on a higher technological spectrum.

Move towards heterodox policies

It is clear that without a deliberate *push*, it is not possible to upgrade Pakistan's production and export structures. A transparent and objective system is needed in the form of Industrial Policy, which would help structural transformation of Pakistan along the lines of successful Asian economies. Export-orientation of the industrial policy should be explicit, because this would give businesses a clear perspective of actions taken by policymakers. Just like Southeast Asian NIEs, the focus should not be on giving sector-specific *incentives*, but towards a broader institutional support to exporters; duty-free regime for inputs into exports; a strategic collaboration between public and private sectors; capacity building through education and trainings toward specific sectors; agreements to ensure transfer of foreign technology; and make export credit available for smaller firms for technology up-gradation.

Provide legal cover for domestic research

The most important aspect for the growth in any industry is to provide legal protection to intellectual property rights (IPRs), as developing and marketing new varieties entails huge cost to manufacturers. On urgent basis, the government should complete the legal framework necessary for the development of the country's seed industry, to enhance yield of agriculture crops.⁶⁸ Export of textiles, rice, fruits, vegetables and related products would benefit. Similarly, controlling the violation of existing IPRs is equally necessary that has hampered the growth in pharmaceutical exports.

Fix the regulatory muddle

The government should further simplify regulatory procedures, to lessen the transaction time and improve activity by the exporting firms. More specifically, the government must expedite the process of disbursing refunds/drawbacks to exporting firms to improve their cash flows. Similarly, we also recommend design a procedure that automatically liquidates these claims in the future. A large number of procedures are being practiced in various countries, which either expedite the processes or compensate exporters for delays.⁶⁹

Establish conformity assessment infrastructure

Pakistan should promote the growth of competitive and internationally recognized laboratory testing, certification and accreditation services, as well as, supporting facilities including internationally traceable measurement services. Cost is a major barrier to proving standards compliance and smaller firms should benefit more from a credible local testing facility.

⁶⁸ India had enacted PBR Act back in 2001. Indonesia enacted Plant Variety Protection Law in 2000; Thailand in 1999; Philippine in 2002; and Malaysia in 2004.

⁶⁹ For instance, exporters are entitled to interest on delayed refunds (beyond the prescribed time limit) in Singapore and the UK. Similarly, in some countries like Canada and Hungary, tax authorities are allowed to offset refunds against other tax debts owed by the tax payer (Source: Harrison, Graham and Krelove, Russell (2005). "VAT Refunds: A Review of Country Experience". IMF Working Paper No. WP/05/218. November 2005).

Get a handle on informal industries

By formalizing a few sectors, Pakistan has the ability to generate more exportable surplus. Dairy is one such sector. Pakistan can take lead from India and Turkey to initiate a co-operative movement to formalize the dairy sector, which to some extent, is the only solution to organizing and formalizing the livestock sector.⁷⁰ These cooperatives need to be established at the Union Council or Divisional levels and therefore can address the basic issues of the small scale farmers through effective provision of livestock services, technology and financial assistance.⁷¹

Do not charge exporters for imported raw-materials

One way to do this is to remove the tariff/regulatory duty on the import of key raw-materials, to reduce production costs. Presently, many developing economies are providing duty-free inputs to their exporters to make them competitive in the global market.

Lend financial and technological help to SMEs

SMEs cannot grow without a focused policy intervention. The government has to play an important role in improving export potential of SMEs in the country, especially those clustered around the industrial areas of Sialkot, Wazirabad and Gujrat. Taiwan provides a success story to follow.⁷² Small and Medium Enterprise Development Authority (SMEDA) should be revamped and special focus should be given to operational management skills, financial assistance, innovation, and most importantly, promote technological up-gradation.

Capacity building to enhance productivity

The government should take coordinated measures along with the private sector, to enhance capacity among local entrepreneurs as well as labor. The government should strengthen capacity building institutions like Technical Education and Vocational Training Authority (TEVTA), deepen the collaboration between industry and universities. Furthermore, the government needs to help create opportunities for the systematic training of entrepreneurs in business management, and export procedures, etc., to be held in any of the export clusters. Government bodies like National Productivity Organization, Engineering Development Board, Trade Development Authority of Pakistan, and SMEDA can help conducting such courses.

These are not the kind of issues that the industry or market would sort out itself; the role of government is quite dominating. However, instead of allocating funds for incentives like subsidies, the government has to fix the fundamentals for this sector: right from the enactment of necessary legislation in the country, the government should seriously pursue stricter regulation on quality;

⁷⁰ Operation Flood (or the White Revolution) began in India in 1970, which basically developed a national grid across country between milk producers and consumers. At its core, there were milk producing co-operatives at village level that procure milk and provide inputs and services, making modern management and technology available to members. The Indian government had adopted this idea of co-operatives from successful operation of Gujarat Cooperative Milk Marketing Federation (GCMMF), which today is the largest milk exporter in India (with the brand name, Amul).

⁷¹ The production of milk can substantially be enhanced through scientific feeding, breeding and marketing. Although the investors are inclined to enter into this segment, but lack of information on modern farming methodologies and marketing channels that would ensure disposal of their produce and let them earn good value for their money, restricts them from taking instant decisions. Furthermore, there is a need for the carrying out training of the farmers in modern feeding and breeding practices as well as establishing proper logistics for milk collection and transportation through cool chain system which can be readily available for exports.

⁷² More than 95 percent of firms in Taiwan are SMEs. In fact, the major reason behind success of Taiwanese economy has been an impressive set of policies, programs and funds availability for SMEs by the government that helped developed this sector. While Credit Guarantee and SME Development Funds Program have contributed significantly in the growth of SMEs all across Taiwan, the government's ten guidance system was pivotal in their export-orientation and success. These pertained to credit; management; technology; R&D; information management; marketing; industrial safety; quality enhancement; pollution control; and manual support. For more details, see *The Role of SMEs in National Economies of East Asia*, Edited by edited by Charles Harvie, Boon-Chye Lee, Edward Elgar Publishing Inc. 2002.

strengthening research institutions; capacity building; technology up-gradation; fiber diversification; and tariff rationalization.

Meanwhile, the industry must also rise up to the challenges coming from the competitive global market. Importantly, they need to broaden the scope and vision of their businesses: making margins is not sufficient, local firms must become the source of technological change in the country, and invest in skill up-gradation, innovation, product mix, and market diversification. Probably, the government can play an important role here in institutionalizing a system of reward and penalties, which “encourage firms to take a longer-term view in their investment decisions and foster a spirit of entrepreneurship, creativity and innovativeness”.⁷³ In short, a fundamental shift in policy is required to gain competition in the global market. While cost-cutting incentives would remain important especially duty-free inputs, gains in overall productivity and product quality, would drive the competitiveness of Pakistan’s exports.

⁷³ Haque, Irfan ul (2013). “Toward a Competitive Pakistan: The Role of Industrial Policy”. The Lahore Journal of Economics, Volume 19, SE, September 2014.