<u>How is Pakistan positioning itself for challenges of globalization</u>?

ISHRAT HUSAIN

The late Mahbubul Haq had very aptly summarized the debate on globalization by observing that 'Globalisation is no longer an option, it is a fact. Developing countries have either to learn to manage it far more skillfully or simply drown in the global cross currents'.

The anti-capitalist sentiment, protests and rhetoric in the past few years have helped focus the attention on the negative aspects of globalization. But the potential gains from globalization have either been deliberately understated or mired in the notion that these gains will only make rich countries and multinational corporations better off. No attempt is even made to explaining the differences between South Korea and North Korea, Malaysia and Myanmar, and East Asia and Africa in terms of their relative differentiated linkages with global economy. It is hardly mentioned that India and China, the two most populous countries in the world with almost one half of the world's poor have demonstrated that integration in the global economy is indeed the way out of poverty through the mechanism of high rates of economic growth. There is strong evidence that free trade does not put poor countries at a disadvantage; it helps them. A World Bank study shows that 24 developing countries that increased their integration into the world economy over two decades ending in the late 1990s achieved higher growth in incomes, longer life expectancy and better schooling. These countries home to some 3 billion people, enjoyed an average 5 percent growth in income per capita in the 1990s compared to 2 percent in rich countries. These countries have been catching up with the rich ones – their annual growth rates increased from

1 percent in the 1960s to 5 percent in the 1990s. People in these integrating countries saw their wages rise and the number of people in poverty declined.

But not all countries have integrated successfully into the global economy. The report says that some 2 billion people – particularly in Sub-Saharan Africa, the Middle East and the former Soviet Union – live in countries that are being left behind. These countries have been unable to increase their integration with the world economy, their ratio of trade to GDP either remained flat or actually declined. On average, these economies have contracted, poverty has risen and education levels have risen less rapidly than in the more globalized countries.

The main argument of this paper is that developing countries such as Pakistan can either position themselves like the 24 countries mentioned above and maximize benefits from participation in international trade, financial flows, labor migration, technological advances or let the torrents of globalization sweep it away as by-stander or marginal player as is the case of Sub-Saharan Africa, the Middle East etc. The Human Development Report in South Asia is quite right when it asserts that "the potential costs of becoming marginalized from the global economy may be great in terms of lost efficiency, technology and growth that globalization could ultimately bring". Of course, international economic relations have to be reordered and the rich countries have to reduce trade barriers and thus improve access to their markets, eliminate subsidies on agricultural products, agree to a dispute resolution and enforcement mechanism which is not tilted in their favor, desist from introducing new kind of restrictions in the name of protecting labor and environment and bear the political costs of internal economic dislocation courageously. But it is also equally obvious that even if such reordering takes place some of the poor countries may not be able to gain in terms of rapid economic growth and faster poverty alleviation unless they organize themselves internally to extract the potential benefits and avoid the likely perils of globalization.

This paper assesses as to how far Pakistan is positioning itself to meet the challenges of globalization. Although there are a large number of known and unknown variables which affect this choice we have identified at least ten factors which, in our opinion, are critical.

1. Agriculture The main reforms in agriculture sector have been to free agriculture markets for products and inputs by deregulating prices and dismantling the monopoly of the public sector in mandatory procurement of major crops. Cotton, Rice and Sugarcane were already sold by the farmers to private sector but recently it has been decided to allow the private traders to buy wheat directly from the growers without the intervention of the Food Department. Farmers receive market-based prices equivalent to export or import parity but they are safeguarded against excessive volatility in prices through the second buyer channel which is the Government.

Imports and exports of agriculture commodities have also been liberalized and private sector is allowed to trade in these commodities. Import tariffs and export duties on these commodities have also be abolished and there are no quantitative restrictions in place.

Removal of subsidies, expansion of water storage and distribution channels, efficient use and conservation of water through land leveling and lining of water courses, constructing spines for disposal of drainage effluent to avert salinity, introduction of new seed varieties, encouraging corporate agriculture to bring vast tracks of uncultivable land under cultivation are some of the measures which are being implemented to enhance productivity in agriculture sector. Productivity gains will lower unit cost of production thus making agricultural exports from Pakistan competitive in international markets. As agricultural subsidies and support for production in the OECD countries are hopefully removed under the new WTO Development Round Pakistan should be able to capture a share of global commodities market particularly in the proximate geographical areas. The switch over to higher value added non-traditional products such as meat and dairy, fruits and vegetables and marine products would become more feasible under a liberalized trading environment.

2. <u>Trade regime</u> Pakistani manufacturing sector was one of the highly protected sectors among the developing countries through a combination of high external tariff structure and quantitative restrictions. The level and dispersal of tariff rates have both been excessively high historically. Reforms in the recent years have substantially reduced the maximum and average tariff rates, narrowed the dispersal and removed quantitative restrictions to reduce the anti-export bias, promote competitive and efficient industries and encourage investment in industries in which Pakistan has a comparative advantage. The maximum rate of tariff which was 225 % a decade ago has been gradually brought down and will be further reduced from the present level of 30 percent to 25 percent effective July 2002. Similarly, the average tariff rate has also declined significantly to 11 percent in 2000-01 from 51 percent a decade ago. The on-going trade liberalization also includes elimination of para tariffs, deregulation of administrative controls, and simplification and rationalization of tariff structure by reducing statutory rules and orders. The Government will also phase out Trade Related Investment Measures in accordance with the agreement with WTO and will not introduce any quantitative import restrictions beyond the standard restrictions related to security, health, public morals, religious and cultural concerns. Legislation on anti-dumping and countervailing duties will be used for safeguarding the interests of local industry against potential damage caused by subsidized exports.

Exports of all goods are allowed except for a few items. Recently restrictions on the main staple food of the country i.e. wheat have also been removed. There are no subsidies of any kind for exports. But the growth of Pakistani exports in the 1990s has remained sluggish and the country's share in world exports has in fact declined. The lack of diversification has resulted in rising concentration indices during the 1990s and thus increased exposure to market risk. Pakistan has just begun to diversify its export base and export markets. This will insulate the country from shocks arising due to the price fluctuations or production shortfall in cotton or lower demand in the dominant market.

Exchange rate is now determined by market forces in the Inter-bank market and the currency is floating free of any intervention by the Central Bank. All current account transactions are fully convertible and the foreign exchange regime has been liberalized.

There is strong empirical evidence that the countries that have increased trade as a share of GDP substantially over the past 20 years and opened up to trade have seen their economic performance improve significantly and reduced poverty rates avoiding any systematic increase in inequality. As Pakistan continues to pursue policies aimed at maintenance of a market-based and competitive exchange rate, strengthening of foreign exchange market, import liberalization and tariff reforms and export promotion measures there is strong probability that Pakistan's prospects for exports in world markets will improve allowing it to increase its market share.

3. **Textiles** The termination of Multi Fibre agreement (MFA) in 2004 presents an enormous opportunity for Pakistani textile producers. As future market shares will depend on price and quality advantage as compared to the current quota regime it will facilitate efficient and low cost producers to enlarge their share in the North American and EU markets. Simulation results have shown that Pakistan will be one of the few developing countries which will retain its competitiveness in international textile trade. Pakistan is a major producer of Cotton and textiles are relatively more labor intensive which confers price advantage upon its exports.

During the last two years, textile industry has invested heavily in balancing, modernization and replacement and so far imported new machinery worth $ 1 billion. This will certainly improve the productivity, quality of products and capital efficiency but equal attention needs to be given to the training and upgradation of skills in textile industry at all levels. The institutional infrastructure such as Textile University, Textile Institutes etc. does already exist in the country but the quality, staffing, standards of instruction, curriculum and its relevance to subsequent job requirement are the issues which need to be quickly resolved. Employers should invest in on-the-job training and organize in-house courses in basic literacy for those are illiterate as the pay-off from this investment will be quite substantial in form of higher labor productivity and higher returns to the firms making such investments. Induction level training and apprenticeship are the other tools which can help upgrade the quality of manpower in textile industry. The recent shift to value added goods within textile sector requires developing capability in design, processing, inventory management, marketing and keeping track of the fashions and changing demand and adapting products to meet this demand on time maintaining the quality. Pakistan should also take advantage of high growth in the volume of trade in synthetic textiles. A number of synthetic fibre plants have already been installed in the country but there is a need to expand the capacity and in some cases to reduce the end-use price through increased efficiency or scale economies. As the U.S. and European firms become uncompetitive in textile and apparel business, Pakistani firms should enter into joint venture agreements with them for technology transfer and marketing.

This combination of natural comparative advantage, renewal of capital equipment, investment in training and skill up gradation and joint ventures with the Western firms should enable Pakistan to move from its existing rank to become the 5^{th} largest exporter of textiles and apparels as envisaged in the Textile Vision 2005.

4. Promotion of Science and Technology: One of the worrisome developments during the last three decades has been a lack of attention to producing scientific manpower of caliber in the country. According to a study on scientific education in the country the proportion of the graduates opting for scientific disciplines has in fact declined since 1960s. The Government has recently formed a Task Force (TF) to mitigate this problem and asked the TF, to come up with specific recommendations to improve the higher education sector in the country particularly in the fields of Science & Technology (S&T). In addition to addressing manpower issues the S&T policy also aims at expanding application of scientific knowledge for solving problems faced by the country in select areas such as biotechnology, Material Sciences, Renewal energy, Pharmaceuticals and Chemicals; to link research and development to the country's economic needs and finally to make large scale commercial use of new products, new processes and new techniques of production to enhance the competitive edge of the country. The Government has realized that unless the governance and incentive structure of the universities, research laboratories, scientific establishments and technological organizations are drastically revamped and larger allocations are made by the private and public sector towards R & D, Pakistan may be facing a serious risk of becoming a laggard. For the first time in three decades, measures are being taken to implement these ingredients of S & T policy. Inadequate past attention to S&T in Pakistan will continue to remain a drag for some time in meeting the high technology export demands or exporting skilled manpower overseas.

5. Upgrading Quality of products: A serious difficulty in expanding Pakistani exports in the Western countries markets has been the perennial problem of low, uneven and inconsistent quality of our products. It is only recently that a National Accreditation Council has been formed to check the quality of products in order to bring these to internationally accepted standards. Work is underway to establish Laboratories in the country and train the staff to carry out the quality verification work. Private sector has responded well by improving the manufacturing processes and about 2000 companies have been given ISO 9000 certification. With this certification, the acceptability of products of these companies has increased in foreign markets. In future, the Pakistani companies will have to prepare themselves for meeting the standards of social audit and environmental audit to be able to sell their goods in the OECD markets. The sooner they equip themselves to do so they will have a head start over their competitors.

6. Exports in Services: Studies have shown that removing barriers to trade in services in the new WTO round would increase the global welfare gain considerably in view of the dominant role of the services sectors in most economies and the typically large trade barriers existing in these sectors. The results from model simulation suggest that for developing countries these gains would be about as large as those from merchandise trade liberalization. It is therefore imperative that exports in services should at least be given as much policy attention as merchandise trade. Pakistan has so far focused its attention upon exports of merchandise goods and neglected this most dynamic element of world trade i.e. exports of services. The General Agreement on Trade in Services has liberalized this sector and a number of developing countries have begun to derive benefits. World exports in services has tripled from $ 560 billion to $ 1500 billion during the last decade while the share of Pakistan has only doubled from $ 0.8 billion to $ 1.6 billion in the same period. The most important service export so far has been the supply of labor to other countries particularly to those in the Middle East and their remittances have been a significant source of foreign exchange earnings for Pakistan. Pakistan has not been able benefited from the rapid growth of services exports.

It is only recently that the State bank of Pakistan (SBP) has allowed a set of incentives to exporters of financial services, IT enabled services, consultancy, accountancy, engineering services. These incentives allow exporters of services to retain 35 percent of their export earnings. They have also been allowed access to Export Refinance scheme. The SBP has also permitted Pakistani companies to purchase equity in overseas enterprises. Export of financial services particularly to the Middle East, Central Asia and Africa is being actively encouraged as Pakistan has a well established professional cadre of professional bankers and financial experts of world class who can be deployed for this purpose. But for this to happen we have to strengthen our home base and develop a few highly competitive, strong and efficient financial institutions which can take the lead in export of their services. The emerging model of combining capital and financial strength of Middle East investors and management expertise from Pakistan is still in its infancy but can be further developed. In other areas such as Construction and Engineering services Pakistani firms have played a leading role in the past in Africa and the Middle East and there is little reason as to why this cannot be revived. The scope of Pakistan to increase its participation in the exports of services is fairly large and the key ingredients seem to be in place. What seems to be missing at present is aggressive marketing and net working by the exporter community.

7. Information technology and Communications: Although measurement problems do not allow an unambiguous view on the linkage between Information technology and growth via labor productivity, a growing body of literature has established that IT contributes to labor productivity growth. This takes place through both increases in the level of IT Capital per worker i.e. capital deepening and Total Factor Productivity (TFP) growth in IT production. The main outstanding issue is whether IT has contributed to TFP growth more generally by increasing the efficiency of production. An IMF study of Asean-4 and China shows that IT-related capital deepening started from a low base and roughly doubled to around ¼ percent of GDP in these countries. Anecdotal evidence is abound that the usage of IT has a positive influence on efficiency of factor utilization. The economic benefits of the IT revolution are already significant and will continue.

In developing countries such as Pakistan there is an additional reason for investment in the IT related sectors and particularly in IT education. The changing demographics in the

OECD countries along with rapid technological changes in IT and communications have raised the demand for skilled professional workers from developing countries. India and Israel have been supplying such workers in large numbers to the United States and more recently to the EU countries. Pakistan has entered in this field late and is beginning to put its act together.

The Government has allowed a host of incentives for the growth of software exports and IT-enabled services. Private sector has expanded IT educational services significantly. The present base is too small and thus it will take several years of dedicated quality work, enterprise and marketing for making Pakistan IT industry and Pakistani IT personnel familiar brand in the U.S. and European markets.

8. Foreign Investment regime and Capital inflows: The distinctive feature of the decade of 1990s that affected the pattern and volume of capital flows to developing countries was the shift from official development assistance (ODA) to private capital. This was facilitated both by a growing dissatisfaction among the donor countries with the effectiveness of aid and by international financial deregulation and removal of capital controls. Although these flows have increased the risks to recipient countries in form of external volatility and also accentuated the contagion effect the net benefits to developing countries can be maximized under the right policy environment. Open financial markets have been associated with higher growth but not to the same extent as openness to trade. Annual FDI flows to developing countries now amount to about three times the value of official flows. But the share of Pakistan in total private capital flows to developing countries has in fact declined.

Pakistan has deregulated financial markets, introduced full convertibility on current account and partial convertibility on capital market, is pursuing a market based flexible exchange rate policy, and liberalized investment regime. Both foreign direct and portfolio investment can flow in and out freely without any restrictions or prior approval. Remittances and repatriation of profits, dividends and capital can be made automatically by the authorized dealers.

The above policy measures had raised the ratio of FDI and portfolio flows to GDP until May 1998. But a series of exogenous shocks such as the nuclear test in May 1998, change in the Government in October 1999, and the war in Afghanistan in post September 11, 2001 period have accentuated uncertainties and slowed down private capital flows. The withdrawals of economic sanctions, restoration of lines of credit by Export Credit agencies, grant of substantial debt relief by Paris Club, access to the Poverty Reduction and Growth Facility (PRGF), and revamping of external assistance by bilateral donors are some of the potential factors that will improve the enabling environment for foreign investment in Pakistan in coming years. Financial integration through stock market development is still relatively underdeveloped in Pakistan, and provides a major avenue. Market capitalization and returns to investors have suffered in 2000-01 due to slide in price index as well as significant depreciation of rupee but this trend is likely to reverse itself in view of the developments recounted above.

Pakistan can take advantage of the growing private financial flows and integration with financial markets by maintaining an open trade policy, macro economic stability, and a conducive environment for foreign investment flows.

9. **Macroeconomic stability**: Pakistani economy has been characterized by chronic fiscal deficit and current account deficit for an extended period of time. The persistence of these deficits has made Pakistan a heavily indebted country with total debt exceeding 100% of GDP. Consequently, the expenditure on debt servicing has doubled to 11.8% of GDP in this decade pre-empting 55% of total budgetary expenditure and leaving very little fiscal space for social spending or infrastructure development. Inflationary pressures were also quite manifest in the decade of 1990s.

During the last two years the Government has made strenuous efforts to generate primary budget surplus and non-interest current account surplus to ease the burden of incremental borrowing. Fiscal deficit has consequently been reduced to 5.3 percent of GDP from 6.5 percent and the debt indicators are beginning to move downwards. Inflation has been contained to less than 5 percent per annum and current account deficit is down to 1.6 percent of GDP. The country has thus reversed its course and regained its credibility by establishing a solid track record of macroeconomic stability.

The impact of unanticipated exogenous shocks such as the worst drought in the history recorded in 2000 and the post September 11 events in 2001 has slowed down the rate of economic growth but the economy has become much resilient due to the repair of macroeconomic fundamentals.

If the current economic policies and reforms are continued unabated in the coming years and a sustainable solution to external debt problem is found this favorable macroeconomic environment should help Pakistan regain its lost competitive edge. This stability will also help in resumption of equitable and sustainable growth and reduction in poverty.

Paris club bilateral creditors are expected to allow Pakistan to tailor its debt servicing obligations to its capacity to service. This will further strengthen current account and reduce the external imbalance improving the credit worthiness of the country and reinforcing macroeconomic stability.

10. Good governance: Most of the economic malaises which have afflicted Pakistan in the decade of 1990s owe their origin to poor governance and the decay of economic institutions. Corruption, patronage, cronyism and nepotism by and large characterized economic decisions making. Unproductive and wasteful public expenditures and schemes, Commissions, Kickbacks and favors to party loyalists were the main criteria in the selection of projects.

Almost every single public sector enterprise, bank and institution became dysfunctional as these were with some exceptions, manned by people whose hallmark was personal loyalty to the rulers of the day rather than competence or integrity. The fiscal and quasi-fiscal deficits of WAPDA, KESC, PIA, Railways, Steel Mills, OGDC and nationalized commercial banks were a major source of hemorrhage of public finances and main contributor to the growing debt burden of the country.

Since October 1999 the Government is making strenuous efforts to improve governance and restructure and reform key economic institutions. Ensuing predictability and transparency, adhering to rule of law, creating a level playing field and continuity of economic policies are the ingredients of good governance agenda which the present

Government is trying to pursue. The key instruments to implement this agenda are wide ranging reforms in Civil Service, Judiciary, Police, Tax Administration and an institutional mechanism for accountability. Devolution of power to local tiers of government has been successfully achieved making a radical change from the colonial structure of administration.

During the last two years, some modest success has been achieved in restructuring Railways, Steel Mills, PIA, WAPDA and nationalized commercial banks but the process has to go long way before tangible results can be achieved. Privatization of large utilities, banks, and infrastructure companies would also help in improving the governance as will the elimination of discretionary powers in the allotment of land and appointments to public offices.

The cleaning up of these key institutions and strengthening governance structure would remove the uncertainty and the impediments foreign investors and businesses have faced in Pakistan due to the opaque, slow and cumbersome nature of decision making process. The attractiveness of Pakistan as a choice for locating their industries or joint ventures vis a vis other competing countries will only improve if the Government functionaries who come in contact with these investors adopt a more positive and helpful attitude rather than creating hurdles and obstacles.

Human Development: Overlaying all the above factors, the most compelling factor for Pakistan to derive benefits from globalization is to upgrade its human development. Unfortunately this has been an area of neglect by successive governments over a long period of its history. In fact, this underdevelopment of human capital is the single most daunting challenge facing Pakistan at present. Unlike other countries in the region which have moved to middle category of human development index (HDI) Pakistan continues to remain stuck in the low category. High population growth - one of the fastest in the world – has given rise to a young dependent population and increased unemployment among the youth. One half of the population is illiterate making it more difficult to impart new skills to the ever burgeoning labor force. The mean years of schooling remains quite low and has displayed only minor improvements over time. On the other hand globalisation imperatives dictate that the level of schooling and skill formation should be moving up-the-curve at a fairly rapid pace. Poor health status of the majority of the population encourages absenteeism and results in low labor productivity. Pervasive poverty and inequitable distribution of income and assets have allowed the benefits of economic growth to be concentrated in the hands of a small minority of elite generated social and regional inequities and depleted social capital.

Political instability, religious extremism and sectarian violence in Pakistan can also be ascribed, to some extent, to poor human development attainment. Gender disparities in Pakistan have also been a major contributory factor to the underdevelopment and underutilization of human resources. Every single indicator – mean year of schooling, literacy ratio, emolument rates and participation in labor force – show a vast difference among the males and females. This waste of human capital can be harnessed into a potential source of productive capital under a proper set of policies and incentives.

The above characteristics of Pakistan's human development has not allowed the country's labor force to adapt to the demands of the world market which increasingly require skilled and semi-skilled workers. Widespread self-employment along with informal, casual, contract, part-time nature of wage employment has not allowed intensified training and investment in skill formation. Public sector training and apprenticeship schemes have failed to deliver the results.

The recent efforts of multi-donor multi-billion Social Action Program (SAP) have generated more controversy in regard to its efficacy and impact on social indicators. The program laid too much emphasis on measuring and monitoring inputs rather than the actual outcomes and thus distorted the management choices.

More recently Pakistan has realized that exclusive dependence on public sector institutions to deliver the basic social services is fraught with high risks and danger of failure. Public-private-community partnership is now being recognized and practised as the predominant mode for delivery of these services. The devolution of financial and administrative powers to local governments is expected to enhance the effectiveness, out reach and access of basic services at the grass roots level. Monitoring and tracking systems are being put in place to gauge the progress on outcomes and effectiveness of delivery.

A comprehensive package of educational reforms with medium term Education Sector Reforms (ESR) has been finalized and linked with the Devolution and Local Government Plan 2000 and SAP II restructuring. A Task Force on Human Development has been established to identify best practices spell out the implementation modalities. The main planks of the ESR Action Plan are Universal Primary Education and 100% literacy and eliminating gender disparities in primary and secondary education.

The overall thrust of the government's medium term health strategy is focused towards areas of intervention designed to improve health outcomes by focusing public expenditures towards primary and secondary tiers. Infant mortality rates are expected to decline from 90 to 65 per 1000 births and population growth is projected to decline from 2.2 percent to 1.8 percent by 2003-04.

Fiscal restructuring and debt servicing relief will allow higher allocations of public expenditure for underpinning these strategies of education and health. The level of these expenditures will rise from 3.4 percent of GDP in 2000-01 to 4 percent by 2003-04. Changes in the governance structure and increased emphasis on accountability for results should improve the effectiveness of these expenditures as past increases in allocations have only fed ghost schools and ghost teachers.

Private sector organizations particularly in labor intensive industries have to actively embark on literacy and training programs for upgrading the quality of their labor force.

Knowledge based and technology intensive industries also need to be nurtured and facilitated by public policies such as investment in high quality professional, technical and higher education. It is encouraging that the Government has established a Task Force on Higher Education for preparing recommendations.

CONCLUSION

Pakistan is faced with a stark choice today – whether it can actively participate in the growing world trade of goods and services, foreign investment and capital flows, technological advances, labor and skill supply and thus benefit its population and improving their standards of living or remain a by-stander and marginal player pursuing an inward looking strategy. The findings of this paper are that Pakistan is beginning to position itself for maximizing benefits from globalization as the same policies that are conducive for accelerating economic growth and poverty alleviation domestically are also pre-requisites for gaining from globalization. The serious concern, however, is, the underdevelopment of the country's human resources and the low skill intensity of its labor force. Unless the quality and outreach of education, training, literacy, skills, health status are significantly improved Pakistan will remain handicapped in maximizing these benefits.