INDUSTRIAL COMPETITIVENESS: BENCH MARKING PAKISTAN:

Ishrat Husain [1]

I very much appreciate the initiative taken by the Asian Development Bank Institute (ADBI) in responding to our request and organizing these policy forums. I hope this is the beginning of a long and continuing process where the ADBI will share its analytical resources and disseminate best practices among the policy makers in Pakistan.

The paper on Industrial competitiveness: The Challenge for Pakistan by Sanjay Lall and John Weiss has assembled a lot of useful empirical information and cross-country comparisons of key variables and factors determining the competitiveness of a country's industrial firms. Its main value to us is the attempt to benchmark Pakistan's performance, which allows us to look ourselves in the mirror and the challenges ahead of us.

Although I will come back to the methodological and analytical issues particularly the various indices later on, I agree with the broad thrust and findings of the paper. Let me elaborate on these points of agreement.

There is no doubt in my mind that the factors affecting a country's competitive edge outlined in the paper are empirically valid and intuitively clear. To recapitulate these factors are (a) sound and stable macroeconomic and trade policies, (b) a level playing field for all economic actors, (c) cost and access to capital, (d) infrastructure, (e) human capital, (f) technology and (g) cluster effects.

I am also happy to note that the popular Amsden-Wade characterization of the East Asian success story has rightly been abandoned in this paper and due caution has been exercised about the role of industrial policy, the kind and extent of state intervention and protection. The authors have wisely used the experience of Pakistan to argue that "highly protected domestic markets not

[1] Opening remarks at the Pakistan's Resident Mission – Asian Development Bank Institute High Policy Forum held at Karachi on November 20, 2003

only reduce the incentive to export but also penalize the economy by allowing inefficient domestic producers to extract policy-induced rents from domestic consumers". This statement is simply music to my ears as this is the message which we have been trying to disseminate and practice in this country for the last four years.

I also feel vindicated by the paper's findings that the East Asian success owes primarily to building their domestic capabilities and undertaking constant technological effort to create, access, absorb and adapt new technologies. This statement is in sharp contrast to Paul Krugman – Allwyn Young Thesis - that it was pure and simple capital accumulation that accounted for the rapid growth of East Asia. In my rejoinder to Paul Krugman's paper, which was published in Foreign Affairs, I had submitted that it was Total factor productivity that was main contributor to the sources of growth in East Asia. Eight years later this paper coming from quite a different angle, seems to corroborate that particular viewpoint.

Before I get into an assessment of the factors identified by the paper as they apply in case of Pakistan, I would like to offer some thoughts on the methodological and analytical issues.

Without distracting from the usefulness of the work presented in Lall-Weiss paper, let me say that since the introduction of Human Development Index there has sprung up a cottage industry of indices of all kinds, shapes and forms. As economists, we believe that what cannot be measured is not worth our while and lack rigor. We have, therefore, striven hard to develop Governance Indicators, Corruption Index, Index of Economic Freedom, Index of Human Rights, Index of Environmental Quality, many more and now Index of Terrorism. The simplicity, precision and elegance behind these indicators and indices have captured the imagination of the laymen and media all over the world. Every pressure group, advocacy or lobby groups espousing a cause can come up with the index of their choice to convince the general public about the efficacy and potency of their instrument and, therefore, to the cause or issue they are advancing. Some of them go even further by putting up partial correlations and scatter diagrams showing the association or relationship between the index of their choice and poverty reduction, economic growth or whatever other dependent variable they are interested in. Fancy pie charts, upward or downward sloping graphs and histograms make us believe that there is a lot of truth in what they are telling us.

I don't wish to imply for a moment that the indices so carefully constructed by Lall and Weiss fall in the same category, but I do have some serious problems with the way they have been designed. No classification system is perfect and we can find fault with any one of them. But in the paper, East Asia dominates the developing country universe disproportionately and thus one has to look carefully at the counter-intuitive finding i.e. in developing countries manufactured export grew faster than in industrial ones but their lead was greatest in high tech products". This is based on two simple constructs (a) East Asia and developing countries category includes Taiwan, Hong Kong, Korea and Singapore which are highly mature tiger economies and (b) Box 1 shows that Electronic exports account for as much as 40.7 percent of total manufactured exports of the world. As these four countries are major exporters of electronics, semi-conductors and other related products their inclusion in this category tilts the balance in favor of hi-tech exports. I have a strong suspicion that once these four countries are excluded from the developing country grouping then this conclusion will no longer be tenable.

The second index used in the paper i.e. the Sophistication Index and its categorization in six levels is analytically even more obtuse and less appealing. It appears to me more of a tautology that the high the income of a country the more sophisticated is the level of its exports. How does this help us in policy formulation? May be I am missing something which may be more straightforward than I can perceive.

Policy advice should be based on robust empirical evidence and sound intuitive judgments based on experience and questions can be raised on the basis of choice of a particular scheme or classification system, then the acceptance of findings emanating from such indicators becomes quite hard to sell to the policy makers.

We can examine this particular finding from a totally different perspective. Hi-tech exports account for 21 percent of world exports while all other exports form almost 80 percent of exports. Although this group may not be growing as fast as Hi-tech but if countries such as

Pakistan are able to capture their lost historical world market share, their export receipts will rise by at least 50 percent from the present level. This is essentially the thrust of the efforts being made by us during the last four years. Pakistan's market share in 1990 was 0.22 percent but the decade of the 1990s was a lost decade for Pakistani economy and the share declined to 0.15 percent by 1999. Had we maintained a constant share our exports would have been $12 billion rather than $7.7 billion recorded in 1999. Since 1999 the export growth rate has averaged 10 percent and by June 2004 the exports level is expected to exceed $12 billion or almost 0.18 percent of world exports. This path is to be maintained and this growth rate – faster than world export growth – achieved to be able to capture and then enhance the share. We do not have wherewithal to compete at least in the short to medium terms, hi-tech exports. So, instead of chasing an elusive goal we have to set our sights on a more modest outcome capitalizing on what we already can produce efficiently.

The short-term strategy we are following does not detract from the very useful advice contained in the Lall-Weiss paper for the long term but it is aimed at present in reversing of the adverse trend which had hit us for over a decade. What does this strategy consist of?

Our starting hypothesis is that competitiveness is about productivity which in turn is a function of factors related to cost of products as well as those related to non-price factors such as delivery schedules, reliability of producers and other intangible factors like image of the country/company and brand equity.

A product is export competitive if (a) growth rate in unit value of the product exported from Pakistan exceeds the average growth rate in unit value of the product from all suppliers in world market and (b) the market share of Pakistani export grows.

During the 1990s textile trade grew at an average rate of 4 percent and clothing 6 percent. Clothing trade's share in total textile and clothing is 56 percent. During the last four years, we have strived hard to accelerate our growth rate of clothing and textile far in excess of the world growth rate. Within this group the relative share of clothing exports should rise even more rapidly. This is exactly what has been done. There has been a reversal of shares between cotton yarn and fabrics which used to account for two-thirds of total textile manufactured exports and made-ups one-third. In 2002-03 the combined share of yarn and fabrics was only 30 percent while the made-ups accounted for 70 percent.

It is also gratifying that the textile industry has invested $3-4 billion in the last four years to balance, modernize and replace the old machinery and equipment to prepare itself for the post 2005 textile trade.

What are the elements of this strategy where we have made some headway and where we are still far away from the goals we have set for ourselves.

First, we had to achieve macroeconomic stability and ensure that the macro prices are right and offer incentives to exporters. Real exchange rate is not only stable but at a realistic level and real interest rates have been brought down to historically low levels. Export refinance rate today is 3 percent very much close to rate of inflation. Thus, the low cost and improved access to finance to exporters has improved their competitiveness.

Second, debt-servicing ratio was 66 percent of Government's revenues in FY 1999-00 leaving very little for public expenditure on infrastructure and social services. An aggressive Debt Management plan has brought down this ratio to 36 percent this year. The additional fiscal space created by savings in debt servicing is being used to increase development expenditure and easing infrastructure congestion and shortages.

Third, a level playing field has been laid out for all businesses and the past practices of issuing SROs to favour a particular group or firm to the detriment of others in the same field of business have been dispensed with. Most tax concessions and exemptions have been withdrawn. Various kinds of visible and invisible barriers to entry and exit have been removed.

Fourth, as the Lall-Weiss paper acknowledges the tariffs have been reduced quite significantly and non-tariff barriers have been eliminated. The maximum tariff rate is 25 percent while the average rate is 14-15 percent and the effective rate i.e. custom duties collected on dutiable imports is less than 10 percent. There are only 4 slabs left and all others have been removed.

But there are still many difficult challenges ahead of us in capturing world market share.

The most disconcerting feature of our economic landscape is the neglect of human capital and poor social indicators. We have suffered both in upgrading our skills and imparting basic functional education to our labor force. I agree with most of the findings of the ADBI paper that Pakistan lags behind other countries in South Asia region. Our Universities and Research Institutes are saddled with manpower, which has hardly made any significant contribution in qualitative or quantative expansion of our higher education or in applying research to develop new industrial products, processes or improve quality or cost of production. It is only recently that reforms in higher education have been initiated but they are facing stiff resistance from the teachers and faculty members throughout the country.

Related to the first challenge is the low technological base and indifferent output of our scientific research laboratories and establishments. We were producing a much larger proportion of scientific manpower in the 1960s than what we are doing today. Almost all kinds of scientific laboratories were established as long ago as the 1950s but their quality and relevance have diminished significantly over the years. Those who are competent and capable have migrated to North America, Europe, Middle East or Africa. The Musharraf Government has raised funding for R&D by a big quantum but its impact will be felt after sometime. The private industry has not invested a paisa in domestic R&D and thus they are dependent on new technology embedded in imports. Fortunately, the liberal policy of Pakistan towards imports of goods, services and technology has proved to be the saviour in assimilation of new production techniques.

The other major constraint to the achievement of our export potential is the bureaucratic hassle and the mind set of our government officials. There is either an adversial relationship between business and government officials characterized by mutual mistrust and suspicion or a hands-in-glove relationship based on reciprocal exchange of favours. The intermediate course of a helpful, facilitative and unbiased behaviour is almost non-existent. Petty corruption at lower levels by Police, Revenue, Customs, Labour and other officials does increase the cost of doing business or forces the businesses to evade taxes and duties to compensate for these extra-legal payments. The recent move to separate policy, regulatory and operational responsibilities of the ministries and to form independent quasi-judicial regulatory agency is likely to reduce the burden of bureaucratic over-bearance.

Pakistan had inherited a strong independent English law based judicial system from the British. But this system has become clogged over time by both case overload as well as poor quality of entrants in the lower judiciary. Thus, enforcement of contract and preservation of property rights – so vital to a well functioning market system – have become marred by long delays and dilatory practices: Absence of alternative dispute mechanisms further exacerbates the situation. The ADB assisted Access to Justice project will hopefully have some salutary effect in unclogging the system.

Finally, we have realized that the economies of agglomeration and cluster effect are important elements in firms' capturing externalities and spillovers and thus reducing their cost of production. This enlightenment has hit us very late and it is in the most recent Trade Policy that the Government has announced the establishment of four textile cities and two garment cities. The example of Sialkot City very much epitomizes the beneficial impact of clusters. Airport, warehousing facilities, quality testing laboratories, dry port, link roads, design centers have all brought a virtuous cycle to the exporters of Sialkot.

To conclude, I am once again thankful to Prof. Lall and Prof. Weiss for their highly useful contribution in highlighting Pakistan's competitive positioning vis-à-vis other developing countries. We agree with most of their findings but will invite them and the Institute to carry out an in-depth empirical study of those factors that impinge upon our competitiveness.