

# **An Assessment of Pakistan's Export Performance and the Way Forward**

**Afia Malik, Ejaz Ghani and Musleh ud Din**

**Abstract:** This paper examines in detail Pakistan's export performance in the light of emerging global challenges and identifies key structural and policy issues that stifle Pakistan's exports. It is argued that Pakistan has lagged behind its comparators due to a combination of factors including lack of modern technology and human resource development, shortage of required skills, lack of quality certifications and conformity to international standards, poor physical infrastructure, lack of foreign direct investment, and high cost of doing business. The paper stresses that while regional economic integration can help Pakistan boost its exports, there is a need to introduce an appropriate regulatory and legal framework that streamlines cross-border flow of goods, people and vehicles with well-defined transit rights and arrangements. To improve global competitiveness, Pakistan needs to create competency in more labor intensive components of complex products gradually advancing to more skill and technology intensive activities. Moreover, there is a need to devise policies and strategies to promote technology upgradation, improve business climate, enhance institutional quality and support small and medium enterprises. These initiatives can be instrumental in achieving greater competitiveness which is essential to galvanize exports and thus enhance the country's long term growth prospects.

## 1. Introduction

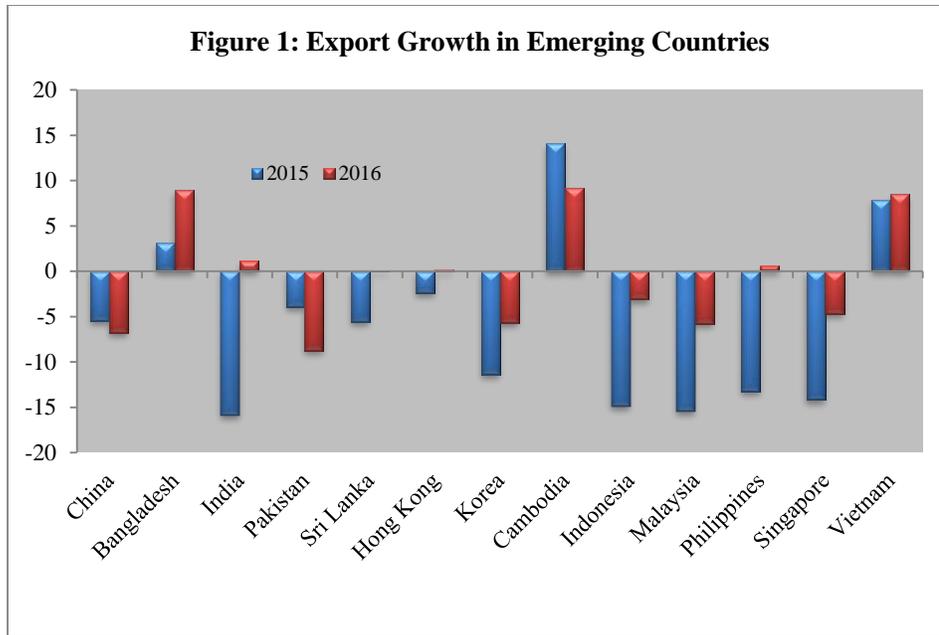
Exports provide an interface into how globally competitive a country is. Likewise, a robust export base secures a country against deteriorating current account balance. In general, exports facilitate the exploitation of economies of scale; allow resource allocation according to comparative advantage; improve foreign exchange reserves position and guarantee easy financing of imports; increase efficiency and productivity through competition; increase employment and allow for knowledge spill-overs that will encourage domestic innovation. There is strong evidence in the literature favouring exports as an important driver of sustainable economic growth (Weiss, 2005). It has also been proven in the case of South Asian economies in general (Kemal, et. al. 2002), and Pakistan in particular (Khan, et.al., 1995, Shirazi and Manap, 2004).

Despite a revival of economic growth since 2013-14, Pakistan's export earnings have declined since 2014. While the recent decline in exports has been attributed to global developments (State Bank, 2016), Pakistan's exports performance has remained unimpressive even before 2014. In fact, Pakistan's exports have continued to lag behind other developing countries over the last several years. A comparison of Pakistan's exports with other developing countries clearly points out the weaknesses of the trade regime followed in Pakistan in the last few decades. The most disturbing trend is the consistent fall in exports to GDP ratio in Pakistan as compared with other developing countries. In 2014-15 exports to GDP ratio was hardly 10.95 %. It is true to some extent that, with the exception of Vietnam, Cambodia and Bangladesh, the export performance of some emerging economies was actually worse than Pakistan in 2015<sup>1</sup>, but revived (to some extent) in 2016 (Figure 1) with stronger demand from advanced countries. In 2016, Pakistan witnessed a further fall in exports despite government's support package to boost exports<sup>2</sup>.

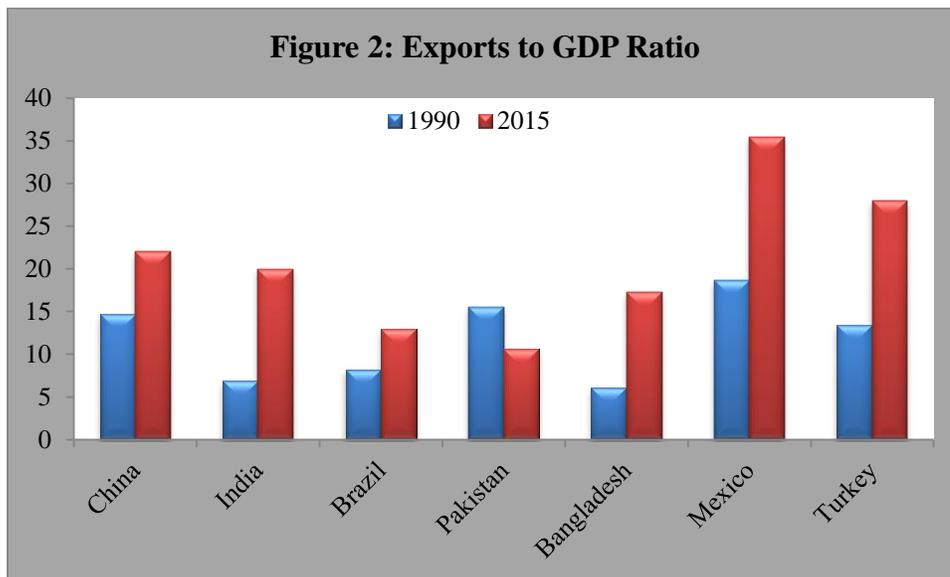
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<sup>1</sup> China has started relocating its labour intensive production in low wage countries like Vietnam, Myanmar, and Cambodia. This has boosted exports in these countries.

<sup>2</sup> According to Pakistan Textile Exporters Association (PTEA) Vice Chairman enough funds were not allocated for the incentives of this package, for details see Imran Rana, "Textile Representatives Stage Protest" *The Express Tribune*, June 22nd, 2017.



Source: Asian Development Bank (2017)



Source: World Development Indicators

The most serious concern for Pakistan's economy is the decline in foreign exchange reserves despite a significant increase in foreign borrowing<sup>3</sup>. The falling exports revenue along with declining remittances and the rising oil prices will put further pressure on our already tumbling foreign exchange reserves. Undoubtedly, CPEC will bring in the foreign exchange needed to strengthen reserves. But this is

<sup>3</sup> Pakistan obtained a record high \$10.1 billion in foreign loans during 2016-17, as it looked to repay old debt and support foreign exchange reserves (Rana, 2017).

not going to be sustainable. The sustainable GDP growth depends on the strength of the overall economy, along with stable macroeconomic environment. It is only possible through exports growth (Amjad, 2017).

In Pakistan, despite economic liberalisation and privatisation, introduction of various incentives packages, and a sustained period of exchange rate stability with no energy shortage between 2001 and 2005, export performance has remained poor in comparison to other countries<sup>4</sup>. This indicates that there are deep structural and institutional issues behind Pakistan’s lacklustre export performance which need to be addressed to enhance its productive capacity and boost exports (Mian, 2014). Pakistan’s stagnant exports demand serious reforms which have been developed several times but never implemented seriously.

The goal of this paper is to carry out an in-depth analysis of Pakistan’s export performance with a view to identifying key structural and policy issues that impede Pakistan’s exports. Section 2 provides an overview of Pakistan’s export performance in an historical perspective. Section 3 explores the role of regional trade integration while section 4 highlights key challenges facing Pakistan in the emerging global trading environment. Section 5 offers summary and conclusions.

## 2. Pakistan’s Export Performance

The composition of Pakistan’s exports has changed significantly over the years with a steep fall in the shares of primary and semi manufactured exports and equally sharp increase in the share of manufactured exports. In 1971-72, the shares of primary goods, semi-manufactured goods and manufactured goods in total exports were respectively 45%, 27% and 28%. While in 2015-16, these shares were 16%, 1 % and 72 % for primary, semi-manufactured and manufactured exports respectively.

**Table.1: Average Growth rate of Output and Exports in Pakistan**

	<b>Manufactured Exports (% growth)</b>	<b>Exports (% growth)</b>	<b>Manufacturing VA (real) (% growth)</b>	<b>Real GDP (% growth)</b>	<b>Purchasing power of total exports (% growth)</b>	<b>Domestic Absorption</b>
<b>1973-80</b>	21.3	15.5	5.1	5.3	---	---
<b>1981-90</b>	18.3	15.4	7.9	6.1	13.0	2.2
<b>1991-00</b>	16.9	13.8	3.9	3.8	3.9	1.2
<b>2001-10</b>	12.9	12.9	6.7	4.5	0.4	13.3
<b>2011-16</b>	1.2	0.43	4.1	4.3	-5.7	9.8

Source: Author’s Estimation

Undoubtedly the pattern of trade has changed substantially in response to trade reform measures and Pakistan has moved from primary products to finished manufactured goods. But unfortunately, overall export performance is not so promising and showing a declining trend. In contrast to the 1970s

<sup>4</sup> Although Pakistan export receipts doubled from 2001 to 2008 with stable nominal exchange rate; however, with depreciation afterwards, there was no corresponding increase in export value. While for other developing countries like for instance Bangladesh, Cambodia, India, export receipts are continuously increasing.

and 1980s when total exports grew by 15% (on average), the growth was 13.8 % in the 1990s and 12.9 % in the 2000s. Similarly, manufactured exports grew at the rates of 21%, 18%, 17% and 13% in the 1970s, 1980s, 1990s, and 2000s respectively. Since 2010-11, total exports have grown by only 0.43%, while manufactured exports grew by only 1%. Pakistan's share in the world market has gradually eroded from 0.18% in 1990 to 0.15 % in 2003, then to 0.13 % in 2015. This slowdown took place when other countries in the region expanded their export market shares. For example, Bangladesh increased its share from 0.04% in 1990 to 0.19% in 2015 and India increased its share from 0.5 % in 1990 to almost 2 % in 2015 respectively.

A key factor determining a country's export performance is the profile of revealed comparative advantage (RCA). In terms of this indicator as Table 2 illustrates, Pakistan has comparative advantage mainly in low value added consumer good categories like for instance, textiles and clothing, leather and its products (hides and skin) and vegetables. Additionally, Pakistan also has comparative advantage in minerals and animals. Overall, Pakistan has relatively weak advantage in more sophisticated capital goods like for instance, automotive (transport), machinery and electronics, fuels, metals, and chemicals, etc.

**Table 2: Revealed Comparative Advantage (major product categories)**

<b>Products</b>	<b>2003</b>	<b>2010</b>	<b>2015</b>
<b>Animal</b>	0.81	1.03	1.15
<b>Vegetable</b>	2.88	4.43	3.03
<b>Food Products</b>	0.53	0.65	0.94
<b>Minerals</b>	0.29	1.35	1.58
<b>Fuels</b>	0.13	0.17	0.26
<b>Chemicals</b>	0.13	0.13	0.12
<b>Plastic or Rubber</b>	0.37	0.37	0.28
<b>Hides and skin</b>	8.22	8.87	7.7
<b>Wood</b>	0.06	0.13	0.08
<b>Textiles and Clothing</b>	12.67	13.83	14.63
<b>Footwear</b>	0.65	0.58	0.78
<b>Stone and Glass</b>	0.32	1.78	0.24
<b>Metals</b>	0.17	0.37	0.30
<b>Mach and Electronics</b>	0.03	0.04	0.03
<b>Manufactures</b>	1.15	1.04	1.17
<b>Transportation</b>	0.02	0.03	0.02
<b>Machinery and Transport equipment</b>	0.03	0.04	0.02
<b>Miscellaneous</b>	0.47	0.44	0.51
<b>Capital Goods</b>	0.05	0.07	0.07
<b>Consumer Goods</b>	1.74	1.77	1.92
<b>Intermediate Goods</b>	1.7	1.41	1.23
<b>Raw Material</b>	0.47	0.51	0.81

Source: World Integrated Trade Solutions (WITS)

With increasing liberalisation and globalisation, importance of industrial competitiveness is growing as enterprises are facing difficulties in exporting and in competing with imports as the economies open up. The nature of competitiveness is also changing as technology is modifying trade and industrial structures towards more complex and technology-based activities. Technology makes production processes more efficient, thereby increasing the competitiveness of countries and reducing their vulnerability to market fluctuations. Moreover, knowledge is playing a central role in modern production systems and has become a key to sustain or increase competitiveness. The competitiveness of a firm is no longer predominantly attained by cost-reduction, for instance through labour wages, but by risk-taking through innovations in the production process, by accessing new markets through creative marketing. Manufacturing in particular has become more information-intensive: with more focus on research, design, engineering, marketing and networking. To compete, enterprises must use new technologies and organisational methods at best practice and link up to global value chains.

**Table 3: Pakistan Competitiveness Ranking**

	<b>Industrial Competitiveness Index 2013 Rank out of 141</b>	<b>Global Competitiveness Index 2016-17 Rank out of 138</b>
<b>Pakistan</b>	75	122
<b>China</b>	5	28
<b>India</b>	43	39
<b>Korea</b>	3	26
<b>Malaysia</b>	24	25
<b>Thailand</b>	26	34
<b>Indonesia</b>	42	41
<b>Bangladesh</b>	77	106
<b>Turkey</b>	30	55

Source: Industrial Development Report 2016 and Global Competitiveness Report 2016-17

In the changed scenario some developing countries have performed quite well. Unfortunately, Pakistan's performance is not up to the mark. Pakistan continues to struggle to accelerate its manufactured exports. The country's exports are not competitive in international markets. According to the Industrial Competitiveness Index 2013, Pakistan is ranked at number 75; whereas neighbouring country India is ranked at 43 (Table 3). Similarly, according to the Global Competitiveness Report 2016-2017, Pakistan's performance is abysmal with a ranking at 126 and a score of 3.5 out of 7; whereas other countries in the region are coping well with competitiveness processes. The structure of industrial production in Pakistan has mostly remained unchanged since the 1970s. The country seems to be stuck at the lower end of the technology ladder while other Asian countries (such as India, Malaysia, Thailand, China, etc.) have exhibited tremendous growth moving from low technology to high technology production. The reason behind this progression is the successful innovation leading to introduction of new

sophisticated products and processes as well as up gradation of existing processes. In contrast, Pakistan’s manufacturing sector has remained on a roller coaster ride since independence, with boom bust cycles of growth exhibiting wide fluctuations across decades and even within decades. After the disappointing performance of 1990s<sup>5</sup> share of the manufacturing sector in GDP increased to 18.6 % in 2004-05. However, 2006 onwards its share in GDP declined<sup>6</sup>.

Pakistan adopted a private sector-oriented approach somewhat earlier than other economies in the region but has not been able to expand its exports compared to other economies in the region. Even after the passage of more than sixty years Pakistan is still at its *resource-driven stage*. The export mix is extremely narrow and limited to low value-added products. Dependence on international business intermediaries is high, and margins are low and susceptible to fluctuation in prices and terms of trade. Similarly, manufacturing activity in Pakistan is dominated by resource based and low technology activities. Although share of complex products has risen over time but still the performance of manufacturing sector is not optimal, especially when it is compared with other countries in the region; and textiles and food remain the two major manufacturing activities. In terms of exports, our manufactured exports are concentrated in few items. Cotton yarn, cotton fabrics, apparels, leather and its products are among the major export categories.

**Table 4: Pakistan’s Manufacturing Sector**

<b>Manufacturing value added growth (2015)</b>	<b>4 %</b>
<b>Share of manufacturing value added in GDP (2015)</b>	13.4%
<b>Share of LSM in GDP in 2014-15</b>	10.9%
<b>Major manufacturing activities (VD in % to total MVA)</b>	Textiles (25%) Food and Beverages (18%) Chemicals & Chemical products (15%)
<b>Share of Manufacturing exports in total (2015-16)</b>	72 %
<b>Share of textiles in total exports 2015-16</b>	60 %

Source: World Development Indicators and Pakistan Economic Survey 2016-17

The share of medium to high technology products in our total export basket is hardly 6% whereas low-tech textiles based exports account for 60% of total exports. Pakistan’s manufactures are not dynamic activities and are among the slowest growing industrial activities in the world offering limited potential for learning or technological and skill development. Textiles being the main manufacturing activity with longest production chain along with inherent potential for value addition at each stage of

<sup>5</sup> Owing to political instability, worsening of the law and order situation in major hubs of economic activity, reduction in protection rates resulting in the closure of a number of industries, significant infrastructural bottlenecks in transport and other sectors, electricity shortages in the early part of 1990s and its high prices in the latter half and inadequate industrial investment.

<sup>6</sup> Pakistan experienced not only a stable political period between 2000 and 2007, but also till 2005 power supply was in surplus along with stable prices.

processing; but value-added activities are limited. While economic research<sup>7</sup> has established the positive role of foreign direct investment (FDI) and multinational corporations in export development, Pakistan's export-oriented manufacturers have attracted relatively little foreign direct investment (FDI). Consequently, Pakistan's current export structure is neither complex nor technologically sophisticated<sup>8</sup> reflecting a weak competitive base which is not suitable for sustainable economic growth. By not moving up the value chain, Pakistan is facing competition from low income countries exporting low technology products at more competitive wage rates, while countries with comparable income to Pakistan, have moved up the technology ladder to high technology activities (cited from Khan and Afzal, 2016).

A balanced manufacturing structure requires almost similar shares for medium to high technology in production (value added) and in exports. In Pakistan, share of medium to high technology in production is higher than the share of similar products in exports<sup>9</sup>, reflecting competitive weaknesses in complex activities. As compared with other countries in the region, share of medium to high technology in both production and exports is very low indicating slow upgrading over time (whatever upgrading there is, it occurs in production rather than exports)<sup>10</sup>. Moreover, its impact on world manufacturing value added (0 %) and impact on world trade (0.13%) is negligible compared to other regional competitors. Another point of serious concern is the weakening in the purchasing power of exports (that is, declining real price of major exports) in the 2000s (Table 1).

In terms of existing export markets, Pakistan's export partners have increased from 190 to 198 from 2003 to 2015, but exports to most of these countries are extremely minimal. Its major export markets continue to be United States (16.58%) and countries in Europe, for instance, United Kingdom (7.12%), Germany (5.19%), Spain (3.54%), Netherlands (3.02%), Italy (2.80%), Belgium (2.68%), and France (1.63%). Pakistan has only been successful in increasing its exports to China and Afghanistan. These two are now second and third largest export markets for Pakistan with an export market share of 8.76% and 7.80% respectively. Pakistan's largest import suppliers are China (25%), United Arab Emirates (13%), followed by Saudi Arabia (7%), Indonesia (5%) and United States (4%). Limited market access in terms of exports and imports have increased Pakistan's vulnerability to shocks in these few economies.

Recent global developments indicate a heightened risk of growing protectionism and a rising wave of anti-globalisation under new political regimes in the west. In this scenario, it may be more difficult to boost exports especially in view of the rising protectionist sentiments in the USA and UK

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<sup>7</sup> See, for example, Mahmood, et. al. (2009) and Amjad et. al. (2012).

<sup>8</sup> Pakistan's score in export sophistication level has dropped overtime, reflecting its specialization in low technology products (Weiss and Lall, 2004; Fortunato and Razo, 2014).

<sup>9</sup> In 2013, share of medium to high tech in manufacturing value added was 24.6%, while share of medium to high technology in manufactured exports was 10.4% (Industrial Development Report 2016).

<sup>10</sup> In industrialised countries share of medium to high technology in manufacturing value added and exports was above 60 percent in 2013, where share of exports was slightly higher. Similarly, in export-oriented economies of the region share of medium to high technology in exports was much higher than in manufacturing value addition.

which are Pakistan's major trading partners. Pakistan thus needs to focus more on bilateral as well as regional trading partnerships with relatively less explored markets like Iran, Turkey and Central and East Asia, as well as Africa.

### **3. Regional Trade Integration and Pakistan**

In today's world, regional trade integration is gaining importance for economic growth in both developed and developing countries. Regional integration is mainly driven by the theory of customs union in which preferential trade and economic agreements encourages trade creation and diversion effects on member countries. Example of East Asian countries in this context is of great significance. East Asian countries through trade cooperation and integration have exploited the potential synergies among member countries. High economic performances by most of the countries in the ASEAN region have been attributed to integration within the region (Mohanty and Pohit (2007)).

Like many other developing economies, Pakistan is also actively pursuing a policy of promoting regional economic cooperation to boost trade and enhance economic growth. Pakistan has signed many regional and bilateral trade agreements including South Asian Free Trade Agreement (SAFTA) and bilateral trade agreements with Afghanistan, China, Malaysia, Sri Lanka, Iran, Indonesia and Mauritius. In 2003, Pakistan developed its vision of focusing on East Asia to promote trade and investment with the region, in addition to existing relations with the rest of the world. Pakistan's bilateral trade with all of its preferential trading partners for instance, China, Malaysia, and Indonesia (Table 5) has witnessed an increase over time. Great potential still exists for expansion of trade with not only these countries but also with other countries in the region. Diverse business cultures and macroeconomic situations in Asia provide opportunities for trade, investment and economic growth.

#### **3.1. ASEAN Countries and Pakistan**

ASEAN has made great progress in terms of regional economic integration and the creation of a common market and a shared production base – the ASEAN Economic Community (AEC). Pakistan's share of exports to ASEAN countries was hardly 5% in 2015, increasing from 3% in 2003. Trade Specialisation Indices suggest that there are significant non-complementarities between the trade structures of Pakistan and the ASEAN member states (for details see PIDE, 2010). Apart from non-complementarity of trade structures and the absence of a history of economic and social relationships, the role of domestic weaknesses in the case of Pakistan are often cited as reasons for low levels of trade between the ASEAN countries and Pakistan. Moreover, non-tariff measures prevalent in each of the

ASEAN member states as well as in Pakistan are hampering trade growth between Pakistan and the countries in the ASEAN region.

In the services sector, both sides offer large market potential. The findings of a perception survey done by Qadir, et.al., (2010) of various stakeholders in Pakistan and ASEAN member states about the proposed FTA between Pakistan and the ASEAN member states revealed that of the 10 countries included in the survey, only Brunei, Malaysia and Pakistan were in favour of the FTA. Lao PDR, Myanmar, Singapore, Thailand and Vietnam were neutral, while Indonesia and Philippines showed doubts regarding the potential benefit of the FTA. The study further suggests that trade complementarities between Pakistan and ASEAN are weak and investment linkages are almost non-existent.

Recent developments in East Asian economies are providing a fresh impetus to the ASEAN region. For example, China's pace of workforce expansion has slowed in recent years, increasing at no more than one per cent a year since the beginning of the global financial crisis. Over the same period, most ASEAN countries have seen their labour forces expand at a faster rate on average double than that of China. Among the ASEAN, Vietnam has considerable appeal for relocation of industries, given its comparatively low wage costs and its reliable labour supply. Aside from manufacturing low cost items, such as in the flourishing garment industries of Cambodia and Vietnam, ASEAN has also become progressively more capable of handling more sophisticated manufacturing on an increasingly large scale. This is largely due to the growing availability of talented workers and the continual influx of FDI earmarked for higher-end manufacturing projects<sup>11</sup>. Thailand has emerged as an automotive manufacturing hub, while Indonesia is also succeeding in attracting investment from abroad in the automotive sector.

In 2012, electronic products overtook garments as Vietnam's leading export sector. The ASEAN countries (Indonesia, Malaysia, Thailand, the Philippines and Vietnam) have all initiated a number of reforms aimed at attracting foreign companies. These have centred on those trade and investment measures that make it easier for foreign companies to start businesses, trade and enforce contracts. It is believed that these improvements will be seen as a clear response to longstanding calls for greater transparency in the administration of business regulations across all of these emerging markets. These countries are doing extremely well as far as ease of doing business is concerned e.g., starting a business, dealing with construction permits, securing credit, protecting investors, access to electricity, registering property, paying taxes, trading across borders, enforcing contracts and resolving insolvency issues.

Major manufacturers in China are moving their production facilities to Indonesia, Bangladesh, India and Thailand but Pakistan is not among their top priority area. Many industries that rely on low-cost

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<sup>11</sup> East Asia accounted for 60% of global FDI flows to Asia in 2015, whereas Developing Asia was the largest recipient of global FDI in 2015.

labour such as the garment industry for example have relocated production to smaller Asian countries such as Myanmar, Vietnam and Cambodia and even further afield in Africa. These developments have a significant positive impact on the trade share as well as export competitiveness of these countries, while having a negative effect on Pakistan's exports.

To strengthen trade linkages with the ASEAN region, Pakistan's economy needs a much more diversified production structure along with favourable environment for foreign investment. Additionally, development of a new regional trading arrangement -- Regional Comprehensive Economic Partnership (RCEP) involving ASEAN+6 (ASEAN+ China, Japan, Korea, India, New Zealand and Australia) -- poses a serious challenge for Pakistan. The main objective of the RCEP is to increase integration in the region, building upon existing economic linkages. Pakistan, not having a current FTA with ASEAN, is not a negotiating partner to the RCEP while all of the non-ASEAN (invited) member countries in RCEP are either direct or indirect competitors of Pakistan's exports to major markets. These countries will enjoy major concessions via RCEP. If Pakistan is left out of this trading bloc, it will adversely affect Pakistan's exports to the region.

At present, Pakistan is well-integrated with the member countries of ASEAN+6. Pakistan's trade with these countries have increased significantly over the last decade. Five of the ASEAN+6 countries are placed among the top 10 import origin states for Pakistan; these include China, Japan, Malaysia, Indonesia, and India. Moreover, seven out of the top ten Pakistani import commodity groups match with the top ten traded commodity groups of the ASEAN region. Yet, the formation of the RCEP brings with it the risk of diverting trade away from Pakistan to members of the new alliance.

The China Pakistan Economic Corridor (CPEC) is expected to enhance connectivity within region and boost Pakistan's chances to become a part of East Asian trading bloc. Hence Pakistan should seriously pursue to have FTA with ASEAN. But at the same time there is a need to resolve domestic structural issues (discussed in detail in the next section) responsible for the lacklustre export performance. An FTA (if signed) between Pakistan and ASEAN may also facilitate changes in production structure in Pakistan leading to more diversification and greater trade complementarity as well as investor friendly policies and institutions.

**Table 5: Pakistan's Trade with countries in East Asia and Asia Pacific Region**

	Exports from Pakistan (Million US\$)				Imports to Pakistan (Million US\$)			
	2003	2010	2014	2015	2003	2010	2014	2015
Brunei	4.66	0.39	0.69	0.69	1.30	1.88	0.02	0.001
Laos	0.07	0.00	0.76	0.96	0.002	0.00	0.005	0.11
Cambodia	6.01	23.11	33.11	32.35	0.39	0.12	0.25	1.07
Myanmar	5.34	10.84	13.07	17.10	9.20	58.95	20.36	6.20

Malaysia	93.96	145.59	233.93	186.23	601.25	2054.8	1280.1	910.96
Indonesia	47.39	73.85	138.17	140.75	265.92	675.66	2107.2	2041.8
Philippines	23.15	168.20	76.09	66.63	8.42	37.30	40.82	42.45
Singapore	137.80	71.60	245.09	209.23	525.35	913.60	1149.1	874.55
Vietnam	19.64	129.12	260.53	276.63	11.06	76.51	146.21	226.99
Thailand	69.27	80.90	118.46	120.34	231.84	872.38	730.06	852.74
Korea	206.02	279.38	377.89	294.75	348.7	739.1	657.6	702.0
China	259.64	1435.94	2252.90	1934.93	957.3	5247.7	9588.4	11019.0
Japan	139.14	123.38	193.92	182.28	861.9	1594.7	1753.0	1725.9
Australia	115.43	148.15	167.22	175.67	217.9	467.0	336.5	537.6
New Zealand	31.02	33.69	40.97	36.48	15.8	60.4	59.0	48.8

Source: World Integrated Trade Solutions (WITS).

### 3.2. CPEC and Pakistan China Trade

There is immense potential to increase bilateral trade between Pakistan and China in the context of Free Trade Agreement (FTA) between the two countries, especially after the signing of Memorandum of Understanding on the construction of China-Pakistan Economic Corridor (CPEC). China's share in Pakistan's total exports has gradually picked up from 2.2% in 2003 to 8.8% in 2015. Whereas trade is heavily tilted in favour of China as imports share from China has increased from 7.3% in 2003 to 25.1 % in 2015. Research has shown that by promoting a more efficient allocation of resources, bilateral trade will help increase productivity, living standards and long-run growth of the two economies (Din, et. al., 2009). It is further suggested that trade will remain in favour of China in the short term. In the long term, change in the production structures may support a more balanced level of bilateral trade between the two countries. Increased level of trade between the two countries will foster competition resulting in lower prices for consumers, more product variety as well as improved quality and increased incentives for innovation.

Under CPEC, the Government of Pakistan has proposed the creation of 29 industrial parks and 21 mineral zones, 27 of these to be granted the status of Special Economic Zones (SEZs) in different cities of Pakistan which will support Pakistan's struggling economy. The most developed of these projects is the Gwadar SEZ, expected to be fully operational by the end of 2017, which will house industrial units for mines and minerals, food processing, agriculture, livestock and energy. It is hoped that these initiatives will attract Chinese investment, technology and know-how, which will translate into greater and more diversified Pakistani exports<sup>12</sup>. Pakistan needs to clearly design an industry and trade promotion programme to gain from the CPEC in terms of additional business opportunities (Esteban, 2016).

<sup>12</sup> However, business community in Pakistan is quite apprehensive that Chinese investors are neither interested in investing in Pakistan as an export base nor in generating profits from Pakistan through joint ventures of private foreign ownership.

No doubt at present, despite a rapid growth in bilateral trade between the two countries, there exist difficulties and obstacles. Pakistan's trade deficit with China has increased from UD\$698 million in 2003 to US\$9084 million in 2015. Transportation conditions between the neighbouring regions of the two countries do not meet the needs of bilateral trade development and there is relatively low efficiency in customs clearance. One of the CPEC's primary objectives is to address vital infrastructural requirements of Pakistan. CPEC will enhance connectivity and improve transportation facilities.

The Chinese consumer market is transforming<sup>13</sup>, thus offering new opportunities for Pakistan's businesses. China is moving up in the value chain in manufacturing sector and is out sourcing its low-tech manufacturing activities to other countries. Pakistan can benefit while catering to the demand of Chinese middle class for a wide range of products at affordable prices. The challenge for Pakistan is to actively promote trade facilitation, upgrade the trade structure and make bilateral trade more broad-based and diversified, while also exploring additional areas of cooperation (Din, et. al., 2009).

As highlighted above, Pakistan has not fully tapped the potential to export goods to China. One of the reasons cited for this is that Pakistan is not making goods which are in demand in China. Din, et. al., (2009) have highlighted areas to focus for increasing trade with China: diversification in Pakistan's industrial sector; development and utilization of mineral resources; and the use of improved processing technology in the agricultural sector. Similarly, the two countries have a huge potential for cooperation in the service industry and service trade<sup>14</sup>.

### **3.3. Pakistan in South Asian region**

Table 6 below illustrates the situation of Pakistan in South Asian Region. The share of exports to South Asia is 14% of Pakistan's total exports. Afghanistan leads this group with almost 57% of Pakistani exports within region is going to Afghanistan, followed by Bangladesh, India and Sri Lanka. In terms of overall South Asian exports to the world Pakistan is ranked at number three. Almost 80% is contributed by India followed by Bangladesh and Pakistan with a share of 10% and 7% respectively. While India is increasing its world market share for Pakistan this share is declining.

Trade structure of Pakistan is not much different from most of the other countries in the South Asian region. With similar comparative advantages Pakistan has to compete with other countries in the region. Additionally, geo-political factors also contribute to its slow growth in exports. As a region, both India and Pakistan are the largest economies in terms of population as well as size, two countries share a long border with similar socio-economic characteristics, yet the trade between these two countries has

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<sup>13</sup> Rise of upper middle class, a generation of free spenders and increasingly powerful role of e-commerce.

<sup>14</sup> For details see Din, et. al., (2009).

remained extremely low (especially exports from Pakistan). Both SAFTA and SAPTA have failed to deliver as per expectations mainly because of India-Pakistan tensions.

With the exception of Afghanistan, all major trade partners of Pakistan are from outside the region. India is also looking forward to other countries than working on improving relations with its neighbour. Pakistan's exports mainly constitute low value added industrial products and agricultural products, while Pakistan's imports from the South Asian countries are mainly raw material and low value-added products (Mamoon, et. al., 2011). As a region it is least integrated as compared to other regions, although the countries within this region have made significant progress in integrating with the rest of the world.

**Table 6: Pakistan Trade within SAARC (Million US\$)**

	Exports from Pakistan				Imports to Pakistan			
	2003	2010	2014	2015	2003	2010	2014	2015
Afghanistan	408.2	1684.7	1879.1	1722.2	31.1	138.4	392.2	390.4
Bangladesh	166.2	636.8	687.6	700.6	42.9	73.9	60.7	60.3
Bhutan	0.29	0	0	0	0.16	0.02	0.01	2.75
India	83.6	275.0	392.2	312.3	226.3	1559.9	2104.8	1669..3
Nepal	4.81	0.72	0.84	2.28	1.96	1.35	0.95	0.46
Maldives	2.57	3.95	8.35	7.58	0.21	0.17	0.004	2.93
Sri Lanka	83.5	283.9	266.2	260.0	43.3	53.4	63.0	72.3
Total	749.2	2885.0	3234.3	3005.0	345.9	1827.1	2621.6	2198.3

Source: World Integrated Trade Solutions (WITS)

South Asian region shares almost identical pattern of comparative advantage in a relatively narrow range of products<sup>15</sup>. The region has low levels of intra-regional trade<sup>16</sup> and is less dependent on coordinated regional partnerships. This group of seven countries has kept higher level of protection within the region than with the rest of the world. Restrictive policies for the neighbour countries accompanied with serious political issues have counterbalanced the advantages of cultural harmonies, common geography, and the 'gravitational' pull of proximity on movement of goods and people. The region is least integrated not only in terms of trade, cross-border investment is modest and human connectivity<sup>17</sup> is also low for South Asia (Ahmad and Ghani, 2007).

Production structures worldwide have changed and shifted from vertically integrated final goods to regional or global value chains. Intermediate goods and components are acquired from countries which

<sup>15</sup> Export Structures of Bangladesh, India, Nepal and Pakistan have comparative advantage in food and live animals, basic manufactures, and miscellaneous manufactured goods. Sri Lanka too has comparative advantage in food and live animals, and miscellaneous products (for details see Kemal, et. al., 2000).

<sup>16</sup> Similar trade structures and absence of comparative advantage in products that are normally imported by countries in the region have impeded the growth of intra-regional trade (Kemal, et. al., 2000).

<sup>17</sup> The flow of ideas through people to people contact, through telephonic conversations, through purchase of technology and royalty are all low.

offer suitable quality at lower costs. This has lowered assembly cost of manufactured products. Countries that have liberalised services trade, reduced tariff rates, facilitated cross-border trade and movement of skilled and expert manpower, and softened custom regulations have benefited from the global supply chains as well as manufacture-embedded services exchange (Hussain, 2017). ASEAN is a good example in this regard. In many respects, and particularly in terms of labour endowments, South Asian countries resemble many Southeast Asian countries and have the capacity for global value chain activity provided it improves on the quality of its infrastructure and removes its political bottlenecks.

The region has great potential to integrate further by eliminating intra-regional tariffs and through more liberalisation of services and investment regimes. Co-operation in the development of physical and institutional infrastructure would also help. South Asia needs to learn from ASEAN connectivity to identify ways to increase logistics performance in South Asia (OECD, 2015).

### 3.4. Pakistan in ECO

**Table 7: Pakistan’s Exports to ECO members (Million US\$)**

	Exports to ECO				Imports from ECO			
	2003	2010	2014	2015	2003	2010	2014	2015
Afghanistan	408.2	1684.7	1879.1	1722.2	31.14	138.4	392.2	390.4
Azerbaijan	1.09	3.94	27.7	42.2	0.02	0.04	0.11	0.04
Iran	82.1	182.2	43.1	32.3	301.7	883.6	185.7	260.9
Kazakhstan	10.04	5.9	6.7	12.8	0.05	35.0	4.21	3.72
Kyrgyz Republic	2.8	1.3	1.0	0.9	0.00	0.10	0.15	0.06
Tajikistan	0.24	0.7	9.1	4.0	0.08	6.18	0.05	0.10
Turkey	200.3	644.1	391.1	235.4	65.58	155.70	192.86	205.23
Turkmenistan	1.6	1.5	7.0	8.2	0.09	31.88	15.78	14.71
Uzbekistan	3.3	2.7	2.4	2.0	1.30	19.19	0.69	1.12
ECO	710	2527	2367	2060	400	1270	792	876

Source: World Integrated Trade Solutions (WITS)

The ECO region, given its geographical proximity, common social and cultural characteristics, and diversity in economic structures, presents a strong case for promoting regional economic integration. Pakistan is its member since 1985, but so far has not been able to reap benefits from this regional bloc. Undoubtedly there exists enormous integration potential for the development of this resource rich ECO region and for including its excluded segments in today’s global world (Ghani, et.al. (2013). But unfortunately, ECO’s goals for regional trade integration and trade facilitation have shown little progress (Table 7).

Despite various initiatives to strengthen regional economic cooperation, it has weak intra-regional trade and investment linkages. The lack of success in promoting trade in the region despite the agreements and pronouncements at highest levels reflects the vague attitude of the member countries towards regional cooperation (Kemal, 2004). As a region, total merchandise exports from ECO to the world were only a minor share of 1.72% in 2015; and this share is declining. Pakistan's exports to ECO have increased from 0.7 billion US\$ in 2003 to 2.1 billion US\$ in 2015 (only because of Afghanistan). The bilateral trade between Pakistan and Afghanistan has increased enormously over the years. But the point of real concern is the declining exports to two of the major economies in the region -- Iran and Turkey. The substantial decline in exports to these countries reflects diplomatic weaknesses as well as other domestic structural issues.

There is huge potential for intra-regional trade across a wide range of commodities in ECO given enormous mineral and energy resources in some countries while diverse production structures in others. In ECO though the existing volume of bilateral trade with the ECO countries remains small, and in some instances trade complementarity is low, there exists potential for strengthening intra-regional trade across a wide-range of commodities in the presence of Regional Trade Agreements. Once trade is liberalized in the ECO region, the volume of intra-regional trade is expected to increase manifold (PIDE, 2011). According to the study, trade in the region can increase by a factor of eight as a result of a potential Free Trade Agreement among ECO countries as Regional Trade Agreements promise cheaper imports and more valuable exports.

If the region fully utilised this trade potential it can lead to vigorous growth in ECO economies. It is important for overall economic development and prosperity of the region. The analysis in the PIDE study has revealed that the potential annual trade volume of US\$ 280 billion is underutilised. As suggested by the PIDE Study appropriate measures are required to be taken to harness the actual potential which is being wasted and not being put to the benefit of regional business communities.

In summary, tapping the existing potential within Central Asia depends on physical connectivity, i.e., efficient infrastructure connections besides improving cross-border relations and correcting domestic flaws (as discussed in the next section). In addition, strengthening of regional institutions, particularly with a view to promoting regional governance and cooperation for peace and security and to improving a national institutional capacity to implement regional policies is required. This includes appropriate regulatory and legal frameworks to define rights of passage of goods, people and vehicles; permits to facilitate transit rights and arrangements to compensate transit countries for granting those rights as well as for other costs and risks such transit involves; dispute settlement mechanism; jurisdiction and responsibility over title and ownership of offshore pipeline segments, particularly those outside a state's territorial waters.

Pakistan is located on a very important corridor joining China, India, Middle East and Africa. Pakistan can exploit this location advantage while undertaking regional initiatives. In the context of regional connectivity, CPEC is expected to play a fundamental role in not only establishing economic linkages between China and Pakistan but also with East and Central Asian countries. Pakistan should try to build on its trading relations, but before seeking to enter the trading bloc, Pakistan should try to build its trade capacity, that is, its ability to produce according to world market requirements, improvement in its supply-side infrastructure, and building its institutions. Next section will reflect on some of the major issues faced by Pakistan's export sector.

#### **4. Pakistan's Export Sector Challenges in Changing Global Environment**

Given Pakistan's cotton resources and upgrading of textile facilities, it will remain a major player in world textile and apparel markets, but for long-run dynamism a diversification of exports should be an ultimate goal<sup>18</sup>. An important reason behind losing world market share is Pakistan's little technological progress over time and that too in production not in exports. The manufacturing sector, having grown behind heavy protection (of the past decades) has become inefficient; consequently, unable to acquire modern techniques (Weiss and Lall, 2004). Slow growth of manufactured exports goes along with increased susceptibility to external factors. That is, dependence on imports has increased because of increased import intensity of production and consumption predominantly in those export products where no progress has taken place. In short, Pakistan has not fully utilised the benefits of open trade regime.

No doubt, diversification is the most appropriate response to this problem. But at the same time to be successful in the long run, a major structural change is required, i.e., transition from a labour-intensive to a technology-intensive economy. In addition, human resource development is a prerequisite. As technological change also requires a new labour force trained to use increasingly complex machinery and equipment. Furthermore, institutional capacity building along with appropriate domestic policy environment cannot be ignored.

##### **4.1. Technological Progress and Human Resource Development**

The state of science and technology has been far less satisfactory in Pakistan as compared with other emerging economies<sup>19</sup>. The poor state of science and technology may be attributed to the relatively low awareness of technological needs and capacity of the domestic industries; weak link between industry, academia, and research institutions; and lack of resources for scientific research to develop new industrial products, processes or to improve quality or minimise cost of production. Although a large

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<sup>18</sup> Concentration of exports in few items is one of the main reasons of instability in export earnings.

<sup>19</sup> In Global Competitiveness ranking of 2016-17, higher education and training, technological readiness, and innovation Pakistan scores 2.9, 2.7 and 3.3 out of 7 respectively.

number of research and development (R&D) organisations have been established with huge investments by the Federal and Provincial governments but the financial support has not been consistent. Further, as there is no real demand from industry, R&D in Pakistan is oriented towards the supply side. R&D activity in the industrial sector in itself is assumed to be negligible. This is in contrast to the industrialised countries where the industrial sector is a major contributor to the overall R&D effort of the country. No policy can be successful unless it is demand-driven and people-centric.

Similarly, Pakistan is deficient in the skilled human resources that are vital for technological advancement. Pakistan's labour force is not properly trained and mostly it is unskilled. The shortage of skilled labour is more severe in textiles, chemicals, and hosiery/bed linen. Inadequate institutional training and the low quality of education are regarded as the most important reasons for the lack of labour skills (Amjad, et. al., 2012). In the textile sector, an average worker produces only 40% of what his Chinese counterpart produces per day. Pakistan's productivity growth rate in the manufacturing sector from 2000 to 2010 was only 2.3% compared to 8% in China and 3.4 % in India, and this gap has further increased (Hussain, 2017).

As mentioned in earlier paragraphs, in a rapidly changing international environment, skilled manpower; along with science and technology capabilities are extremely important for sustaining development momentum. Significant and consistent commitment in terms of public investment in relevant technical and general education, as well as strengthening of research and development activities is very critical to bolster our export competitiveness. Pakistan needs to attach high priority to human resource development. More efforts should be towards improving the quality of education, on-the-job training, skill up-gradation and dissemination of new knowledge and techniques. This will help in achieving high value addition and low unit labour cost. To prepare the country to face emerging challenges, the development of science and technology and its linkage with industry has to be at the top of our trade and industrial vision for the future. Labour productivity is an important driver of market diversification at the firm level. Development of human resources with the required abilities can help to improve productivity and their ability to diversify their exports in international markets (Ghani, et.al., 2012).

New businesses or younger firms are more likely to adopt new technologies and are more prone to export, and there are learning effects from the export activity. They need to be encouraged through proper fiscal incentives for technology adoption including tax credits for research and development activities. Further, domestically owned enterprises should be offered the same incentive package as are made available to foreign owned firms to enable them to continue investing in better product and process technologies (Mahmood, et. al., 2009).

#### **4.2. Quality Certification and Standards**

Pakistan is facing strict competition from other developing countries. There are increasing concerns of the importing countries about social and environmental issue, the green technologies, child labour, gender balance, and bonded labour. These issues have further reduced the demand for Pakistani products. Pakistan's image of an exporter of low quality products is restricting the placement of orders for high quality products.

A serious challenge faced by Pakistan is the lack of capability to produce according to required standards and technical regulations applied in the international markets (Amjad, et. al., 2012). In addition to product related standards and technical regulations, system standards are also attaining importance. Businesses in Pakistan, especially small and potential exporters, lack the capacity to demonstrate compliance with standards and technical regulations through conformity assessment procedures. While Pakistan has set up the necessary institutional arrangements for certification, implementation remains limited mainly because exporters are not aware of these standards. Raising their level of awareness can result in significant gains in certification and quality improvements. The quality of product is basic to increasing value addition and until the brand name is established, certification is vital to get the benefits of quality improvement. For Pakistani exporters, quality certification and adherence to health, labour, and environment standards is still a major challenge (Amjad, et. al., 2012). Simplification and assistance for certification to technical standards can encourage the adoption of new technology in the export-oriented enterprises (Mahmood, et. al., 2009).

#### **4.3. Infrastructure Development and Cost of Doing Business**

High cost of doing business in Pakistan<sup>20</sup> is a major issue, eroding the competitiveness of domestic manufacturers. Inefficiencies in the public sector institutions have contributed to high costs of production. Pakistan is facing the challenge of severe energy shortages (electricity, gas). Similarly, fuel costs also put a heavy burden on firms and has an adverse effect on their competitiveness (Amjad, et.al., 2012). Energy problems have changed the dynamics of large scale manufacturing. Acute deficiencies have forced large number of industries to switch to alternate energy systems. However, given the high cost involved in this shift, not all firms have the resources to do so. Hence, smaller firms are either closing down, or are cutting down their businesses. According to a survey conducted by the World Bank, the majority of respondents identified problems related to power supply as a major obstacle to business expansion<sup>21</sup>.

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<sup>20</sup> In Pakistan high energy cost, labour wages and discount rate compare to other countries in the region are thus having a negative impact on growth and performance of the industrial sector.

<sup>21</sup> It is estimated that a typical business in Pakistan on average losses 5.6 % of annual output due to power outages as compared with less than 2 % for the average plant in China.

Additionally, weak physical infrastructure has been a major factor deterring the performance of our trade related activities<sup>22</sup>. The quality of infrastructure is below world average. Lack of repair and maintenance has resulted in the depreciation of physical infrastructure. This is likely to hamper economic integration not just domestically (connecting remote regions), but also regionally and internationally. Here, investment in the maintenance and upgrading of existing and new infrastructure could provide an important boost to economic activity.

Infrastructure projects under CPEC are of vital importance in this regard as the CPEC's primary objective is to address urgent infrastructural requirements of Pakistan. CPEC provides an opportunity to revive Pakistan's economic structure through the development of its energy sector and by nurturing greater connectivity through road development, provided it is executed sensibly guarding domestic interests.

#### **4.4. Business Climate**

For export-oriented enterprises to become efficient there is a need for an efficient market economy, free flow of information and adequate provision of amenities. Though Pakistan is making improvements in its overall business climate<sup>23</sup>, flaws still remain in the regulatory and legal framework<sup>24</sup>. Entrepreneurs are required to conform with many regulations relating to the work environment including health and sanitation, product standards, and taxation (as discussed above). However, granting too much authority to the enforcement agencies often leads to harassment of enterprises as well as corruption, causing loss of business confidence.

Despite being the main manufacturing activity with longest production chain along with inherent potential for value addition at each stage of processing, the textiles sector continues to concentrate on low-end product with limited value addition. In Pakistan, firms often complained the lack of an investment-conducive environment, which hinders business expansion and exports. The textile industry of Pakistan has the potential for performing better both in productions as well as in export because of its intrinsic competitiveness in the international market for its conventional products. However, to sustain its position and to move in high value added products as well as for the increased market share, a large investment in new technology along with favourable business environment is essential. To improve firms' efficiencies to develop increasingly sophisticated products, focus should be on further improving the business environment through revisions in regulatory arrangements (customs, taxation and company law) and through uninterrupted energy supplies at reasonable cost comparable to its regional competitors.

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<sup>22</sup> For infrastructure Pakistan scores only 2.7 out of 7 in Global Competitiveness scoring 2016-17.

<sup>23</sup> In 2017, Pakistan is among top ten economies with bigger improvements in business regulations. Pakistan improves its score by 2.08 points.

<sup>24</sup> In *Ease of Doing Business* ranking 2017, Pakistan with score of 51.77 is at no. 144 out of 190 countries.

In general, for enhancing our export competitiveness, there is a need for regulatory, administrative and bureaucratic reforms. The focus should be on strengthening public institutions for the support of the private sector. Serious efforts towards creating and strengthening institutions for effective implementation of policy reforms with transparency, efficiency and consistency are required. Cost-effective enforcement of property rights and contracts, reforms in the procedures to issue NOCs, permits and licences (that is to minimise restrictions) and inspections by government agencies are obligatory for overall improvement in business climate (Hussain, 2017).

#### **4.5. Industrial Clusters**

Cluster of industries connected via vertical and horizontal linkages are viewed as key to become competitive in the global market place. The most dynamic feature of industrial clusters is the ability to foster improvement in efficiency and promote innovation. Proximity encourages intense competition among competing firms, leading to technological advances with the industry. In Pakistan industrial zones were established in 1990s but after withdrawal of incentives they became irrelevant. Gawadar Industrial Zone and Textile City Karachi are steps in the right direction. Clusters are more important for SMEs because they provide cost-effective opportunities to deliver targeted technical assistance for upgrading technology, management and marketing. Development of Industrial clusters for improvement in efficiency and technology diffusion is another crucial issue in Pakistan. Businesses thrive and grow in clusters which help the firms in lowering their costs through easy access to amenities and other business related facilities that are typically available in such clusters. There is a need for more such initiatives to help cluster export oriented manufacturing.

#### **4.6. Financial Market Development**

Access to finance is another major issue that requires thorough consideration<sup>25</sup>. Small and medium industries (SMIs) are facing financial difficulties. Lending money to SMEs is still a problem. Pakistan is weak in terms of legal rights for both borrowers and lenders. Easy availability of long-term credit to finance the working capital needs of small and medium enterprises in Pakistan could lower firm's transaction costs thus increasing their competitiveness. Collateral and bankruptcy laws need to be redesigned to facilitate access to credit. Institutional support in terms of provision of institutional credit, facilitating technical and management skills, fiscal concessions and effective legal system for SMEs is required. The most effective way of delivering institutional support is to focus on selected sectors with growth potential and make it time-limited.

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<sup>25</sup> In Global competitiveness ranking, Pakistan scored 4.0 out of 7 in 2013-14 in financial market development, which decreased to 3.4 out of 7 in 2016-17.

#### **4.7. Coherent Trade policy**

Another serious issue is the inconsistency in the trade policy formulation in Pakistan, that is, trade policy lacks coordination with other related policies and is unduly influenced by external actors. Trade liberalisation policies should be aligned with other macroeconomic policies such as exchange rate liberalisation that would also work to mitigate budgetary pressures. Besides, research has shown that in the manufacturing sector of Pakistan, the exchange rate volatility partially offsets the positive effect of depreciation on exports (Zia and Mahmood, 2013). In terms of trade liberalisation, Pakistan has taken cautious steps towards opening up the economy. However, 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 which lowers the predictability of the trade regime and promotes a culture of rent-seeking.

#### **4.8. Low level of Foreign Direct Investment (FDI)**

Low level of FDI is another major obstacle behind the poor performance of Pakistan's external sector. FDI contributes directly to economic growth through physical and human capital accumulation, along with improving total factor productivity through technological and knowledge spill-overs. FDI in export oriented industries can play a significant role in increasing Pakistan's exports (Din et. al., 2009). Moreover, FDI enables regional integration by allowing countries to link to global and regional value chains, as done effectively by East Asia to promote exports.

Developing Asia received US\$ 442.7 billion in 2016, which accounts for almost 25% of total FDI inflows in 2016 (UNCTAD, 2017). Pakistan's share in this total is hardly 0.5%, i.e., US\$ 2 billion. Although FDI increased from 2015 (US\$ 1.3 billion), but still it is very low compared to other regional competitors. This increase is mainly from a number of projects being implemented along the China-Pakistan Economic Corridor (CPEC). This has resulted in a large amount of foreign investment in infrastructure industries, especially electricity generation and transport<sup>26</sup>.

Policy makers should design plans to attract more capital investment (foreign as well as domestic). Promotion of FDI should be the main concern for policy makers besides supporting in-country business partnerships. We should attract foreign investors for export oriented joint ventures in Pakistan and also establish joint ventures abroad. There is a need to target brand name merchandisers and large retailers of standardised products. Foreign joint ventures can provide marketing, design, logistics, financing while the production can be handled by domestic forms. However, it will require greater

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<sup>26</sup> For instance, Power Construction Corporation (China) and Al-Mirqab Capital (Qatar) have started to jointly invest in a power plant at Port Qasim, the second largest port in Pakistan. In addition, the State Power Investment Corporation (China) and the local Hub Power Company have initiated the construction of a coal-fired plant.

transparency and disclosure by Pakistani firms aspiring for joint venture relationships and a reliable dispute resolution mechanism to redress grievances.

## 5. Conclusions and Way Forward

Despite liberalisation of its trade regime, Pakistan has not fully benefitted from opportunities emanating from the growth in international trade during the past decade. Our industrial sector that initially grew under import substitution bias with substantial governmental support has not prepared itself for global market competitiveness. The lack of entrepreneurship and gaps in business support policies have kept Pakistan from moving up on the technology ladder preventing the country to achieve higher value addition and greater export diversification. Inefficient firms are gaining in terms of tax exemptions and concessions through lobbying, while new dynamic and efficient firms are not encouraged to enter the market (Hussain, 2017).

Undoubtedly, there is recognition at the government level to take initiatives vis-à-vis competitiveness and technological upgrading; but the key issue is how to go about it. Pakistan is reforming its industrial strategy to meet domestic and external challenges and attract foreign investment, improve export performance and move towards further integration at the global and regional levels. But at the same time, challenges faced by Pakistan are how to improve its growth, attract more FDI, skill formation, build technological capability and enlarge and diversify exports. In the dynamic areas comprising electronics, machinery, and metal products, progress is nominal in terms of exports for Pakistan. Industries like automobiles have progressed rapidly but confined to the domestic market only<sup>27</sup>. Engineering sector, in general is dominated by either assembly operations based on imported parts, or the production of basic and simple components. Pakistan has not been able to develop a strong capital goods sector.

Increasing world population and growing global prosperity is fuelling the demand for new products. Relocation of industries from developed to developing countries in the wake of global restructuring and increasing outsourcing opportunities from developed countries offer greater opportunities for Pakistani exporters. Pakistan is also awarded with the Generalised System of Preferences Plus (GSP-Plus) status in 2014 in the EU. So far numerous tariff lines under GSP-Plus remain un-exploited<sup>28</sup>. Given our inherent textile base, Pakistan's exporters have a strong chance to acquire competitive advantage by importing raw material not available locally or through joint venture agreements with businessmen of the countries having raw material.

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<sup>27</sup> Trade policy still has an import substitution bias for automobiles, whose imports are subject to tariff peaks. The continued protection has not helped it to become globally competitive.

<sup>28</sup> Pakistan lacks the capacity to supply man-made fibre-cotton mix.

Pakistan adopted a private sector-oriented approach somewhat earlier than other economies in the region but has not been able to expand its exports compared to other economies in the region. Though the contribution of private sector enterprises is increasing significantly, there is an urgent need to assist private entrepreneurs (who are dynamic, open to innovation and have managerial capabilities) by providing a favourable business environment with good governance, appropriate institutional and financial support mechanisms, an adequate legal and support framework and other physical and social infrastructure. Additionally, creating awareness among enterprises to bring in professional managers and skilled manpower to operate export oriented industries (in particular) would lead to higher overall productivity.

Government's role should be confined to legislation, policy development, regulation, capacity building and facilitation with an objective to increase productivity in all exports sectors. The private sector should take the lead in investment and value chain development on its own. Focus of policy makers should be towards the broader components of national competitiveness, specifically health, education and infrastructure. We should learn from the experience of China, especially how they have promoted their exports while neutralizing import substitution.

For sustainable competitiveness, Pakistan may begin by creating competency in the more labour intensive components of complex products, gradually progressing to more skill and technology intensive activities. To increase exports first there is a need to increase the production of goods and services in all sectors in general but in exportable sector the most. There is a need to devise policies and strategies to increase the production through capacity utilisation, capacity expansion and productivity growth. There is significant capacity in every industrial unit which cannot be utilised because of expensive raw materials, lack of finance, and shortage of expertise. A comprehensive analysis of all such export units may provide guidelines for optimum utilisation of their excess capacity. In this regard, industries which have lost their competitive edge should be ignored (Hussain, 2015).

For capacity expansion, we need to diversify the production base in favour of goods and services with comparative advantage, global demand and growth potential. Some of these industries are electronic and telecommunication equipment, automotive parts, biological pharmaceuticals, renewable energy, petrochemicals and aerospace. Further as our auto industry is beginning to look efficient other downstream and upstream industries should be established. Within textile sector clothing and value added products should be expanded (Hussain, 2015). Finally, productivity growth will come automatically from investment in human capital and promoting innovation (as discussed earlier).

Small and Medium Enterprises (SMEs) can play a crucial role in any economy. There is a need to involve SMEs in an organised production network for exports. Currently, SMEs are playing an important role in our manufacturing activities but for exports their weak technological base and management

practices and limited access to information is creating major issues in terms of quality, delivery delays, and reliability. Without integrating the export oriented SMEs in an organised production network for exports we cannot stimulate our exports. The formal industrial sector, through strategic alliances, subcontracting, outsourcing can bring the SMEs into the production network and lead to overall productivity gains. The state will have to play a proactive role to ensure easy and affordable access to information, finances and create facilitation centres in cluster areas.

In the globalised world it is no longer necessary to master entire production chain and to organize the production processes within a single firm. For reorienting our SMEs, we can focus on mastering only one aspect of production in the group of activities involved in the final product. This not only will save learning costs but will allow SMEs to establish relations with large national and multinational corporations. Technology acquisition, diffusion and transfer constantly involve inter-firm production links between small, medium and large industries within country as well as with other countries. Effective linkages must be put in place to facilitate production and market.

Identification of suitable firms and facilitation of linkages with firms in friendly countries like China, Iran and Turkey as well as in other regional countries through business groups would be extremely useful for technology transfer and to get involved in Regional or Global Value Chains; specifically in areas where we lack in comparative advantage. As happened in other countries (for instance, ASEAN members), participation in any such arrangement will bring economic benefits, in terms of productivity, sophistication and diversification of exports. The issue of raw material could also be resolved through such initiatives.

Furthermore, Pakistan could be the destination for the Chinese industry<sup>29</sup>. Pakistan is planning industrial parks, special economic zones and science parks to facilitate the establishment of the Chinese industry in Pakistan. Pakistan can attract the Chinese manufacturing sector by developing a trained workforce for industries together with overcoming the energy shortage and improving business climate. Pakistan needs to train its workforce to the Chinese standards. Chinese industry if relocated to Pakistan would have a positive impact on our productivity as well as on our exports.

In the changing global environment, another challenge for Pakistan is to build further on suitable international alliances (bilateral or regional) to foster technological capability in sectors operating at a lower technological level and earn more foreign exchange. Declining exports to United Arab Emirates, Saudi Arabia, Iran and Turkey, despite having good political relations is quite worrying. These markets have great potential for our exports. Reinvigorating trade relations with these countries would be of great help.

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<sup>29</sup> Many large companies in China have plans to relocate their business to other countries.

We need to revive economic diplomacy in our foreign relations. The role and effectiveness of the Commercial Councillors in improving the relations with trading partners is extremely important. For regional cooperation and trade the strengthening of institutions is a must. The objective should be to improve national institutional capacity to implement regional policies. This will require appropriate regulatory and legal frameworks to define rights of passage of goods, people and vehicles; permits to facilitate transit rights and arrangements to compensate transit countries for granting those rights as well as for other costs and risks such transit involves; dispute settlement mechanism; jurisdiction and responsibility over title and ownership etc.

The development projects under CPEC are expected to fulfil energy requirements as well as enhance connectivity. Pakistan's economy has huge strategic development potential, as it is located at the crossroads of South Asia, Central Asia, China and the Middle East. CPEC would link a vast sweep of regional markets from China to Asia to the Middle East and to Europe. This will create enormous inter and intra-regional trade opportunities for Pakistan. Pakistan with a vast population, large and diverse resources, and untapped potential for trade can benefit from this regional development provided it gets its policies right on an urgent basis.

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