Re-stoking the Fire: Pakistan's Exports Imperative

Dr. Farrukh Iqbal | February2022
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In recent decades, Pakistan has faced recurring economic crises whose common feature is the severe depletion of international reserves to a level where serious economic disruption seems but weeks away. This leads Government to seek emergency supplies of foreign currency from friendly governments and from the IMF. While there are numerous reasons for the plight in which the country finds itself with alarming regularity, an important one is certainly the inability to generate enough foreign exchange through exports to avoid the repeated reserves crises. My main point in this note is to suggest that we recognize the external financing constraint to be our highest priority and redouble efforts to expand exports accordingly.

The exports problem

The chart below illustrates our exports problem. The top line shows that our exports of goods and services have stagnated in nominal dollar terms since 2011 at a ten-year average of around US$30 billion. The bottom line shows that the ratio of our exports to GDP has been declining since 2003. In other words, while the capacity of our economy has grown (roughly approximated by GDP growth) our ability to use that capacity to produce exports has steadily fallen. Meanwhile, neighboring countries such as Bangladesh and India have made done much better in terms of both the exports measures shown in the chart in the past two decades.

Why focus on exports?

As a policy objective, export enhancement offers a path that combines growth of output, growth of employment and reduced reliance on external debt. When successful, it raises output and employment directly. By earning foreign exchange, it reduces the need for foreign debt which is already at a high level in Pakistan. Indeed, the experience of East Asia suggests that much foreign direct investment was associated with exports, especially via participation in global value chains. So an exports-oriented strategy can attract an additional source of foreign exchange in the form of foreign direct investment. An exports push is also less politically contentious than other approaches that attempt to restore macroeconomic balance through raising taxes or selling public sector enterprises, for example.

Why have previous efforts at enhancing exports not succeeded? Let's consider some reasons for this. First, the real depreciation

achieved has usually been small and often reversed as macroeconomic discipline was relaxed after a few years. In other words, governments in Pakistan typically do not allow enough time to pass under a competitive exchange rate regime. Second, Pakistani exports have been constrained by factors other than the exchange rate, such as the costs and availability of electricity, logistics and finance. The structure of domestic taxes is also not conducive to exports. In other words, not enough is typically done by way of structural reforms to address the non-price determinants of exports. Third, politicians, bureaucrats and business elites have usually paid lip service to the cause of export enhancement in Pakistan. A comfortable existence is available for all three groups in an economy dominated by the seeking and providing of economic rents. Various institutions have been set up to promote exports but they have proved ineffective.

Clearly, any future effort will have to deal with these lessons. A market-determined exchange rate regime will have to be sustained as a matter of principle. Structural reforms will have to be carried out to facilitate power supply, logistics and finance for exports. The relevant bureaucracies will have to be disciplined in order to more effectively provide information and training support for this purpose. Public policy support to corporate elites will have to be conditioned on exports performance.

How do we know that a strategy focused on the above elements can work? We know this largely from Asian examples of the last sixty years. Initially, countries and territories such as Korea, Taiwan, Hong Kong and Singapore rose to prosperity on the back of labor intensive manufactured exports. At a later stage, countries such as Malaysia, Thailand and Indonesia rose to middle-income status in similar fashion, although in their cases primary exports were also important. In the last three decades, Bangladesh, China, India and Vietnam have developed rapidly, again driven by exports.

In most of the above cases, competitive exchange rates maintained over long periods were critical. So much so that, in some periods, western governments have accused some of the successful exporting countries of currency manipulation. Critical also was sustained attention from the top political echelon, as illustrated, in particular, by the well-studied cases of Korea and Taiwan. One area in which such attention proves critical is that of coordinating policy across several ministries. For example, while one agency, such as the State Bank, can be relied upon to maintain a competitive exchange rate, several different ministries are involved in getting all the other elements right. These include good roads from factories to ports, effective port management to reduce dwell time for ships, and good management of power supply. Unless these efforts are coordinated across the various ministries, as was done via the creation of a Deputy Prime Minister position in Korea in the 1960s, the desired results may not be achieved.

Oftentimes, coordination is helped by a clear assignment of priorities. For example, if subsidies have to be reduced in order to meet fiscal targets, the order in which different sectors lose their subsidies could be determined by such an assignment. If exports are given the highest priority, as this blog argues, they could retain some subsidies for longer. The Adviser to the PM for Commerce was recently cited as referring to just such an issue waiting to be resolved through higher level intervention.

Another area where high level political attention and direction would be useful in Pakistan is the performance of economic zones. Where other interests do not allow certain policies to be applied at the national level, countries set up special economic zones to attract exporters. Shenzhen in China is an oft-cited example from the 1980s. Why has this not succeeded in Pakistan? The most recent example of drift is the fact that whereas the CPEC initiative is now entering its ninth year, not a single export zone contemplated under it has attracted

significant new investment yet. One hears of delays in setting up the sites and services needed or issues with respect to the legal provisions and contracts required in different provinces. Surely, sustained attention from above should be able to resolve impediments to the setting up of the zones in the first place and signing up exporting firms for these zones in the second. Furthermore, emerging research suggests that the overall investment climate matters a lot to the performance of a country's special economic zones while traditional instruments, such as low wages, fiscal incentives and trade preferences, do not. Following such findings, the Pakistani government should address economy-wide issues relating to the climate for investment in order to derive the full benefits of existing and new special economic zones.

The present context in Pakistan

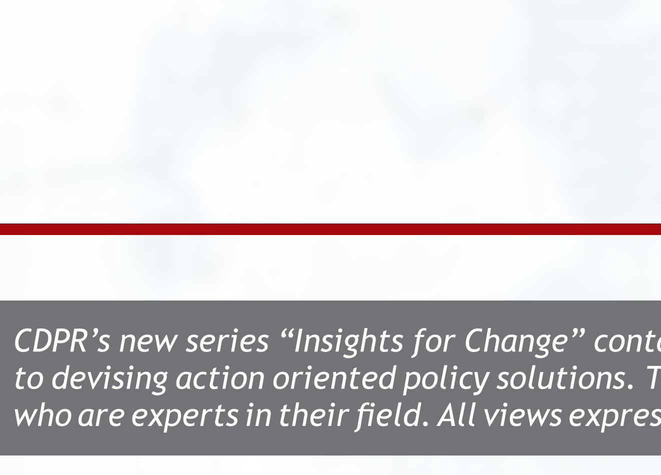
The present situation in Pakistan suggests that the first pillar of a sustained export enhancement effort is in place through mechanisms that should permit a market-oriented exchange rate to be sustained over time. In particular, the granting of additional autonomy to the State Bank (in the latest round of the ongoing IMF program) suggests that this policy will be maintained. It is not clear, however, if the second pillar is firm enough yet. This refers to high level coordination of non-price support for export enhancement. This should be handled like a national campaign, led by the PM using a dashboard on which progress can be tracked monthly. The PM should play an active role in resolving inter-agency coordination issues. Senior ministers should be in constant touch with prominent exporters both to exhort more effort and to find out what may be blocking progress. Not just carrots but sticks should be employed. Unless companies meet export targets, various facilities available to them via public policy (loans, guarantees, input subsidies etc.) should be withdrawn.

A question that comes up every time Pakistan goes to the IMF is whether or not it would be better to develop a home-grown reform program that does not require as much fiscal austerity as typically demanded by the IMF. If the home-grown effort focuses on export expansion as its top priority, it would be consistent with what has been set out above. The question then is whether fiscal austerity would help or hinder the export effort. Depending on the specifics, either outcome is possible. For example, if revenue raising efforts result in higher import tariffs, delays in processing duty drawbacks, higher corporate tax rates, higher sales tax rates affecting intermediate inputs and so on, exports would clearly face higher costs. A similar outcome is possible if the revenue raising steps require the reduction of subsidies to exporters, such as those presently available on gas and electricity. But it is possible that the structure of taxes and subsidies could be revised in such a way as to raise revenues but not impose heavy additional costs on exporters. Furthermore, it is also likely that the reduction of inflation due to fiscal consolidation may eventually reduce a number on input costs for exporters. This is basically an empirical issue. Unfortunately, the literature does not provide clear guidance one way or the other.

One might also consider the impact on exports of fiscal austerity from the spending side. Some empirical literature suggests that government spending in the form of infrastructure investment often crowds in private investment. In such cases, if fiscal austerity leads to low public investment, it may discourage private investment, including in export-oriented sectors. Tighter monetary policy, featuring high interest rates, may have the same effect. For Pakistan, more research is needed to establish the appropriate dimensions of the empirical link between public and private investment and, further, that between private investment and exports.

Meanwhile, one aspect of private investment behavior in recent years has clearer implications for exports. The chart below shows that Pakistan's private investment rate has fluctuated around a level of 11 percent of GDP since 2011. This is a comparatively low level (India and Bangladesh have had levels twice as high) and may be related to the stagnation of exports in Pakistan over the

same period.



Exports as unbalanced development

What is being called for here is a special effort in one area, exports. A conceptual argument for such an approach was provided many decades ago by Albert Hirschman through the notion of "unbalanced development." He argued that countries would be better off striking out along a few promising paths rather than waiting for the resources, both financial and administrative, to implement broad programs containing many objectives and many paths in pursuit of "balanced development." He noted that pursuing a few rather than many programs was better suited to the scarce administrative capacity available to developing countries. The problems that a strategy of balanced development tries to foresee and fix in advance are better dealt with as they occur. Finally, he argued that success in achieving a narrower set of programs would create both the momentum and the resources to tackle others in the fullness of time. The experiences of many Asian countries over the last half century suggest that he was right. Many who struck out along the path of labor-intensive manufactured exports were able to solve various problems as they emerged. In exports as in many other endeavors, learning by doing is the right way to proceed.

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Dr. Farrukh Iqbal

About the Author

Dr. Farrukh Iqbal is the Executive Director of the Institute of Business Administration in Karachi, Pakistan. He was formerly on the staff of the World Bank for thirty years.

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