HARD SELL

Attaining Pakistani Competitiveness in Global Trade

Woodrow Wilson
International
Center
for Scholars
Asia Program

HARD SELL

Attaining Pakistani Competitiveness in Global Trade

Essays by:

Manzoor Ahmad
Shaghil Ahmed
Mirza Qamar Beg
Shahid Javed Burki
Abid Farooq
Edward Gresser
Douglas A. Hartwick
Parvez Hasan
Gary Hufbauer and Agustín Cornejo
Esperanza Gomez Jelalian
Shahrukh Rafi Khan
Zareen F. Naqvi and Ijaz Nabi
Karin Astrid Siegmann

Edited by:

Michael Kugelman
Robert M. Hathaway

April 2008

Woodrow Wilson
International
Center
for Scholars

Available from :

Asia Program
Woodrow Wilson International Center for Scholars
One Woodrow Wilson Plaza
1300 Pennsylvania Avenue NW
Washington, DC 20004-3027

www.wilsoncenter.org

ISBN 1-933549-33-5

The Woodrow Wilson International Center for Scholars, established by Congress in 1968 and headquartered in Washington, D.C., is a living national memorial to President Wilson. The Center's mission is to commemorate the ideals and concerns of Woodrow Wilson by providing a link between the worlds of ideas and policy, while fostering research, study, discussion, and collaboration among a broad spectrum of individuals concerned with policy and scholarship in national and international affairs. Supported by public and private funds, the Center is a nonpartisan institution engaged in the study of national and world affairs. It establishes and maintains a neutral forum for free, open, and informed dialogue. Conclusions or opinions expressed in Center publications and programs are those of the authors and speakers and do not necessarily reflect the views of the Center staff, fellows, trustees, advisory groups, or any individuals or organizations that provide financial support to the Center.

The Center is the publisher of *The Wilson Quarterly* and home of Woodrow Wilson Center Press, *dialogue* radio and television, and the monthly news-letter "Centerpoint." For more information about the Center's activities and publications, please visit us on the web at www.wilsoncenter.org.

CONTENTS

PART III: PAKISTAN AND REGIONAL TRADE

PART IV: THE PAKISTAN-U.S. TRADE RELATIONSHIP

ACKNOWLEDGMENTS

This volume of essays, like the three earlier reports in this series, is the result of an exceedingly fruitful collaboration between the Woodrow Wilson International Center for Scholars and the Fellowship Fund for Pakistan, a Karachi-based charitable foundation. The editors of this report are deeply indebted to Munawar Noorani, FFFP chairman, and to the other members of the foundation's board of trustees and advisory council for their generous support in helping the Wilson Center in its efforts to encourage informed discussion of the challenges facing Pakistan in the early years of the 21st century.

The editors also wish to thank the individuals whose essays appear within these pages, many of whom hold senior positions of responsibility, yet were wonderfully willing to steal moments from their weekends and other personal time to respond to the queries and entreaties of the editors. Without their unstinting and invariably cheerful cooperation, this volume could not have been compiled.

Some, though not all, of the essays appearing here were first written for a Wilson Center conference in June 2007. The editors wish to acknowledge the invaluable assistance in making this conference successful offered by Hon. Alan P. Larson, Mr. Ziad Alahdad, Mr. Bashir Mohammad, Ambassador William Milam, and Pakistan's exceptionally able ambassador in Washington, Mahmud Ali Durrani.

Lastly, warm thanks to current and former staff of the Wilson Center's Asia Program, and especially Bhumika Muchhala and Sooyee Choi.

INTRODUCTION

Michael Kugelman

In November 2007, President Pervez Musharraf declared a state of emergency in Pakistan, plunging the country deeper into political crisis. While most of his justifications for this action were based on national security considerations, it is often forgotten that he also gave an economic rationale. In his address to the nation explaining his decision, he warned that terrorism, extremism, "demoralized" law enforcement agencies, and "interference" in the democratic system "have unfortunately had an impact on the economic situation of the country and there has been a change in our move forward towards prosperity." Invoking emergency rule, he explained, "was the easiest way" to ensure that economic progress continued "unabated."[1]

Perhaps Musharraf was speaking sincerely. Or perhaps he was exploiting Pakistanis' worries about the economy—which had surfaced in polls before his declaration of emergency—in an effort to mask his real reasons for imposing emergency rule. Yet regardless of his true intentions, Musharraf's public comments about alleged threats to the economy underscore the salience of economic matters in Pakistan—even during periods of political volatility. One economic issue that has been on Islamabad's front burner—and will presumably remain so for the foreseeable future, no matter who governs the country—is trade.

Export or Bust

This concern about trade is fueled by the pressure Pakistan's robust economic growth has put on the country to boost its exports. Gross

---

Michael Kugelman is program associate with the Asia Program at the Woodrow Wilson International Center for Scholars. He is responsible for research, programming, and publications on South and Southeast Asia.

domestic product (GDP) growth has averaged 7 percent since 2002, while per capita income has increased by around 5 percent per year—the highest rate in Pakistan's history. The growing economy has triggered increased demand for imports, particularly oil, machinery, and raw materials for textiles. Pakistan's exports, however, have not kept up with this surge in imports. The result has been a trade deficit that reached nearly $10 billion during the first nine months of fiscal year 2006-07—a 15 percent increase from the same period of FY 2005-06. By the end of FY 2006-07, Pakistan had imported about $13.5 billion more than it had exported.[2]

Perhaps not coincidentally, Pakistan's government has accelerated its export-driven trade policy. In March 2007, Islamabad announced "Export Plan Pakistan," an effort to increase annual export revenues to $45 billion by 2013—almost $30 billion more than Pakistan exported in FY 2006-07. Additionally, Islamabad has waged an active campaign of trade diplomacy to secure more duty- and tariff-free market access for its exports. Pakistan has negotiated bilateral free trade agreements (FTAs) with China, Sri Lanka, and Malaysia, and it has been in talks with Bangladesh, Nepal, Singapore, and Egypt. It has also held discussions about possible FTAs with Japan, Russia, Switzerland, and member countries of the MERCOSUR trade bloc in South America.

This trade diplomacy does not always pay off. In March 2007, the European Union—after announcing its intention to conclude an FTA with India—signaled its unwillingness to sign such an agreement with Pakistan, arguing that the latter's economy was too small. Several Pakistani reactions—which surfaced in South Asian media and were attributed to unnamed government officials—gave voice to Islamabad's apprehensions about its exports. "Pakistan's reliance on the EU market and the U.S. is too much and in case the EU market is lost, Pakistan would stand nowhere with regard to exports," confided one "unnamed official." Another anonymous government source pointed out that most South Asian nations face zero duties on exports to the EU. If India were to ink its FTA deal with the EU, then New Delhi would enjoy the same privilege. This, the official concluded, "is really an alarming situation for Pakistan."[3]

These comments reflect the anxieties that surround Pakistan's trade policies. Indeed, embracing an export-intensive trade regime raises key questions: How will Pakistan make its exports competitive? What range of exports will Pakistan emphasize? And how and where will it seek new export markets? In an effort to examine these and other questions, the Woodrow Wilson Center's Pakistan Program convened a day-long conference on Pakistani trade issues in June 2007. Most of the essays that appear in these pages were prepared for this conference. Several others, which focus on the broader impacts of trade liberalization in Pakistan, were written after the event.

Because these essays were drafted before the political crisis of late 2007, which culminated in the December 27 assassination of former prime minister Benazir Bhutto, several reflect an optimism that may no longer seem quite so warranted. At a minimum, Pakistanis will face 2008 under dramatically altered political conditions from the relative stability of the present decade's earlier years. Calculations and decisions about trade—and economics more generally—will need to be tailored accordingly. The essays' themes and conclusions, however, remain as relevant now as they did when first written prior to the turmoil of late 2007.

In the first essay, **Mirza Qamar Beg**, a former Pakistani commerce secretary, explains why an export-led trade policy is important for Pakistan. Exports can attract new investment, spark necessary upgrades to infrastructure and human capital, and bring about technological change and knowledge diffusion—"the most important determinants of growth." Sustained export growth in Pakistan will require macroeconomic stability, a favorable investment climate, and "equitable access to major markets." Meeting the first two criteria will require prudent fiscal and monetary policies, while one of Pakistan's best hopes for fulfilling the third one may lie in a favorable outcome to the World Trade Organization's (WTO) market access negotiations. Beg is doubtful about the ability of "FTA-driven market access" to generate sufficient trade, asserting that Pakistan's gains would be minimal with smaller economies and unlikely with larger ones. He also suggests that instead of seeking markets for its existing goods, Pakistan should "produce the goods wanted by the markets to which Pakistan has preferential access." He acknowledges, however, that such a major change in export priorities "is not likely over the short term." Nonetheless, according to Beg, the stakes are high. "If exports do not grow substantially," he writes, then "at the very least" future economic reforms will be "jeopardized." At the worst, export stagnation "could stir up the forces that would like to see Pakistan a more closed economy and indeed a more closed polity."

Parvez Hasan, now a senior consultant for and formerly a chief economist with the World Bank, reviews Pakistan's trade history—which was for many years heavy on import substitution and subsidies for the country's large textile sector, and light on export-intensive policies. This history, he argues, is defined by "major missed opportunities in export development." Crucially, Pakistan has not exploited opportunities in the global manufactured goods trade. From 1980 to 2005, Hasan explains, major developing countries on the whole demonstrated dramatic growth, increasing their market share of global trade in manufactured exports from 8.6 to 30.5 percent. However, by 2005 Pakistan had garnered only a 0.18 percent share of this market—a considerably smaller portion than many of its developing world competitors, including China and the East Asian tigers.

Why is this so? According to Hasan, Pakistan has been cursed by its historic dependence on textile exports. The nation has simply been unable to take advantage of global market demand for modern, high-tech manufactured products. More than 80 percent of Pakistan's manufactured exports still consist of traditional, low-tech textile and clothing goods (compared to 12 percent of the developing world's exports and 6.5 percent for the entire world). In 2005, Pakistan's non-textile and non-clothing exports totaled $2.3 billion—a minuscule 0.03 percent of the world total. This abysmal export performance has profound implications for Pakistan's economy, because "sustained high growth rates are difficult to achieve without rapidly rising exports." Hasan concludes that to maintain annual GDP growth rates of 7 to 8 percent, Pakistan's real export growth rates must "sharply increase" to 10 to 11 percent per year.

Export Plan Pakistan, the government initiative announced in early 2007, goes even further, envisioning a need for 15 percent annual export growth over 2006-2013—a target that Hasan dismisses as "rather unrealistic given the current weakness in exports." Indeed, Pakistan's export growth plummeted from nearly 15 percent in FY 2005-06 to just over 3 percent in FY 2006-07.[4] However, **Manzoor Ahmad**, Pakistan's ambassador and permanent representative to the WTO, is somewhat more optimistic about reaching the plan's $45 billion export target. He contends that progress in tariff reforms, market access, and diversification of exports will determine if Pakistan can attain this "ambitious" milestone. He notes that Pakistani exports increased 28 percent in 2003 after tariff reforms were in full swing. He chronicles Pakistan's experience with ethanol to illustrate how better market access can boost Pakistani exports. Once awarded the EU's preferential duty rate on ethanol in 2002, Pakistan—which to that point had never exported ethanol—soon became the largest ethanol exporter to the EU. It lost this status in 2005, when these preferential concessions were withdrawn. As for diversification, 75 percent of Pakistan's exports come from only four commodities, while almost half of its exports go to the United States or the EU. Ahmad underscores that the nation must diversify both its range of products and its export destinations. While clothing and textiles comprise the lion's share of Pakistani exports, electrical consumer products, pharmaceuticals, and value-added agricultural products also hold considerable promise. The country should also target markets in strong or growing economies such as Japan, South Korea, and Mexico—all nations to whom Pakistan currently sends less than 1 percent of its total exports.

Societal Impacts of Pakistan's Trade

Pakistan's export-driven trade regime does not operate in a vacuum, and it has a considerable effect on Pakistani society. Accordingly, several essayists describe the impact Islamabad's trade policies have on poverty, the environment, and gender in Pakistan. **Shaghil Ahmed**, a senior economist with the international finance division of the U.S. Federal Reserve's Board of Governors, examines how Pakistan's trade liberalization affects the poor in a nation where about a quarter of the population subsists below the poverty line.[5] Based on the results of econometric analyses, Ahmed concludes that while trade liberalization generally reduces poverty in Pakistan, the effect it has on government revenues may offset some of its poverty-reducing qualities.

What accounts for this finding? According to Ahmed, trade liberalization generates certain effects—more investment, higher productivity, stronger economic growth, and lower consumer prices—that decrease poverty in Pakistan. However, because free trade reduces or eliminates tariffs that would otherwise be government revenue sources, trade liberalization also decreases government funds. With fewer funds, the government has fewer expenditures for development programs that help the poor. Ahmed demonstrates from a counter-factual simulation (which models how Pakistan's economy would have looked had it not decreased import taxes in recent decades) that with less trade liberalization, government revenue and development expenditures in Pakistan would have increased by 11 or 12 percent. The optimal pro-poor policy, he suggests, is to encourage trade liberalization while utilizing non-tariff revenue sources to cover development expenditures. In a forward-looking simulation (which assumes the future existence of certain economic conditions), Pakistan reduces poverty levels by 5 percent over five years—if it is assumed that import taxes decrease by 50 percent; that increased direct and sales taxes are used to help finance development programs; and that development expenditures rise to an average of about 5 percent of GDP. Ahmed argues that Pakistan has in fact started "to move in the direction" of such "pro-poor fiscal policies" in recent years—and poverty rates have indeed declined. He asserts that if greater attention is focused on Pakistan's income inequality and inflation, "even bigger reductions in poverty could be achieved."

Shahrukh Rafi Khan, a visiting professor of economics at Mount Holyoke College, surveys the environmental impact of trade. He does not dispute the notion that free trade is harmful to the environment: "Common sense suggests" that trade liberalization "will lead to higher environmental degradation." However, he argues that in Pakistan the benefits of adopting mitigation measures (actions that reduce environmental damage) far outweigh the costs.

Khan describes the results of studies he has undertaken of Pakistan's textile and leather industries, two of Pakistan's largest—and most polluting—sectors. One study, a speculative cost-benefit analysis of the use of environmentally friendly policies in the two industries, found that between 1996 and 2004, a striking 91 percent of emissions from cloth (textiles) and 66 percent of emissions from tanning (leather) could have been reduced through the use of mitigation measures. Significantly, the study found that adopting such measures would have had a negligible effect on the two sectors' costs. Given its clear benefits, Khan asks, why is there not more widespread use of clean production (CP) in Pakistan? He speculates that many export firms are not given enough economic incentives (such as paybacks) to implement CP measures, and that firms are dissuaded by Pakistan's modest national environmental standards enforcement regime, which often does not punish firms that fail to use clean production techniques.

Ahmed and Khan posit that appropriate policies—such as the use of non-tariff revenue to fund public development programs and the implementation of CP measures—can enable trade liberalization to reduce poverty and to limit pollution. By contrast, **Karin Astrid Siegmann**, in her essay on gender and trade, suggests that more than mere policy adjustments will be required if trade liberalization is to improve the difficult status of women in Pakistan. Siegmann, a research fellow at the Sustainable Development Policy Institute in Islamabad, highlights the country's "strong gender hierarchies" and the institution of *purdah*, the "religiously legitimated segregation of the sexes." Both limit women's employment opportunities outside the home, and, as a result, women work in far fewer sectors and occupations than men. These limited employment opportunities undermine women's negotiating power in the work force, which causes their labor conditions—including their compensation—to be inferior to those of men. Such gender biases, according to Siegmann, fuel Pakistan's export-driven trade policy. She provides sketches of women's experiences in agriculture and manufacturing, two key Pakistani export sectors and the source of much of Pakistan's female labor pool. Women and girls comprise the majority of Pakistan's cotton pickers, and Pakistan's "export engine"—cotton textiles—"has relied on pickers' poor pay for competitiveness." Similarly, the competitiveness of Pakistan's growing garment exports is "enhanced" by women's low pay.

The "crucial question," Siegmann declares, is how "trade-related opportunities for paid employment" have affected women's status. While conceding that trade has stimulated "labor-intensive sub-sectors" (such as soccer-ball manufacturing and cotton picking) that reward women with precious income and resources, she concludes that recent trade patterns bode poorly for Pakistan's women. The world is moving toward more capital-intensive production. While Pakistani men can migrate to these high-skills opportunities, women—who have less access to education and less mobility than men—are more likely to miss out. Siegmann emphasizes that the impacts of trade liberalization are "gendered," meaning that free trade affects men and women differently. She warns that unless this is recognized, trade liberalization "carries the danger of further marginalizing Pakistani women."

Tough Neighborhood for Trade

Pakistan has found trade partners in faraway Latin America and Europe. Its efforts closer to home, however, have been less fruitful. Indeed, because of political and security problems, Pakistan's backyard has long been a regional trade backwater. The South Asian Association for Regional Cooperation (SAARC) is the world's largest regional organization in terms of population, yet its total intraregional trade accounts for less than 2 percent of GDP.[6] It has been estimated that more than 60 percent of world trade is generated through regional trade arrangements, yet intraregional trade among SAARC countries accounts for a paltry 5 percent of the region's total international trade—compared to 63 percent for the EU, 38 percent for the Association of Southeast Asian Nations (ASEAN), and 37 percent for the North American Free Trade Agreement (NAFTA).[7] A 2007 World Bank report lays bare the facts behind the "least integrated region in the world": it has the globe's worst rail lines and road density; it is only "slightly ahead" of sub-Saharan Africa in terms of electricity and sanitation; and it suffers from crippling transaction costs, as measured in particular by lengthy waiting times (as long as an average of a whopping 99 hours in some places) for goods to pass through certain border checkpoints.[8]

Despite these obstacles to regional trade, progress is being made, with Pakistan a key part of it. The World Bank's 2007 report on doing business in South Asia assigns Pakistan a ranking of 98th (out of 175 countries) in the category of trade across borders—not stellar, but a significant improvement from its position of 117th in 2006. The report also notes that trade facilitation in Pakistan is improving, with less time needed now than before to export and to import goods.[9]

Several essays address Pakistan's regional trade possibilities. **Douglas A. Hartwick**, who earlier in the decade served as assistant U.S. trade representative for South and Southwest Asia, charts four future challenges for South Asian regional trade. One is attaining the full trade potential of SAARC and the South Asian Free Trade Area (SAFTA). A second challenge is producing more Pakistan-India trade. The erstwhile partners share comparative advantage in many goods, he notes, and yet only about 1.5 percent of Pakistan's exports go to India, while fewer than 3 percent of India's exports are sent to Pakistan. At the same time, a flourishing informal bilateral trade (involving goods smuggled directly or routed through Dubai or other ports) consists not only of Bollywood movies but also of crucial inputs for both nations' agricultural and manufacturing sectors. A third challenge is "realizing the benefits" of trade with Afghanistan, a relationship currently hamstrung by smuggling, corruption, port delays, and high transit trade costs. The fourth challenge is "weathering" the expiration of the "China safeguards," which place restrictions on 34 categories of U.S. imports of Chinese apparel products. These restrictions, to be lifted at the end of 2008, may spell trouble for Pakistan, which currently exports $1.5 billion in these same categories. Forty percent of Pakistani and Indian textile exports—and more for smaller South Asian economies—could be at risk when and if the Chinese apparel exports flood American markets.

Hartwick's essay describes the benefits that could accrue to Pakistan if these challenges are overcome. Increased trade flows, he notes, would bring "flexibility" and "resiliency" to an often-fragile Pakistani economy. **Shahid Javed Burki** concurs, arguing that more regional trade would give the Pakistani economy a much-needed restructuring. Burki, a former Pakistani finance minister and senior World Bank official, argues that taking advantage of SAFTA would be the best way to address the "distortions" in the patterns and structure of Pakistani trade—distortions manifested by the lack of diversity in its export products and destinations. Burki projects that if SAFTA were implemented successfully, Pakistan's total trade would increase at a rate of 10 to 12 percent annually over the next 10 years, from $33.5 to $90 billion. Pakistan-Afghan trade would jump from $1.9 billion to more than $8 billion, while Pakistan-India trade would rise from $2 billion (a figure that includes informal trade) to $20 billion. With new export markets across South Asia, Pakistan's agricultural, banking, and services sectors would be revitalized and provide more value-added products than at present. With transit trade garnering more foreign exchange, Pakistan's transport sector would be modernized. And the country's hotel, restaurant, and entertainment industries—buoyed by increased tourism—would flourish. Pakistan, in other words, would be transformed from a nation of few and frequently uncompetitive exports and limited trade partners into one boasting a diverse and competitive export portfolio—with the world's most populous region clamoring for its products.

Burki concedes that for this transformation to occur, Pakistan's relations with India are crucial. The two countries must come to agreement on how to regulate cross-border capital flows. They must "restore and develop" transport and communication links; join their electric power grids and natural gas pipelines; and provide open use of each other's airports and ports. Additionally, Islamabad must reorient its foreign policy toward New Delhi, with whom the former has long been "consumed with challenging"—particularly over the Kashmir issue.

Indeed, achieving stronger economic ties between Pakistan and India sometimes seems an elusive goal. Pakistan has often refused to discuss normalizing relations with India until the Kashmir conflict is resolved. The two countries continue to bicker about Most Favored Nation status (which Pakistan has not granted to India) and about which goods can and cannot be legally traded. The fact that two neighboring states can benefit from each other's goods yet often choose not to trade with each other can seem downright farcical. The Pakistani businessman Syed Babar Ali remarked in early 2007 that Pakistan has faced wheat surpluses while India faced wheat deficits. Yet instead of exporting this surplus to India, Pakistan has shipped wheat to Australia—a policy that Ali describes as "ridiculous."[10]

As a matter of fact, however, Pakistan-India trade is now increasing—rapidly. Official bilateral trade reached a record $982 million in FY 2005-06, according to **Zareen F. Naqvi** and **Ijaz Nabi**—a dramatic surge since 2001-03, when it averaged less than $250 million. Naqvi, of Canada's University College of the Fraser Valley, and Nabi, of the World Bank, identify in their essay several key indications that trade between the two countries may be moving toward a "higher trajectory." They note that Pakistan's government has taken much more of an interest in the issue, with the Ministry of Commerce and State Bank of Pakistan particularly engaged. Similarly, the India-Pakistan Composite Dialogue process, which began in 2004, features "economic and commercial cooperation" as an agenda item. The authors also describe improved political relations, which have revived rail services and produced new cross-border bus links. They point as well to Pakistan's many trade liberalization reforms. Together, these developments reflect progress in surmounting historic roadblocks—political tensions and import-substitution policies—to increased bilateral trade.

Naqvi and Nabi estimate that, at best, the two nations "are exploiting only a third to a tenth of the potential that exists" for bilateral trade. The opportunities for greater bilateral trade flows are immense; the authors argue that "in the most optimistic scenario" greater Pakistan-India commerce could restore pre-1947 trade patterns and benefit all of Pakistan's provinces. Lahore could become a trade hub for towns along India's northern border, while these towns and others in both Punjabs could profit from intra-industry trade in manufactured and agricultural goods. Meanwhile, Peshawar and other towns in Northwest Frontier Province "could gain substantially" if Pakistan allowed land transit facilities to India for the latter's trade with Afghanistan. Also, Quetta and other towns in Balochistan could benefit from trade with India, particularly if India were to use Pakistani land routes and new port facilities in Gwadar as byways for trade with Afghanistan, Central Asia, and the Gulf. Finally, Sindh would gain from cross-border trade with western and central India. The authors insist, however, that to ensure these benefits, there must be free movement of people and investments as well as of goods. They warn that an absence of human mobility could spawn trade monopolies and offset the gains of increased bilateral trade.

The Pakistan-U.S. Trade Relationship

While some essays in this collection advocate the strengthening of Pakistan's trade links with its neighbors, others examine trade relations with the United States. The Pakistan-U.S. trade relationship totals about

$5 billion, and about a quarter of Pakistan's exports have a U.S. destination. A particularly important dimension of this bilateral trade relationship is American investment. The United States has been Pakistan's largest investor in recent years, contributing about 30 percent of total foreign direct investment (FDI) in Pakistan since 1990.

This volume features several contributions on Pakistan-U.S. trade. Two of these essays represent the countries' respective business communities. **Abid Farooq**, a Lahore-based businessman and managing director of one of Pakistan's largest textile mills, provides the Pakistani perspective. He writes that Pakistan's structural reforms—including those of taxes, governance, and privatization—have bolstered the country's strong investment record. He emphasizes the "inherent, highly lucrative opportunity" for investment in Pakistan's rapidly expanding telecommunications sector, which is now the world's fifth largest. He highlights the "tremendous opportunity" for American companies to invest in Pakistan's "lucrative energy market." Farooq also expresses his frustration with media-driven negative perceptions of Pakistan, which undermine "our sincere efforts" to cultivate long-term business partnerships with the international community. He does not explicitly state a desire for the United States to combat this poor image, but he suggests that the American private sector can do its part through "establishing a stronger bond [with Pakistan], with a commitment from the U.S. private sector to further enhance trade." Ultimately, he writes, Pakistan seeks to be perceived as "a progressive and enlightened nation of sound economic strength."

Esperanza Gomez Jelalian, the executive director of the Washington-based U.S.-Pakistan Business Council (USPBC), represents American private sector views. Writing about the strong U.S. business presence in Pakistan, Jelalian notes that the Karachi-based American Business Council of Pakistan (ABC) represents 60 American companies in Pakistan. These firms employ more than 40,000 people and "indirectly employ" almost a million more through agents, distributors, and suppliers. What do these firms seek from Pakistan? One desire of the USPBC and ABC is stronger intellectual property rights and enforcement. Their wish list also includes tax reductions, especially on the 15 percent sales tax on information technology (IT) products and on the various duties slapped on carbonated soft drinks. The IT tax "is hampering growth in a sector that the government is keen to develop," she writes. Meanwhile, tax relief for U.S. soft drink companies—which supply 95 percent of Pakistan's carbonated sodas—would likely hasten a higher volume of sales, increased investment, employment, and tax revenue.

Jelalian echoes Farooq's comments about U.S. investment opportunities in the telecommunications and energy sectors. Additionally, she notes that Pakistan's computer industry, with its "English-speaking, well-educated work force," offers many possibilities for U.S. companies, and that the air transport sector, with new airports in Islamabad and Gwadar, will require equipment that U.S. investment can provide. Farooq would perhaps be comforted by Jelalian's discussion of Pakistan's image abroad. ABC members are concerned about this negative portrayal, she says, and the U.S. business community has impressed on Pakistani officials "the need to devise mechanisms that would enhance the country's image abroad and to brand Pakistan as a profitable business destination." Of course, given Pakistan's recent political turmoil, and given that several credit ratings agencies reduced their rating of investments in Pakistan after the November 2007 declaration of emergency rule, repairing Pakistan's image in the eyes of investors will not be easy.

Jelalian does not address Washington's policies toward Pakistan's U.S.-bound exports. This aspect of the Pakistan-U.S. trade relationship is of considerable import for Farooq, who argues that Pakistan's food and textile exports face undue taxation and regulation upon arrival in the United States. Food items face "peak season surcharges" that drive up freight costs. Additionally, U.S. Food and Drug Administration (FDA) guidelines impose such a burden on Pakistani food exports in terms of cost and resources that they "are too high for most exporters to bear." Farooq describes these FDA regulations as a "non-tariff barrier" that "further impedes" the growth of food exports. Meanwhile, Farooq notes that of Pakistan's total exports to the United States, 80 percent are textiles and clothing. Once in the United States, these goods are classified as "non-preferential" and levied with import duties ranging from around 9 to 15 percent. By comparison, nations that enjoy preferential trade agreements with the United States are subject to duties on similar goods that are often less than 2 percent.

These import tariffs on Pakistani exports are the subject of **Edward Gresser**'s critical examination of U.S. trade policy toward Pakistan. Like Farooq, Gresser, of the Progressive Policy Institute, argues that Washington's tariff regime covering Pakistan's textiles undermines the ability of Pakistan to compete with its rivals in the highly coveted U.S. market. Gresser presents stark figures to demonstrate how Pakistan pays a disproportionate share of penalties relative to its competitors and to wealthier nations. He calculates that Pakistani towels, worth $300 million when they reach U.S. shores, are charged an annual total of $27 million in U.S. import tariffs—a figure that exceeds the $24 million that Norway shells out each year for its entire array of U.S.-bound exports, which are valued at $7 billion. Perhaps more significantly, many of Pakistan's competitors enjoy preference programs with the United States that Pakistan does not. This is why a country like Egypt—now the fastest-growing towel exporter to the United States—is exempted from paying the 9 percent tariff levied on Pakistani towels. And it is why members of the Central America Free Trade Agreement (CAFTA) pay no tax on the $1.7 billion worth of pullover shirts they export to the United States, while Pakistan is burdened with a 16.5 percent tariff for just $330 million of the same shirt export.

Gresser questions why, given Washington's stated goal to generate economic growth in Pakistan with enhanced trade, U.S. trade policies are "working to frustrate" this very objective. The U.S. government, he argues, has done little to change its tariff policy. Islamabad's 2001 appeal for tariff preferences went "unheeded," while the George W. Bush administration did not endorse a U.S. congressional proposal for a tariff exemption program for Muslim countries in 2004. Gresser advocates that the U.S. government remove all tariffs on Pakistani towels, clothes, and other manufactured goods. This would enable Pakistani exporters to compete fairly with rivals in other developing countries, and consequently would keep Pakistani textile businesses healthy and employment strong.

Gresser asserts that Pakistan loses out to export competitors who benefit from tariff-reducing preference programs. In fact, there is a possibility that one such program—Reconstruction Opportunity Zones (ROZs)—may eventually be launched in Pakistan. The Bush administration hopes to establish ROZs in the impoverished border areas of Pakistan and Afghanistan, where export producers would enjoy preferential access to American markets. Gresser contends that at this point, the ROZ initiative is not far enough along to merit attention. However, in this volume's forward-looking final essay, which considers what may lie on the horizon for the Pakistan-U.S. trade relationship, **Gary Hufbauer** of the Peterson Institute for International Economics and **Agustín Cornejo** of Geneva's Graduate Institute of International Economics take a closer look at ROZs' prospects for success in Pakistan. Highlighting the track records of arrangements similar to ROZs, they find reasons for optimism. Pakistan's Export Processing Zones (EPZs), which offer incentives to draw foreign investors (short of preferential access to foreign markets), generate more than $8 billion in annual export revenue and employ about 400,000 workers. Significantly, Qualified Industrial Zones (QIZs)—essentially ROZs based in the Middle East—are making success stories out of Jordanian and Egyptian clothing exporters. On the other hand, Hufbauer and Cornejo note that EPZs are thought by many to function best when located near "dense local economic networks." Such a finding is bad news for Pakistan's proposed ROZs, which would be situated in some of the remotest parts of the country. Also, ROZs in Pakistan would need to provide security for investors and workers—which would translate to "considerably higher public expenditure." Furthermore, Pakistan's EPZs have been flagged by the International Labor Organization for questionable labor and gender policies (though the authors intimate that U.S. legislators would lobby for the incorporation of appropriate protections in ROZ legislation).

The Hufbauer/Cornejo essay also examines prospects for a Pakistan-U.S. bilateral investment treaty (BIT)—which according to Jelalian is keenly sought by the U.S. business community. While the authors acknowledge that a BIT does not typically attract as much FDI as an FTA, they do find reasons to support its presence in the Pakistan-U.S. trade picture. Pakistan's proposed BIT with Washington is a "deep agreement," resembling investment chapters in FTAs and providing particularly strong investor protections. The investor-protecting BIT, in tandem with investment-attracting ROZs, could therefore bring a remarkable take-off in FDI—an important benefit in a country that, despite its impressive rise in FDI flows, is still regarded as "punching below its weight" in FDI attraction. The authors' implicit message is that in the absence of a Pakistan-U.S. FTA—still "a distant prospect"—ROZs and a BIT may constitute pillars of the future bilateral trade relationship.[11]

It is undeniable that Pakistan's late 2007 political crisis—and Washington's response—has affected Pakistan-U.S. relations. In recent months, anti-Americanism has surged in Pakistan. An International Republican Institute (IRI) poll released in December 2007 concludes that 82 percent of Pakistanis now reject cooperation with the United States in the war on terror—up from 43 percent in September 2006.[12] There is some evidence, however, that deepening Pakistan-U.S. trade ties might help boost Pakistani views of the United States. In August 2007, the group Terror Free Tomorrow (TFT) mined public sentiment of more than one thousand Pakistanis in all four of the country's provinces. Majorities or near-majorities of Pakistanis stated that more U.S. business investment in Pakistan and a Pakistan-U.S. FTA would improve opinion toward the United States "a great deal" or "somewhat." The poll also revealed considerable support for attracting U.S. investment in factories that would employ Pakistanis, and for exporting more Pakistani products to the United States.[13]

Challenges Ahead

A consensus view in these pages is that Pakistan's export-driven trade regime is frequently undermined by poor export performance. Pakistan cannot always offer the products the world wants, and the products it can offer are often either not wanted by the world in sufficient quantities or are shut out of markets by the competition. Though the reasons for this poor performance are varied, many essays here attribute these export problems to the absence of export diversification and human skills development. Even as the world seeks sleek, modern technology and hungers for services, Pakistan remains mired in a virtual mono-export rut that dates to the 1950s. Though some authors agree that Pakistan's textile industry is too important to abandon—and some insist that measures must be taken to keep it strong—the implication emerging from this volume is that Pakistan's future economic growth hinges on its ability to diversify its exports (in terms of both products and destinations) and to make them more competitive. Meanwhile, improving the quality, value, and competitiveness of Pakistani exports—no matter the type—will require major investments in skills training, and, by extension, education. Several essays criticize Pakistan for not following the example of Asia's new economic behemoths, India and China, both of which have equipped their populations with the skills and schooling to produce modern, high-value-added exports.

To its credit, Pakistani authorities appear to be taking on these challenges. Pakistan's commerce minister, in a speech that unveiled Islamabad's official 2007-08 trade policy, pointed to sharp increases in non-cotton textile exports in 2006-07—an indication that "our product base within textiles is diversifying from the traditional cotton base."[14] The minister also spotlighted major export increases in the engineering, jewelry, and services sectors, and proposed incentives to spark growth in non-textile exports (though many of these incentives are laden with subsidies). The new trade policy also established an "Export Skills Development Council," which would be housed in Pakistan's Trade Development Authority (TDAP) to ensure that skills taught in training programs are in fact the skills most required by Pakistan's export sectors. Furthermore, an initiative to increase Pakistan's competitiveness—sponsored in part by Pakistan's finance ministry—produced a report in 2007 that reinforces the linkages between education, marketable skills, employment, and competitiveness.[15]

Clearly, however, there is still much to be done. The government aspires for export revenues of $19.2 billion in fiscal year 2007-08. However, Pakistan's official trade figures reveal that the country's total exports fell $320 million short of their target for the first quarter of FY 2007-08.[16] Around the time this shortfall was announced, the Asian Development Bank (ADB) released a report predicting "relatively slow growth" for Pakistan's exports in 2008 and forecasting "continuing weakness" in textiles and "elevated" import growth due to high oil costs. The ADB projected that Pakistan's trade deficit will remain "heavy" at $11.4 billion, or more than 7 percent of its GDP.[17]

The Case for Trade

These trade challenges are daunting, and resolving them will not be easy. Yet they must continue to be addressed. While it is clear from the Pakistani government's export promotion efforts that it cares about trade issues, it is notable that significant majorities of Pakistanis now express a strong interest in trade as well. A 47-nation Pew Global Attitudes Survey, which polled several thousand Pakistanis in the spring of 2007, found that 82 percent favor "growing trade ties between countries."[18] Additionally, last summer's TFT survey asked Pakistanis to describe the importance of "seeking better trade and political relations with the West" as a long-term goal for Pakistan's government. Sixty-eight percent said "very" or "somewhat" important.[19]

It is true that this data was compiled several months before the political crisis in late 2007; one might therefore assume the results would be somewhat different if collected in 2008. Nonetheless, even while Pakistan's political situation will surely dominate the country's headlines in the months ahead, one can argue that trade, as a key economic issue, retains its importance for Pakistanis. The country's citizens continue to care about the economy. The IRI poll (conducted several weeks after emergency was declared) found that 77 percent of Pakistanis would base their voting decisions in the next election on economic issues—inflation, unemployment, and poverty.[20] Clearly, even amid political uncertainty, Pakistan's populace covets economic security. It is therefore noteworthy that many experts—including some of this volume's contributors—argue that the ticket to sustained economic growth and decreased poverty in Pakistan is an export-driven trade policy. Regardless of whether this is correct, it is apparent from Pakistani public opinion that Islamabad has a strong mandate to craft a trade policy—whether export-driven or not—that helps deliver economic security.

While by no means authoritative, public opinion does enable one to take a country's pulse. Pakistanis, Americans, and the broader international community must recognize both Pakistanis' concerns about their economy and the need to develop a trade policy that helps alleviate these concerns. Some economists have already predicted that, owing to the fallout from political turmoil, Pakistan's GDP growth rate could fall by 1 to 2 percent over FY

2007–08. For a country as fragile as Pakistan, such a slowdown would not be a welcome prospect. It is therefore in everyone's best interest to ensure that Pakistani trade issues remain a priority moving forward.

Notes

1. An English translation of Musharraf's address can be found in Aziz Malik, "Musharraf Vows: Emergency Imposed in Larger National Interest," *Pakistan Times*, November 5, 2007, available from http://www.pakistantimes.net/2007/11/05/top.htm.

2. Humayun Akhtar Khan, "Trade Policy 2007–08" (speech delivered July 18, 2007, Ministry of Commerce, government of Pakistan). Available from http://commerce.gov.pk/Downloads/TPSpeech2007-08.pdf.

3. "EU Declines Free Trade Pact With Pakistan," *The Financial Express*, March 1, 2007, available from http://www.financialexpress.com/latest_full_story.php?content_id=156422.

4. Asian Development Bank (ADB), "Asian Development Outlook Update 2007" (Manila: ADB, 2007), 114. Available from http://www.adb.org/Documents/Books/ADO/2007/update/default.asp.

5. See, for example, Competitiveness Support Fund (CSF), "The State of Pakistan's Competitiveness 2007," (Islamabad: CSF, 2007), 37. This figure tracks with estimates provided by the World Bank, the United Nations Development Program, and the U.S. government. Pakistan's government has argued the figure is somewhat lower.

6. World Bank, "South Asia: Growth and Regional Integration," Report #37858-SAS (Washington, DC: World Bank/Poverty Reduction and Economic Management Sector Unit, South Asia Region, 2006), 180.

7. Jalil Ahmed, "Saarc: Challenges Ahead," *Dawn*, April 3, 2007, available from http://www.dawn.com/2007/04/03/op.htm#2.

8. World Bank, "South Asia: Growth and Regional Integration," 19, 161.

9. World Bank, "Doing Business in South Asia 2007" (Washington, DC: World Bank, 2007), 49.

10. Syed Babar Ali, "Pakistan's Transformation in a Global World: A Businessman's Perspective" (lecture at SAIS Annual Pakistan Speakers' Forum, School of Advanced International Studies, Johns Hopkins University, Washington, DC, April 9, 2007).

11. There is some recent speculation, however, that the BIT negotiations have stalled or even ended altogether, because of an inability to agree on the treaty's terms. See, for example, Ashfak Bokhari, "Has US-Pakistan Investment Treaty Been Shelved?" *Dawn*, December 3, 2007, available from http://www.dawn.com/2007/12/03/ebr2.htm.

12. International Republican Institute (IRI), "International Republican Institute Index: Pakistan Public Opinion Survey, November 19-28, 2007," (Washington, DC: IRI, 2007). Available from http://www.iri.org/mena/pakistan/pdfs/2007-12-12-pakistan-poll.pdf.

13 Terror Free Tommorrow (TFT), "Pakistanis Reject U.S. Military Action Against Al-Qaeda; More Support bin Laden than President Musharraf: Results of a New Nationwide Public Opinion Survey of Pakistan" (Washington, DC: TFT, 2007). Available from http://www.terrorfreetomorrow.org/upimagestft/Pakistan%20Poll%20Report.pdf.

14. Khan, "Trade Policy 2007-08."

15. CSF, "The State of Pakistan's Competitiveness 2007," 77-78. It remains to be seen whether these policies of the Shaukat Aziz government are continued by the next government.

16. Sajid Chaudhry, "Exports Miss Another Target, Fall Short By $320m," *Daily Times*, October 14, 2007, available from http://www.dailytimes.com.pk/default.asp?page=2007%5C10%5C14%5Cstory_14-10-2007_pg5_1.

17. ADB, "Asian Development Outlook Update 2007," 116.

18. The Pew Global Attitudes Project, "World Publics Welcome Global Trade—But Not Immigration: 47-Nation Global Attitudes Survey," (Washington, DC: Pew Research Center, 2007). Available from http://pewglobal.org/reports/pdf/258.pdf. In the context of the Ahmed, Khan, and Siegmann essays, it is also notable that majorities of Pakistanis believe that environmental protection should be a priority—even if jobs are lost—and that the state should take care of the poor. Furthermore, majorities state that education is equally important for boys and girls, but that there should be restrictions on men and women being employed in the same workplace.

19. TFT, "Results of a New Nationwide Public Opinion Survey of Pakistan."

20. IRI, "Pakistan Public Opinion Survey, November 19-28, 2007."

PART I

Overview of Pakistani Trade Issues

PAKISTAN'S EXPORT IMPERATIVE

Mirza Qamar Beg

Over the last decade, Pakistan's exports have doubled. Growth was particularly marked during the last five years (until FY 2006), with a compound annual growth rate of 16 percent. A combination of domestic reforms and a favorable external environment contributed to this significant growth.

The domestic scene was marked by responsible leadership committed to an economic turnaround. A well-implemented program of reforms, fiscal discipline, political stability, and a fair internal security situation helped strengthen the macroeconomic framework. The textile sector invested $4 to 5 billion to meet post-MFA (Multi-Fiber Agreement) challenges. Until at least 2004, the real effective exchange rate remained stable. Extensive trade and tariff reforms lowered the implicit tax on exports, reduced the anti-export bias, and enabled higher import content. Simultaneously, some "internal liberalization"—improvements in the regulatory environment and factor markets (capital and labor) —also took place.

On the external front, global demand for textiles remained favorable. Pakistan enjoyed duty-free access to its biggest market, the European Union, for most of its products during 2001-05. After 9/11, and with some trade policy adjustments, Afghanistan emerged as a "new" market, becoming Pakistan's third biggest buyer. Debt rescheduling and sizeable capital inflows kept the external sector healthy and provided greater fiscal space.

This doubling of exports, however, has masked certain weaknesses. During the same period, Pakistan's competitors (e.g. China, India, Vietnam, and Bangladesh) fared much better. Pakistan's exports (as a percentage of gross domestic product or GDP) actually declined, and

---

Mirza Qamar Beg is a former commerce secretary of Pakistan. Most recently, he was Pakistan's ambassador to Italy. This essay represents the personal views of the author, and does not necessarily represent the views of the government of Pakistan.

there was imperceptible product and market diversification. There was little movement up the value chain, unit prices decelerated, and sufficient technological change and technology diffusion were not in evidence. Pakistan's share of exports in total trade declined from 43 to 36 percent, and the export growth rate has fallen from 22 percent in FY 2003 to 16.8 percent in FY 2005; to 13.8 percent in FY 2006; and to less than 5 percent in FY 2007.

Export Troubles

A multitude of explanations is offered for Pakistan's exports not having fared better: unfair competition (subsidies, undervalued exchange rates, preferential market access), higher costs (impoverished infrastructure including unreliability of the power supply, higher shipping costs, poor trade logistics and facilitation, diseconomies of scale, unofficial payments), and weak supply base (lack of diversification, export bias, insufficient attention to quality). Each of these explanations is plausible, but unfortunately there are few objective studies available to establish the extent to which each explanation accounts for Pakistan's export disadvantage. The temptation to "prove the point"—find the data to support the claim—is quite prevalent.

The suggested "solutions" are as varied as the explanations. Market access (more free trade agreements, or FTAs), better exchange rate alignment, "compensatory" subsidies, regional integration (a euphemism for open trade with India), deeper tariff reforms, and product diversification (i.e. a deemphasizing of textiles) are offered as the main elements of a response matrix.

These proposed solutions—like the explanations—merit consideration, but it is uncertain if they will launch Pakistan's exports on a sustainably high growth trajectory.

FTA-driven market access is unlikely to ensure significant trade creation: with the smaller economies, gains will be quite limited, and with the EU and United States—where there is promise of substantial gains—it is unlikely to materialize, and if it does it is likely to come with high public welfare costs. While Pakistan's rupee is currently overvalued, a sudden correction could have grave macroeconomic implications without ensuring commensurate export gains, as our past adventures with exchange rate adjustments have demonstrated. Subsidies can never be a substitute for lowering costs; in fact they do more harm than good as entrepreneurial focus shifts from efficiency gains to rent-seeking. Regional integration has its advantages, but it is subordinate to political realities and risks a shift in investment bases that may be inimical to long-term merchandise export prospects, especially in regards to the more value-added products. Any further lowering of tariffs (except the glaring peaks and dispersion anomalies) would have a limited export growth effect and would be ill-advised—unless preceded by other reforms (capital and risk markets, tax/GDP ratio, savings and investment rates, exchange rate regime, skills, social protection). (India's greater emphasis on internal liberalization, as it gingerly pushes external liberalization, is instructive.) Product diversification certainly needs to be pursued, but it cannot be done at the cost of textiles and will not happen unless there is substantial new and technology-based investment in the non-textile sectors.

The absence of objective and evidence-based studies challenges appropriate institutional policy responses. It adds to the hazard of dominant interests trumping sustainable solutions.

It is also uncertain if the importance of exports to the national economy and welfare is fully recognized and shared across the policy-making spectrum. It is not enough for an export strategy to be well-designed. It has to be nationally owned and export interests protected when making tough policy choices.

Export-led growth strategies have lost some of their appeal. Professor Joseph Stiglitz is not alone in questioning the universality of the trade-welfare enhancement linkage. There are many in Pakistan—and not just the Washington Consensus contrarians—who question the wisdom of an export-led growth strategy. Some do so because they do not think exports can stimulate growth: how, such critics ask, can 10 to 15 percent of Pakistan's GDP—which is based too largely on cotton ("cottonomics," as the International Labor Organization's Dr. Rashid Amjad has labeled it[1])—be the locomotive for growth? Or, as Naved Hamid has argued with respect to merchandise exports, the days of the flying geese model with spillover effect and neighborhood advantages are over.[2] Others argue that such export-led growth has high adjustment and implementation costs, and even if achieved, it does not ensure significant welfare gains. Indeed, they argue, it accentuates income inequalities, and with imperfect risk and capital markets, trade liberalization could do more harm than good.

In Defense of Export-Led Growth

On the other hand, it can be argued that in terms of maximizing welfare gains, Pakistan's export profile—dominated by agricultural-based products—is part of the solution. Agriculture contributes, directly or indirectly, to about three-fourths of exports—and the bulk of Pakistan's poverty and underdevelopment is domiciled in agriculture. The nexus between export growth and poverty reduction can be strengthened with some agricultural policy adjustments to ensure greater efficiency and a more equitable sharing of gains. For instance, correcting the current policy bias that favors major crops would promote agricultural diversification, especially into more pro-poor sectors such as horticulture and livestock. An important byproduct would be the empowerment of women, who are more active participants in the rural economy.

It also has to be recognized that Pakistan's present level of trade openness risks being rolled back unless there is a significant jump in exports. There are limits to privatization, concessionary capital flows, and remittances. If exports do not grow substantially, then at the very least this will jeopardize the next generation of reforms. At worst, it could stir up the forces that would like to see Pakistan a more closed economy and indeed a more closed polity.

The way Pakistan's economy is positioned today, exports appear to be the best bet to attract new foreign and domestic investment, trigger the badly needed infrastructural and human capital upgrades, and prompt technological change and knowledge diffusion—the most important determinants of growth.

Some also question the "costs" of greater exports, especially in terms of labor welfare, gender equity, and environmental health. These are valid areas of concern. However, there is sufficient evidence to suggest that higher exports and social and environmental compliance can be mutually inclusive where governments have the political will to enforce their own labor, gender, and environmental laws. Indeed, a good "social compliance" regime supports export growth. The buyer's message is increasingly unambiguous: comply or we don't buy. It would be shortsighted for a government to promote exports at the cost of labor, gender, and environmental interests.

The Way Forward

If the export imperative is indeed accepted, then what will it take to achieve a quantum jump in our exports within a reasonable period of time?

Unfortunately, there are few stroke-of-the-pen solutions. Compelling as the case is for Amjad's shift to a knowledge economy, or Hamid's to one of services, or Sanjaya Lall's and John Weiss's to one that is technology-intensive, none of these is likely to stand the reality check of resources and time.

Over the short term, it is the triumvirate of macroeconomic stability, a conducive investment climate, and equitable access to major markets that is of the essence. And all three have to move in tandem. None on its own can secure significant gains.

Pakistan's macroeconomic situation is reasonably well-poised, but nonetheless needs to be carefully watched because of concerns like an overheating of the economy, monetary overhang, and the still-uncomfortably high debt burden. Fiscal discipline, improved savings/investment rates and tax/GDP ratios, and optimal interest rates will be required to address these concerns, even if such measures mean a somewhat lower GDP growth rate.

It is our competitiveness disadvantage that is at the heart of the problem. The main drivers—human resources, technological inflows, supporting institutions—are weak and not improving fast enough. Also, there is insufficient focus on microeconomics. To overcome competitiveness weaknesses, a highly supportive regime needs to be put in place—and urgently.

Economic governance, regulatory quality, trade facilitation, and reform of factor markets—all necessary ingredients of a favorable investment environment—are more a function of political will; indeed, there is already a lot of work in progress. This political will has to be prioritized, expedited, and mainstreamed—and not just in Islamabad.

Tariff reforms, especially in tariff dispersion and tariff escalation, where we have been seeing some recent backsliding, is another short-term doable area. Also, all exports—not domestic sales, and not just textiles—have to be genuinely zero-rated.

The challenges of physical as well as social infrastructure require a committed effort. The high cost and unreliability of utilities is unsustainable. The short-term solution could well be special economic zones—even when one is not unmindful of their fallout effects—and better and greater cluster development. Meanwhile, WAPDA (Pakistan's Water and Power Development Authority) unbundling and privatization has to be accelerated along with the correction of price signals, theft and losses, and subsidies.

The skills deficit seems to show no signs of narrowing despite the large sums spent by the Export Promotion Bureau (EPB), mainly because of design defects. Without greater enterprise involvement, it will be difficult to make a difference. Enterprises must invest in skills development, and they will only do so if the disincentives for having a stable work force and for recourse to contract labor are removed. Measures to ensure labor market flexibility must be balanced with a degree of stability of the work force. As a short-term measure, the import of skilled manpower would need to be encouraged. For the medium-term, of course we cannot do without a drastic revamping of our educational system so that it produces more "employable" and more "trainable" manpower.

It is high time that entrepreneurs accelerate the shift from family to professional management. Without a genuine empowerment of professional management, efficiencies and economies of scale will not be possible.

The urgency, and the rewards, of a favorable investment climate—which are critical to improved competitiveness—do not seem to have percolated down to the provinces, which are major players, especially in factor markets (land and labor), regulatory quality, and governance. Islamabad has to ensure greater provincial motivation by proactively engaging them in these areas and by giving them more policy space.

The restructured investment regime should be cognizant of the importance of the services sector as well. This is not just because this sector can become a fairly significant contributor to the export mix over time, but, more importantly, because of the critical support that an established services sector lends to merchandise exports.

The mushrooming of preferential market access arrangements, especially in the United States and EU, places Pakistan at a considerable disadvantage. Despite its concerted efforts, and a persuasive case based on economic as well as geopolitical grounds, there is no sign of the materialization of a Pakistani FTA with either the United States or the EU.

If Pakistan has failed to find favorable market access for the goods it produces, then an answer could be to produce the goods wanted by the markets to which Pakistan has preferential access. This, however, would require a significant change in the export mix, which is not likely over the short term, except for the services sector, which clearly needs to be focused on.

Pakistan is likely to find a friendlier ear from opinion-makers in the United States and EU if it shifts its demand from a "preferential" arrangement to an "equitable" one. There is enough evidence to establish that, even for the sensitive textile and apparel sector, Washington and Brussels, with their growing bilateral preferential arrangements, are in effect subsidizing Pakistan's competitors more than protecting American and European industry.

It appears Pakistan's only real prospect of mitigating the access disadvantage is through the World Trade Organization. Efforts to accelerate the non-agricultural market access (NAMA) negotiations have to be prioritized. An overall reduction of tariffs would serve Pakistan's interests best.

To conclude, exports are important to public welfare enhancement, but the real solutions reside outside the Ministry of Commerce. Significant and sustainable export growth is unlikely without an intragovernmental acceptance of the export imperative.

Notes

1. See, for example, Rashid Amjad, "Skills and Competitiveness: Can Pakistan Break Out of the Low-Level Skills Trap?" *The Pakistan Development Review* 44 (2005): 387-409.

2. For more information, see Naved Hamid, "South Asia: A Development Strategy for the Information Age" (paper presented at the Asian Development Bank's third South Asia Department Economists' Conference, New Delhi, December 7-8, 2006). Available from http://www.adb.org/Documents/Conference/SAD-Economists-Annual-Conference/chap01.pdf.

PAKISTAN'S TRADE STRATEGIES AND PERFORMANCE: MISSED OPPORTUNITIES AND CURRENT CHALLENGES

Parvez Hasan

Pakistan's trade performance is a story of important early successes, followed by major missed opportunities in export development. Despite periods of export spurts—including 2000–05—structural weaknesses and competitive pressures facing exports are again very much in the forefront. There are major challenges in the way of achieving and sustaining the high growth rates of exports so critical for the rapid expansion of the Pakistan economy. Pakistan's trade history during the last few decades has been characterized by three major shortcomings: the overlooking, both by the government and private sector entrepreneurs, of possibilities offered by the very rapid expansion in world trade of labor-intensive manufactured goods; the failure to learn lessons from evolving international experience; and remaining preoccupied for far too long with short-term gains and the protection of large economic rents.

A central economic issue now facing Pakistan is whether the sense of urgency generated by the sharp slowdown of exports since the end of 2005 can be translated into actions and policies that will help to revive strong export growth—even though achieving the very ambitious export target that Pakistan's government has set for 2013 might not be feasible, given the deep structural problems in industry and exports.

Pakistan's Trade History

I would like to begin by outlining the broad historical contours of trade developments in Pakistan and the policies and parameters that shaped them.

Parvez Hasan is a senior consultant with the World Bank and formerly a chief economist at the Bank. He is also a past chairman of the government of Pakistan's Debt Management & Reduction Committee.

In its early years, Pakistan placed a heavy emphasis on import substitution and diversion of trade away from India. A trade deadlock with India resulted from India's refusal to accept the new parity between the Indian and Pakistan currencies in September 1949: India followed the pound sterling's devaluation in relation to the American dollar, and Pakistan did not. The resulting virtual trade war with India that lasted until 1952 proved costly—especially for East Pakistan—because India increased its raw jute production, thus depriving Pakistan of a major market for one of its top exports.

West Pakistan greatly benefited from import substitution—particularly in the cotton textiles sector, but also in fruits such as mangos. Pakistan's cotton textiles industry was essentially developed over a short period of three years (1952–55) under complete suspension of textiles imports. These stringent import controls became necessary after Pakistan's large windfall in export earnings from the Korean War–generated commodity boom was frittered away through an unsustainable import-liberalization policy, which was especially harmful because of a clearly overvalued exchange rate.

A good deal—though not all of—the protection afforded to industry in Pakistan's early years could be justified on infant industry grounds. By and large, the very rapid industrial development in the country's early years (the growth rate of large-scale manufacturing was close to 25 percent per annum during 1950–55) was in line with Pakistan's comparative advantage.

However, protection for final consumer goods continued for too long, and incentives for the development of intermediate and capital goods industries remained weak. What is more, though greater attention began to be given to exports of manufactured goods in the early 1960s, the chosen instrument—the famous or infamous export bonus scheme (a system of multiple exchange rates)—deepened economic distortions.[1]

Though the 1960s were a period of relatively high export growth, this growth was achieved at a very heavy cost. According to estimates made by Gary Hufbauer, the effective rate of subsidy on exports of manufactured goods in 1967–68 was well over 100 percent, and even higher for cotton textiles. The result was that to a large extent low-value-added yarn exports substituted for cotton exports, agriculture was taxed indirectly, and, given large profits in cotton textiles, there were few incentives to move into areas of greater-value-added manufactures such as garments or mixed textiles, and even fewer incentives for moving into intermediate products and capital goods.

Missed Export Opportunities

Why do I dwell on what may appear to be somewhat ancient economic history? The fact is that economic distortions introduced by the trade and industrial policies of the 1960s and 1970s continued to hamper Pakistan's economic and trade performance well into the late 1980s. Indeed, despite a great deal of economic rationalization and liberalization since 1990, some vestiges of these policies still remain today. Equally important, the history of these policies provides a good deal of explanation for Pakistan's missed opportunities in exports.

The massive formal nominal devaluation of the rupee from Rs. 4.76 per U.S. dollar to Rs. 11 in May 1972—an average effective real devaluation of around 20 percent—failed to remove the large wedge between average effective import and export rates. Policies thus continued to favor import substitution and retained an anti-agricultural bias. Even worse, government revenues became heavily dependent on foreign trade taxation. The policies of Pakistani leader Zulfiqar Ali Bhutto toward the private sector at this time further contributed to a sharp slowdown in exports.

During the rule of Zia ul-Haq, there were significant improvements in the industrial policy framework, as there was now an emphasis on the role of the private sector. However, the industries nationalized under Bhutto remained largely in the public sector. Additionally, little was done to create conditions for exploiting the tremendous opportunities in world trade in manufactured goods. Pakistan's manufactured exports expansion, on average, was only about half the rate of the world's high performers and remained heavily dependent on cotton-related exports.

In the 1990s, there was a significant liberalization of the economy: state interventions in agricultural prices—especially cotton—were greatly reduced; import and investment controls were relaxed; import tariffs were brought down; and serious financial sector reforms—including the privatization of publicly controlled banks—were initiated. These policy adjustments removed some of the worst anomalies in Pakistan's trade policies—namely, the indirect subsidy to cotton textiles, the import controls, and high import tariffs.

Still, these developments did not translate into a stronger export performance. There are several reasons for this result. First, large macroeconomic imbalances developed. Second, Pakistan's exchange rate became overvalued. And third, the cotton textile industry was slow to adjust to the new reality of non-subsidized cotton, relying excessively on state-owned banks and foreign loans to finance investments, the profitability of which had come under serious pressure.

Pakistan's Exports in World Context

Pakistan's share of world merchandise exports—which had been in the range of 0.25–0.30 percent in the relatively heady days of the 1960s—had declined to 0.14 percent by 2000. The figure remains at this level today (strong export growth over 2000–05 notwithstanding) partly because export growth in current U.S. dollars slowed to only 5 percent in 2006. Even after the substantial export expansion of the last few years, the ratio of exports to gross domestic product (GDP) remains at 13 percent, very much below the range of 25–50 percent of GDP in successful East Asian economies.[2]

The full extent of Pakistan's missed opportunities in international trade becomes clear, however, only when one looks at the developments in world trade of manufactured goods, and at the successful exploitation by many developing countries of the openings in developed country markets.

Stimulated by the liberalization of trade, reduction of tariffs, technological changes, declining transport costs, and improving information flows, world trade has grown at a much faster pace than world output since the 1960s. The leading edge of this expansion has been the growth of world manufactured goods exports, which increased nearly 40-fold from less than $200 billion in 1970 to $7.3 trillion in 2005.

More importantly, because of shifting comparative advantage (especially in labor-intensive manufactured goods), the share of developed countries (the United States, Japan, and the original 15 member states of the European Union) in world manufactured exports has declined sharply during the last few decades. It came down from 75.8 percent in 1980 to 63.8 percent in 2000, and it is estimated to have dropped further to around 55 percent in 2006.

Table 1 indicates that almost all of the market share lost by developed countries has been captured by Asian countries, whose exports are increasingly dominated by manufactured goods exports. The total manufactured exports from the 16 developing countries listed in Table 1 increased nearly 24-fold in current prices to about $2,255 billion over 1980-2005, while their share in world manufactured exports grew from 8.6 to 30.5 percent.[3]

As is well known, export expansion by China during the last couple of decades has been spectacular. China's market share in world manufactured goods exports grew rather astoundingly from 0.8 percent of the total in 1980 to almost 9.6 percent in 2005. But many other countries also did well. The high performers of the 1960s and 1970s in East Asia (Korea, Singapore, Hong Kong, Taiwan, Malaysia, and Thailand) further expanded their dominant export positions, especially during 1980-1995. In the more recent decade, gains in export shares by Mexico, Turkey, India, and Vietnam have been particularly impressive. However, they did not nearly match China's performance, which has been in a class of its own.

In contrast, Pakistan, though it has enjoyed periods of spurts in export growth (in the 1960s, 1980s, and from 2000-05), has actually witnessed a small decline in its share of world manufactured goods exports—from an estimated 0.2 percent in 1970 to 0.18 percent in 2005. There was recovery after 1980, following a great decline in market share in the 1970s. Even so, over 1980-2005, Pakistan lost relative ground in manufactured exports to all major developing countries listed in Table 1, with the exception of Brazil.

One can also say that the failure to develop manufactured exports has been one of the main reasons why Pakistan did not match the economic performance of the Asian tigers during the last half century. The great development success stories of this period—Korea, Taiwan, Hong Kong, Singapore, Thailand, Malaysia, and the relative newcomer China—have

Table 1: Major Developing Countries' Exports and Their Market Share of World Manufactured Exports, 1980-2005

Country	Total exports in U.S.$ billion, 2006	Manufactured exports in U.S.$ billion, 1980	Manufactured exports market share, 1980, as percentage	Manufactured exports in U.S.$ billion, 2005	Manufactured exports market share, 2005, as percentage
China	969.0	8.7	0.80	700.3	9.58
Hong Kong, China	322.7	18.0	1.65	279.9	3.53
Korea	325.7	15.7	1.44	258.2	3.50
Singapore	271.8	8.3	0.76	185.2	2.53
Taipei, Chinese	223.6	17.4	1.59	171.4	2.35
Mexico	250.3	4.4	0.40	164.4	2.25
Malaysia	160.6	2.4	0.22	104.9	1.43
Thailand	130.6	1.6	0.15	84.3	1.15
India	120.2	5.0	0.46	69.8	0.95
Brazil	134.5	7.5	0.69	61.6	0.84
Turkey	85.1	0.8	0.07	59.8	0.82
Indonesia	104.0	0.5	0.05	40.2	0.55
Philippines	47.0	2.1	0.19	36.7	0.50
Vietnam	39.6	---	---	17.8	0.24
Pakistan	16.9	1.3	0.12	13.0	0.18
Bangladesh	12.1	0.5	0.05	7.3	0.10
Total(for nations above)	3,213.7	94.2	8.64	2254.8	30.5
World exports	12,062.0	1,092.4	100.0	7,311.5	100.0

Source: WTO Statistical Tables.

one thing in common: they have all successfully exploited the possibilities offered by almost explosive growth in international trade. Putting it another way, there have been few cases of rapid economic advance in modern history that have not relied on exports as an engine of growth.

Why Pakistan Fell Behind

Why has Pakistan fallen so far behind in the export field? First, export growth has never been a central pillar of Pakistan's development strategy as it has been in Korea, Malaysia, and China. Until 1971, both the continued availability of the protected market in East Pakistan (now Bangladesh) and the ample supply of external assistance on concessionary terms from both multilateral and bilateral sources diluted the urgency of export development.

In its early years, Pakistan was not unique among developing countries in attaching low priority to export development. In the 1950s, there was general pessimism about expectations from the agricultural sector as well as a worldview that assumed serious international demand limitations on manufactured goods exports. It is interesting to note that the export growth target for both Pakistan's first (1955–1960) and second (1960–65) five-year economic plans was set at 3 percent per annum in nominal terms.

Pakistan did not learn from the manufactured goods exports experience of Korea, Taiwan, Hong Kong, and Singapore in the 1960s; Thailand, the Philippines, Malaysia, and Indonesia in the 1970s; and China and Turkey in the 1980s. Not realizing, for over an extended period (nearly three decades), that (a) the almost explosive growth in world trade in manufactures offered unparalleled opportunities and that (b) rapid export growth was an almost sure route to high growth—as demonstrated again and again by East Asian countries—represents a strategic failure.

Pakistan's early industrial strategy, which placed an excessive emphasis on the processing of domestic raw materials—especially cotton (reminiscent of the development notions of Thomas Jefferson in late-1700s America)—also hurt exports. Export development based on imported inputs was strongly discriminated against by generally high duties on imports of intermediate goods.

At least some of the trade policy failures—excessive domestic protection for industry and anti-export bias—can be attributed to this emphasis on indigenous raw materials. Indeed, I recall the then-commerce secretary of Pakistan telling me in the mid-1980s that, in his opinion, importing cloth and exporting shirts was hardly industrialization. This sort of thinking certainly influenced the heavy import duties on synthetic fibers, and Pakistan initially did in fact miss out in developing synthetic textiles and garments exports. A lack of attention to exports made from imported components also explains why the burgeoning electronics trade bypassed Pakistan.

But trade policy failures cannot take all the blame. There were also serious shortcomings in the effective implementation of periodic efforts to create a duty-free environment for imported inputs for exports. The system of duty rebates has been flawed, has not always functioned smoothly, and has been subject to abuse.

As mentioned earlier, over time, many of the distortions in trade policy acting against exports have been removed or reduced. The export taxation of cotton was phased out at the end of the 1980s. Import tariffs have been gradually reduced and imports greatly liberalized. But the consequences of past policies are still with us and are reflected not only in the relatively low level of our manufactured exports, but also in the structure of these exports.

As Table 2 shows, among large developing countries Pakistan has the least diversified pattern of manufactured exports, with the exception of Bangladesh. More than 80 percent of Pakistan's manufactured exports consist of textiles and clothing, compared with 12 percent for developing countries as a group and 6.5 percent for the world as a whole.

While Pakistan is a major exporter of textiles and clothing, the level of its exports of manufactured goods other than textiles and clothing is very low. At $2.3 billion in 2005, these exports accounted for only a little over 0.03 percent of world manufactured goods exports other than textiles and clothing, which totaled over $6800 billion. India's manufactured exports (excluding textiles and clothing) are nearly 25 times that of Pakistan, while countries like the

Table 2: Textiles, Clothing and Other Manufactured Exports from Major Developing Countries, 2005 (In Billions of U.S.$)

Country	Textiles exports	Clothing exports	Other manufactured goods exports	Total manufactured goods exports
China	41.0	74.2	585.1	700.3
Hong Kong, China	13.8	27.3	238.8	279.9
Korea	10.4	2.6	245.2	258.2
Singapore	0.9	1.7	182.6	185.2
Taipei, Chinese	9.7	1.6	160.1	171.4
Mexico	2.1	7.3	155.0	164.4
Malaysia	1.4	2.5	101.0	104.9
Thailand	2.8	4.1	77.4	84.3
India	7.9	8.3	53.6	69.8
Brazil	1.3	0.3	60.0	61.6
Turkey	7.1	11.8	40.9	59.8
Indonesia	3.4	5.1	31.7	40.2
Philippines	0.3	2.3	34.1	36.7
Vietnam	----	4.8	13.0	17.8
Pakistan	7.1	3.6	2.3	13.0
Bangladesh	0.2	6.4	0.7	7.3
Total (for nations above)	109.4	163.9	1981.5	2254.8
World exports	203.0	275.6	6832.9	7,311.5

Source: WTO Statistical Tables.

Philippines, Indonesia, and Turkey—by no means stellar performers in the export field—have non-textile/non-clothing manufactured goods export levels at about 14 to 18 times that of Pakistan's. Even a newcomer like Vietnam enjoys a five- to six-fold advantage over Pakistan in this regard.

Pakistan's being heavily locked into textile and clothing exports can thus also be considered one of the main reasons why it has not made major headway in international trade. The rate of expansion in the world textile and clothing trade has not been and will not be nearly as robust as the rate of the rest of world manufacturing sector exports.

Future Challenges for Pakistani Exports

What does this analysis imply for future export expansion and economic policies?

Pakistan's own economic history, as well as the rich experience of rapidly growing East Asian countries, suggest that sustained high growth rates are difficult to achieve without rapidly rising exports. Rapid export development also helps to create jobs, raise wages, improve technological capability, and meet the rising obligations of debt servicing and investment income payments if, as in Pakistan's case, investment expenditures are financed by large external inflows.

In my view, if Pakistan hopes to sustain a high GDP growth rate of 7 to 8 percent per annum and at the same time avoid future balance of payments difficulties, it will need to sharply increase its long-term real export growth rate to 10 to 11 percent per annum, implying annual growth in nominal U.S. dollars of 12 to 13 percent. This would involve, unlike in the past, substantially increasing the share of merchandise exports in its GDP (which at present is only 13 percent—roughly the same level as in 1980) as well as significantly expanding Pakistan's share in world exports.

Pakistan's government has now set an export target of $40 to 45 billion in 2013, implying a growth rate of 15 percent per annum over 2006–2013. These export goals are even more ambitious than those mentioned just above, and they are also rather unrealistic given the current weakness in exports.

The urgent attention being given to export development is to be greatly welcomed. However, the setting of ambitious goals has to be accompanied by a clear vision; a much stronger national commitment than in the past to export development; a well-defined strategy to diversify and broad-base exports, especially in the manufacturing sector but also in agriculture; a range of policies that will improve Pakistan's competitiveness in world markets; and close attention to implementation through coordinated economic and trade policy actions.

This is a very broad agenda. But I would like to stress a few points.

The vision for rapid export development must give a central place to the very speedy growth of manufactured goods other than textiles and clothing for which our presence in world markets is trifling. For the longer run, the virtual absence of Pakistan in world markets for manufactures other than textile and clothing (a 0.03 percent share) actually represents an unparalleled opportunity.

But there is a danger that excessive government attention will remain focused on textile and clothing exports—as it historically has—because these exports appear to be posing immediate policy problems arising out of diminished international competitiveness, and because the lobby for textile exporters is strong. Indeed, it is interesting to note that government export targets for 2013 pin their hopes on an expansion in textile and clothing exports to $22 to 25 billion from $11 billion at present.

In the best-case scenario, Pakistan would be able to increase its market share in the world textile and clothing market. However, this market is not growing rapidly. Notwithstanding the Multi-Fiber Agreement (MFA) phase-out, world trade in textile and clothing markets has grown at the annual rate of 5 percent per annum during the last two years, about the same rate of growth as in the previous decade. Even abstracting from current textile industry problems, it would be extremely difficult for Pakistan's textile exports to grow faster than 7 percent per annum over the medium term. And even on this rather heroic assumption, these textile exports would grow to less than $18 billion, compared to the government's target of $22 to 25 billion. On a realistic basis, the incremental contribution of textile and clothing exports to the desired growth in exports over 2006-2013 would be around 25 percent—rather than the 50 percent implied by the government targets.

Clearly, Pakistan's textile industry and exports will remain vital for Pakistan's economic future. But attaining a type of diversification that embraces manufactured goods other than textiles and clothing as well as high-value agricultural exports will be the key challenge. Government incentives and policies should focus especially on these categories of exports.

The case for financial support to the textile industry is weak. It is not clear whether financial support would expand the value of textile exports or just cause a further loss of terms of trade. The unit values of textile exports from Pakistan are already the lowest among major international exporters.

Pakistan's textile industry problems are mainly structural, relating to low skills, poor quality, low scale, poor delivery records, and not much movement up the value-added chain. These structural problems cannot be solved without major new investments in plants, equipment, and human skills. These investments are not happening on the scale needed.

In order to broaden its export base, Islamabad's policy must especially target direct foreign investment in manufacturing and export-oriented activities; this investment is at present small. More thought needs to be given to managing the process of large foreign investment flows to assist in upgrading technologies and expanding and diversifying exports.

Export promotion efforts must also focus on the fast-growing markets in China and the countries of the Middle East. In these countries, Pakistan must strive to use its good political relations effectively in pursuit of export goals. At the same time, trade relations with India should be opened up as quickly as possible.

Finally, policy coordination on exports needs substantial improvement. The responsibilities for export promotion are quite dispersed among many actors, including the Ministry of Commerce, the Trade Development Authority (a very good idea), the Ministry of Industry, the Textiles Ministry, etc. A cabinet-level committee could help by closely monitoring exports and speedily resolving policy and implementation issues.

The task of a major and truly historic turnaround in exports is huge. Without clear national resolve and a multipronged approach, the chances of success will not be great.

Notes

1. The Export Bonus Scheme was introduced in January 1959 at the suggestion of a German expert, who probably saw it as a temporary expedient. Its essence was to entitle exporters of manufactured goods to a part of foreign exchange earned (typically 20 to 40 percent) for financing imports which were otherwise subject to strict import quotas made necessary because of a seriously overvalued official exchange rate. Large excess profits—which could be made on imports or through the selling of transferable foreign exchange vouchers—meant that the effective exchange rate for exporters of manufactured goods was in the range of Rs. 15-18 per U.S. dollar, as against the official exchange rate of Rs. 4.76 per U.S. dollar. This meant that exports—especially of cotton textiles—were heavily subsidized at the cost of both the consumer and the agricultural producers. For details, see Parvez Hasan, *Pakistan's Economy at the Crossroads* (Karachi: Oxford University Press, 1998), 160-166.

2. Unless otherwise noted, figures in this essay are drawn from the Pakistan Ministry of Finance's *Annual Economic Surveys*; from the State Bank of Pakistan's *Annual Economic Reports*; and from Parvez Hasan, *Pakistan's Economy at the Crossroads* (Karachi: Oxford University Press, 1998).

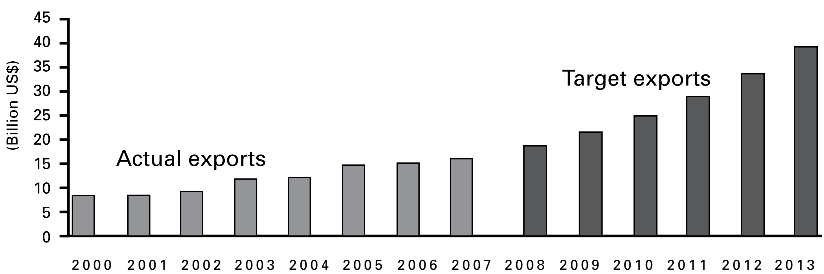
3. Growth in Pakistan's manufactured goods exports over 1980-2005 was 10-fold in current prices and probably only 3-fold in real terms.

ACHIEVING $45 BILLION EXPORT TARGET BY 2013: THE WAY FORWARD FOR PAKISTAN

MANZOOR AHMAD

Three key issues are of paramount relevance to Pakistan's trade policy: these are tariff reforms, market access, and diversification of exports. These factors will determine if Pakistan's government can reach the ambitious target of $45 billion in annual exports that it has set for itself in the next five years. This target of $45 billion can be put into perspective. Currently, Pakistan exports $17 billion worth of goods, which means that in five years annual exports should be more than two and a half times what they are now, or that the annual increase in exports should be 17.6 percent (according to the compound annual growth rate). This rate of growth has never been reached by Pakistan's exports for any sustainable period. Over the past 10 years, the average increase has been 7 percent.

Figure 1-Pakistan's Actual Exports Vs. Target



Source for actual exports is UN Comtrade.

Manzoor Ahmad is Pakistan's ambassador and permanent representative to the World Trade Organization, based in Geneva. This essay represents the personal views of the author, and should not be construed as necessarily reflecting the position of the government of Pakistan.

Achieving this target would undoubtedly be a major boost for Pakistan's economy, but looking at this annual exports goal from another perspective, it would still be well below the current figures for countries of comparable size: Brazil's $138 billion, Indonesia's $102 billion, Turkey's $85 billion, and South Africa's $59 billion.

Trade/Tariff Policy Reforms

Pakistan's main trade policy instrument is its customs tariff. Islamabad started to liberalize its tariffs in the early 1990s in order to integrate its economy with the rest of the world. Up until 1997, the process was slow and was often interrupted to raise revenues through import taxes. The liberalization was accelerated in 1997, but it was still a stop-and-go approach. Until 2001, some 86 import-substitution programs were in force.

During 2001 and 2002, however, the pace of reforms intensified. The dependence on subsidies for the promotion of exports was reduced, and except for the auto sector, all import-substitution programs—whereby manufacturers and assemblers of goods must progressively lower the content of imported goods used in the production of local goods—were scrapped.

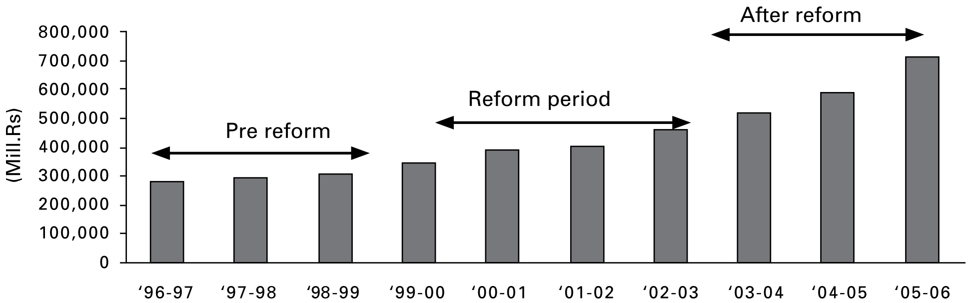
The reform process had its detractors, who were suspicious about the motives and skeptical about the outcome of these reforms. There was a fear that liberalization would have a negative impact on industrial growth and revenues for the government. Events since then have proved these fears to be baseless.

During the highly protective period of the 1990s, manufacturing and revenue grew by less than 5 percent. However, starting from 2002, when the tariff reforms reached a critical level, manufacturing as well as revenues have been growing at 12 to 14 percent per annum. By 2003, exports were growing by 28 percent.

Despite this clear success, "top-down" tariff reforms ended in 2002-03. Since then, only piecemeal reforms have been carried out.

In the meantime, Pakistan's competitors have continued their full-scale liberalization process. At present, according to a WTO report, the simple average of applied rates for Association of Southeast Asian Nations

Figure 2-Total Tax Collection



Source: Central Board of Revenue, Government of Pakistan.

(ASEAN) countries ranges between 4 to 8 percent and is being further reduced, while the figure for Pakistan is 15 percent. More than 40 percent of Pakistan's tariff lines have international tariff peaks, i.e. tariff rates exceeding 15 percent. According to the *2007 Index of Economic Freedom* (Kane et al. 2007), Pakistan's economy is mostly unfree and is ranked at a low 89 out of 161 countries. Even in the Asia–Pacific region, its overall score is below the regional average. Islamabad's trade policy is also said to have weak trade freedom, with imports not only subject to a high average tariff rate but also burdened with non-tariff barriers.

If Pakistan's exports are to grow, further tariff reforms will have to be carried out. Several studies have shown that a reduction in tariffs boosts exports, since an implicit tax on exports is reduced. The International Monetary Fund's Stephen Tokarick, in a 2006 study (Tokarick 2006), argued that tariffs and other import barriers discourage exports by raising the price of imported and domestic intermediate inputs used by exporters (other things constant). If one were to interpolate the results of this study, then it can be concluded that by removing its import tariffs, Pakistan could achieve a 16 percent increase in exports, whereas the increase would be only 11 percent if developed countries removed all their tariffs on imports from Pakistan.

Customs duties, high though they may be, do not tell the whole story. There are other levies on imports, which Pakistan's competitors do not apply. As a result of these levies, a duty rate of 10 percent translates into effective levies of 34 percent. This is because of a 15 percent sales tax—which is not levied by most other countries—and a 2 to 6 percent withholding income tax. Yet even leaving aside these additional levies, and strictly on the basis of the customs duty, Pakistan's industry seems to be protected twice as much as Indonesia's and one and a half times as much as Sri Lanka's.

It is a truism that higher protection means higher inefficiency. Pakistan's industry cannot afford to be less competitive than that of similarly placed countries. Given the high freight and insurance costs faced by Pakistan's exporters, these traders have to be more competitive than others even if all other things were equal. The best way for Pakistan to enhance competitiveness through its internal tariff reforms is to benchmark against a group of successful developing countries such as the ASEAN and reach that target. India has been working toward achieving that target for the last five years and is gradually closing the gap.

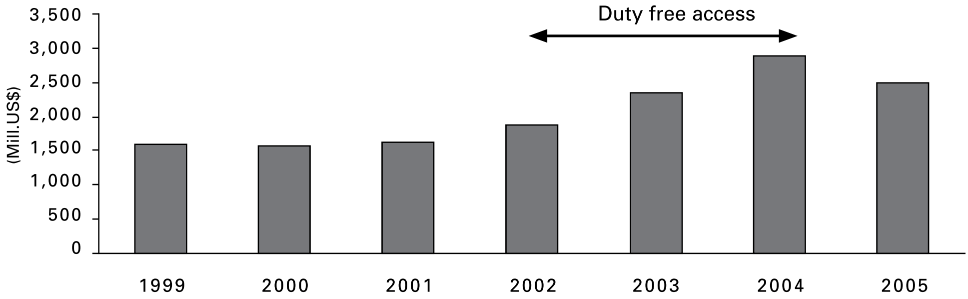
Pakistan can also learn a lesson from Chile. In the 1960s, Chile was one of the world's most protectionist countries. Besides high tariffs, it had extensive import-substitution policies. Yet in 1979, it adopted a uniform tariff of 10 percent and has since decreased it to 6 percent for all products and for all countries. In fact, since it has free trade agreements with almost all of its trading partners, practically 97 percent of its imports are now duty-free. As a result, Chile's exports have been skyrocketing. Chile's exports in 1999 were $15.6 billion (as against $8.1 billion for Pakistan); its exports in 2007 were over $58.2 billion (vs. Pakistan's $17 billion). The Chilean reform model might seem to be too radical in the short term, but it could conceivably be regarded as a long-term objective.

Market Access

Next to tariff reforms, the most important factor for boosting exports is access to target markets. Whenever this access has increased, Pakistan's exports have jumped as a result.

Starting on January 1, 2002, the European Union (EU) provided duty-free access to its market by including Pakistan in its Generalized System of Preferences (GSP) drug regime. The results were dramatic:

Figure 3-Pakistan's Exports of Textiles and Clothing to EU



Source: International Textiles and Clothing Bureau.

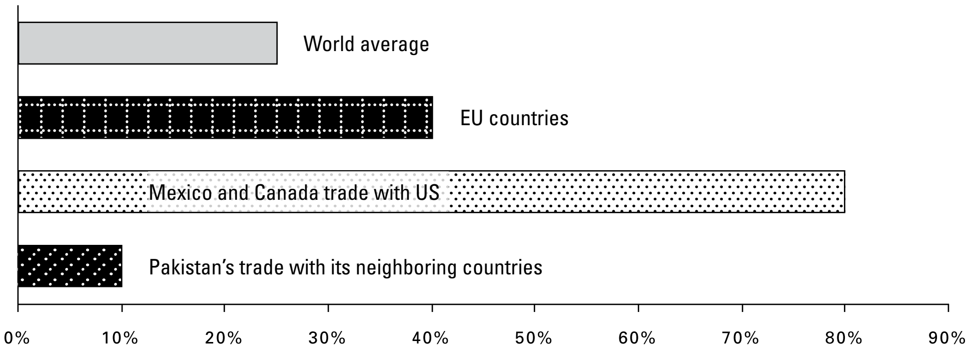
exports of textiles and clothing to the EU—which had been stagnant for several years—increased by 16 percent in 2002, 26 percent in 2003, and 22 percent in 2004. When the concession was withdrawn in 2005, the decrease of 13 percent in exports was just as remarkable.

Also in 2002, all restrictions on bilateral trade with Afghanistan were removed just when reconstruction work was starting there. Exports to Afghanistan surged to $1.2 billion by 2006, compared to just $168 million in 2001. Afghanistan is now Pakistan's third largest export market, accounting for 6 percent of its exports.

Other than Afghanistan, Pakistan shares borders with China, India, and Iran. Each of these countries is a big potential market that largely remains untapped. Pakistan's total trade with its bordering countries, even after taking into account its recent surge of trade with Afghanistan, remains less than 10 percent—a figure much lower than the world average of 25 percent for countries sharing borders, not to mention 40 percent for the EU, and 80 percent for Canadian and Mexican trade with the United States. In the case of India, with whom Pakistan shares an 1800-mile-long border, exports are less than $300 million, or less than 1.8 percent of total Pakistan trade. Yet the potential is huge; the Indo-Pakistan Business Council estimated in 2005 that the trade level between the two countries could reach $10 billion annually within five years.

These regional opportunities are worth pursuing. As for other bilateral opportunities, it is unlikely that Pakistan will get improved market

Figure 4-Border Trade



Source: Author's calculations and online resources.

access in the near future from any other large economy—in particular the EU or the United States—in the absence of enough political or economic leverage. And the free trade agreements already concluded with China, Singapore, and Sri Lanka are somewhat restricted in that they do not cover substantial trade.

Pakistan's best hope is a multilateral agreement resulting from the current WTO Doha Round. In all previous rounds, Pakistan did not gain much, since it looked toward its defensive interests only. The situation is different this time, and Pakistan's involvement is active. It has made significant proposals for market access for industrial and agricultural goods. Several studies indicate that if these efforts succeed, Islamabad will gain.

At present, Pakistan's most significant export products, i.e. textiles and clothing—which account for almost two-thirds of its exports—face high tariffs, while the majority of its competitors get duty-free access to at least some of these textiles/clothing export markets. For example, Bangladesh, Sri Lanka, Turkey, Mexico, and a large number of Latin and African countries have duty-free access to the EU market. Similarly, a large number of countries enjoy duty-free access to the United States and to other developed and developing countries. Through an ambitious Doha Round, tariffs would become much less significant, as maximum tariffs would likely be reduced to lower than 7 percent from current peaks of 12 to 32 percent in developed countries' markets; in some markets, they may be eliminated altogether. Thus a major barrier to Pakistan's exports would be reduced or eliminated.

Owing to its climate and location, Pakistan has a strong comparative advantage in the production and export of a number of agricultural products. Pakistan is one of the world's top 5 producers of cotton and milk and one of the top 10 for rice, wheat, and sugar cane. Its production of fruits and vegetables is also significant. If, as a result of the Doha Round, trade-distorting subsidies on agriculture and exports of agricultural products are reduced, Pakistan's agriculture would become competitive. At present, Pakistan does not export much, except for rice, mainly because these subsidies are imposed by OECD countries. Of course, even after the subsidies are reduced, Pakistan would still have to solve the problem of high post-harvest losses and other inefficiencies. Furthermore, Pakistan should move forward on value-added agricultural exports, which constitute less than 2 percent of its total agricultural exports.

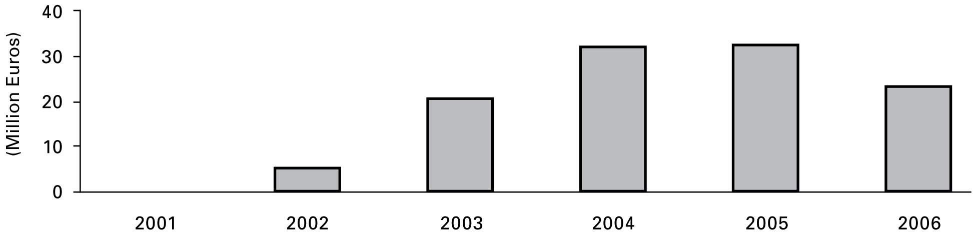
It is often questioned whether without exportable surpluses, improved market access is of any use. Experience shows that improved market access creates supply-side capability. Pakistan has been a traditional exporter of rice, but its exports had always been limited to less than 1 million tons before 1995. Under the Uruguay Round, Pakistan was granted preferential market access for basmati rice and since then has enjoyed 11.4 percent average annual growth. This growth suffered a setback in 2004 when the EU decided to exclude Pakistani basmati rice from the preferential scheme. However, the EU was persuaded to revise its decision, and in September 2004 it introduced a new tariff system, which allowed a bound rate of 0 percent for basmati rice. As a result, Pakistan's rice exports jumped by 33 percent in 2005–06. Pakistan's annual exports of rice are now more than 3 million tons and worth $1.2 billion, up from the threshold of $500 million, which it had never crossed before. A study by de Gorter et al. (2004) shows that if the Doha Round attains a 50 percent liberalization of the global rice market, production of rice in the United States would fall by 33 percent and in the EU by 28 percent. Thus, Pakistan would have a major opportunity to fill part of this vacuum. Furthermore, if the EU could be made to eliminate its tariff escalation (which often causes relatively higher tariffs for value-added imports), it would result in Pakistan exporting processed value-added rice instead of husked rice.

Another example is ethanol, which has been in the news lately and has become a rather well-known commodity because of its use in the fuel supply. Recently, its demand has been growing very fast. Before the EU reduced its import barriers in 2002, Pakistan exported no ethanol. Yet ever since the EU preferential duty rate was extended to Pakistan, Islamabad's export of ethanol started climbing and that of its raw material molasses decreasing. A number of distilleries were set up and by 2004, Pakistan had become the biggest ethanol exporter to the EU. Its annual exports of 31.28 million euros accounted for 20 percent of the EU imports.

In order to halt this rise in exports, the EU in 2005 not only withdrew all tariff concessions but also started anti-dumping investigations. This resulted in a levy of $190 per ton of import duty, and Pakistan's exports to the EU started falling rapidly. Most of its seven distilleries—which could produce 1 million liters a day—and another five new distilleries—which were in the process of being set up to produce another 0.5 million liters a day—had to scale back their production. Still, with the completion of the Doha Round and tariff cuts on ethanol, Pakistan can once again become a major exporter of ethanol, which fetches 10 times the price compared with its raw material of molasses. Furthermore, even if it does not cash in on ethanol, Pakistan's other commodities—rice at present, but in the future perhaps wheat, sugar, and other agricultural crops as well—would fetch far higher prices because most developed countries are shifting their production from cereals and other crops to biofuel crops.

Opportunities provided by the Doha Round for improved market access could be substantial, and Pakistan would have a better opportunity than many other countries to make use of such opportunities. However, this will depend upon how well Pakistan is prepared to make use of these opportunities. According to an old saying, "failure to prepare is preparing to fail." So Pakistan needs to develop and diversify its exports, in order to prepare itself for new market access opportunities that may arise through the Doha Round.

Figure 5-Pakistan's Exports of Ethanol to EU



Source: EUROSTAT.

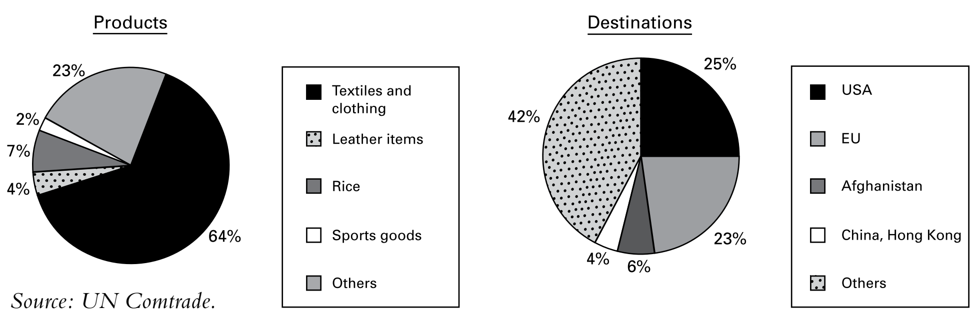
Diversification of Exports

Currently, more than 75 percent of Pakistan's exports originate from four items (cotton, rice, leather, and sports goods), while almost 50 percent of its exports go to either the United States or the EU. Therefore, Pakistan must diversify both its product range and its export destinations.

One of the reasons why Pakistan's exports are mostly concentrated in textiles and clothing is that the country has been pampering this sector at the expense of others. Islamabad must provide a level playing field to its other exports.

Pakistan has to observe what other comparable countries are selling and try to make a place for itself as an exporter of dynamic products whose export value grows at the fastest rate. According to an UNCTAD

Figure 6-Pakistan's Exports in 2006



Source: UN Comtrade.

2002 report, the 20 most dynamic product groups for exports during the last 20 years can be classified within the following four categories:

1. Electronics and electrical goods
2. Textiles and labor-intensive products, particularly clothing
3. Finished products from industries that require high research and development
4. Primary commodities including silk, non-alcoholic beverages, and cereals

Pakistan is now well-placed to make use of new opportunities in all four areas. In the case of electronics and electrical goods, Pakistan's advantage is the good domestic base it has been able to set up in the five years since the tariff structure for these items was rationalized, import-substitution programs were eliminated, and these goods were opened to competition. Since 2003, growth in electronics industries has ranged between 35 to 40 percent per annum. For example, the production of air conditioners grew by 300 percent—from 12,000 units to 363,000 units—between 2001 and 2006, at an annual compound growth rate of almost 100 percent. The production of refrigerators more than tripled from 200,000 in 2001 to over 700,000 in 2006, while the production of television sets expanded from 120,000 in 2001 to almost 1 million in 2007. Now that these products have achieved production and quality levels that allow them to be produced with economies of scale, it is much easier to export part of the production. Top-quality joint ventures are now needed so that branded goods can be exported. Already, a very well-known Chinese brand is in the process of expanding its home appliances industrial unit in Pakistan. This plant is expected to produce an additional 1 million household appliances per year, with plans to export to the Middle East and Asia.

For the second category of products, emphasizing textiles and clothing, Pakistan is already an established player. According to the WTO's *World Trade Report 2006* (WTO 2006), Pakistan's exports to the United States as well as to the EU increased by 12 percent in 2006. Given its raw material base and vertical integration across stages of production, Pakistan's exports should grow by 20 to 25 percent—as happened in the cases of Bangladesh and Cambodia—if high tariff rates get reduced through the implementation of the Doha Round. A number of countries that have had artificial industries built around tariff concessions, as well as highly protected industries in developed countries, may not be able to survive tariff reductions. As in the case of electronics, export markets for value-added goods would depend upon how many brand names Pakistan is able to attract. Despite the fact that Pakistan's textile industry has invested substantially in new equipment and technologies in recent years, it continues to focus on the least sophisticated products. It needs to build on its share of champions and grow on its share of the most dynamic global textile and clothing exports.

In the third category, that of finished products requiring high research and development (products such as chemicals, dyes, medicines, fertilizers, plastics, etc.), Pakistan has recently been establishing a good base and is already making inroads with some of these products. It now has a well-established pharmaceutical industry that includes over 400 local and 28 multinational manufacturing units. Its exports of medicines, which were less than $40 million in 2002-03, crossed the $100 million mark last year. They are growing at an annual growth rate of 26 percent. Pakistan is also a competitive exporter of surgical and sports goods. But its exports have remained rather limited for many years, as the country has failed to have any brand name large-scale joint ventures.

As far as diversification of export destinations is concerned, Pakistan should concentrate on major economies. It needs to analyze why its share of exports to Japan, which is the world's second largest economy, has fallen from 6.8 percent or $500 million in 1992-93 to less than 1 percent of Pakistan's exports, or a mere $200 million. In fact, if Pakistan's exports to Japan had grown at the same rate as overall exports, then this export volume would have been over $1.3 billion instead of $200 million. Present export levels make Japan the 23rd largest export destination of Pakistan, which is even lower than Portugal. Other major economies that account for less than 1 percent of exports include South Korea, Australia, Malaysia, Indonesia, Thailand, and Mexico, whose imports from other countries have been rising rather rapidly. These are all growing economies where tariff barriers are being reduced and labor costs are going up. Pakistan can make a niche for itself in labor-intensive goods, where it has an edge because of abundant labor and lower costs of production.

Conclusion

To sum up, Pakistan has already come a long way from the days of its tightly regulated economy, when it had high tariff barriers; strict exchange controls; and government-owned and controlled banks, insurance, telecommunications, utilities, and industries. The challenge now is to continue on this reform path and fully embrace 21st century business principles of openness, competition, and quality. Islamabad should unilaterally open its economy by bringing down its tariffs to those of ASEAN levels, and by removing domestic taxes such as withholding income tax and sales tax on its international trade. It should expand its regional trade to allow cheaper inputs, and it should also increase its trade with major economies where current trade volume is very small. It needs to prepare itself for the opportunities that may be arising through the Doha Round. With its financial position now more stable, Pakistan should give more attention to enhancing the educational and skills levels needed to export value-added and high technology goods and services. At the same time, it needs to further improve its infrastructure to reduce costs associated with international trade. With these changes, there is no reason why Pakistan should not be able to join the ranks of more successful countries within a matter of 8 to 10 years.

References

EUROSTAT. Available from http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1090,30070682,1090_33076576&_ dad=portal&_schema=PORTAL.

de Gorter, Harry, Merlinda D. Ingco, and Laura Ignacio. 2004. "Domestic Support: Economics and Policy Instruments." In *Agriculture and the WTO: Creating a Trading System for Development*, ed. Merlinda D. Ingco and John D. Nash. Washington, D.C.: The World Bank.

Government of Pakistan. 2007. CBR *Quarterly Review* 6 (January-March). Islamabad: Central Board of Revenue. Available from http://www.cbr.gov.pk/FRS/2007/May12-2007.pdf.

Government of Pakistan. Various years. Ministry of Finance, economic surveys. Available from http://www.finance.gov.pk/survey/survey.htm.

Husain, Ishrat. 2003. "Pakistan's Export Competitiveness in Global Markets." Paper presented at seminar on export-led growth strategy, May 27, 2003.

Organized by the Export Promotion Bureau and held in Lahore, Pakistan. Available from http://www.sbp.org.pk/about/speech/2003/29-may-03-2.pdf.

International Textiles and Clothing Bureau (ITCB). 2007. "Evolution of Textile and Clothing Imports into EU-25 (1995-2006)." (Chart.) Available from http://www.itcb.org/Documents/ITCB-TD2-07.pdf.

Kane, Timothy, Kim R. Holmes, and Mary Anastasia O'Grady. *2007 Index of Economic Freedom: The Link Between Economic Opportunity and Prosperity*. 13th ed. Washington, D.C.: The Heritage Foundation.

Pakistan Institute of Development Economics (PIDE). 2006. *Trade Related Challenges Facing Exporters in Pakistan*. Islamabad: commissioned by the United Nations Industrial Development Organization.

State Bank of Pakistan. Various years. Annual reports. Available from http://www.sbp.org.pk/reports/annual/index.htm.

Tokarick, Stephen. 2006. "Does Import Protection Discourage Export?" IMF Working Paper WP/06/20, Washington, D.C. Available from http://www.imf.org/external/pubs/ft/wp/2006/wp0620.pdf.

Trade Development Authority of Pakistan (TDAP). Various years. Exports statistics. Available from http://www.tdap.gov.pk/v1/statistics/index.php.

United Nations Commodity Trade Statistics Database. Various years. Available from http://comtrade.un.org/.

United Nations Conference on Trade and Development (UNCTAD). 2002. *Trade and Development Report 2002*. Geneva: United Nations.

World Trade Organization (WTO). 2006. *World Trade Report 2006: Exploring the Links Between Subsidies, Trade and the WTO*. Geneva: WTO.

World Trade Organization (WTO). Unpublished. 2007 Trade Policy Review, Pakistan.

PART II

Societal Effects of Trade in Pakistan

THE IMPACT OF TRADE LIBERALIZATION ON GROWTH AND POVERTY IN PAKISTAN

Shaghil Ahmed

The trend toward the dismantling of trade barriers, together with renewed emphasis on fighting poverty around the globe, has fueled worldwide debate on the interactions between trade liberalization, growth, and poverty. Critics of globalization argue that free trade does not really free the poor from the clutches of poverty; rather, it makes the distribution of income more unequal, which, in fact, exacerbates poverty. Proponents, however, see the expansion of trade as a powerful force for enhancing economic growth and, thereby, for reducing poverty in developing countries. There is also a more middle-ground view which accepts that trade liberalization promotes growth in the long run, but argues that there are serious adjustment costs that leave behind large segments of the population in the short to medium run. The interactions are complex and depend crucially on the nature, sequencing, and degree of various liberalization measures that have been undertaken, as well as on the structure of the economy and the other policies that accompany the process of trade liberalization.

The objective of this essay is to place this ongoing debate in the context of Pakistan. In doing so, I draw on some results obtained by researchers at the Social Policy and Development Centre (SPDC), who have isolated the quantitative effects of trade liberalization policies—and the resulting changes in trade outcomes—on Pakistan's economic

Shaghil Ahmed is senior economist with the Division of International Finance, Board of Governors of the Federal Reserve System, Washington, D.C. Formerly, he was acting managing director of the Social Policy and Development Centre, Karachi. The views expressed in this essay are those of the author and do not necessarily reflect the views of the Board of Governors of the Federal Reserve System or any other members of its staff.

development. These results were obtained using rigorous econometric methods, including counterfactual simulations from a large-scale model of Pakistan's economy. I also evaluate the empirical evidence in light of predictions of economic theory.[1]

Potential Importance of Trade Liberalization

Many argue that trade liberalization—the easing of restrictions on an economy's ability to trade goods and services with the rest of the world—has the potential to enhance long-run economic growth. And, in turn, growth is argued to be a necessary condition for the sustained alleviation of poverty. Much cross-country evidence appears to support the link from trade to growth. For example, one well-known study concluded that a one percentage point higher ratio of trade-to-gross domestic product (GDP) (that is, the sum of exports and imports as a fraction of output produced) is associated with a 2 percent higher level of per capita income.[2] This result implies that, over the past 15 years, if Pakistan's trade-to-GDP ratio had risen just half a percentage point faster per year than it actually did, then trade as a fraction of output today would be about 48 percent (instead of around 40 percent), and per capita income in Pakistan would be about 15 percent higher. It is also generally believed that economic growth can be expected to reduce poverty, other things being equal. Some cross-country evidence also supports this notion, with the mean income of the poor going up and poverty rates going down as overall mean income increases.[3]

However, the above cross-country evidence is subject to some qualifications. First, the direction of causation is an issue—it is not easy to determine whether trade causes growth or growth causes trade. Second, greater trade openness works best in an environment of macroeconomic stability and in combination with other appropriate policies. Moreover, in some economies, the adjustment costs of trade liberalization can be high and produce growth-negative effects in the transition period. Finally, the literature recognizes that how much growth reduces poverty depends on the existing distribution of income and how that distribution changes as the economy grows. Adverse distributional effects can offset the positive direct effects of growth and make trade liberalization anti-poor.

The above discussion suggests that episodes of trade liberalization must be studied in a country-specific context. Here, the evidence for Pakistan is evaluated in this regard.

Pace and Sequencing of Trade Liberalization in Pakistan

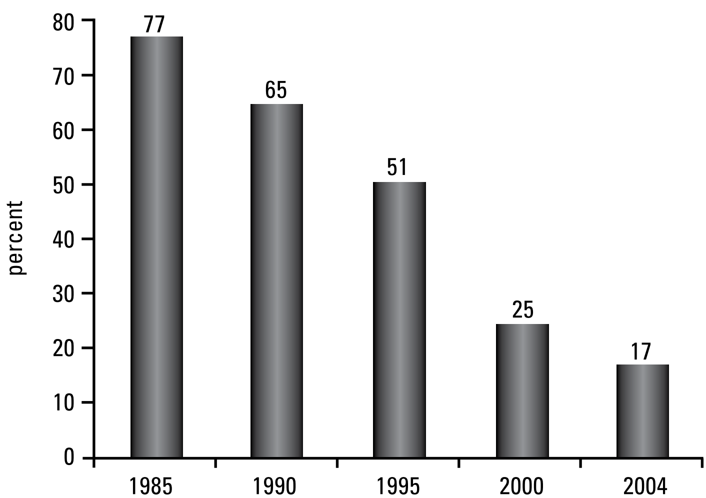
There are two main ways to measure the degree of trade openness. Policy measures focus directly on trade policy variables such as import tariffs and export taxes as well as non-tariff barriers that include such policies as import licensing, import quotas, and voluntary export restraints. Outcome measures consider how the policy variables translate into actual outcomes of exports and imports.

In the period up to the mid- to late-1980s, Pakistan's trade policies were rather ad hoc, erratic, and characterized on the whole by a high degree of protectionism. During this period, one or more of the following policies was in effect for extended periods of time: policies of substituting away from imports through restrictions on international trade to insulate domestic markets from foreign competition; the Export Bonus Scheme, which amounted to a multiple exchange rate system to promote exports; and Statutory Regulatory Orders (SROs), which exempted certain industries and even specific firms from import duties. These policies were generally run in a non-transparent manner, were distortionary, and became instruments for rent-seeking.

After this period, and especially since 1991, substantial trade liberalization has taken place in Pakistan. In particular, there has been a sharp reduction in the average (unweighted) import tariff rate from 77 percent in 1985 to 17 percent in 2004, about a 78 percent reduction, as shown in Figure 1. The sharp downward trajectory in import taxes has been quite broad-based, applying to a wide array of final consumer and capital goods, as well as raw materials for the production of these goods. Moreover, by 1995, export taxes had been largely eliminated, and, by 2004, most of the SROs had also been withdrawn. In addition, there has been substantial progress in the reduction of non-tariff barriers as well—quantitative restrictions on trade under these barriers have largely been eliminated, except for a ban on imports of items from India not explicitly on the "positive" list (that is, the list of goods that can be legally traded), and even this positive list has been growing over time.

Where does Pakistan's progress toward more liberal trade policies leave it today in terms of trade openness, relative to other emerging market economies in Asia? In making this comparison, we use two measures of trade restrictiveness computed in a recent study by some World Bank researchers.[4] Their first index is the Overall Trade Restrictiveness Index (OTRI), which combines the tariff-equivalent of all the trade restrictions imposed by a country on its own imports in a single measure. Specifically, starting with the hypothetical level of imports that would exist under free trade, a tariff rate—which, if applied to all imported goods, would bring imports to their actually observed level—is computed. According to this index, in a selected group of Asian countries, Pakistan—at a 21 percent equivalent import tariff rate—falls toward the middle of the group. Pakistan restricts imports less than India, Malaysia, the Philippines, and Bangladesh, about the same as China, and substantially more than Thailand, Turkey, Indonesia, Sri Lanka, and Hong Kong.

Figure 1: Average Import Tariff Rates



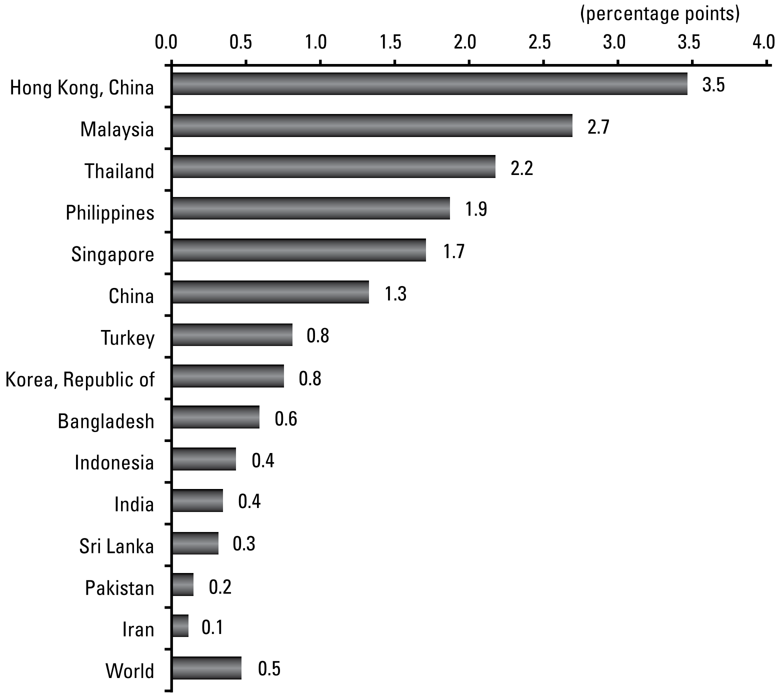
Source: UNCTAD Trade Analysis and Information Systems (TRAINS) data obtained from World Bank website.

Of course, free trade is a two-way street, and trade can also be restricted because other countries do not allow market access to a particular country's goods. The second measure used in the study by the World Bank researchers focuses on such restrictions. Specifically, a Market Access Overall Trade Restrictiveness Index (MAOTRI) is computed as the tariff-equivalent of all the trade restrictions imposed by trading partners on a country's exports. According to this study, Pakistan has the least amount of market access allowed by trading partners in the group of Asian economies listed earlier—its tariff-equivalent of the restrictions imposed by other countries on its exports is 28 percent, which is significantly higher than the second-highest in the group—Sri Lanka, with 22 percent. In fact, of the 91 economies for which the MAOTRI was computed in the study, Pakistan ranked the fourth highest in terms of lack of market access. Clearly, Pakistan faces very high trade barriers imposed by trading partners on its exports.

Turning to trade outcomes, Pakistan's path toward progressively more liberalized trade policies since the beginning of the 1990s led to some acceleration in its international trade. In the period from 1991 to 2005, the sum of imports and exports as a share of the total output of the economy increased by about half a percentage point per year, while this ratio had only increased by one-tenth of a percentage point per year in the 15-year period prior to this liberalization period. Since the turn of the millennium, Pakistan's real imports and real exports have accelerated a bit more. However, compared to other countries in developing Asia, Pakistan's trade performance has been rather modest, despite its fairly impressive record of policy liberalization. Figure 2 shows that Pakistan's exports-to-GDP ratio grew by only about two-tenths of a percentage point per year between 1990 and 2004, less than half of the average growth in the world as a whole, and also less than all of the selected economies shown, except Iran. The imports-to-GDP ratio (not shown) also displayed relative weak growth in Pakistan over this period. This left trade as a share of GDP in Pakistan at about 38 percent in 2004, much lower than much of developing Asia, and also lower than the world average of 46 percent.

The above analysis raises the important question of why Pakistan's trade—particularly its exports—has not increased in response to more liberalized

Figure 2: Average Per Annum Growth in Exports-to-GDP (1990-2004)



Note: Numbers next to the bars are rounded to the nearest tenth.
Source: WTO, World Trade Data.

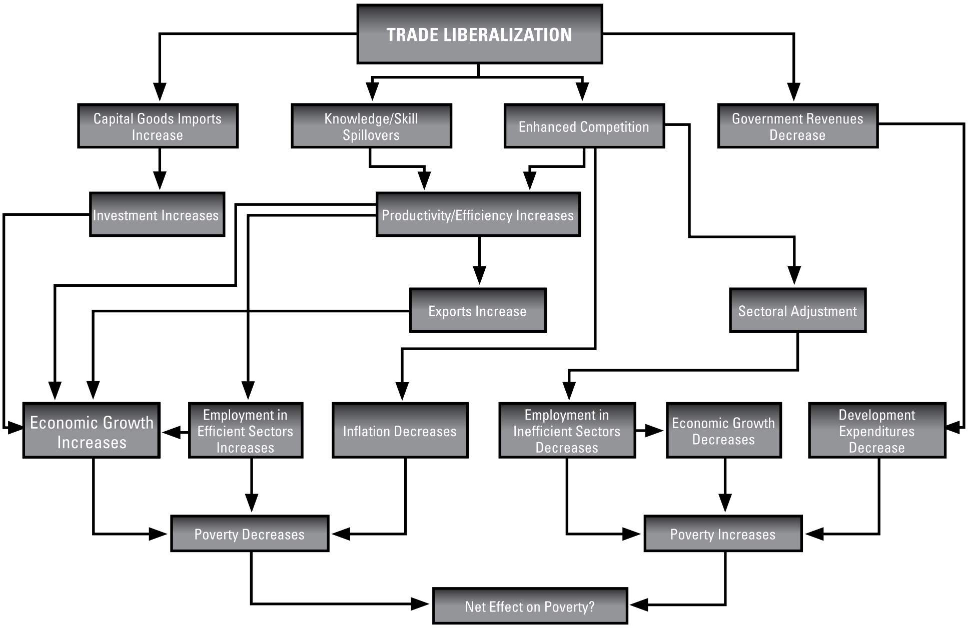
policies, as has been the case with trade in many other countries in Asia. Is it because of the lack of market access allowed to Pakistan by trading partners noted earlier, or are there other factors at work that explain the differences? The evidence to be presented below will shed light on this issue.

Effects on Economic Growth and Poverty

Channels of Transmission

In the channels of transmission governing the effects of trade liberalization on poverty, there are both positive and negative influences, as summarized by the flow chart in Figure 3.

Figure 3: Effects of Trade Liberalization on Poverty



Source: SPDC, Social Development in Pakistan Annual Review 2005-06

As import taxes and other barriers on imports fall, imports of capital goods are stimulated; this increases investment, which, in turn, promotes economic growth and thereby decreases poverty. The enhanced competition and knowledge/skill spillovers increase productivity, enabling an economy to get more output for any amount of inputs. This directly increases growth, while greater employment and higher exports boost growth indirectly. Again, poverty falls on this count; enhanced competition and lower import taxes also lead to lower inflation, which is poverty-reducing.

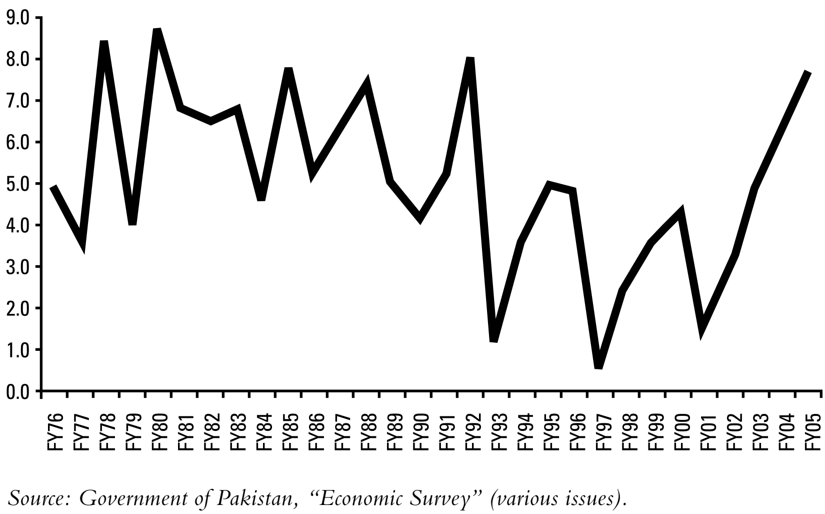
However, this enhanced competition entails a cost in terms of sectoral adjustments. Inefficient sectors that cannot compete internationally contract, which decreases employment in these sectors and threatens increases in poverty. Major adjustment costs can also arise from the fiscal side. Government revenue generally decreases because of lower tariff rates, and this can adversely affect pro-poor public programs, thereby worsening the distribution of income and exacerbating poverty.

Thus, the channels of transmission are the following: (1) the *growth channel*, working through investment, productivity, and increases in employment in the efficient sectors to reduce poverty; (2) the *price channel*, working through a direct effect on import prices and an indirect effect through enhanced competition to reduce inflation and, therefore, poverty; (3) the *public finance channel*, through which lower government revenues can compromise pro-poor public development programs and increase poverty; and (4) the *sectoral shifts channel*, whereby decreases in employment in the inefficient sectors put upward pressure on poverty. The net impact of trade liberalization on poverty depends on the magnitudes of these various effects, and is, thus, an empirical matter.[5]

Stylized Facts and Developments in the 1990s, in Addition to Trade Liberalization

The natural place to begin in considering the empirical evidence is to consider the behavior of some key variables over the liberalization period. As seen in Figure 4, over much of the trade liberalization period

Figure 4: Real GDP Growth (percent)



Source: Government of Pakistan, "Economic Survey" (various issues).

since the late 1980s up until fiscal year 2001, Pakistan's economic growth was uneven and generally on a downward trend, though it took off on an upward trajectory after that point.

The performance of other key variables since FY 1975 over five-year subperiods is shown in Table 1. In the first half of the 1990s, when trade liberalization in Pakistan accelerated, inflation was relatively high and employment growth low, although performance improved after that. Moreover, although poverty decreased in the early phases of trade liberalization, it increased after 1995. More updated figures show a decline in poverty in the past three or four years, but the exact magnitude of this decline is in dispute. Importantly, throughout the liberalization period, income inequality continued to rise.

On the face of it, these stylized facts tend to raise considerable skepticism about the role of trade liberalization in promoting growth and reducing poverty in Pakistan. But we have to dig deeper; a lot of other factors were at work that could potentially account, in part at least, for the adverse performance of Pakistan's economy during the 1990s, which has sometimes been referred to as Pakistan's "lost decade."

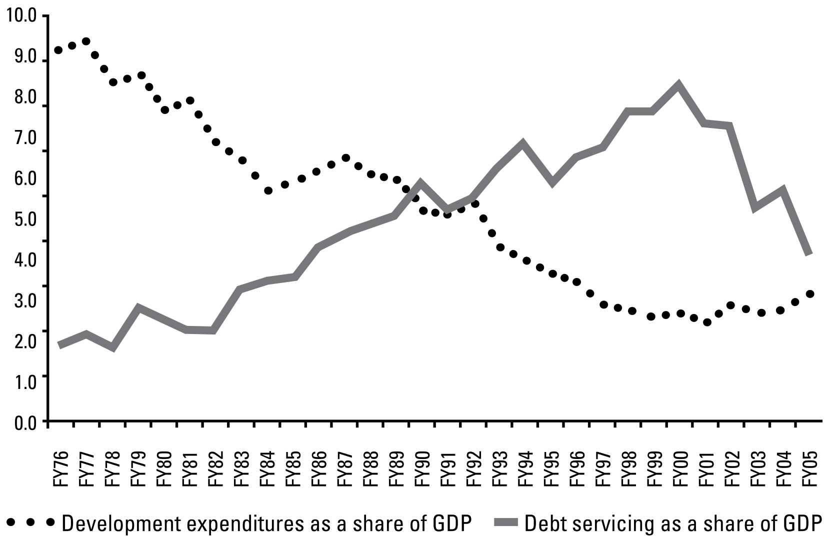
Table 1: Performance of Selected Variables by Period

	Average Annual Growth (%) of		Average Level of	
	Consumer Prices	Employment	Poverty (%) (Headcount)	Income Inequality (Gini)
FY76-FY80	9.7	3.5	33.8	0.3288
FY81-FY85	8.2	2.2	25.6	0.3495
FY86-FY90	6.1	2.6	21.4	0.3687
FY91-FY95	11.1	1.1	21.3	0.3863
FY96-FY00	8.1	2.9	25.1	0.4023
FY01-FY05	5.0	3.0	31.0*	0.4140*
*FY01-FY03 as data on these variables are only available until 2003				

Source: Government of Pakistan, "Economic Survey" (various issues) and SPDC estimates.

One important factor holding back performance was that macroeconomic stability somehow eluded the economy. There were several reasons for this—the policymakers of that era inherited a difficult situation in terms of the fiscal and current account deficits; there was political instability, with frequent changes in the government; investor confidence was lacking; and there were negative shocks, such as the sanctions after the 1998 nuclear tests. There was also fiscal adjustment taking place under the International Monetary Fund's Structural Adjustment Program. In the pre-liberalization period, there was already in place a change in the composition of government expenditures away from development expenditures, with an increasing share of expenditure being taken up by debt servicing. This trend continued in the 1990s, as can be seen from Figure 5. Thus, fiscal policy was not very pro-poor during the 1990s. In addition, there was a reduced flow of remittances and grants from abroad. Some researchers have argued that, earlier, the rise

Figure 5: Selected Government Expenditure Ratios (Percent)



Source: Computations based on data from government of Pakistan, "Economic Survey" (various issues).

in remittances had played a role in decreasing poverty, and so when these remittances weakened, poverty started going back up.

These factors certainly contributed to the decline in Pakistan's economic growth and to an elevated level of poverty during the 1990s. With this in mind, one can then hypothesize that trade liberalization in fact acted as a positive force for the growth and poverty situation, while these other factors held back the overall performance of the economy. More direct evidence on the effects of the trade liberalization, keeping other influences fixed, must be presented to evaluate this hypothesis.

Results from Estimation of a Poverty Equation

In order to isolate the influence of trade liberalization more directly, the parameters of a poverty equation were estimated. The level of poverty—defined as the percentage of the population falling below the poverty line—was modeled as a function of per capita GDP, inflation, openness as measured by trade outcomes (an index of economic liberalization made up of both international trade and international investment flows), and openness as measured by trade policy (proxied by the average import tariff rate).

The statistical properties and the technical details of the estimated equations are omitted here; rather, the implications of the results are emphasized. Other things being equal, each 1 percent increase in per capita income would reduce poverty by 0.6 percent. On the other hand, a one percentage point increase in the inflation rate (say, from 9 percent to 10 percent inflation) would increase poverty by nearly 1 percent. Turning to the effects of trade, a 10 percent increase in the degree of trade openness (say, from an initial ratio of trade-to-GDP of 40 percent to 44 percent) would reduce poverty by four percentage points in five years (for example, from a poverty rate of 30 percent to 26 percent). On the other hand, the estimated equation also implies that a decrease in tariffs (i.e. a more liberal policy) would actually increase poverty. This is probably capturing the loss of revenue effect through the fiscal channel, as the beneficial effects of trade are already being captured in the equation through more favorable growth and inflation outcomes as well as the trade outcome variables.

The above results suggest that the increased trade that emerges from trade liberalization, as well as an increase in growth and a reduction in inflation, can potentially be beneficial for alleviating poverty in Pakistan. However, the results also suggest that the poverty-alleviating effects of trade are offset to some degree by a negative effect on government revenues, which appears to hurt the poor.

What the results do not tell us is the relative contribution of the different transmission mechanisms that were discussed earlier. For instance, what are the most important channels through which changes in trade outcomes translate into poverty reduction? Similarly, what portion of the changes in growth and in inflation—whose effects are being estimated in the equation—can be attributed to trade liberalization? To delineate these different effects more clearly, model simulations were undertaken next. Of course, as is usually the case in empirical work in economics, the sharper delineation comes at the expense of more dependence on the assumptions of the particular model being used.

Model-Based Counterfactual Simulations

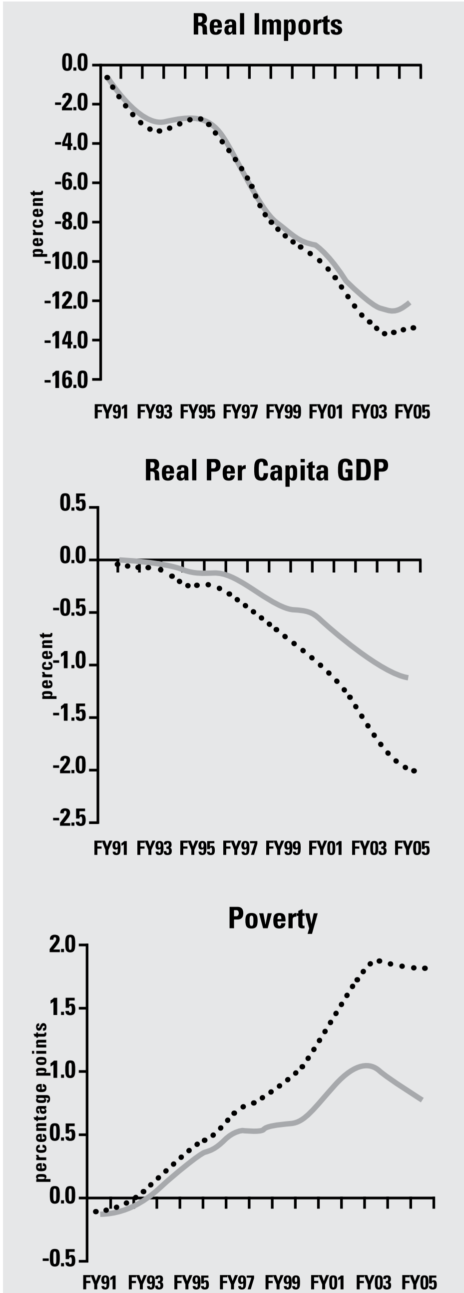
The model simulation results reported here are based on the Integrated Social Policy and Macroeconomic (ISPM) model, which is a pioneering effort of the SPDC. The ISPM model is a large-scale model of the Pakistan economy, which emphasizes the interlinkages between the macroeconomy (including an international trade module), public finances, and social sector development.

Using this large-scale econometric model, counterfactual simulations are run to determine what the economy would have looked like without a decrease in import taxes. Counterfactual simulations are intended to tell us what history would have been like if certain key facts (in this case import taxes) were assumed to have been different than they actually were. In the first simulation, the incidence of import taxes on consumer goods, capital goods, and raw material for consumer and capital goods (defined as import tax revenue as a share of total revenues) is assumed to remain at its 1980s average from FY 1990 onward. This means that average import taxes from FY 1990 onward are fixed at 45 percent, instead of falling from 40 percent in FY 1990 to 9 percent in FY 2004. This first simulation is intended to capture the *net* benefits of trade liberalization—that is, the benefits of trade liberalization through the various channels discussed earlier, less the costs accruing from the loss of fiscal revenue and the associated cuts in government expenditures on development programs.

We might also be interested in the gross benefits of trade liberalization—that is, what trade liberalization would have done to the economy if liberalization had been accompanied by other fiscal policy changes so as to make up for revenue losses from lower import tariffs and thus not compromised pro-poor development expenditures by the government. This is studied through the second simulation, in which we again take away the reduction in import tariffs that actually occurred, as we did in Simulation 1, but, in addition, changes (decreases) in other taxes (sales and direct) are now assumed such that government revenues are left at their actual observed paths and are lower than government revenues in Simulation 1. It should be emphasized that both Simulations 1 and 2 are intended to tell us what the economic situation would have been like in the absence of trade liberalization; the difference is that the first simulation will allow us to infer the net benefits, while the second simulation will allow us to infer the gross benefits, after shutting off the losses through the fiscal revenue channel of transmission.

The results are presented as deviations from baseline paths, shown by the solid and dotted lines in Figures 6 and 7. These deviations represent the differences between the predicted paths (based on the equations of the model) that the economic variables would have taken under the assumed counterfactual policies, and their predicted baseline paths under the actual policies that were followed. The units in which the deviations are measured (usually the difference between the counterfactual path and the baseline path expressed as a percentage of the baseline value) are labeled on the vertical axis. For example, a 0 percent deviation from the baseline path would mean that the value of the variable under the counterfactual policy would be the same as under the actual policy. The solid lines represent the deviations from baseline paths under the assumed counterfactual in Simulation 1, while the dotted lines represent the deviations from baseline paths under the assumed counterfactual in Simulation 2. Consider first the solid lines in Figure 6. Without trade liberalization, real imports would have been about 12 percent lower in FY 2005, real per capita income about 1 percent lower, and poverty about one-half to one percentage point higher. Inequality (not shown) would have been slightly higher.

Figure 6: Counterfactual Simulations: Effects on Outcome Variables (Deviations from Baseline Paths)



Note: Solid line represents Simulation 1 (if there had been no decrease in import taxes) and dotted line represents Simulation 2 (if there had been no decrease in import taxes and other taxes were also adjusted to leave the government's total revenues at their actual historically observed levels).

Source: *SPDC estimates.*

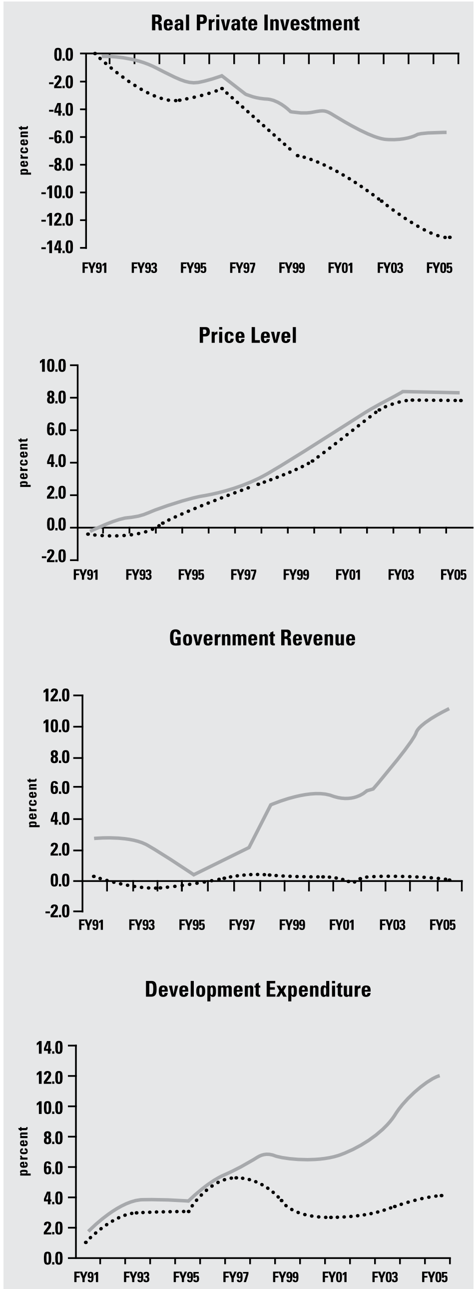
The effects on poverty and growth are rather modest, but it is important to emphasize that these effects go in the beneficial direction; that is, poverty would have been a bit higher and economic growth a bit lower if the process of trade liberalization had not occurred. Moreover, considering Simulation 2 (the dotted lines), the deviations from baseline paths are larger than in Simulation 1. In particular, without trade liberalization, but with the same revenue for the government as actually observed rather than the higher revenue that would have prevailed under Simulation 1, poverty would have been about two percentage points higher rather than one-half to one percentage point higher. From this, we can infer that trade liberalization would have helped the poverty situation a bit more if the fiscal revenue had been fully made up and thus not resulted in fiscal policy becoming anti-poor, as a consequence of a fall in the government's development expenditures.

The paths of some other key variables to isolate the transmission mechanisms are presented in Figure 7. As can be seen from the solid lines, without trade liberalization, real private investment would have been about 6 percent lower in FY05, and consumer prices would have been about 8 percent higher. However, without trade liberalization, government revenue and development expenditures would also have been 11 to 12 percent higher. This suggests that some benefits of trade liberalization are major, but have been largely negated by the adjustment costs through the fiscal channel. This can be seen more clearly from the dotted lines (Simulation 2), which, recall, depict what would have happened in the absence of trade liberalization, but with changes in other taxes so as to leave total government revenue unchanged, rather than having higher revenues implied by just undoing the cuts in import taxes (Simulation 1). In this case, development expenditures would still have been higher, but only by about 4 percent—instead of the 12 percent in Simulation 1. The results bolster the argument that adjustment costs would have been much lower if development expenditures had not been compromised.

Model-Based Forward-Looking Simulations

To further reinforce this point, forward-looking simulations were also run, in which rather than just assuming (as in Simulation 2 above) that trade liberalization does not result in anti-poor fiscal policies, a stronger

Figure 7: Counterfactual Simulation: Channels of Transmission (Deviations from Baseline Paths)



Note: Solid line represents Simulation 1 (if there had been no decrease in import taxes) and dotted line represents Simulation 2 (if there had been no decrease in import taxes and other taxes were also adjusted to leave the government's total revenues at their actual historically observed levels).

Source: SPDC estimates.

assumption is made that trade liberalization in the future interacts with fiscal policies that are actually strongly *pro-poor.* Specifically, a permanent 50 percent further reduction in import taxes is assumed starting immediately, and there is also an increase in development expenditures to an average of roughly 5 percent of GDP. Resources are also assumed to be mobilized through increases in direct taxes and sales taxes to partly finance the development expenditures.

The results are quite striking—about a five percentage point reduction in poverty (for example, from 30 percent to 25 percent) can be achieved in five years through this policy combination. Pakistan, while continuing its policies of liberalizing trade, has begun to move in the direction of pro-poor fiscal policies in the past few years, and indeed a substantial reduction of poverty has been achieved over this period, although the exact magnitude is the subject of much debate. If direct measures are also taken to improve the ever-worsening income inequality situation, and if the inflation situation is also improved, then even bigger reductions in poverty could be achieved.

Enhancing Pakistan's Exports in the Long Run

Besides adjustment costs through the fiscal channel, the other important factor restraining the benefits of trade liberalization in the case of Pakistan was identified earlier to be a lack of response of trade outcomes (especially exports) to policies promoting free trade.

The issue of how to enhance exports on a sustainable basis was also touched upon in the SPDC report by estimating a cross-country exports equation. Following some recent research, the exports-to-GDP ratio in a cross-section of countries was modeled as a function of per capita net inflow of foreign direct investment (FDI) and the Overall Trade Restrictiveness Index (OTRI) and the Market Access Overall Trade Restrictiveness Index (MAOTRI) discussed earlier. FDI, in turn, following channels highlighted in the literature, was modeled as a function of the average of six institutional quality indicators (AVINST) related to voice and accountability (a measure of the extent to which citizens in a country can enjoy democratic freedoms, including freedom of expression and the media), political stability, government effectiveness, regulatory environment, rule of law, and control of corruption. In addition, FDI also happened to be correlated empirically with the MAOTRI, which was also taken into account.

Using the estimated cross-country equations, it was determined what Pakistan's export-to-GDP ratio would be under various scenarios. Some illustrative implications are presented in Table 2. If Pakistan was able to reduce its own trade restrictions to the level of that of the Philippines, for instance, its exports-to-GDP ratio could be five and a half percentage points higher. This means exports would have been 18.5 percent of GDP in FY

Table 2: Change in Pakistan's Exports/GDP Ratio (Percentage Points) under Various Scenarios Using Estimated Exports and FDI Equations

Country X	Scenario 1: Pakistan's OTRI measure equal to country X's OTRI measure	Scenario 2: Pakistan's MAOTRI measure equal to country X's MAOTRI measure	Scenario 3: Pakistan's AVINST measure equal to country X's AVINST measure
Bangladesh	-1.0	4.3	0.4
China	1.5	14.8	1.4
Hong Kong	7.2	11.4	5.1
India	-5.4	4.7	1.7
Malaysia	4.6	14.8	3.3
Philippines	5.5	13.7	1.6
Sri Lanka	3.7	4.2	1.9
Thailand	1.7	10.2	2.8
Turkey	4.2	8.5	1.5
Note: Pakistan's actual exports/GDP value was 13 percent in FY05			

Source: SPDC estimates.

2005 instead of 13 percent. If Pakistan's institutions were of the quality of Thailand or Malaysia, its exports-to-GDP ratio could be 2.75-3.25 percentage points higher. And, if Pakistan had market access like China or Malaysia (and the correspondingly higher FDI that is correlated with that), the effect on its exports-to-GDP ratio would be even larger.

While illustrative in nature, these implications do suggest that, in addition to keeping import restrictions low, a much higher quality of Pakistan's institutions—which would bring in a lot of export-oriented FDI—and greater market access allowed by trading partners are also necessary conditions for enhancing exports.

Conclusion and Policy Implications

This essay considered the empirical evidence related to Pakistan's experience with trade liberalization over the past two decades or so. The evidence suggests that there are important channels through which trade liberalization efforts have benefited the economy. The primary ones are an increase in investment (capital accumulation) and productivity—which promotes growth—and a lower level of consumer prices. According to the evidence, both channels tended to decrease poverty in the country.

However, these beneficial effects of trade liberalization became masked in the overall outcomes following freer trade. This was both because of some partially offsetting negative effects of trade liberalization as well as some other accompanying changes in the economy that were not related to the process of trade liberalization. For example, there were large adjustment costs through the fiscal channel: the reduction in the collection of customs duties, which occurred at a time when there was substantial pressure for fiscal consolidation due to already high government budget deficits, led to cuts in public expenditures. Unfortunately, the axe of expenditure cuts fell primarily on development programs. Not only are such programs directly pro-poor, but the employment opportunities that could have been created as a result of these programs were also foregone, adversely affecting the income of the poor. Another important factor was the relatively poor quality of the country's institutions (covering such spheres as voice and accountability, governance, regulation, rule of law, and corruption), which resulted in very little FDI coming into the country. This, along with a lack of adequate market access provided by Pakistan's trading partners, created an environment in which import liberalization did not translate into an increase in long-run exports to anywhere near the same extent as in many high-performing emerging economies in Asia. Moreover, there was political and macroeconomic instability over much of the liberalization period, which adversely affected growth and inflation.

Over the past four or five years, as the environment of trade liberalization has interacted with more macroeconomic stability, better performance in terms of inward FDI, and substantial increases in development expenditures, Pakistan's economic growth has recovered handsomely, and there has also been a significant reduction in poverty. However, the still-deteriorating income inequality situation and a fairly high inflation rate have continued to restrain progress.

Several broad policy implications emerge from the empirical results. First, since investment and economic growth are important channels through which the benefits of trade liberalization accrue, if other policies are not pro-investment and pro-growth, this can hamper progress. While better policies have certainly helped in achieving economic growth rates of 7 to 8 percent in recent years, policymakers cannot afford to become complacent about long-term economic growth, as some of the higher growth can be explained by external shocks such as an increase in the flow of remittances from abroad after the events of September 11, 2001. There is little doubt that Pakistan's current investment-to-GDP ratio cannot support 7 to 8 percent economic growth, and more productivity-induced investment is needed.

Second, the increase in development expenditures that is rightfully occurring should not be allowed to compromise hard-earned macroeconomic stability and policy credibility, or to put further pressure on the fiscal deficit, and thereby on inflation, which increases poverty. The tax-to-GDP ratio needs to rise significantly, and some expenditure switching on the part of the government is also in order.

Third, when there is trade liberalization, inefficient sectors contract and economies are obliged to restructure. Employment losses occur as a result of this restructuring, and it is important that these losses be well-managed. Better social safety nets and skills development and training schemes are needed in order for the sectoral shifts channel of trade liberalization not to further worsen income inequality.

Fourth, while progress has been made, there is a long way to go in improving the quality of the institutional infrastructure in Pakistan and in attracting foreign investment to enhance exports in the long run. Market access is also important for improving the performance of exports, and a better case must be made by Pakistani authorities in this regard. The historical lack of access allowed to Pakistani products may partly reflect the heavy reliance on textiles in Pakistan's exports, which were subject to quota restrictions until January 2005. With the quotas now removed, this hurdle should not potentially exist anymore. However, the evidence suggests that Pakistan's international competitiveness vis-à-vis other countries that also stand to benefit from the textile quota removals needs to improve to realize the potential opportunity. Another way to penetrate markets is to diversify away from textiles and develop other export markets where access barriers may be lower.

Finally, in setting policy, it should be recognized that the source of the recent sharp increases in Pakistan's trade deficit is not the process of trade liberalization. Rather, without there being much unused capacity now, the economy has reached a situation where aggregate demand is growing at a faster rate than the capacity of domestic production to satisfy that demand. The excess demand is thus satisfied by importing more, which fuels inflationary pressures in the long run. Appropriate measures are needed to redress Pakistan's growing macroeconomic imbalances and to prevent the economy from overheating, rather than to reverse the policies of trade liberalization. Any temptation to increase restrictions on imports in an attempt to bring down Pakistan's widening external deficits would be unfortunate and must be resisted.

Notes

1. The author was the lead researcher of the SPDC study on which this essay is based. SPDC is an independent research think tank that undertakes research related to issues of social sector development in Pakistan. For the full report, see: *Social Development in Pakistan Annual Review 2005-06: Trade Liberalization,*

Growth, and Poverty (Karachi: Social Policy and Development Centre, April 2006). Available from http://spdc-pak.com/publications/pubdisp.asp?id=anr7.

2. Jeffrey A. Frankel and David Romer, "Does Trade Cause Growth?" *American Economic Review* 89 (April 1999): 379–99.

3. David Dollar and Aart Kray, "Growth is Good for the Poor," *Journal of Economic Growth* 7 (3): 195–225 (2002); and Martin Ravallion, "Growth, Inequality, and Poverty: Looking Beyond the Averages," *World Development* 29 (11): 1803–15 (2001).

4. Hiau Looi Kee, Alessandro Nicita, and Marcelo Olarreaga, "Estimating Trade Restrictiveness Indices," World Bank Policy Research Working Paper Series 3840, Washington D.C., 2006.

5. Allan L. Winters, Neil McCulloch, and Andrew Mackay, "Trade Liberalization and Poverty: The Evidence so Far," *Journal of Economic Literature* 42 (1): 72–115 (2004) provides an excellent survey of the various transmission mechanisms as well as the empirical evidence on these mechanisms.

TRADE AND ENVIRONMENT: SOME EMPIRICAL AND POLICY ISSUES FOR PAKISTAN

Shahrukh Rafi Khan

Governments and businesses in high-income countries (HICs) are increasingly taking note of civil society advocacy and consumer preferences for ecologically friendly production and consumption of imported or exported goods that enter trade. This means that the goods exported by low- or middle-income countries (LICs/MICs) like Pakistan will increasingly have to conform to environmental standards.[1] HIC governments may require conformance as part of an environmental movement, and businesses based in HICs may require their production partners based in LICs/MICs to respond to their consumer and shareholder constituencies. With concerns about climate change on the rise, such pressure will also rise.

Many LICs/MICs continue to view environmental standards—and also social ones—as protectionist devices. The position adopted in this essay is that while LICs/MICs are fully within their rights to protect their policy space for industrialization, they should do so in a reasoned way. Thus, if the gains from adopting clean production provide greater benefits to the country than the costs (with a greater emphasis on the poor in this calculus), then it does not matter where the stimulus for clean production comes from because it is in the national interest of the country to adopt it. Based on complementary prior research, at the macro and micro level, I argue in this essay that the social benefits exceed the social costs in the case of Pakistan, and possibly of many other LICs/MICs. The essay shows that at the macro level, the costs of mitigation (defined

Shahrukh Rafi Khan is visiting professor of economics at Mount Holyoke College. He served as executive director of the Sustainable Development Policy Institute in Islamabad from 1996 to 2002. He has also taught economics at the University of Utah, the State University of New York, and Vassar College.

as less pollution per unit output due to cleaner production) are exaggerated and that the social benefits exceed the social costs. It also shows that at the micro level, mitigation represents a win-win by improving the well-being of the poor—who are the most vulnerable to environmental degradation—and by lowering costs.

This essay explores the trade-environment link; briefly explains the method used for the complementary studies to establish win-win empirically in the Pakistani context; summarizes the findings of these studies; and concludes by exploring why, if win-win is evident, there is a lack of spontaneous market uptake in adopting clean production and how national and global policy could address this problem.[2]

The Trade-Environment Link

Traditional trade theory, based on the concept of comparative advantage, suggests that trade brings mutual benefits to all parties engaged in exchange. The presence of external costs, such as environmental degradation associated with traded goods, can reduce or reverse the gains suggested by this theory.

The trade and environment literature deals with a number of issues and hypotheses that are not a part of traditional trade theory. Many of these are related to concerns about fairness and equity. First, trade liberalization could result in strategic movement on the part of northern multinational corporations (MNCs) to southern countries with more lax environmental regulations and hence result in losses in northern jobs. Most researchers agree that environmental standards on their own are not enough to cause investment shifts, since many other variables are involved in determining trade and investment patterns.

Second, the north could use trade liberalization to dump its dirty technology and other domestically prohibited goods on the south. Third, multilateral environmental agreements are increasingly affecting the world-trading environment and these could block southern exports. Fourth, the north has a greater resource and technological ability to meet the standards it sets, which will mean blocking imports from the south that do not meet these standards. Fifth, export promotion policies could result in the south exporting its environmental capital in the form of high pollution and domestic resource degradation. Sixth, the mitigation costs of such pollution are very high in the south.

The last two propositions are of particular concern to LICs/MICs and so are elaborated on in more detail. Critics of free trade ideology claim that increased exports— partly driven by trade liberalization, a cornerstone of economic globalization—generate costs of natural resource depletion and degradation and increase industrial pollution. The World Commission on Environment and Development, in what is referred to as the Brundtland Report, recognized that during the 1980s the south's commodity trade was based on the over-harvesting of nature in order to service its debt. The problem was especially acute in that the south lacked the resources and technological prowess to combat environmental degradation.

Proponents of liberalization argue that, quite to the contrary, enhanced exports are likely to benefit the environment in the long run. They point out that competition would induce the drive toward the latest manufacturing technologies, and, since these are likely to be procured from the north, they are probably much cleaner. Further, northern importers may require cleaner processes to ensure greener products. Trade liberalization supporters present evidence—albeit challenged in both method and findings—showing greater trade openness to be associated with less pollution-intensive industrialization. Further, they argue that trade liberalization does not induce a "race to the bottom" (that is, a relaxation of production standards to the dirtiest possible level). Their findings also suggest a positive relationship between stringency of environmental regulations and trade openness, as well as an equivalent degree of stringency in regulations among trading partners.

The environmental impact of trade has been disaggregated into product, scale, structural, and regulatory effects. In each category, there can be positive and negative effects. The negative scale effect—the first concern for this essay—can result from trade expansion and trade liberalization. Thus, as production expands to respond to growing export markets, these enhanced exports could prove to be environmentally disastrous without proper environmental safeguards in place.

A related and widely discussed topic in the trade and environment literature is that of the environmental Kuznets curve (EKC), which suggests that with growing prosperity—partly accounted for by trade—there is both a tendency for countries to attach more weight to the environment and a greater ability to address environmental issues. This is suggestive of a passive policy stance (like the associated trickle down theory) that ecologists find objectionable. An ecological position on the EKC is that much biodiversity and ecosystem loss is nonreversible, and, in any case, knowledge about the nonreversible threshold is limited. Furthermore, even if these thresholds were known, they may be above world median per capita GDP (gross domestic product) levels—meaning that irreversible losses are likely to continue into the future. Put another way, it is dangerous to assume that countries can only deal with environmental damage as they get richer, because nonreversible environmental damage occurs everywhere, including in poor countries—and if nothing is done, particularly in these poor countries, then the nonreversibility situation will only worsen. This would suggest the use of a precautionary policy in the south to avoid the nonreversibility problem.

Even though the debate is not settled, common sense suggests that at least due to the scale effect, trade liberalization will lead to higher environmental degradation.

As noted above, there are fears and some evidence to support the contention that mitigation costs are too high for LICs to do much about environmental damage. Some colleagues and I have explored this position empirically at a macro level for Pakistan and found it untenable.

Further, we found that implementing a stringent environmental policy at a micro level represents a win-win situation, because environmental investments are likely to pay for themselves either directly or indirectly. They do so directly if the cleaner technology is more productive and the payback period of the investment is small. They do so indirectly in two different possible ways: (1) the abatement of pollution allows the firm to meet domestic and international (buyer-imposed) standards, and (2) the nonreversibility problem, discussed above, is avoided. In addition, there are social benefits such as a healthier work force and lower health costs imposed on the larger population.

I now turn briefly to the method used in the macro and micro studies to establish these propositions for Pakistan's most successful export industries, textiles and leather, which are also the most damaging environmentally.

METHOD

For the macro study, our overall objective was to do a heuristic (speculative) cost-benefit analysis of the abatement of the incremental pollution resulting from cloth and leather exports. We estimated, using a standard forecasting method, the increase in cloth and leather exports within a specified period (1996-2004), with 1996 as the benchmark year. Next, we estimated the environmental impact of cloth and leather exports. Following this, we assessed the import costs of using cleaner technologies (since—at least for textiles—these would have to be imported), and the mitigation impact of using cleaner technologies in terms of reduced pollution.

We also documented the health and other social costs resulting from the pollution. In effect, the reduction of such costs represented the benefit from pollution mitigation. While it was not possible to specifically link the health costs to incremental export-related leather and cloth production, we drew on research quantifying the cost of pollution on an aggregate level. Based on the shares of leather and cloth production in total value added, and breaking that down further by exports as a percentage of total cloth and leather production, we attributed pollution costs to exports by these industries and hence arrived at the implicit benefit from mitigating such pollution.

For the micro study, the cost data covered various clean production (CP) measures undertaken—such as machinery upgrades, recycling, waste recovery, other process changes, raw material substitution, end-of-pipe treatment (that is, treatment prior to liquid emissions out of factory), and ancillary activities such as captive energy generation. Again, given the methodological and data problems of quantifying health benefits, we only documented these as an additional bonus, but the focus was on exploring the private mitigation costs relative to the private efficiency gains from adopting CP.

Tanneries and textile units were selected purposively (representing small- and medium-sized firms) from four of the five larger industrial clusters in the country. Initially, questionnaires were sent to 12 leather and 12 textile units. The response rate was poor; only three leather tanneries and four textile units completed and returned the questionnaires. Further, only the completed financial sections were adequate; the environment sections did not yield much useful information.

Thus, in 2002, we followed up with field visits to Lahore, Faisalabad, Kasur, and Sialkot to interview company owners, managers, and technical and administrative staff. Joint-treatment plants—based on business-government-donor partnerships—were evident in the leather industry, and we visited two CP tannery projects in Sialkot and Kasur. We also obtained data for the analysis from the ETPI (Environment Technology Program for Industry), a joint effort of the Federation of Pakistan Chambers of Commerce and Industry and the Dutch government that seeks to help industries develop measures and technologies that boost environmental performance.

Findings

Textiles and leather are two of the most polluting industries, and, within these industries, producing cloth and tanning leather are the most polluting processes. We selected the textile and leather industries because of their economic significance for Pakistan and their pollution impact. According to Pakistani government figures, in 1996 (the base year of the macro study) the textile industry ranked number one in terms of exports, value added, and employment. Leather ranked second in terms of exports.[3] While not as significant in terms of value added or employment, leather was the most polluting of all the industries.

In the macro study, we found that between 1996 and 2004, a 45 percent increase in textile exports would be associated with an 81 percent increase in pollution load (i.e. an export-pollution elasticity of about two). Leather exports were expected to decline, so one could expect a 7 percent lower pollution load generated by leather tanning without mitigation measures. If mitigation measures were adopted, up to 91 percent of the emissions from cloth and 66 percent of the emissions from tanning could be reduced.

The costs of such mitigation measures in 1996 at a macro level would have been 0.12 percent of GDP. The foreign exchange liability of mitigation (importing clean technology) for 1996 amounted to just 1.6 percent of the earnings of cloth exports in 1996. More important, the cost to industrialists of mitigation in a cloth-producing plant with a 21.45

million-square-meter production capacity would have been 1.6 percent of its sales revenue.

For the leather industry, on a macro level, the net mitigation cost (after subtracting the value of chromium recovery) in 1996 would have been 0.0048 percent of GDP and the mitigation cost to exporters of leather would have been 0.88 percent of their export revenue. These mitigation costs are much lower than for cloth production since clean production technology is locally available.

The evidence from these case studies supports the proposition that export growth may generate a great deal of pollution. However, there is little support for the associated proposition that the costs of establishing and operating clean technology are necessarily very high. More important, a rough calculation of the benefits from mitigating pollution is estimated to be 0.5 percent and 0.04 percent of GDP (for textiles and leather, respectively, in 1996)—an indication that the benefits far exceed the costs. Our estimates are crude, but the benefits exceed the costs by such a large margin that it is unlikely that refinements would change the main message that, from a social benefit cost-analysis perspective, it would pay to encourage clean production.

The findings from our micro research lead to a similar conclusion. Our analysis confirms the win-win premise that there are efficiency and environmental gains resulting from compliance with international process standards in both the leather and the textile industries. The conjunction of in-plant measures with combined wastewater treatment for tannery clusters demonstrated clear win-wins. This was evident in the relatively short payback periods for in-plant measures, the dispersion of recurring costs associated with end-of-pipe treatment across the cluster, and the land reclamation gains. The latter refers to the benefit-cost calculus of clean-ups (of stagnant toxic pools), which we built into the analysis of the leather industry. This revealed impressive environmental and health benefits relative to the cost.

Discussion: Uptake and Policy Issues

The main issue of policy concern for us, flagged in the introduction, is the lack of spontaneous uptake of clean production. In the leather industry, the situation was ambivalent when we gathered our data for the micro study in 2002. While firms were willing to institute in-plant measures because of their relatively quick paybacks, they were less willing to pay for the costs of running combined water treatment plants. In-plant measures are a necessary but not a sufficient condition for meeting either Pakistan's NEQS (National Environmental Quality Standards) or international standards, and such measures need to be supplemented with end-of-pipe treatment.

Despite the obvious cost advantages associated with joint action (understood here as firms in a given industry and locality working together to address a problem) by producers, it may not actually be observed, and for a number of reasons. For example, joint action can be constrained because of the free-rider problem (when not all firms contribute but all benefit). This is very much in evidence in the case of the Kasur tanneries. These facilities have exhibited widespread delinquency in making mandatory contributions—even though, at the individual plant level, these firms have represented success stories. As for the Sialkot CP project, a combination of project-instigated awareness and subsidies induced firms to buy into CP activities initially. The project had the foresight to recognize that hard-headed businessmen would not subscribe to public interest issues unless these were underpinned by economic benefits. Consequently, the Sialkot effort introduced a number of in-plant measures with short- to medium-term paybacks. The uptake by firms both within the project and outside has been encouraging. Conversely, many environmentally friendly options—for example, the use of dust collectors for the buffing stage of leather processing—yield no economic benefits and firms have shown no interest in them.

From a policy perspective, large one-time investments are feasible and likely to elicit donor interest. Since the bulk of tanneries in Pakistan are clustered, there is merit in a concerted attempt to leverage financial support for additional joint-treatment plants, as well as to address the post-project financial sustainability constraints. One possible option could be for the government to take on the responsibility of running these plants, for which they could charge a mandatory fee from the tanneries. Another option could be to contract the plants out to the private sector. While private contractors would, presumably, charge relatively higher fees, by the same token they could also be expected to run the plants more efficiently.

Also, in the case of private investment, despite clear win-win possibilities, uptake is constrained by imperfect information pertaining to CP technology. Imperfect information constraints are compounded by capital market imperfections, because loans are not often easily available for lumpy capital investments such as water treatment plants.[4] A useful strategy would be that of initially addressing the joint action problem via subsidies to demonstrate that win-win potential exists, while simultaneously addressing the information and capital market imperfections (ensuring that the relevant information is diffused and that credit is available).

A more fundamental issue is that exporting firms are a subset of a much larger industrial universe. Large firms and SMEs (small- and medium-sized enterprises) catering to domestic markets can be threatened with judicial action, but this is unlikely to work without the kind of concrete incentives and pressures that exporters are subject to. Mobilizing community and labor pressure (since both are subject to negative environmental consequences), threats of sanctions (based on the environmental legislation already in place), and support with information and credit may induce the needed joint action. One can describe this strategy—as applied to the leather industry—as a carrot and stick approach.

Firms in the textiles industry do not enjoy the benefit of clustering and the possibilities of joint treatment. However, our research has found pressure for compliance to be much stronger in this industry. Textile firms comply unequivocally with product standards, such as refraining from using carcinogens, because noncompliance would mean a discontinuation of export orders.

Process standards are more of a gray area. While the ISO (International Organization for Standardization) 14000 (the ISO series that refers to environmental management standards) requires documented proof of compliance with national environmental quality standards (NEQS), some firms in Pakistan have secured such certification even though they did not appear to be fully cognizant of the NEQS. Also, a number of firms have been granted ISO and/or bilateral certification ahead of full compliance, by demonstrating partial compliance or intent to comply.

There is also a public-private chasm. Pakistani textile exporters, though late in responding to the urgency surrounding international standards, are nonetheless taking steps to ensure their competitiveness in the world market. This is happening even as the government and civil society representatives struggle to develop a common and informed stance on the issue. There is a lack of awareness on the part of both industry and government regarding the overlaps and potential synergies that exist between international and national standards. The fact that these commonalities are not being stressed and that both parties keep each other at arm's length is a problem. The government needs to adopt a more proactive strategy for bridge-building, and this is only possible by investing in the provincial Environmental Protection Agencies (EPAs).[5]

Issues of transparency also arise. The EPAs have called in large producers for being in violation of the NEQS and threatened them with closure. By and large, exporters either obtain stay orders from the courts or simply ignore such warnings. That the warnings have frequently been issued without onsite checks has resulted in firms not taking them seriously. In Pakistan, voluntary compliance via the Self Monitoring and Reporting Tool (SMART)[6] and payments of pollution charges for emissions above NEQS are seen as ways of addressing the weak technical and enforcement capabilities of the EPAs. However, this process of voluntary compliance has not reached operational maturity due to a lack of resources, commitment, and oversight.[7]

In Faisalabad, textile firms have conceded that joint treatment would be in the interests of the firms, the municipal authority, and urban residents. However, a proposal for getting local government support did not get off the ground. The firms were unable to engage in joint action because of both uneven benefits across firms and mistrust. We propose a carrot and stick approach to induce joint action, as suggested above for the leather industry.

Currently, the larger firms are installing their own treatment plants as part of the requirement of ISO certification. In a few cases, anticipating more stringent standards regimes in the foreseeable future, several leading textile plants have installed very expensive water treatment plants (e.g. Crescent Textiles in Faisalabad). However, joint action—which would profit from the involvement of SMEs—would defray the costs of such facilities for the individual firm and lead to much larger benefits.

One also needs to address local issues with global policy. As an intergovernmental trade body, the World Trade Organization or WTO (with recommendations from the Trade and Environment Committee) can be an important instrument in facilitating compliance and in ensuring that trade and environment are mutually supportive and reinforcing. It can play a key role in reducing mistrust between southern and northern governments by discouraging the imposition of unilateral standards and by ascertaining that environmental concerns are not used as a protectionist tool. It should draw the attention of HICs toward the technical assistance and capacity-building needs of the LICs/MICs. It should also address issues such as harmonizing standards intranorth and gradually phasing them in in the south. It should look closely into the performance of international certifying agencies to ensure transparency and accountability. Finally, it should assist developing countries in formulating their national strategies toward compliance.

The challenge is to integrate trade and environmental policies harmoniously in order to achieve maximum synergy. In other words, the ideal paradigm is one where southern trade policies become environmentally sensitive and northern environmental policies are not trade-restrictive. A key requirement is that southern countries be encouraged and assisted in every possible way to take advantage of win-win opportunities such as the kind reviewed and documented here. While the south has its own environmental agenda, which coincides with many northern environmental concerns, the task is to ensure that these two agendas converge at the policy and institutional levels.

Notes

1. I will also use "north" and "south" to distinguish between HICs and LICs/MICs. While this is less accurate as a country classification, it is common parlance.

2. This essay draws on S.R. Khan, M. Khwaja, and A. M. Khan, "Environmental Impacts and Mitigation Costs Associated with Cloth and Leather Exports from Pakistan," *Cambridge Journal of Environment and Development* 6 (2001), and Shaheen R. Khan, M. S. Qureshi, S. R. Khan, and M. A. Khwaja, "The Costs and Benefits of Compliance with International Environmental Standards," in

Sustainable Development and Southern Realities: Past and Future in South Asia (Karachi: City Press, 2003) to which the reader can refer for necessary documentation and detailed analyses.

3. Government of Pakistan, "Economic Survey 1996-97" (Statistical Appendix), (Islamabad: Government of Pakistan, 1997), 74-75.

4. Lumpy capital refers to cases where there are large initial outlays or investments and long gestation periods before the revenues from the investments start accruing. The sums involved are much too high for individual businesses to support from their profits, and if capital markets are imperfect, the ability to borrow to make the investments is not present. Such investments are also associated with high risks due to the long gestation periods, and they require large markets for economies of scale to kick in. These are additional factors deterring such investments.

5. EPAs were instituted by the Pakistan Environmental Protection Act of 1997. Under this act, EPAs are "to formulate NEQS and devise systems and procedures required to determine whether industries comply with them." More information available from http://www.environment.gov.pk/smart/site/index1.html.

6. SMART, an initiative of Pakistan's environment ministry, allows firms to be responsible for "systematic monitoring and reporting of their environmental performance." Firms monitor their emission levels and then use electronic means, such as SMART software, to convey this information to EPAs. More information available from http://www.environment.gov.pk/smart/site/index1.html.

7. An anecdote may illustrate the problem. When as head of an environmental public interest think-tank the author was in a high-level meeting and lobbying for greater environment policy enforcement, Islamabad's then-minister of the environment (who hailed from a major industrialist family) argued that the country needed to be concerned simply about getting industry moving.

THE TRADE AND GENDER INTERFACE: A PERSPECTIVE FROM PAKISTAN

KARIN ASTRID SIEGMANN

News on Pakistan's trade performance is rarely found side by side, or even associated with, headlines on gender equality. Yet both are burning issues for Pakistani society. This article aims at highlighting their connections. Put differently, it shows how the world market is tied to Pakistani stoves.

Trade is important for Pakistan's economy due to the country's comparative openness. The country—like most parts of the subcontinent—is a late globalizer, as compared to, for example, East Asia or Latin America.

Structural adjustment programs implemented since 1988 under the aegis of the World Bank and the International Monetary Fund have been one catalyst for trade liberalization. Trade tariffs were reduced significantly, resulting in rising trade to gross domestic product (GDP) ratios. Today, the value of exports from Pakistan surpasses 21 billion U.S. dollars. Besides textile manufactures such as cotton cloth, bed wear, and knitwear, key exports include rice as well as leather manufactures, indicating the special role of the agricultural and manufacturing sectors for Pakistan's trade. The main export destinations include the northern markets of the United States and European countries—such as the United Kingdom and Germany—as well as the Gulf states and Hong Kong (China).

Trade is more than an aggregate statistic on flows of goods and services. It means employment in export garment manufacturing for some, and job losses caused by cheaper Chinese imports for others. It may provide some consumers with access to affordable generic medicines that were previously unavailable, supply others with cheaper prices due to

---

Karin Astrid Siegmann is a research fellow at the Sustainable Development Policy Institute in Islamabad. She wishes to gratefully acknowledge the research assistance provided by Nazima Shaheen.

intensified competition, and present a third group with less choice as cheap imports gain a monopoly in the market.

Gender Matters

These economic roles as workers, consumers, savers, and investors are gendered. Hardly any woman is involved in weaving cotton for the world market. In contrast, imported creams are in high demand by female customers. Decisions at the Karachi Stock Exchange are mainly made by men. These few examples indicate that trade may mean different things for women and men. They imply that women's and men's roles matter for the interface of gender and trade.

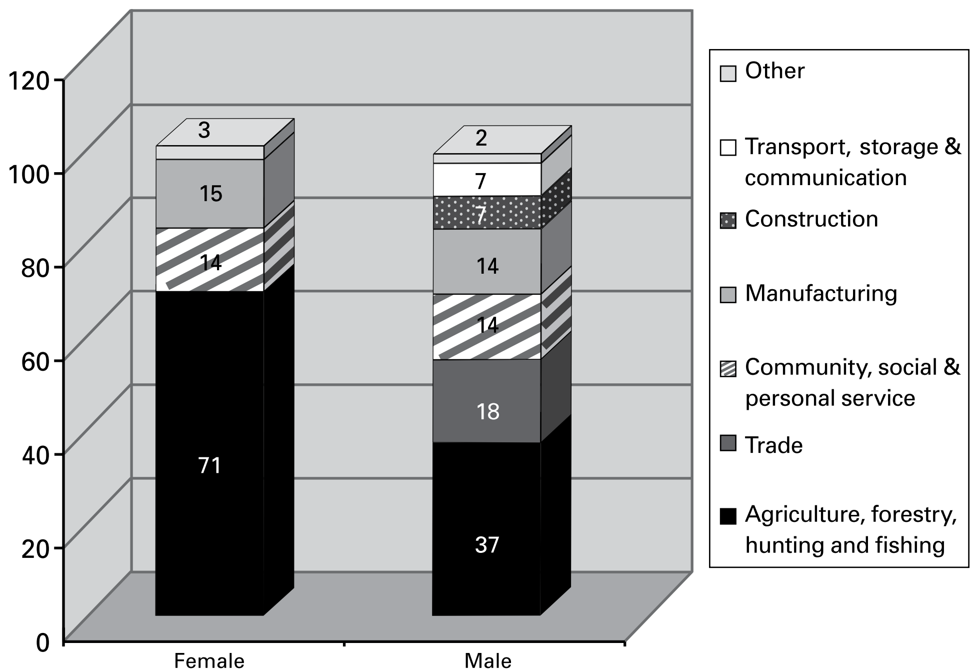
Pakistan is characterized by strong gender hierarchies. Men are perceived as economic providers and women as dependents and homemakers. The institution of *purdah*, that is, the religiously legitimated segregation of the sexes, provides further support to the demarcation of male and female space and roles (Mumtaz and Salway 2007). In Pakistan and other parts of South Asia, gender norms link certain spaces and activities exclusively to women, and others to men. The home is defined as women's ideological and physical space, whereas the world outside the home is perceived as being related to men (ADB 2000). As women's confinement within this spatial boundary as well as their sexual behavior is linked to the male's honor, women's movements are restricted and controlled in order to protect the family's reputation.

However, gender relations in Pakistan are not homogenous. As compared to other provinces, Punjab is characterized by comparatively fewer rigid gender rules (Mumtaz and Salway 2007). Class differences interact with gender norms. Whereas economic imperatives force poor women to be mobile beyond the home (Sathar and Kazi 1997), they are discouraged from other public activities (Mumtaz 2007).

This has effects on gender equality in the economic realm and beyond. Efforts to confine women's circulation to the homestead lower their participation in income-generating work. With 27 percent of its female population economically active, Pakistani women's engagement in the labor market ranks right at the bottom of the Asian distribution (UNESCAP 2007). And of this 27 percent, a majority work as unpaid family helpers (GoP 2006b). Those involved in paid employment face a narrower range of sectors and occupations as compared to men (see Figure 1 below).

In addition to the agricultural sector that absorbs the brunt of the female work force, manufacturing (such as in the garment and surgical industries) and nursing and teaching (subsumed under "Community, social & personal service" in Figure 1) are other sectors that employ a significant share of women. Men face comparatively more choices in the labor market, such as in the trade, construction, and transport sectors. Narrower choices also imply a weaker negotiating position. As a result, women workers face poorer working conditions in comparison to their male colleagues. This includes the fact that average female incomes

Figure 1: Gendered Employment by Sector, 2005-06 (Percent)



Source: Government of Pakistan (GoP), Federal Bureau of Statistics (2006b).

represent less than two-thirds of what their male colleagues earn, as well as that a greater proportion of women as compared to men are employed informally (this would include piece-rate workers in cotton picking, who are paid by the weight of their harvest; home-based workers stitching soccer balls; or self-employed vendors of milk and eggs in their neighborhoods). Such informalization of women's work has been shown to be rising across South Asia (Unni 2001).

Additionally, the mobility constraints mentioned above have a role to play in the wide gender gaps in education and health that characterize Pakistan. In rural areas, girls beyond puberty are often discouraged from attending school, particularly if the school is located far from the home. In addition to mobility constraints, the major role they serve in housekeeping as well as pervasive poverty also lower girls' school attendance (UNESCAP 2007). As a result, girls' overall enrollment is nine percentage points lower than boys' at the primary level. The gender gap in literacy varies regionally between 12 percentage points in urban Punjab and 38 percentage points in rural Northwest Frontier Province (NWFP) (GoP 2007a and 2006a).

Women and girls are comparatively more vulnerable to injuries and sickness. Similar to gendered literacy, gender gaps are highest in the provinces characterized by more conservative gender regimes, i.e. NWFP and Balochistan (GoP 2006a). These outcomes are linked to women's and girls' relatively poor access to health services, higher workloads, and low nutritional status—all mediated by prevailing gender norms (Mumtaz and Salway 2007; Siegmann and Sadaf 2006; Khan 1999). This can lead to complications in pregnancy and childbirth, which are the leading cause of death and disability among women of reproductive age. The maternal mortality ratio for Pakistan is one of the highest worldwide, with 500 per 100,000 live births as compared to 92 in Sri Lanka (WHO, UNICEF, and UNFPA 2004). Poor schooling and health again represent handicaps to joining the labor force and to attaining a decent occupational status and good working conditions. The fact that the majority of Pakistani daughters are denied their due share in land ownership and inheritance further reduces their access to productive resources.

Obviously, gender biases in such access have consequences for women's and men's abilities to benefit from opportunities that arise from increasing trade flows to and from Pakistan. This essay elaborates on such linkages, or what was referred to above as the ties between the world market and Pakistani stoves. First, it provides an outline of theoretical perspectives on the intersection of gender and trade. Images from Pakistan's agricultural and manufacturing sectors are presented in the next section. Finally, the last section discusses a crucial question: do intensified trade links have the potential to empower women, or rather do they threaten a deterioration of women's already marginal position in Pakistani society?

Theoretical Perspectives[1]

According to Tran-Nguyen (2004), trade flows can be associated with gender equality in different ways: Firstly, they can have a positive or negative impact on growth and employment opportunities for women and men. Secondly, they may induce competitive pressures, which may reduce or encourage gender discrimination in terms of access to employment or regarding wage differentials. Thirdly, they may facilitate or raise barriers to the accessing of resources and services by women and men. And finally, multilateral trading rules may facilitate or constrain governments in applying policies or regulations that address gender inequality.

Gendered Growth

Conventional trade theory identifies trade as a catalyst for growth. It is also assumed that gender gaps in education have an impact on trade and growth performance. When less able boys are substituted for girls, this bias could lead to a misallocation of resources and lower economic growth. Deficits in female education also impose direct economic costs by lowering labor productivity (UNESCAP 2007). The empirical evidence regarding interactions between gender equality and growth remains ambiguous. Whereas Dollar and Gatti (1999) and Klasen (1999) find a negative impact of the gender gap in schooling on growth, Hill and King (1995) similarly found that a low female-male enrollment ratio is associated with a lower level of GDP per capita. Seguino's (2000) results, confirmed by Busse and Spielmann (2005), support the opposite view. The huge numbers of unskilled female workers can explain this puzzling finding. Uneducated female factory workers—whose low wage aspirations are rooted in their poor educational levels—have often sustained the high growth rates of semi-industrialised countries in Asia.

Dollar and Gatti (1999) identify a positive correlation between per capita income and measures of gender equality. This association was both held up and qualified by the United Nations (UN 1995). Whereas a strong positive correlation was observed between economic growth and women's relative participation in the labor force between 1980 and 1990, this association in fact appears to take the form of an inverted "u." This means that in a later stage of development, relative female employment would decrease as the economy grows. The emerging trend of defeminization (the decrease in the female share of the work force) that can be detected in some middle-income countries, such as South Korea and Mexico, is in line with such a nonlinear relationship. Mehra and Gammage (1999) relate this shift to a restructuring in the export sector of the countries in question, which is connected to a process of technologization.

According to mainstream frameworks for trade analysis, trade leads to an equalization of prices for production factors, such as capital goods and labor. This implies an erosion of gender wage differentials. On the other hand, non-neoclassical economists hold the view that competition is based on cost reduction and that firms will use wage disparities to boost product competitiveness (Seguino 2000). Skilled workers will be paid higher wages to attract them, whereas unskilled workers with lower bargaining power will be given lower wages. Given the concentration of male workers in skilled occupations and female workers in unskilled positions, trade expansion would thus lead to an increase in wage differentials. In practice, unlike other aspects of gender discrimination, the gap in wages does not narrow with economic progress (UNESCAP 2007). Increased openness to trade in India's manufacturing industries has been associated with a widening of the wage gap, explained by female workers' weak bargaining power and lower workplace status (Menon and van der Meulen Rodgers 2006). This is consistent with Berik et al.'s (2004) finding that increased trade openness is associated with higher residual wage gaps between men and women in two East Asian economies. The employment of large numbers of women in the low-value links of global production chains can thus be seen as a steppingstone for a systematic industrial strategy in several developing countries (Tran-Nguyen 2004).

Underbelly of the WTO[2]

The opening up of economies for international trade under the rules of the World Trade Organization (WTO) has been a powerful trigger for global economic integration. Trade policies and WTO rules are assumed to have gender-neutral effects. The evidence presented above has emphasized that this is an unrealistic assumption. It is the largely invisible social underpinning of the economy—that is, gender norms related to market and domestic work—that channel (and bias) the effects of trade on women's and men's lives.

The liberalization of agricultural trade, such as that aimed for in the WTO Agreement on Agriculture, tends to generate cheap agricultural products, which may result in lower farm gate prices. It is also accompanied by increased competition with foreign imports. Overall, the combination of these factors, plus the removal of subsidies in developing countries, may lead both to increased income (from the export sector), and to decreased income (in the import-competing sector). Given the greater importance for women of import-competing food production as compared to export crop cultivation, it is more likely that they are affected negatively in terms of access to food, income, and other resources such as land and bargaining power within the household. Heyzer (1989) observes that opportunities for increased exports of agricultural produce are more likely to be seized by men. Males have easier access than women to the best land reserved for export crops and to new technologies. On the other hand, women's subsistence food production may suffer as land is diverted to cash crops. Increased export orientation in agriculture may therefore lead to the replacement of women's agricultural work and endanger food security (Çagatay 2001).

In manufacturing, the Agreement on Textiles and Clothing (ATC) has been a test case for the gendered effects of liberalization under the WTO. In January 2005, the ATC expired. An agreement under the WTO, it was aimed at gradually phasing out the quota system that had governed trade in textiles and clothing (T&C) for more than 30 years. Under this arrangement, industrialized countries put upper limits on T&C imports from the countries producing these items. This system of quantitative restrictions has been perceived as distorting the free flow of trade. Since January 2005, buyers and sellers of T&C products no longer rely on quotas in the main markets. The subsequent restructuring of the global market for T&C has had significant consequences for gender equality in employment. Tougher competition, especially in garment manufacturing, has led to a large number of job losses in this female-intensive subsector (see Box 1).

In the area of services, the General Agreement on Trade in Services (GATS) directly affects the supply of services that is essential for human well-being, such as the provision of schooling, health care, and drinking water. Often, these basic services are to a large extent directly provided or regulated by governments in order to guarantee affordability and equitable access. However, it is feared that the stipulations of the GATS reduce public financial support for basic services. The experience of structural adjustment measures since the 1980s has shown that women and girls are often the first victims of such increased commercialization of essential services. Girls are taken out of school first when school fees are introduced or raised, while healthcare for boys and men—who are regarded as families' actual or potential "breadwinners"—is prioritized. Also, when basic services are lacking, women's workloads increase because of their roles as those who haul water from communal taps or other common sources, and who provide informal care to the sick once the costs of water and health care rise.

The next section assesses the relevance of some of these assumptions and findings regarding the gender-trade interface from the perspective of Pakistan. The focus is on trade's linkages with gendered employment in agriculture and manufacturing.

Sectoral Images

Harvesting for the World Market

Agriculture is Pakistan's single largest sector, providing livelihoods for two-thirds of the country's population. However, the period since the 1990s has been characterized by a decline in the share of agricultural raw materials in merchandise exports and a reverse movement, i.e. a steep rise of agricultural imports. Basmati rice and cotton are two major agricultural exports, but the share of cotton in agricultural exports has dropped. More and more cotton has been further processed into yarn, bed sheets, and garments during the past few years, rather than being exported directly.

As indicated in Figure 1, women in Pakistan depend heavily on agriculture, with more than two-thirds of all female work being associated with crop production, livestock management, forestry, and fisheries. They have a crucial role in the production of agricultural exports, for example, as cotton-pickers and in rice cultivation (see Box 2). However, large portions of their work are related to subsistence such as in wheat production and livestock management. Their common status as unpaid helpers further increases the invisibility of their work in the fields. This might be the reason why, statistically, women's work in agriculture appears to be delinked from trade flows in Pakistan. The association between the share of women's agricultural employment and exports as well as imports is weak and insignificant.

The portion of males' agricultural employment has dropped jointly with the declining share of agricultural raw materials in merchandise exports since the 1990s. It is negatively associated with rising export income and the increasing payments for imports. The wedge between male agricultural employment and export performance—with the former decreasing while exports rose steeply during the 1990s—may be related to men's search for work outside agriculture. Pushed by population pressure and decreasing yields due to land fragmentation and deteriorating soil quality, and pulled by more job opportunities in nonagricultural sectors—including export-oriented employment in textile processing industries—men left their farms for greener pastures. Besides domestic employment, this included large flows of labor migrants to the booming Gulf states. In a similar manner, the drop in male agricultural employment may be linked to the rise in agricultural imports during the same period, replacing agricultural work. Jointly, these processes have led to a rising feminization of Pakistan's agriculture, reflected in the rising share of agricultural work in women's total employment opportunities.

Nimble Fingers Boosting Competitiveness

Manufactured exports as well as imports have almost tripled since 1990. Oscillating around two-thirds of Pakistan's exports, textile manufactures have represented the bulk of industrial sales abroad. Since the 1990s, the

Box 1: Gendered Employment in the Post-Quota Era

The expiry of the quota regime in T&C trade after the full implementation of the ATC had given rise to hopes and fears alike. The T&C sector is of great macroeconomic importance for Pakistan. It accounts for a tenth of the GDP and about 60 percent of the country's exports. But China's entry into the WTO in 2001 signalled that from then on, a great number of producers across Asia, Latin America, and Africa would have to compete with one huge, cost-efficient producer. It triggered fears of losses of market shares—and of millions of jobs. Additionally, in Pakistan, the T&C industry employs more than one-third of the industrial work force. In addition to being labor-intensive, this industry—and clothing producers in particular—is also a major employer of women. After agriculture, the largest number of Pakistani women are employed in the T&C industry.

Overall, T&C exports have increased during the first three years of freer trade in the industry. The rise and fall of sales are not just a numbers game. These fluctuations affect the livelihoods of a large number of workers and their families. Whereas overall employment has slightly increased in Pakistan after the quota expiry, sectoral variations do exist. Exporters of fabric and made-ups, such as towels and bed wear, created new jobs for both female and male workers. This reflects increased sales of these products abroad. In companies producing yarn and apparel, the total work force has shrunk. Male operators have lost their jobs and have been partially replaced by female workers. The lower wages paid to women workers may be part of the explanation. Women help companies survive in the harsher post-quota competition. But knitwear exporters have reduced their female as well as male work force. The intensified competition also puts pressure on wages and working conditions, which were not rosy even before the opening of the market. In response, Pakistan's government has advocated a relaxation of labor-friendly legislation in order to reduce labor costs. The increase in daily working hours from 8 to 12 was one of several drastic measures taken in 2006.

This situation might further deteriorate in the mid term. Given the current skill and gender composition of employment, a further specialization in yarn, cloth, and made-ups as well as a move toward products with higher value added may imply a loss in unskilled and female workers, with the latter especially facing very few job alternatives.

Source: Siegmann (2006).

Box 2: Weakest Link in the Textile Chain—Pakistan's Cotton-Pickers After the Quota Expiry

In Pakistan, cotton provides livelihoods for millions of people engaged in its cultivation, industrial use, and trade. Cotton picking as one of the stages involved is a seasonal activity, representing by far the largest share of employment in cotton cultivation. About 2 million cotton-pickers are estimated to harvest the fuel for Pakistan's export engine. Most of the pickers are women and girls. On the other hand, sprayers, tractor drivers, and other agricultural laborers are commonly men.

The fact that women face fewer choices for paid employment significantly reduces their bargaining power in negotiations with the growers. The laborers' lack of bargaining power is reflected in the fact that often the harvest's weight is reduced by those in charge of weighing. Most of the cotton-pickers are unable to check whether their harvest has been weighed correctly. Gender-based differences in schooling have a role to play. Female cotton-pickers are paid by the weight of their harvest. In such a piece-rate system, wages are paid per unit of output rather than per unit of time, as in the case of daily wage laborers. Overall, cotton-pickers' earnings are lower than those of male agricultural workers. Picking rates of 50 to 80 Pakistani rupees per maund (a maund is equivalent to 40 kilograms) were reported to be common rates during the 2005-06 season (in 2005, one U.S. dollar equalled 62.12 rupees).

Apart from poor remuneration for hard work, cotton-pickers are exposed to serious health hazards. The most significant health risk they face is their chronic exposure to pesticide residuals in their working and living environment. Cotton is the crop in Pakistan on which most pesticides are applied. It is estimated that 80 percent of the total pesticides consumed in Pakistan are used for the protection of the cotton crop. During their work in the fields, cotton-pickers are exposed to residuals of these sprays. As a result, a majority of them are affected by chronic pesticide poisoning.

Pakistan's export engine—cotton textiles—has relied on pickers' poor pay for competitiveness. However, the significant restructuring of the global textile chain brought on by the end of the quota system (which had regulated trade in textiles and clothing for more than 30 years) brought no change to cotton-pickers' bitter harvest. They did not benefit from higher quality demands regarding chemicals—including pesticides—found in apparel that customers purchase in the shopping malls of North America and Europe. Independent of the rise in Pakistani exports directly after the quota expiry, cotton-pickers' employment opportunities shrank with the drop in yield in the first post-quota harvest.

Source: Siegmann and Shaheen (forthcoming); Siegmann (2007a, b).

share of garments and home textiles herein has risen significantly, associated with more—mostly informal—employment opportunities for women. Their nimble fingers' poorly paid work enhances the competitiveness of Pakistani garment exports. This was particularly relevant in the restructuring of global T&C markets that took place after the expiry of the quota system (see Box 1).

There is a strong negative correlation between women's relative employment in the industrial sector and trade performance, whereas male industrial employment appears to be unrelated to trade performance. The increased feminization of agriculture that has paralleled trade development in Pakistan, as well as the greater capital and technology intensity of industrial production, are possible causes for these correlations. The latter explanation, as exemplified by investment totalling 5 billion U.S. dollars made in the T&C sector between 1999 and 2004, disadvantages female workers. The concentration of women in few, mostly unskilled, occupations as well as gender gaps in education and training make men the preferred work force in the fewer, more technology-intensive jobs.

Linkages Between the World Market and Pakistani Stoves: Empowering or Marginalizing?

The preceding sections have emphasized that trade flows have had different meanings for and impacts on women and men in Pakistan. Especially in the realm of employment, job opportunities for men in export-oriented sectors have often meant employment losses for women—and vice-versa. It has been highlighted that such dissimilar effects of trade are channelled by gender norms, which stipulate different economic and social roles for females and males. In this way, the world market is tied to Pakistani stoves. The stove is a major location of women's work and thus symbolizes a gender division of work that puts women in charge of domestic chores. From the perspective of gender equality, a crucial question is whether trade-related opportunities for paid employment have strengthened women's weak economic and overall status.

In both the sector that employs the most women—agriculture and forestry, fishing, and hunting—and in the manufacturing sector, labor-intensive subsectors (including garment and soccer-ball manufacturing as well as cotton picking) have been stimulated through trade, and women have been recruited on a preferential basis. This has provided women with employment and, thus, cash income in an environment that discourages women's participation in the paid labor market. More generally, this has also allowed them access to productive resources. Their work is paid, yet precarious. The widespread informalization of women's work as seasonal, contract, and piece-rate is associated with low social and economic status. Research on subcontracted employment in Pakistan's manufacturing sector has shown that paid employment does not necessarily empower women workers economically—especially if their labor relations are informalized (Khattak and Sayeed 2000). The situation of cotton-pickers described above is a case in point. It is actually their poor bargaining power, rooted in prevailing gender norms, that keeps picking rates low and thus sustains Pakistan's export successes. This mirrors the international experience of lower female wages being used to enhance export competitiveness (Menon and van der Meulen Rodgers 2006; Seguino 2000).

Prevailing gender gaps in schooling crucially influence the distribution of female and male workers across sectors and occupations and thus their ability to benefit from trade-related opportunities. This means that ongoing global moves toward more capital-intensive production, such as in T&C manufacturing, are likely to crowd out a largely unskilled female work force. Hence, gender gaps in wages and education provide women workers with a "competitive advantage" only in the short term. Such competitiveness that is based on women's disadvantaged situation in both the labor market and in wider society is not sustainable in terms of workers' employment, health, and well-being. And in the long term, it probably cannot guarantee the sustained competitiveness of raw materials and manufactures that emphasize cheap labor and, hence, low commodity prices that compromise on quality.

These factors provide entry points for action. Overall, one can say that economic globalization creates economic opportunities for those endowed with productive resources such as human and physical capital, access to formal employment, and geographical mobility. In order to benefit from such opportunities, women and girls must have better land rights, access to capital and technology, support for unconstrained mobility—and above all, equal access to education.

Given the gender blindness of the policies and institutions governing trade at national, regional, and international levels, a conscious effort needs to be made to "engender" the globalization agenda. Potentially dissimilar impacts for women and men—and unfavorable consequences for gender equality—need to be recognized and investigated at national, sectoral, and regional levels before policymakers make liberalization decisions. A number of tools for such gender-sensitive trade assessments have been developed by international organizations (Randriamaro 2005).

Governments need to make use of existing maneuvering space within WTO rules, and in bilateral and regional trade agreements, to make sure trade liberalization is not clashing with national policy goals, such as the achievement of gender equality. Liberalization of trade without recognition of its potential gendered impact and without national policies in support of women's empowerment carries the danger of further marginalizing Pakistani women.

References

Asian Development Bank (ADB). 2000. "Country Briefing Paper: Women in Pakistan." Available from http://www.adb.org/Documents/Books/Country_Briefing_Papers/Women_in_Pakistan/women_pakistan.pdf.

Berik, Gunseli, Yana van der Meulen Rodgers, and Joseph Zveglich. 2004. "International Trade and Gender Wage Discrimination: Evidence from East Asia." *Review of Development Economics* 8 (2): 237-254.

Busse, Matthias, and Christian Spielmann. 2005. "Gender Inequality and Trade." HWWA Discussion Paper No. 308, Hamburg Institute of International Economics, Hamburg. Available from http://www.hwwa.de/Forschung/Publikationen/Discussion_Paper/2005/308.pdf.

Çagaty, Nilufur. 2001. "Trade, Gender and Poverty." UNDP Background Paper, New York.

Dollar, David, and Roberta Gatti. 1999. "Gender Inequality, Income, and Growth: Are Good Times Good for Women?" Policy Research Report on Gender and Development, Working Paper Series No. 1, World Bank, Washington, DC. Available from http://www.onlinewomeninpolitics.org/beijing12/goodtimes.pdf.

Government of Pakistan (GoP). 2007b. "Economic Survey 2006-07." Ministry of Finance, Islamabad. Available from http://www.finance.gov.pk/survey/home.htm.

Government of Pakistan (GoP). 2007a. "Pakistan Social and Living Standards Measurement Survey (PSLM) 2005-06." Federal Bureau of Statistics, Islamabad. Available from http://www.statpak.gov.pk/depts/fbs/statistics/pslm2005_06/pslm2005_06.html.

Government of Pakistan (GoP). 2006b. "Labour Force Survey of Pakistan 2005-2006." Federal Bureau of Statistics, Islamabad. Available from http://www.statpak.gov.pk/depts/fbs/publications/lfs2005_06/lfs2005_06.html.

Government of Pakistan (GoP). 2006a. "Pakistan Social and Living Standards Measurement Survey (PSLM) 2004-05." Federal Bureau of Statistics, Islamabad. Available from http://www.statpak.gov.pk/depts/fbs/publications/lfs0506_q3/lfs0506_q3.html.

Heyzer, Noeleen. 1989. "Asian Women Wage-Earners: Their Situation and Possibilities for Donor Intervention." *World Development* 17: 1109-1123.

Hill, Anne, and Elizabeth King. 1995. "Women's Education and Economic Well-Being." *Feminist Economics* 1 (2): 1-26.

Khan, Ayesha. 1999. "Mobility of Women and Access to Health and Family Planning Services in Pakistan." *Reproductive Health Matters* 7 (14): 39-48.

Khattak, S.G., and A. Sayeed. 2000. "Subcontracted Women Workers in the World Economy: The Case of Pakistan." SDPI Monograph Series, Sustainable Development Policy Institute, Islamabad.

Klasen, Stephan. 1999. "Does Gender Inequality Reduce Growth and Development? Evidence from Cross-Country Regressions." Policy Research Report on Gender and Development, Working Paper Series No. 7, World Bank, Washington, DC. Available from http://siteresources.worldbank.org/INTGENDER/Resources/wp7.pdf.

Mehra, Rekha, and Sarah Gammage. 1999. "Trends, Countertrends, and Gaps in Women's Employment." *World Development* 27: 533-550.

Menon, Nidhiya and Yana van der Meulen Rogers. 2006. "The Impact of Trade Liberalization on Gender Wage Differentials in India's Manufacturing Sector." Social Science Research Network. Available from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=953400.

Mumtaz, Khawar. 2007. "Gender and Poverty in Pakistan." *Development* 50 (2): 149-153.

Mumtaz, Zubia, and Sarah M. Salway. 2007. "Gender, Pregnancy and the Uptake of Antenatal Care Services in Pakistan." *Sociology of Health and Illness* 29 (1): 1-26.

Randriamaro, Zo. 2005. "Gender and Trade-Overview Report." BRIDGE, Institute of Development Studies, University of Sussex, Brighton, United Kingdom. Available from http://www.bridge.ids.ac.uk/reports/CEP-Trade-OR.pdf.

Sathar, Zeba, and Shahnaz Kazi. 1997. "Women's Autonomy, Livelihood and Fertility: A Study of Rural Punjab." Pakistan Institute of Development Economics, Islamabad.

Seguino, Stephanie. 2000. "Accounting for Gender in Asian Economic Growth." *Feminist Economics* 6 (3): 27-58.

Siegmann, Karin Astrid. Forthcoming. "The Underbelly of Globalization: Gender and Economic Integration in South Asia." In *Missing Links in Sustainable Development: South Asian Perspective*, eds. Sama Editorial and Publishing Services (SAMA) and Sustainable Development Policy Institute (SDPI). Karachi and Islamabad: SAMA and SDPI.

Siegmann, Karin Astrid. 2007b. "Bitter Harvest: Part III." *The News*, September 2. Available from http://www.sdpi.org/SDPI_in_the_press/articles_2007/articles_sept_07.html#1.

Siegmann, Karin Astrid. 2007a. "Poverty Despite Productivity: Part I." *The News*, July 29. Available from http://jang.com.pk/thenews/jul2007-weekly/nos-29-07-2007/pol1.htm#5.

Siegmann, Karin Astrid. 2006. "Unskilled Outfits." *The News*, January 8.

Siegmann, Karin Astrid, and N. Shaheen. Forthcoming. "Weakest Link in the Textile Chain-Pakistani Cotton Pickers after the Quota Expiry." Forthcoming as SDPI Research Paper, Islamabad.

Siegmann, Karin Astrid and Tahira Sadaf. 2006. "Gendered Livelihood Assets and Workloads in Pakistan's North-West Frontier Province (NWFP)." In *Troubled Times, Sustainable Development and Governance in the Age of Extremes*, ed. SDPI, 25-43. Karachi: SDPI.

Tran-Nguyen, Anh-Nga. 2004. "The Economics of Gender Equality, Trade and Development." In *Trade and Gender: Opportunities and Challenges for Developing Countries,* eds. Anh-Nga Tran-Nguyen and Americo Beviglia Zampetti, 1-54. UN Interagency Network on Women and Gender Equality. Task Force on Gender and Trade. New York and Geneva: UNCTAD. Available from http://www.unctad.org/en/docs/edm20042_en.pdf.

United Nations (UN). 1995. *1994 World Survey on the Role of Women in Development*. New York: United Nations.

United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP). 2007. "Economic and Social Survey of Asia and the Pacific 2007: Surging Ahead in Uncertain Times." New York: UNESCAP. Available from http://www.unescap.org/survey2007/download/index.asp.

Unni, Jeemol. 2001. "Gender and Informality in Labour Market in South Asia." *Economic and Political Weekly*, June 30, 2360-2377.

Williams, Mariama. 2004. "Gender, the Doha Development Agenda, and the Post-Cancun Trade Negotiations." *Gender and Development* 17 (2): 73-81. Available from http://www.arts.ualberta.ca/~courses/PoliticalScience/670A1/documents/MariamaWilliamsGenderDohaPostCancunTrade.pdf.

World Health Organization (WHO), United Nations Children's Fund (UNICEF) and United Nations Population Fund (UNFPA). 2004. "Maternal Mortality in 2000: Estimates Developed by WHO, UNICEF and UNFPA."

Geneva: WHO. Available from http://www.who.int/reproductivehealth/publications/maternal_mortality_2000/mme.pdf.

Notes

1. This section is based on Siegmann (forthcoming).
2. The following discussion is based on Williams (2004).

PART III

Pakistan and Regional Trade

PAKISTAN AND ITS NEIGHBORS: TRADE CHALLENGES AHEAD

Douglas A. Hartwick

The United States has a considerable stake in the economic success of the South Asia region, and also in the economic relations among the key players of Pakistan, India, and Afghanistan. There is significant scope for improving the climate for trade within the region and from the region to outside markets, including the United States and resource-rich Central Asia. An economically vibrant region trading with its neighbors is also far more likely to address other pressing regional problems in a more peaceful manner.

In the past five years, we have seen significant economic developments in Pakistan, India, and Afghanistan:

1. Pakistan has demonstrated annual economic growth of around 7 to 8 percent, despite domestic challenges. It achieved this by embracing market principles, lowering tariffs, and synchronizing many of its internal policies with international trading rules. The World Bank named Pakistan one of the top 10 reforming economies of the world in 2006. The United States enjoys a $5 billion trade relationship with Pakistan, and Pakistan is America's ninth largest services trading partner.[1]
2. To Pakistan's east, economists are falling over each other to describe the changes within India and between India and the rest of the world.

Douglas A. Hartwick served, at the time this was written, as Assistant U.S. Trade Representative for South and Southwest Asia. A retired member of the U.S. Senior Foreign Service, his appointments included Ambassador to the Lao People's Democratic Republic; Counselor of Embassy for Economic and Science Affairs in New Delhi; and Economic Counselor in Kuala Lumpur.

In the past decade India has become a major global player, with 8.5 percent average gross domestic product (GDP) growth since 2003.
3. To the west, Afghanistan has made significant progress since 2001 in the face of lingering security challenges, a decimated infrastructure, and problems linked to the opium trade. Afghanistan has undertaken a multibillion dollar reconstruction effort, transitioned to democracy, and begun implementing an investor-friendly trade regime, with the support of the international community. As a result, it is experiencing the fastest growth rate in the region.[2]

In the past few years, President Bush's administration has worked to deepen its bilateral economic ties with the countries of South Asia so as to expand opportunities for trade, investment, and development. These goals are vital for both American exporters and for economic prosperity within a country like Pakistan.

One of the key mechanisms available is a Trade and Investment Framework Agreement (TIFA), which we hold with Afghanistan, Pakistan, and Sri Lanka. The second meeting of the U.S.-Pakistan TIFA was held in Islamabad in October 2006. Over the past year, we have worked closely with Pakistan on key issues pertaining to intellectual property protection, we helped expand Generalized System of Preferences (GSP) opportunities for Pakistan producers, and we held negotiations on a bilateral investment treaty. My staff and I have traveled to Pakistan and met with truckers, traders, and textile manufacturers from Peshawar to Karachi. In April 2007, Ambassador Susan Schwab, the current U.S. Trade Representative, visited Pakistan to meet with Commerce Minister Humayun Khan.

But serious challenges remain to enhancing trade within the region. How Pakistan, its neighbors, and its other trading partners address these challenges will certainly shape the trade environment in the immediate future and may well dictate the pace of economic growth and prosperity for both Pakistan and the region. All of Pakistan's friends—including the United States—as well as its competitors have an important stake in seeing Pakistan continue on its current successful trajectory, which can only help facilitate a climate where other political and security challenges can be overcome.

Challenge One: Realizing the Opportunity for Increased Pakistan-India Trade

Recent economic growth in India and Pakistan makes their economies more complementary now than they were 15 years ago. A recent study of goods traded across the border showed India and Pakistan each have comparative advantages in dozens of categories, which points to broad opportunities for cooperation in textiles, agriculture, engineering, chemicals, electronics, metals, and minerals.[3] The short- to medium-term potential for bilateral trade is $5 to $6.5 billion,[4] or five to six times the current level.

Instead, approximately 1.5 percent of Pakistan's exports go to India ($285 million of $19.24 billion total), and imports from India are less than 3 percent of total Pakistani imports ($700 million of $26.8 billion total). By comparison, informal trade (not formally recorded) represents $1.5 to $2.0 billion, mostly routed through Dubai and other ports or smuggled directly.[5] And these informally traded goods are not only Bollywood movies—many are inputs that are essential to growing agricultural and manufacturing sectors in both countries.

To be sure, there are political tensions that have stunted the pace and depth of bilateral trade between South Asia's two largest economies. India has granted Pakistan Most Favored Nation (MFN) status but maintains a lengthy negative list against trade from its neighbor. Pakistan asserts that India continues to impose additional non-tariff barriers. India, for its part, complains that Pakistan does not extend MFN treatment to Indian products. Instead, Pakistan maintains a positive list of around 1,000 items it allows to be imported from India. Items recently added to the list include some minerals, chemicals, fertilizer, tools, irrigation machines, and turbines—all items not produced in large quantity in Pakistan but vital for the country's development. Past government efforts to liberalize cross-border bilateral trade have generally seen trade flows increase significantly.

Most economists agree that opening Pakistan-India trade (in both directions) would be the single most important thing the two countries could do to spur trade flows and benefits within South Asia. Pakistan would undoubtedly reap the benefit that enhanced trade flows promise:

new markets for exports and cheaper imports to help satisfy the Pakistani consumer. Moreover, it would reduce smuggling and provide welcome flexibility to Pakistan's economy, giving its manufacturing and agricultural bases added resiliency to weather inevitable economic fluctuations and disruptions.

Challenge Two: Realizing the Benefits of Better Trade With Afghanistan and the North-South Trade Corridor

As with expanding trade with India, Pakistan would benefit in many ways from strengthened and more harmonious trade relations with landlocked Afghanistan. Today's trading relationship still reflects a troubled past: it is marred by problems that include smuggling, other forms of corruption, incompatible customs procedures, checkpoints, reliance on an outdated 1965 Transit-Trade Agreement, and port delays for goods transiting Pakistan via Karachi in either direction. The cost of transit trade from Karachi to Jalalabad can exceed 10 percent of the value of goods. A survey of truckers who ferry goods to and from Afghan markets cited these delays and obstacles as much greater concerns to them than security.[6] My visit to Peshawar in October 2006 revealed a vibrant but frustrated chamber of commerce dependent on a healthy and reliable flow of trade to and from Afghanistan. The chamber described the problems of poor infrastructure, costly delays caused by bureaucratic policies requiring loading and off-loading of cargo, and corruption as its greatest hurdles.

Facilitated and expanded trade would foster economic development in Afghanistan, thus reducing problems that affect both countries (i.e. drugs, smuggling, extremism). Further, it would create a greater market for Pakistani goods—Pakistan already exports $1.2 billion per year to Afghanistan and 60,000 Pakistanis work there.[7]

In the absence of transit trade improvements vis-à-vis Afghanistan, Pakistan could lose an increasing share of third-country transit trade to Iran. While the distance is further from Kabul to the Iranian port of Bandar Abbas, the total time spent in transit—including port delays—is less than on the Kabul-Karachi route, according to an Afghan government study. Furthermore, improving trade links with Afghanistan would open routes to Central Asia, thus helping Pakistan become a key North-South link and connecting it to potential energy suppliers including Tajikistan, Kyrgyzstan, and Turkmenistan. Pakistan aspires to see these connections deepen, but policies in place today are not in step with these aspirations.

Reconstruction Opportunity Zones

In 2006, President Bush announced the Reconstruction Opportunity Zones (ROZs) initiative, wherein certain products made in designated zones would qualify for duty-free entry into the United States. We have worked hard to craft the details of the administration's plan and hope legislation authorizing ROZs will be introduced in Congress and passed in the near future. As part of the broader U.S. strategy for the region, the intent of ROZs is to provide a trade-based stimulus to create jobs in these economically challenged areas and thereby to help reduce the conditions that breed extremism. ROZs in the border regions of Pakistan and in Afghanistan would provide a platform for legitimate industry to grow, by tapping into the potential of the people and resources of these regions. Successful ROZs would build flexibility into Pakistan's economy and bring in new investors from the region.

By attracting investors from the region and providing incentives for cumulation for production on both sides of the border, ROZs would support the goal of enhancing economic cooperation. In addition, ROZs would require better harmonization of customs and transit regulations between Pakistan and Afghanistan.

Challenge Three: Can the Potential of SAARC Ever Be Realized?

There has been considerable interest in the coming of age of SAARC (South Asian Association for Regional Cooperation), a regional grouping that has been around for over two decades but that has been largely hampered by the political differences among SAARC's leading members. In 2006, members embraced the South Asian Free Trade Area (SAFTA) with a view that it was a desirable next step for SAARC member countries.

It promised to facilitate breaking down barriers, assuming political differences were navigable. Regardless of SAFTA's pace, the United States strongly supports the notion of reducing barriers within the region, and we would want to work to facilitate this process where needed.

Today, approximately 5.3 percent of the trade of all SAARC members is with one another. That compares with 25 percent within ASEAN, 43 percent within NAFTA, and some 66 percent within the EU.[8] I recognize that this is not an entirely fair comparison, given the economic size and diversity of these different regions, but it nevertheless is illustrative of what can happen over time if good leadership sets aside political differences and reduces barriers, thereby facilitating trade.

Challenge Four: Weathering the Expiry of China Safeguards

The economies of South Asia, including Bangladesh and Sri Lanka, do not yet complement one another well, in many cases producing similar products and competing in the same overseas markets. The textile industry offers a clear example of how a lack of diversity in exports heightens the risk of trade downturns or third country competition, leaving each economy more vulnerable.

Competition from China has been enormously challenging to textile producers of the region. A further shock is coming in the form of the expiration of the "China safeguards" at the end of 2008, when restrictions will be lifted on 34 categories of U.S. imports of Chinese apparel products. Pakistan currently exports $1.5 billion in these categories. What this means for Pakistan, and also for India, is that 40 percent of textile exports could be at risk. The smaller economies of South Asia will be even harder hit—71 percent of Bangladeshi and Sri Lankan apparel exports overlap with the China list.[9]

Doha and its Meaning for Pakistan and Other Developing Countries

Pakistan is playing a useful role in moving the Doha Development Round forward. The key is to put the negotiations on a path that will lead to market access results bringing meaningful new trade flows—in order to enhance south-south trade opportunities. In the Doha Development Round, we are continuing to push for an ambitious and balanced outcome that generates new trade flows in agriculture, manufacturing, and services. Such an outcome is also the best way to secure real development benefits. The greatest beneficiaries will be the developing countries, including Pakistan.

Conclusion

The United States recognizes that the individual pieces of South Asia are progressing economically, but we are also aware that the South Asian economies, in particular Pakistan, could multiply gains with better economic cooperation, integration, diversification, and intraregional trade. This would also help the countries of South Asia weather the coming storm when China safeguards are removed. Recently, we have seen some encouraging signs, and some practical solutions have been implemented. Further progress depends on renewed leadership.

Notes

1. Gary Clyde Hufbauer and Shahid Javed Burki, *Sustaining Reform with a US-Pakistan Free Trade Agreement* (Washington, D.C.: Peterson Institute for International Economics, 2006).

2. International Monetary Fund, "Islamic Republic of Afghanistan—Statement by the IMF Mission at the Conclusion of the Discussions for the Second Review under the Poverty Reduction and Growth Facility Arrangement," May 10, 2007. Available from http://www.imf.org/external/np/ms/2007/051007.htm.

3. Nisha Taneja, "India-Pakistan Trade," Working Paper No. 182, Indian Council for Research on International Economic Relations, New Delhi, June 2006. Available from http://www.icrier.org/pdf/WP182.pdf.

4. Abid Qamar, "Trade Between India and Pakistan: Potential Items and the MFN Status," State Bank of Pakistan Research Bulletin 1 (2005): 45-57. Available from http://www.sbp.org.pk/research/bulletin/2005/Opinion-1.pdf.

5. Taneja, "India-Pakistan Trade."

6. Asian Development Bank, "Cross Border Trade and Transport Facilitation" (paper for the Regional Economic Cooperation Conference on Afghanistan, New Delhi, November 12, 2006).

7. Marvin G. Weinbaum, "Afghanistan and Its Neighbors: An Ever Dangerous Neighborhood," United States Institute of Peace Special Report 162 (June 2006). Available from http://www.usip.org/pubs/specialreports/sr162.pdf.

8. World Trade Organization (WTO), *International Trade Statistics 2006* (Geneva: WTO, 2006). Available from http://www.wto.org/english/res_e/statis_e/its2006_e/its06_toc_e.htm.

9. These figures obtained from the U.S. Department of Commerce, Office of Textiles.

BENEFITING FROM INTERNATIONAL TRADE: PAKISTAN'S MANY MISSED OPPORTUNITIES

Shahid Javed Burki

Public policy in Pakistan has never explicitly looked at international trade as a contributor to economic growth, poverty alleviation, and improvement in income distribution. It has always been treated as a byproduct of other policies. When policymakers have turned to trade, they have done so to improve the balance of payments situation. It has not been treated as a factor that could contribute to economic restructuring or that would help to better integrate the country into the rapidly changing global economy. That was, of course, a great mistake. Pakistan could have learned important lessons from the experiences of the countries of East Asia in which international trade contributed significantly to explosive economic growth and profoundly changed the structure of their economies.[1]

The main point advanced in this essay is that it is still not too late to place trade at the center of public policy, and to reap the benefits that greater participation in the global economic system would bring to Pakistan. This paper is based on four assumptions:

- That international trade can contribute significantly to economic growth.[2] Gross domestic product (GDP) growth in Pakistan in recent years has been high—an average of 7 percent in the five-year period since 2002, with per capita income increasing at the rate of almost 5 percent a year, the highest the country has achieved in its 60 years. Yet this cannot be sustained for very long unless a number of important structural changes are made in the economy. Redirecting international

Shahid Javed Burki is former vice president of the World Bank and former finance minister of Pakistan. He is currently chairman, Advisory Council of the Institute of Public Policy, Lahore.

trade and changing its composition are two of the more important structural transformations that need to be made by the country's policymakers. To make these required changes, Pakistan will need to reverse some of the positions it has taken in international affairs. In this context, it is important to reevaluate the country's relations with India.

- That international trade based on the country's comparative advantage and making use of the advantages available to it by virtue of its location could play a significant role in reducing the high incidence of poverty. There is much debate in Pakistan as to the level of poverty in the country at this time. What is important is not determining with great precision the exact proportion of the population living in what economists describe as "absolute poverty," but rather the rate at which the poverty rate is declining. It is quite apparent that the decline in poverty's incidence is not as high as could (and should) be the case, given the rate of increase in the gross domestic product in recent years. Changing the pattern of trade could help create more jobs, alleviate poverty, and improve income distribution. This would be the case in particular if Pakistan directed its exports to the countries in its neighborhood.

- That the pattern of international trade is the consequence of a series of serious public policy mistakes made over the last 60 years. Some of these mistakes were in response to the challenges—real or perceived—posed to the nation's security by some of its neighbors, in particular India. If these challenges did indeed exist then, they are not in evidence now. In fact, Pakistan now faces a different set of external challenges that could be addressed by establishing a different pattern of international trade. Once again, it is vital to reevaluate economic links with India.

- That the best way of addressing the accumulated distortions in the pattern of international trade—distortions for which the country has already paid a heavy economic price[3]—is to take advantage of the opportunities presented by regional trading arrangements. Such arrangements have become a major part of the international trading system as policymakers around the world attempt to deal with the failure of another multilateral trading regime to bring about further improvements in the system. Indeed, up until recently, policymakers in Islamabad have spent a great deal of their energy actively participating in the ongoing Doha round of multilateral trade negotiations.[4] Some of this energy could be diverted toward strengthening the country's participation in existing regional trade arrangements. Among the several trading arrangements of which Pakistan is now a member, by far the most important is the South Asian Free Trade Area (SAFTA).

Public policy, in other words, has missed a number of opportunities to develop a pattern of international trade that suits Pakistan's many advantages. Changing it will improve the country's long-term economic prospects and also help to address the problem posed by a high incidence of poverty. I will begin with a brief description of the current pattern of international trade.

Pakistan's Current Pattern of International Trade

According to the "gravity model" of trade, the direction of a country's exports and the origin of its imports are largely determined by two factors: the mass (size) of the trading partner and the distance from it. Pakistan, however, has seriously deviated from achieving the outcome the gravity model would predict for the country in terms of direction of trade and content of exports. As shown in Table 1, the United States is by far the largest destination of Pakistan's exports. In 2006-07, it accounted for 28.4 percent of the total value of exports.[5] The United States' share was nearly five times that of the second largest importer of Pakistani goods and commodities, the United Kingdom. In 2006-07, the UK accounted for only 5.8 percent of the value of total exports from Pakistan. It is also worth noting that among the seven largest destinations of Pakistani exports, the United States is the only one that has an increasing share. In fact, over the last decade and a half, the American share has more than doubled, from 13.9 percent in 1992-93 to 28.4 percent in 2006-07.

Pakistan does not count either China or India among the major destinations for its exports. This should not be the case if the gravity model of trade were to apply to the country. These two giant economies of Asia are Pakistan's neighbors, and so they should weigh heavily in the pattern of trade, both in the destination of the country's exports and the origin of its imports. Even more important, by changing the composition of exports by trading with China and India, Pakistan would be able to restructure its economy—which would lead to a reduction in the incidence of poverty. This point will be developed later. Pakistan's policymakers should pay greater attention to the fact that two of its neighbors—China and India—are among the fastest growing economies in the world. According to the World Bank, when gross domestic product is measured in terms of the purchasing power parity rate, China is now the world's second largest economy with a GDP of $8.6 trillion; India is the fourth largest with a GDP of $3.8 trillion.[6]

There are two categories of countries among the major importers of Pakistan's goods and commodities. The first group has large markets for the products of the textile industry, Pakistan's largest export. However, these are not expanding markets. The United States belongs to this group, as do Germany, Japan, the UK, and Hong Kong. The second group includes Saudi Arabia and the United Arab Emirates (UAE), which have a significant number of resident Pakistanis who patronize what are called "ethnic markets." Producers in Pakistan supply these overseas markets with the products needed by the members of the diasporas. The world's most rapidly growing economies and also the most rapidly expanding markets for the products in which Pakistan has comparative advantage are not among the main importers of Pakistani products.

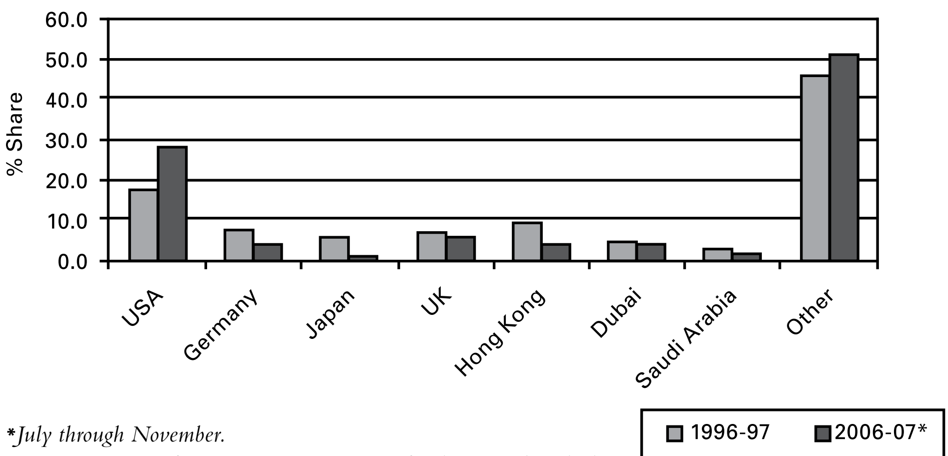
There is also considerable market concentration in Pakistan's exports. As shown in Table 1, this concentration has increased over time; in 2006–07, the seven largest importers of Pakistani merchandise accounted for just less than half of the country's total exports. The share of these countries in 1992–93 was 47.2 percent. It should be noted in this context that all large trading nations in the world have much more diversified markets than Pakistan. Market concentration makes the exporting country extremely vulnerable to changes in demand or public policy. This happened to Pakistan in 2005, when the European Union decided to

Table 1: Pakistan's Major Export Markets: Percentage Share

Country	1996-97	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07*
USA	17.7	21.8	24.8	24.4	24.7	23.5	23.9	23.9	25.5	28.4
Germany	7.5	6.6	6.0	5.3	4.9	5.2	4.9	4.8	4.2	4.1
Japan	5.7	3.5	3.1	2.1	1.8	1.3	1.1	1.1	0.8	0.8
U.K.	7.2	6.6	6.8	6.3	7.2	7.1	7.6	6.2	5.4	5.8
Hong Kong	9.4	7.1	6.1	5.5	4.8	4.6	4.7	3.9	4.1	4.0
Dubai	4.6	5.4	5.7	5.3	7.9	9.0	7.3	3.3	5.6	4.0
Saudi Arabia	2.6	2.4	2.5	2.9	3.6	4.3	2.8	2.5	2.0	1.8
Sub-total	54.7	53.4	55.0	51.8	54.9	55.0	52.3	45.7	47.6	48.9
Other	45.3	46.6	45.0	48.2	45.1	45.0	47.7	54.3	52.4	51.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

**July through November.*
Source: Ministry of Commerce, government of Pakistan, Islamabad.

Pakistan: Major Export Markets, 1996-97 and 2006-07



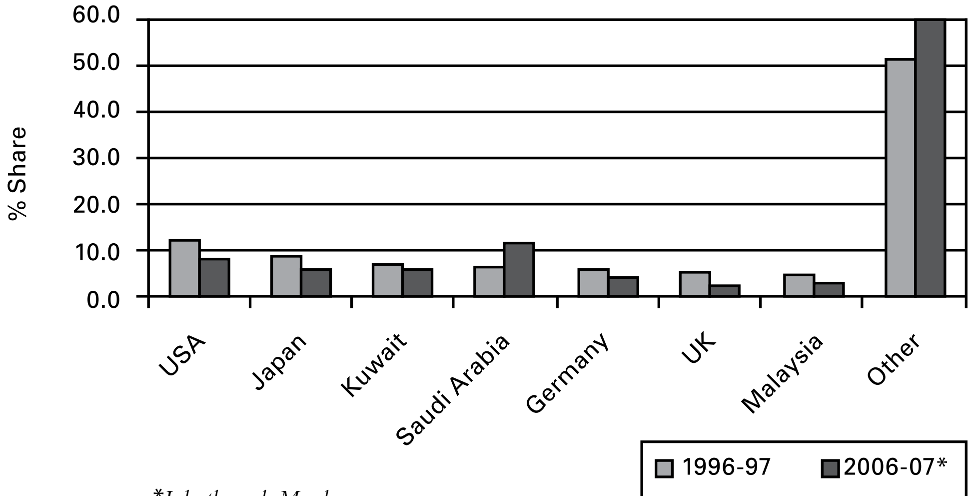
**July through November.*
Source: Ministry of Commerce, government of Pakistan, Islamabad.

Table 2: Major Sources of Imports: Percentage Share

Country	1996-97	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07*
USA	12.0	7.7	6.3	5.3	6.7	6.0	8.5	7.6	5.8	8.1
Japan	8.6	8.3	6.3	5.3	5.0	6.6	6.0	7.0	5.6	5.7
Kuwait	6.9	5.9	12.0	8.9	7.1	6.6	6.4	4.6	6.2	5.4
Saudi Arabia	6.0	6.8	9.0	11.7	11.6	10.7	11.4	12.0	11.2	11.5
Germany	5.6	4.1	4.1	3.5	4.3	4.6	3.9	4.4	4.7	4.1
UK	5.0	4.3	3.4	3.2	3.4	2.9	2.8	2.6	2.8	2.3
Malaysia	4.7	6.7	4.3	3.9	4.4	4.6	3.9	2.6	3.0	3.0
Sub-total	48.8	43.8	45.4	41.8	42.5	42.0	42.9	40.8	39.3	40.1
Other	51.2	56.2	54.6	58.2	57.5	58.0	57.1	59.2	60.7	59.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

**July through March.*
Source: Ministry of Commerce, government of Pakistan, Islamabad.

Pakistan: Source of Imports, 1996-97 and 2006-07



**July through March.*
Source: Ministry of Commerce, government of Pakistan, Islamabad.

impose a hefty dumping duty on exports of home furnishings—specifically bed and table linens, in which Pakistani producers had made large investments.

There is also a high level of concentration among the countries from where Pakistan buys its imports. The share of the largest seven exporters to Pakistan in 2006-07 was slightly more than 40 percent of the total (see Table 2). Five countries appear both in the list of seven largest importers from and exporters to Pakistan—the United States, Japan, Saudi Arabia, Germany, and the United Kingdom; the only two nations that are major sources of imports but not major export markets for Pakistan are Kuwait and Malaysia. These two countries are in the picture because of Pakistan's dependence on certain commodities—fuel oil in the case of Kuwait, and cooking oil in the case of Malaysia.

Pakistan's trade also lacks diversity when viewed in terms of the goods and commodities it exports. In 2006-07, its five largest exports—cotton manufactures, leather and leather products, rice, synthetic textiles, and sports goods—accounted for three-fourths of its total export value. Cotton-based products dominate the list of exports, with their share at close to 60 percent of the total. Again, for the countries that have benefited more from international trade, there is much greater dispersion in the line of products that enter the export markets. By concentrating on a few products, Pakistan invites volatility. As indicated above, this has already happened in the case of the export of some textile products to the European Union. However, there is some decline in the commodity concentration from 83.1 percent of the total for the five top exports in 1992-93 to 74.5 percent in 2005-06 (see Table 3). There is also commodity concentration in imports; the eight largest categories of imports accounted for 72.5 percent of the total in 2005-06 (see Table 4).

Public Policy and the Failure to Take Advantage of Opportunities in International Trade

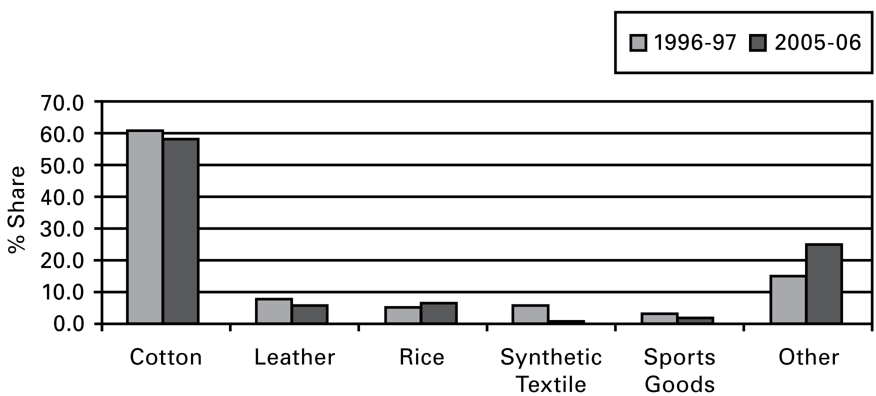
There are many reasons why Pakistan has done poorly in terms of taking advantage of the massive increase in international trade as a result of what economists call the process of globalization. For more than four decades, the country followed the import-substitution strategy of economic

Table 3: Pakistan's Major Exports: Percentage Share

Commodity	1994-95	1996-97	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Cotton	58.7	61.3	59.1	61.0	58.9	59.4	63.3	62.3	57.4	58.4
Leather	8.0	7.7	6.9	6.3	7.5	6.8	6.2	5.4	5.8	6.1
Rice	5.6	5.6	6.9	6.3	5.7	4.9	5.0	5.2	6.5	6.9
Synthetic Textile	7.1	6.1	5.1	5.3	5.9	4.5	5.1	3.8	2.1	1.2
Sports Goods	3.2	3.7	3.3	3.3	2.9	3.3	3.0	2.6	2.1	1.9
Sub-total	82.6	84.4	81.3	82.2	80.9	78.9	82.6	79.3	73.9	74.5
Other	17.4	15.6	18.7	17.8	19.1	21.1	17.4	20.7	26.1	25.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Ministry of Commerce, government of Pakistan, Islamabad.

Pakistan: Major Exports, 1996-97 and 2005-06



Source: Ministry of Commerce, government of Pakistan, Islamabad.

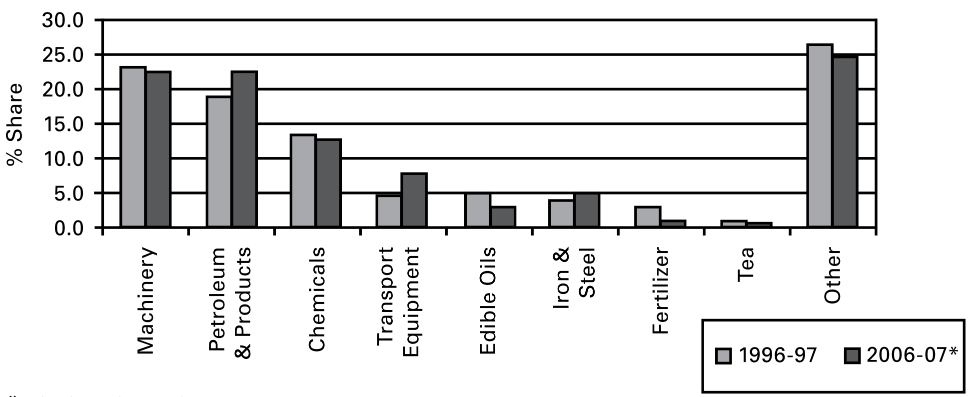
Table 4: Pakistan's Major Imports: Percentage Share

Commodity	1994-95	1996-97	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07*
Machinery	22.8	23.1	17.9	13.9	19.3	17.1	18.5	17.8	22.5	18.0	22.5
Petroleum & Products	15.3	19.0	15.5	27.2	31.3	27.1	25.1	20.3	19.4	22.3	22.5
Chemicals	14.0	13.4	16.6	17.5	20.0	15.9	15.1	16.1	15.5	13.4	12.7
Transport Equipment	5.9	4.7	5.7	5.5	4.0	4.8	5.6	5.6	6.2	7.7	8.0
Edible Oils	9.6	5.1	8.7	4.0	3.1	3.8	4.8	4.2	3.7	2.7	2.9
Iron & Steel	3.6	3.9	3.1	3.0	2.6	3.3	3.3	3.3	4.3	5.1	5.0
Fertilizer	1.2	3.2	2.8	1.9	1.6	1.7	2.1	1.8	2.0	2.4	1.2
Tea	1.8	1.1	2.4	2.0	1.9	1.5	1.4	1.2	1.1	0.9	0.7
Sub-total	74.2	73.5	72.7	75.0	83.8	75.2	75.9	70.3	74.7	72.5	75.5
Other	25.8	26.5	27.3	25.0	16.2	24.8	24.1	29.7	25.3	27.5	24.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

**Pakistan: Major Imports, 1996-97 and 2006-07*

July through March.
Source: Ministry of Commerce, government of Pakistan, Islamabad.

Pakistan: Major Imports, 1996-97 and 2006-07



**July through March.*
Source: Ministry of Commerce, government of Pakistan, Islamabad.

growth. According to this strategy, developing countries needed to protect their infant domestic industries by erecting high walls of tariffs. However, Pakistan was not alone in pursuing this approach; this was also done by other countries in South Asia. It was only in the early 1990s that South Asian countries began to adopt more open policies toward trade and capital flows. Some of this change was a consequence of the pressure exerted by the International Monetary Fund, which, along with the World Bank, was advocating the approach known as the "Washington Consensus." But even then, South Asian nations were cautious about opening their economies. Yet what interests us here is not the impact of the import-substitution strategy on Pakistan's economic growth, but that of the public policies that were peculiar to the country and that impacted its trade.

Of the many failures of public policy over the last 60 years in the area of international trade, three have exceptional significance. These are relations with India; the types of incentives given to the textile industry to develop (particularly in the 1960s); and the failure to educate a large work force to take advantage of the large size of the population.

Relations with India

As already discussed, India does not figure among Pakistan's major trading partners, even though the gravity model of trade—given the size of the Indian economy and its proximity to Pakistan—would see it as a dominant player in Pakistan's international trade. In fact, during the late 1940s, when India and Pakistan gained independence, the two countries were linked together by close trading ties. More than half of Pakistan's exports were bought by India and India accounted for almost two-thirds of Pakistan's imports.[7] At that time Pakistan was also a major supplier of food grains to India. The British colonial administration invested heavily in agricultural development in areas that now make up Pakistan. The British did so in order to develop domestic sources of food supply to feed the food deficit areas in the northeastern part of their domain, now the northeastern states of India. Some of these areas had suffered from repeated famines that took a heavy human toll and created security problems for the colonial administration. One way of addressing that problem was to bring the virgin lands in Punjab and Sindh (now the provinces of

Pakistan) under cultivation. This was done by tapping the waters of the Indus River system for irrigation.

Once irrigation came to Punjab, and hundreds of thousands of hectares of new land were settled by farmers the British administration brought in from the eastern part of Punjab (now part of India), there was a significant increase in the output of wheat and rice, the main food grains consumed by people in British India. However, food grains were not the only crops that were grown. Punjab and Sindh had ideal conditions for the cultivation of cotton, and cotton quickly became one of the important cash crops for the region. But before Pakistan became independent, there was no textile industry of any significance in Punjab and Sindh; the industry was then located in Gujarat and Bombay. Therefore, at the time of independence, a significant part of the Indian textile industry relied on cotton imports from Pakistan.

Had this relationship continued, the structure of the Pakistani economy would have been very different from what it is today. But trading relations between the two countries were suddenly disrupted in 1949 when Pakistan refused to follow other countries of the Sterling Area,[8] including India, and did not devalue its currency with respect to the U.S. dollar. Pakistan made that decision while keeping in view its pattern of trade and its determination that reducing the price of its most important export (jute from East Pakistan, today's Bangladesh)—which would happen as a result of devaluation—would not increase its demand.[9] Declaring that "India would not pay 144 of its rupees for one hundred Pakistani rupees,"[10] New Delhi launched an all-out trade war against its smaller neighbor.

This action had unintended consequences, including Pakistan's successful drive to de-link its economy from that of India's. Since relations between the two countries did not improve—largely on account of the long-enduring Kashmir dispute—intercountry trade did not develop. That situation persists to this day. In the early 2000s, trade between India and Pakistan accounted for less than 5 percent of Pakistan's total trade. For India, the proportion was even smaller. The slow start to the regional trading arrangement approved by the seven countries of the South Asian Association for Regional Cooperation (SAARC) in January

2004 is also the consequence of the suspicion that continues to exist between New Delhi and Islamabad.

Textile Industry Development

The approach to industrialization adopted by the regime of President Ayub Khan (1958-1969) was the second major area of public policy that had unintended consequences for Pakistan's international trade. In order to disburse the ownership of industrial assets, the regime used import licensing mechanisms to establish a large number of small textile spinning and weaving plants in the country. The Ayub regime did not permit the establishment of spinning units that had more than 12,500 spindles, even though economies of scale suggested that spinning units should have at least 100,000 spindles. The government also encouraged weaving in the handloom sector, taking its cue from developments in India.

This industrial policy created a large textile industry that did not have the scale—nor, therefore, the efficiency—to compete in the highly competitive business that has emerged following the end of the quota regime that was a part of the Multi-Fiber Agreement (MFA). The MFA was agreed upon as a stopgap measure following the virtual freeing of trade between rich and poor countries for most industrial products, which had happened as a result of the successful conclusion of the Uruguay round of trade negotiations. A 10-year breathing space was allowed to countries that still had large textile industries that could not compete with the more labor-intensive businesses in the developing world. Pakistan, which is the world's fourth largest producer of cotton and has a large textile industry, was supposed to benefit after the MFA was phased out in 2005. That did not happen. Contrary to expectations, Pakistan's share in the international textile trade actually declined after the protection that was available to it under the MFA was no longer available.

Human Development

The third failure of public policy has been in the area of human development. Had Pakistan paid the same kind of attention as India did to providing modern skills to its very young population, it may have been able to take advantage of the outsourcing that was to become a major feature of the shape of the global economy in the early 2000s. This did not happen. Pakistan continues to suffer from all the ill effects of a large and young population, rather than to take advantage of the window of opportunity that has opened up for large populous countries as the industrial world attempts to cope with the problem posed by rapid declines in rates of fertility. There is a demographic asymmetry between developed and developing countries. While the rate of population increase continues to decline in the developed world, it remains high in most developing countries. By 2011, most European countries will have entered the phase of declining populations. In the case of Pakistan, now the world's sixth most populous country after China, India, the United States, Indonesia, and Brazil, the population will continue to increase at a rate of nearly 2 percent per year over the next couple of decades. India and China have demonstrated how large populations can become economic assets rather than economic and social burdens, provided that public policy is directed toward giving people the skills the global economy needs. This has been done only to a limited extent in the case of Pakistan.

Pakistan, therefore, needs a dramatic reorientation in its approach to economic development and industrialization in order to draw greater benefits from the ongoing process of globalization. One way of doing this is to create the right incentive structure for entrepreneurs. This could be done in the context of regional trading arrangements—particularly in those areas where for political reasons intraregional trade has not developed. This is the case in South Asia.

Regional Trade Arrangements: Could These be the Way to Change the Pattern of Pakistan's International Trade?

The failure of the world's major trading nations to further liberalize the international trading system has increased the importance attached to regional trading arrangements. These have proliferated over the years and now account for a major proportion of global trade. Mostly for political reasons, the countries of South Asia have failed to follow this trend. Persistent difficulties between India and Pakistan have stood in the way of a trading arrangement in the South Asian region.

The first tentative move in that direction was made in 1985 when President Zia ur Rahman, then president of Bangladesh, persuaded the seven countries of the SAARC—Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka[11]—to work toward regional cooperation. The first step toward the creation of regional trading arrangements came in the form of the South Asia Preferential Trading Agreement (SAPTA), which went through four rounds. The last of these was abandoned when Pakistan's military reentered national politics in 1999. India, the largest country in the region, insisted that economic cooperation was contingent upon all countries continuing to be governed democratically. But that was not the only dispute that prevented regional cooperation in South Asia. In 2001–02, India and Pakistan almost went to war over New Delhi's suspicion that its neighbor's intelligence services were involved in the terrorist attacks on the parliamentary compounds in India's capital city.

This stalemate was broken in January 2004, when, on the sidelines of a summit of SAARC leaders held in Islamabad, then-Indian Prime Minister Atal Bihari Vajpayee and General Pervez Musharraf, the Pakistani president, agreed to negotiate their differences. The SAARC leaders also agreed to launch a free trade area, the South Asia Free Trade Area (SAFTA), on January 1, 2006. Two years were allowed for the preparatory work to be done before SAFTA's launch. During this period, it became clear that neither India nor Pakistan was prepared to let economic considerations be the main driving force in negotiating the trade accord. By simultaneously working on another regional arrangement—the BIMSTEC (Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation), which included all SAARC countries (except Pakistan) in addition to Myanmar and Thailand—New Delhi continued with its political objective to isolate Pakistan in Asia. Also, Pakistan tried to align its economy with countries in the Middle East and Central Asia, rather than look just to the south. The result was a tepid approach toward the realization of the full potential of SAFTA.

Nonetheless, SAFTA became operational on July 1, 2006, following ratification by all countries of the region. Pakistan was the last country to sign the documents.

How would the successful implementation of SAFTA affect Pakistan's international trade and the structure of its economy? I attempt to provide answers to this question mostly on the basis of projections, taking into consideration the situation that prevailed six decades ago when the

British, as they prepared to leave, began dividing South Asia into a number of independent states.

The most significant impact of SAFTA on Pakistan would be a sharp increase in international trade as a proportion of GDP. In 2004-05, the trade-to-GDP ratio was on the order of 30 percent, with trade defined as including trade through informal channels and GDP measured according to updated 2001 national income accounts. With SAFTA successfully implemented and with trade with Afghanistan conducted mostly through formal channels, total trade could increase at a rate of 10 to 12 percent per year in the next 10 years. Total trade in real dollars (2004-05 dollars) could increase from the present \$33.5 billion to \$90 billion.[12] With the economy more open, and with trade with India allowed free of the positive test of permitted exports and imports (which refers to goods that may be legally traded), India-Pakistan trade would likely increase 10-fold, from the current \$2 billion (including informal trade) to \$20 billion.[13] In other words, of the \$56.5 billion increase in total trade projected for this period, \$18 billion—or 32 percent of the increase—could come from increased exports to and imports from India (see Table 5).[14]

Table 5: Projected Value of Pakistan's Formal and Informal Trade in 2014-15 (\$ billion), in Comparison to 2004-05

	2004-05			
Type	Exports	Imports	Total	% of GDP
Formal	14.0	18.0	32.0	
Informal	0.5	1.0	1.5	
Total	14.5	19.0	33.5	30.0
	2014-15			
Type	Exports	Imports	Total	% of GDP
Formal	43.0	47.0	90.0	
Informal	--	--		
Total	43.0	47.0	90.0	42.0

Source: Author's projections.

A significant reduction in tariffs as envisaged by SAFTA would not be the main contributor to the sharp increase in India-Pakistan trade. Instead, trade would increase mostly because of the elimination of non-tariff barriers and because of measures to facilitate trade adopted by the two countries. An open trading system would mean the use of short sensitive lists (which can enable the goods of vulnerable domestic producers to be protected) to regulate trade initially, with the understanding that these lists would be dispensed with over time. In addition, Pakistan would need to grant Most Favored Nation (MFN) status to India, and India would need to eliminate non-tariff barriers that keep many items of interest to Pakistani exporters out of India's market.[15]

Both sides will need to restore and develop transport and communication links, connect their electric power grids and natural gas pipelines, and open to each other the use of their airports and ports. In order for all this to happen, SAFTA will need to be not only more aggressively implemented, but also willing to incorporate sectors not currently in its scope. A sharp increase in the quantum of India-Pakistan trade will require regulatory changes in the two nations' banking systems, so that trade financing will be available to all traders without restriction.

Greater openness on the part of Pakistan would also affect trade with Afghanistan. Formal trade between Afghanistan and Pakistan has increased sharply since the fall of the Taliban in December 2001. Counting an estimate of informal trade in the value of current trade, Afghanistan is now the third most important destination (and to a lesser extent, source) of trade for Pakistan. This is likely to grow four-fold, increasing the value of total trade from the current \$1.9 billion to an estimated \$8.3 billion, equivalent to growth of 15 percent per year. With this anticipated increase, Afghanistan is likely to become Pakistan's fourth most important trading partner, approaching the United States and Saudi Arabia in importance, but still considerably behind India (see Table 6).

With the successful implementation of SAFTA, the structure, destination, and origin of Pakistan's international trade will change profoundly. Agricultural and light engineering products will become important export items, while industrial raw material and capital equipment will become important import items. With Pakistan able to meet a significant

Table 6: Projected Direction of Pakistan's Trade—Imports and Exports (Percentage Share of Total Trade)

Country	2004-05	2014-15
United States	19	12
India	5	22
Afghanistan	5	9
Dubai	6	-
United Kingdom	4	3
Saudi Arabia	10	12
Subtotal	49	58

Source: Author's projections.

proportion of its energy needs by tapping the gas pipelines from Iran, Central Asia, and the Middle East to India, the share of fuel imports in total trade should decline. And, with Pakistan able to earn large transit fees from the use of its territory for gas pipelines to India, the share of the service sector in exports earnings should increase significantly.

New trading opportunities with the countries in the region will change the structure of the Pakistani economy. Agriculture should regain some of the importance it had at the time of independence from Britain. But Pakistan will not become the granary for the rest of South Asia as it was then. Its agricultural system, with its year-round supply of water, should be able to provide high value-added output to the growing Indian and Middle Eastern markets. With transit trade earning more foreign exchange, the transport sector should feel the impact, particularly through the modernization of trucking, processing, repackaging, and warehousing industries. The banking sector will also have to develop new product lines to provide financing for new lines of export to India as well as for servicing transit trade. And Pakistan could see a major expansion in tourism, as Indians begin to visit holy sites in Pakistan that have been inaccessible to them as well as other sites in the country's picturesque northern areas. Lahore is already preparing for the arrival of Indian tourists. According to one British newspaper account, the city "is sprucing itself up for a growing flow of visitors from Delhi—many of whom have memories of relatives there—with a fancy new airport, refurbished colonial buildings and ambitious hotel projects."[16] An increase in tourism will result in rapid expansion of the hotel, restaurant, and entertainment industries.

The envisaged structural change in the Pakistani economy will need large amounts of investment, some of which could be provided by Indian companies. For that to happen, however, India and Pakistan will need to agree on a policy framework for regulating the cross-border flow of capital. Such an agreement will be politically easier to conclude within the SAFTA framework. This is one of the several areas in which the SAARC countries will need to begin deliberations in order to increase the reach and scope of the proposed SAFTA.

Conclusion

As I said in the opening paragraphs of this paper, public policy has failed to put trade at the center of economic decision making. Consequently, Pakistan has lost the opportunity to gain from the rapid development of international markets. Had it focused on improving its trade position, it would have not only added to the rate of economic growth but would have also provided employment opportunities to its growing population. Increasing employment would have served to address the problem of poverty and improved income distribution. There is, therefore, a need for correcting the antitrade bias in economic decision making.

I have also argued that it is important to develop trade relations with the countries that border Pakistan. There should be a special emphasis on developing trade relations with India, a country with which Pakistan had close links some 60 years ago. However, that would need a fairly significant change in the orientation of foreign policy. Up until now, Pakistan has been consumed with challenging India—in particular with respect to the dispute over Kashmir. This has been a costly policy to pursue. It has not only reduced the rate of economic growth by eliminating some of the factors from the equation that could have contributed to rapid progress. It has also led to the development of Islamic extremism in Pakistan which, if left unchecked, could further isolate the country. Pakistan needs to give attention to dealing with these forces which are causing the country untold damage.

An economic policy focused on increasing international trade—especially one that restores trading relations with India—will have profound implications for the structure of the economy. This, as discussed in the previous section, will bring into focus the sectors that could help Pakistan address the problem of poverty and reduce the growing gap in the distribution of income.

Notes

1. There is a rich literature on what is generally described as the East Asian Miracle. The most authoritative account remains that of the World Bank, *The East Asian Miracle: Economic Growth and Public Policy* (New York, Oxford University Press, 1993).

2. There is accumulating empirical evidence to show that trade contributes to economic growth. Some of this is presented in William Cline, *Trade Policy and Global Poverty* (Washington, D.C.: Center for Global Development and Institute for International Economics, 2004). For evidence relating to Pakistan, see Muhammad Arshad Khan and Abdul Qayyum, "Trade liberalization, financial development, and economic growth," *PIDE Working Papers* 19 (Islamabad: Pakistan Institute of Development Economics, 2007).

3. I have calculated the opportunity cost of Pakistan's approach toward the long-standing Kashmir problem in a paper commissioned by the United States Institute of Peace (USIP). See Shahid Javed Burki, *Kashmir: A Problem in Search of a Solution* (Washington, D.C.: USIP, 2007).

4. These negotiations were begun in late 2001, following an agreement reached among the world's trade ministers to launch another round of trade talks. This agreement was reached at Doha, the capital of Qatar. Developing countries agreed to participate in these discussions on the condition that some of the issues of particular interest to them that had been ignored in the past would get addressed this time around. Among these issues was trade in agricultural commodities that continued to be protected by the industrial world. It was in order to accommodate the wishes of the developing world that the Doha negotiations were called the "Development Round."

5. Unless otherwise stated, the data used here are from government of Pakistan, *Pakistan Economic Survey, 2006-07* (Islamabad: Pakistan Ministry of Finance, 2007).

6. According to this way of estimating gross domestic products, the United States with a GDP of $12.4 trillion remains the world's largest economy, while Japan with a GDP of $4.0 trillion is in third place. See World Bank, *World Development Indicators, 2007* (Washington D.C.: World Bank, 2007), 15-17. If the European Union were to be counted as one economy, its GDP in purchasing power parity terms would be larger than that of the United States.

7. Shahid Javed Burki, "Potential of the South Asian Free Trade Area" in *South Asian Free Trade Area: Opportunities and Challenges* (Washington, D.C.: USAID, October 2005), 7-31. Available from http://pdf.usaid.gov/pdf_docs/PNADE563.pdf.

8. Sterling Area was made up of the countries that were once the colonies of Britain. Once these countries became independent, they together came to be called first the British Commonwealth and subsequently simply the Commonwealth.

9. This important decision in Pakistan's early economic history is discussed at some length by Chaudhri Muhammad Ali in his book *The Emergence of Pakistan* (New York: Columbia University Press, 1969). Ali, then the senior-most civil servant in Pakistan, was closely involved in reaching that decision.

10. This statement is attributed to Sardar Vallabahi Patel, home minister in the cabinet headed by Prime Minister Jawaharlal Nehru. See Shahid Javed Burki, *Changing Perception, Altered Reality: Pakistan's Economy under President Musharraf, 1999-2006* (Karachi: Oxford University Press, 2007).

11. Afghanistan became the eighth member of the SAARC in 2006.

12. According to the government of Pakistan's Medium Term Development Framework, exports will increase by 12 percent per year on average while imports will increase by 10 percent. GDP is expected to increase by 7 percent per year.

13. Studies in both Pakistan and India show that the present level of trade between the two countries is only 10 to 12 percent of potential trade. See, for example, Eugenia Baroncelli, "Pakistan-India Trade Study: Economic Gains and the 'Peace Dividend' from SAFTA," a study for the Pakistan-India trade project commissioned by the World Bank at the request of the government of Pakistan. This article can be found, in slightly different form, in a recent World Bank publication on Pakistan-India trade: Eugenia Baroncelli, "The 'Peace Dividend,' SAFTA, and Pakistan-India Trade," in *The Challenges and Potential of Pakistan-India Trade*, eds. Zareen Fatima Naqvi and Philip Schuler (Washington, D.C.: The World Bank, 2007): 55-65.

14. A recent World Bank study, *South Asia Free Trade Area: Promise and Pitfalls of Preferential Trade Arrangements* (Washington, D.C.: World Bank, 2004), using the gravity model, estimated that trade between India and Pakistan has the potential to increase more than 40-fold. However, I have taken a much more conservative estimate, keeping in mind various policy-related constraints that trade may face even with the normalized MFN trade relations between the two countries.

15. For a description of the non-tariff barriers that inhibit trade between India and Pakistan, see Muhammad Akbar and Mohammad Sulaiman, "Barriers to Trade with India," mimeo, Study Commissioned by Pakistan-India Business Forum, Karachi, 2005.

16. Victoria Burnett, "What I Love About Lahore: Food, Fiestas and Kites," *Financial Times*, July 16, 2005.

PAKISTAN-INDIA TRADE: THE WAY FORWARD

ZAREEN F. NAQVI AND IJAZ NABI

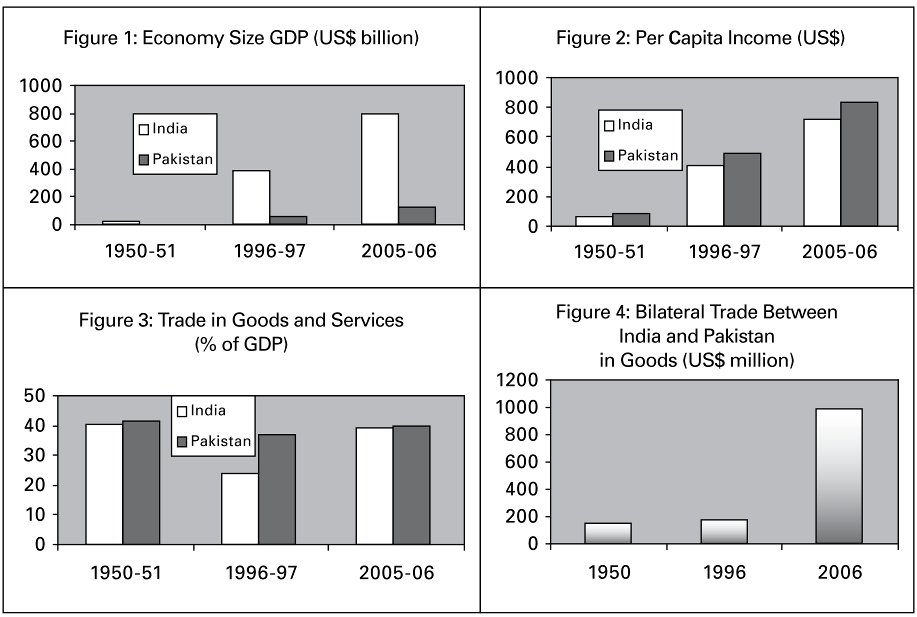
India and Pakistan are the two largest economies in South Asia.[1] Together, they account for 90 percent of the gross domestic product (GDP) of the region. They share a long contiguous border, have similar cultures, and, in the not-too-distant past, enjoyed well-integrated transport and market links. In an increasingly globalized world, this would suggest that Pakistan-India bilateral trade could be a major growth driver for the two countries. The reality, however, is quite different. As recently as 2004, the share of total trade between Pakistan and India, measured by the sum of bilateral exports, was less than 1 percent of their total worldwide exports.

The abysmally low level of Pakistan-India bilateral trade is the result of border disputes and political tensions, but also of inward-looking import-substitution growth strategies. This has rendered South Asia the least integrated economic region in the world. Between 1980 and 2005, intraregional trade as a share of total trade within South Asia only rose from 3 to 4 percent, whereas in East Asia—a region of comparable size in population and GDP—intraregional trade more than doubled from 6 to 14 percent.[2] It is striking that over the same period, South Asia's worldwide exports grew from only $12 billion to $126 billion—a 10-fold increase—while East Asia's jumped from $48 billion to over $1 trillion—a 20-fold increase.[3] This suggests that rapid growth in intraregional trade, by exploiting regional comparative and scale advantage, may well improve the worldwide competitiveness of regional economies.

Zareen F. Naqvi is director for institutional research at the University College of the Fraser Valley in Abbotsford, British Columbia, Canada, while on leave of absence from the World Bank. **Ijaz Nabi** is sector manager, poverty reduction and economic management unit, South Asia region, at the World Bank.

Significantly, sharp economic growth by both India and Pakistan has not been matched by sharply increased bilateral trade. In 1950-51,[4] four years after partition of the Indian subcontinent, the nominal GDP of India stood at $21 billion, while that of Pakistan was a little over $3 billion. Pakistan-India bilateral trade in 1950-51 stood at $147 million, or close to 5 percent of their total world trade. Over the past 55 years, both economies have grown significantly in terms of GDP and per capita incomes. The combined GDP of India and Pakistan was close to $1 trillion in 2005-06, while their trade (exports and imports) with the world accounted for $361 billion, or around 39 percent of their combined GDP in that year. However, bilateral trade accounted for less than $1 billion in 2005-06, or only 0.2 percent of their combined trade with the world. This shows the missed opportunity of anchoring growth in regional

Figures 1-4: Economic and Trade Indices for Pakistan and India



Source: The World Development Indicators database, The World Bank.

comparative advantage, which would have strengthened the global competitiveness of the two economies.

This paper identifies the roadblocks to bilateral trade between Pakistan and India, and suggests a way forward to promote bilateral trade that would also strengthen the region's global competitiveness.

Roadblocks to Pakistan-India Trade

Trade flows between India and Pakistan have been low over the past half century for two main reasons: political tensions and adherence to import-substitution policies to promote industrialization. These two factors together led to little commitment to regional integration, with this lack of commitment standing in marked contrast to other regions of the world. Although we focus here on Pakistan's policies, many of the same forces were at work in India as well.

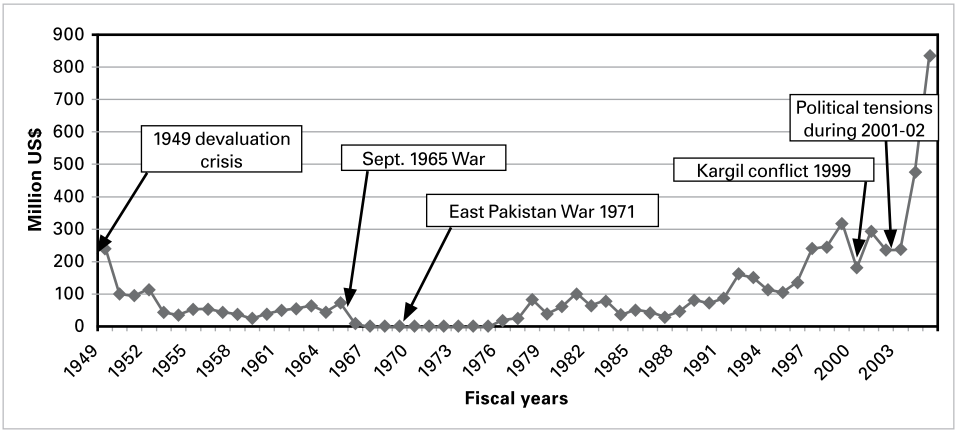
Political Tensions

At the time of independence, almost three-fifths of Pakistan's total exports were directed to the Indian market, and one-third of its imports came from India (Sangani and Schaffer 2003). This situation began to change when Pakistan refused to devalue its currency after India's devaluation in 1949 and later imposed import restrictions. Ever since then, bilateral trade has declined sharply during periods of conflict or heightened tensions (See Figure 5). It increased only slowly as political relations improved. Trade between India and Pakistan almost ceased altogether from the mid-1960s to mid-1970s, due to the 1965 India–Pakistan war and the 1971 East Pakistan war, which led to the creation of Bangladesh. More recently, bilateral relations between the two countries became tense after the 1999 Kargil war, as well as after the attack on the Indian parliament building in December 2001. Overall, it took four long decades before the trade volume (measured in nominal terms) between the two countries exceeded the levels of the early 1950s.

Import-Substitution Policies

Pakistan's international competitiveness has historically suffered from inward-looking import-substitution policies and the protection of

Figure 5: Pakistan-India Trade Has Suffered from Political Tensions



Source: Federal Bureau of Statistics and Ministry of Commerce, government of Pakistan.
Note: Trade is measured as a sum of exports and imports in nominal U.S. dollar values.

domestic industries. The anti-export bias inherent in high import tariffs; a poor investment climate; the high cost of doing business; low labor productivity, particularly in the manufacturing sector; shortages of skilled workers; distortions in land markets; and excessive business regulations collectively restricted the ability of Pakistani companies to engage in trade. This contributed to rather ill-founded nervousness (sparked by concerns of being swamped by the Indian economy due to its economies of scale and of potential dumping of Indian goods in Pakistani markets) about opening up Pakistani markets to Indian imports. Instead of looking to the Indian market as an opportunity, many protected stakeholders saw bilateral trade as a threat to their profits.

The result was a highly managed bilateral trade relationship limited to a few goods. The composition of exports from Pakistan to India is limited to about eight commodity groups, which on average account for around three-fourths of total exports since 2001-02 (Table 1). These include cotton yarn and fabrics, fresh and dried fruits and vegetables, crude vegetable materials (e.g. crude fertilizer), wool, molasses, and, increasingly in more recent years, petroleum products and chemicals.

Table 1: Composition of Pakistan's Official Exports to India (Percent)

Commodities	2001-02	2002-03	2003/04	2004/05	2005/06
Petroleum & its products	0	0	41.6	60.2	33.0
Chemical elements and compounds	0	0.1	0.2	1.4	12.8
Cotton fabrics (woven)	6.7	5.2	8.4	6.5	11.6
Fruits & vegetables	67.8	30.2	20.9	9.1	9.4
Cotton yarn	4.8	2.0	1.4	0.9	2.7
Crude vegetable materials	8.6	5.5	2.0	0.8	0.9
Wool (including wool tops)	1.6	1.8	1.9	0.5	0.9
Molasses	0	0	2.9	5.9	0
All other exports	10.5	55.2	20.7	14.7	28.7

Source: Ministry of Commerce, government of Pakistan.

The composition of official imports from India is broader (see Table 2), reflecting India's more diversified industrial base. The biggest share in imports from India is in chemicals. During the last five years (2001-02 to 2005-06) imports of iron ore and steel products, animal feed, and tires and tubes have also been quite important. Periodically, agricultural products (e.g. raw cotton, wheat, and sugar) account for one-time imports or exports to meet domestic shortages. Tables A1 and A2, which appear as an annex at the end of this essay, provide more trade statistics for India and Pakistan.

One consequence of its political tensions with India and its import-substitution policies is the perception that the government of Pakistan is not really interested in promoting bilateral trade with India. As we shall see in the next section, this perception is misplaced.

Table 2: Composition of Pakistan's Official Imports from India (Percent)

Commodities	2001/02	2002/03	2003/04	2004/05	2005/06
Chemical elements & compounds	33.9	35.4	37.9	35.8	18.4
Chemical material & products	9.3	11.0	6.9	12.7	8.7
Concentrates of iron & steel	7.3	10.8	8.1	11.9	5.8
Animal feed	4.1	0.6	7.3	7.1	9.1
Tires & tubes of rubber	7.2	11.0	5.0	6.0	5.0
Raw cotton	0	0	14.7	2.8	4.9
Dyeing, tanning, & coloring materials	4.9	6.3	2.8	2.5	2.6
Iron and steel manufactures	0.5	0.3	1.8	2.4	3.9
Crude vegetable materials	3.6	3.7	1.4	1.5	1.9
Machinery & its parts	2.0	2.4	0.8	1.0	1.4
Manufactures of nonferrous metals	0.8	1.8	1.8	1.3	0.9
Tea & mate	1.2	2.8	1.8	1.1	1.3
Cotton yarn	0	0.5	2.2	0.9	1.3
Spices	2.4	1.4	0.7	1.1	0.5
Fruits & vegetables	2.7	0.5	0.1	0	0
Concentrates of nonferrous metals	1.7	1.2	0.1	0.1	0
All other imports	18.4	10.3	6.6	11.8	34.3

Source: Ministry of Commerce, government of Pakistan.

Islamabad's Stance on Pakistan-India Trade

Pakistan's government has in fact taken considerable interest in Pakistan-India trade. The evolution of the debate on the issue of bilateral trade has been quite sophisticated and based on good research inputs. In 1995-96, the commerce ministry commissioned a report on whether Pakistan should grant Most Favored Nation (MFN) status to India, thereby reciprocating India's earlier move to award it to Pakistan. The report, completed in 1996, recommended that Pakistan should not only grant MFN status, but also take other measures to expand trade with India. It was presented at a cabinet meeting of then-prime minister Benazir Bhutto, where it received an overwhelmingly positive response. Nawaz Sharif, who succeeded Bhutto as prime minister, was also very interested in expanding trade with India.

Pakistan's government has taken a number of measures since the publication of the commerce ministry's report to improve bilateral economic relations. For example, expanding such relations constitutes an important part of the Composite Dialogue process that began in 2004 (and is discussed below). Additionally, in 2004, Pakistan's commerce ministry asked the World Bank to revisit the issue of Pakistan-India trade; this essay summarizes the key findings of "Challenges and Potential of Pakistan-India Trade," the World Bank report that emerged from the Bank's work on the issue.[5] Recently, Pakistan's central bank (the State Bank of Pakistan, or SBP) has recommended in a study that Pakistan open up trade and investment ties with India for mutual gains. The SBP effort is based on a detailed assessment of a large group of commodities that Pakistan and India can potentially trade with each other, using the Revealed Comparative Advantage methodology.[6] Thus, there has been bipartisan support at the political level and endorsement by important financial organizations, such as the SBP. Additionally, there is great zeal for expanding bilateral trade within the business community, which sees substantial gains from enhancing trade with India. This has all been backed by sophisticated research inputs.

Furthermore, Islamabad has adopted a lenient attitude toward third-party bilateral trade[7] and also trade via informal channels. Estimates of informal trade range between $0.5-10 billion. Our estimates for 2005[8] show India and Pakistan informal trade to be around $545 million. Informal exports from Pakistan to India were no more than $10.4 million, consisting mostly of textiles and agricultural products. Informal imports were $535 million, covering products such as textiles, spices, medicines, machinery, tires, etc. The major routes used for informal trade go through Dubai, Iran, and Afghanistan. These informal trade routes are often over difficult terrain and use multiple modes of transportation. In addition, informal trade also takes place across the extended land borders between the two countries. Much of the informal trade takes place in goods that are either not on Pakistan's positive list (e.g. pharmaceuticals, cosmetics, jewelry; this positive list identifies goods that may be legally imported from India), have high tariffs in Pakistan (e.g., betel leaves, tractor tires), or face high tariffs through specific taxes in India (e.g. Pakistani textile products). Total bilateral trade stood at $1.5 billion, or 3.4 percent of Pakistan's total trade, in 2005-06.[9]

Clearing the Trade Path: The Way Forward

Recent encouraging movement in three areas—political relations, trade competitiveness, and trade integration, all accompanied by rising official bilateral trade—suggests that trade between the two large South Asian economies may be headed to a higher trajectory.

Political Relations

The political environment has improved considerably. Pakistan and India have started the Composite Dialogue process, which emphasizes an eight-point agenda[10] covering a range of defense, political, and economic issues. Almost-monthly announcements on measures agreed to by Pakistan and India have generated new confidence in their mutual relations. On the economic front, the two governments intend to tackle a broad agenda, including improving trade logistics; easing visa restrictions; reducing non-tariff barriers; facilitating trade via sea, land, and rail routes; and opening up banking sectors.

For instance, rail service between Khokrapar and Munabao in the Sindh–Rajasthan border has been revived after having been closed since 1965. New bus services link the two Kashmirs between Srinagar and Muzaffarabad, as well as places of religious significance between Lahore and Amritsar and Amritsar and Nankana Sahib. During the third round of the Composite Dialogue process discussions in March 2006, both countries agreed to discuss a new shipping protocol, deregulation of air services, joint registration of basmati rice, an increase in the size of Pakistan's positive list, proposals for information technology-related medical services and export insurance by India, and work on a memorandum of understanding for cooperation in capital markets by Pakistan. This process has moved forward in subsequent discussions. The revised India–Pakistan shipping protocol was signed in December 2006; Pakistan's positive list of imports from India was further expanded in November 2006; and Pakistan and India decided to open branches of Pakistani-scheduled banks in India and vice versa.

Episodic terrorism (e.g. the commuter train blast in Mumbai in July 2006) and insurgency (e.g. in Balochistan) in India or Pakistan have led to each country blaming the other and to periodic setbacks to warmer relations. However, such interruptions have been relatively short-lived. For the first time in decades, Pakistani cinemas have been allowed to show Indian films as part of growing exchanges in the media and film industries. Cricket and field hockey fans in the two countries greeted with much joy the revival of sporting events between Pakistan and India.

Trade Competitiveness

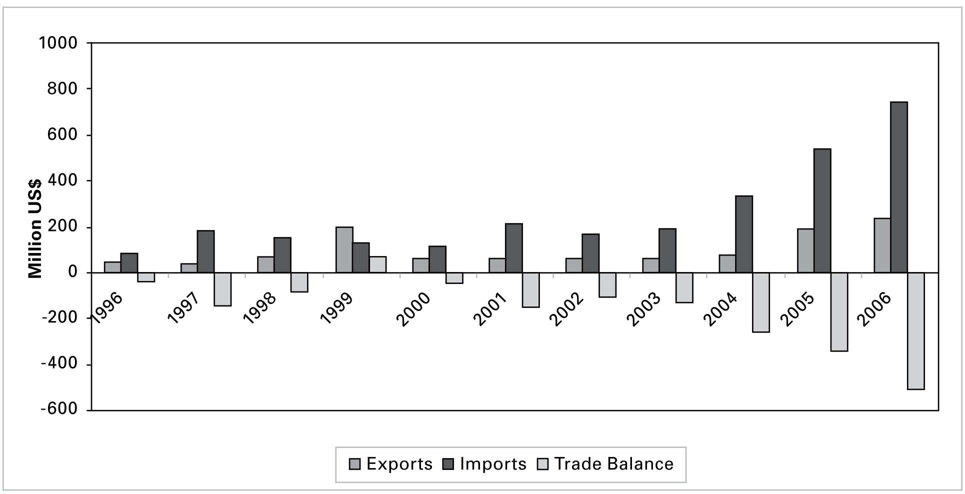
The improved bilateral climate has paid dividends in terms of higher trade flows. While India granted Pakistan MFN status in 1995-96, Pakistan has not yet reciprocated this move. Instead, Pakistan has steadily increased the size of its positive list.[11] This list expanded from 40 items in 1983 to 687 items in 2004-05, to 773 items in 2005-06 and, most recently, to 1,075 items as part of the South Asian Free Trade Area (SAFTA) process. Despite these additions, however, the positive list remains restrictive. It includes approximately 45–50 percent of Pakistan's total importable goods.[12]

Islamabad's policy of gradually expanding the positive list is paying off. Official trade between India and Pakistan reached a record $982 million in 2005-06, almost three-fourths of which were Indian exports to Pakistan.[13]

This compares to an average of less than $250 million during fiscal years 2001–03 and only $129 million in fiscal year 1996 (See Figure 6).

Furthermore, Pakistan has made good progress on wide-ranging economic and institutional reforms. Pakistan abandoned the decades-old program of import substitution in 1998 and embarked on ambitious economic reforms designed to spur economic growth through greater integration with the world economy. The average tariff rate fell to 20 percent in 2001 from over 50 percent in 1995, and stands now at around 14 percent. In addition to cutting import tariff rates, the government eliminated quantitative restrictions, regulatory duties, and other para-tariffs,[14] as well as several other measures that had restricted trade in the past. Institutional reforms in tax administration and trade facilitation also accompanied the reduction in tariffs. These reforms leave Pakistan in a much better position to pursue preferential liberalization, whether

Figure 6: Sharp Increases in Pakistan-India Trade Over 2004-2006



Source: Calculated from the average of Pakistan's and India's bilateral trade statistics.
Note: The trade balance is presented as Pakistan's exports to India minus its imports from India; the years refer to Pakistan's fiscal years (July 1 to June 30).

in the context of SAFTA or through bilateral agreements. The reforms have allowed the country to focus on the behind-the-border trade-related reforms[15] needed to enhance the country's competitiveness.

The impact of these economic, fiscal, and trade reforms is yielding rewards in terms of improved overall economic performance. A sharp increase in demand for imports, rapid growth in exports, and a boost in investments have all contributed to an acceleration of growth. The GDP growth rate jumped to 6.4 percent in 2003-04, 8.6 percent in 2004-05, and 6.6 percent in 2005-06—compared to around 4 percent during the 1990s. It is projected to stay at 6.5–7.2 percent over the medium term until 2008-09. Growth in exports in U.S. dollar terms averaged 16 percent during the last three fiscal years (2003–06), compared to only 6.1 percent in the 1990s. Similarly, imports have been growing by 29 percent during 2003-06, compared to only 4.8 percent during the 1990s. Pakistan's share of trade in GDP sharply increased to 36 percent by the end of 2005-06 from 26–27 percent in the late 1990s.[16] Despite fears that Pakistan would be hurt by the end of world garment and textile quotas in January 2005, the Pakistani textile sector has held its own in the face of stiff competition from countries like China.

Trade Integration

There is also encouraging progress on economic integration in the South Asia region. The signing of SAFTA in January 2004 is perhaps the most visible sign of the push toward greater regional integration. This landmark agreement replaces the unsuccessful South Asian Preferential Trade Area (SAPTA) and potentially establishes the largest free trade area in the world by 2016 (the aim is to make South Asia a free trade area by 2016), covering more than 1.4 billion people. It aims to boost trade among member countries by reducing and eventually eliminating tariff barriers, facilitating cross-border movement of goods, promoting fair competition in the region, and creating an effective framework for regional cooperation. All seven original member states of the South Asian Association for Regional Cooperation (SAARC)[17] have ratified the agreement, which came into force on January 1, 2006. The first two rounds of tariff concessions began in July 2006 and were completed in late 2006. However, before the vision of a South Asia free trade area becomes a reality, critical steps will need to be taken to allow freer Pakistan-India bilateral regimes that govern the movement of goods, people, and investments.

Good progress has been made in finalizing the four SAFTA agreements, namely a list of sensitive items, rules of origin, and both technical assistance and revenue compensation for least developed countries.[18] However, compared to the initial optimism, recent analysis indicates that SAFTA may have a rather limited impact on liberalizing trade in the region. This is because of the fairly restrictive sensitive lists that member countries have put up, rather strict rules of origin, and a slower timeframe and scope of trade liberalization than those built in to other recent bilateral and regional trade arrangements that SAARC members have signed or are considering.[19] Moreover, there have been a few setbacks because of recent disputes between the two largest SAARC economies—Pakistan and India.[20] We hope that there is a quick resolution to these disputes so that the potential benefits from the expansion of intraregional trade and economic integration can be achieved.

Nonetheless, we feel that the time is ripe for Pakistan to reevaluate its trade regime with India. Good progress continues to be made on the bilateral Composite Dialogue on political, defense, and economic issues. Pakistan and India have opened up their economies and entered a period of high growth. The countries of the South Asia region have embraced regional trade and economic integration for economic growth and poverty reduction, and have made some progress on the SAFTA agreement.

Potential Peace Dividends of More Pakistan-India Trade

What could be the potential peace dividend from normalizing and expanding Pakistan-India trade? Baroncelli (2007) uses a gravity model to show that potential trade, including formal and informal trade, could have amounted to $3.2 billion in 2000—which is over 400 percent higher than actual flows. This would have come from enhanced cooperation in security and trade policies. Pakistan and India could potentially increase their bilateral trade by another 79 percent by entering a regional trade arrangement or agreement (RTA) such as SAFTA. The

State Bank of Pakistan (2006) has estimated a trade potential of $5.2 billion for FY 2004 using the Revealed Comparative Advantage methodology. Batra (2004) uses a gravity model to estimate potential trade of $6.6 billion annually. The Federation of Indian Chambers of Commerce and Industry (2003) has estimated potential trade of around $6–8 billion. The Karachi Chamber of Commerce and Industry predicts that trade could be as high as $5–10 billion. We find that estimates of potential bilateral annual trade range between $3–10 billion. So at best, these two large South Asian countries are exploiting only a third to a tenth of the potential that exists in bilateral trade.

The 1996 study by Pakistan's commerce ministry (referred to earlier) argues that the winners from a liberalized Pakistan-India bilateral regime would far outweigh the losers. Consumers (via the expansion of choice), the government (through tariffs on legalized trade) and producers in several important segments of the economy (who look to the Indian market with great relish) would benefit both in the short and the long run. Some highly protected producers would lose out, but this loss would be small compared to the gains. In any case, many producers would come out as stronger global players following stiffer competition in the home market.

The studies reviewed just above present, at best, partial estimates of the gains from liberalized bilateral trade. It is difficult to predict with any certainty the volume of trade creation following trade liberalization, since the dynamics of reintegrating the two large economies after a hiatus of 60 years would be complex and cannot be modelled easily. However, we can safely say that geography, the socioeconomic situation, and the recent rapid increase in consumption demand in Pakistan and India suggest that gains are likely to be multidimensional and substantial.

Nevertheless, powerful lobbies among producers continue to express concern that Pakistan would lose out by expanding trade with its larger neighbor, because India has a long history of industrial development; enjoys economies of scale in a number of sectors; benefits from heavy industry that has better technology compared to Pakistan; and has large numbers of highly skilled workers. Proponents of this argument state that in international trade, India is known to use tariff and non-tariff barriers to protect its domestic producers. Moreover, they argue that the use of agricultural subsidies is quite widespread in India. These arguments often come from protected industries and farmers in Pakistan, and frequently drown out other voices. In fact, many large firms see considerable benefits from liberalized trade with India, particularly the large-scale Pakistan textile sector that has invested heavily to benefit from the end of the Multi-Fiber Agreement (MFA) quota regime in January 2005.

Some concerns (such as India's proclivity to use non-tariff barriers and to provide continued high subsidies to farmers) have merit and will need to be addressed as part of the safeguards while negotiating liberalized trade. However, it would not be productive to set the redress of these interventions as preconditions for liberalizing bilateral trade.

On the other hand, strength can be gained from the progress Pakistan has made in recent years to sharpen the competitive foundations of its economy. As a result of its structural and economic reforms of the past seven years, Pakistan now has a respectable score of 74 out of 175 countries[21] in the World Bank's cost of doing business rankings; the country had a much poorer standing a few years ago. Pakistan faces competition in trade from China, its northern neighbor and an economic dynamo—yet Pakistan seems to be coping well. Moreover, Pakistan has a much better trade-related infrastructure than India, and it is also currently investing heavily in further improving its trade logistics; the new port at Gwadar (Balochistan) and the upgrading of the North-South corridor are some examples. This will help Pakistan face competition from India, especially on trade routes extending to Central Asia and the Gulf region.

Furthermore, there is a sizeable potential for intra-industry trade and exchange of technology and skills between India and Pakistan. Although we did not specifically look at issues of intra-industry trade in our own work,[22] there are indications of significant potential gains in a number of areas that we did analyze. For instance, Pakistan and India already trade in agricultural goods to meet local shortages in bulk items like wheat, sugar, and raw cotton, and in other agricultural products in the event of crop failures (these traded agricultural goods include potatoes, ginger, onions, and garlic). In textiles, intra-industry trade already takes place in both formal and informal trade relations. Pakistan has comparative advantage in both pure cotton-based fabrics and short-staple fiber yarn/fabric. India has a distinct advantage in long-staple fibers, polyester fibers, and polyester-based fabrics. In engineering goods that we examined, Pakistan has an edge in the export of ceiling and pedestal fans, while India can potentially be a dominant player in the Pakistani market for standard workhorse type bicycles. In addition, there could be a large potential for intra-firm trade in the services sectors, particularly in health, information technology, tourism, and entertainment industries. The issue of trade in industries is an area that needs more research in order to fully understand its potential size and implications for each country.

In the most optimistic scenario, we foresee a future for Pakistan-India trade that replicates pre-1947 trade patterns, but in a new setting. Lahore could become the hub for trade with smaller Indian towns like Amritsar, Jullandar, Firozpur, and Ambala, as existed before partition. These and other smaller towns in the Indian Punjab and Pakistani Punjab (e.g. Gujrat, Gujranwala, Sialkot, Wazirabad, Faisalabad) could benefit from intra-industry trade in agriculture and manufactured goods. Peshawar used to be an entry port for the movement of goods from the mainland Indian subcontinent northwest to Afghanistan and beyond. Peshawar and its neighboring towns already replicate this position to some extent in unofficial trade between India and Pakistan. If Pakistan allows transit facilities over land to India for the latter's trade with Afghanistan, then Peshawar and many towns in Northwest Frontier Province could gain substantially. Quetta, Gwadar, and other towns in Balochistan could gain from expanded trade with India, particularly if India uses land routes over Pakistan and the new Gwadar port facilities to trade with the Gulf, Afghanistan, and Central Asia. Karachi and towns in Sindh could be the beneficiaries of normal trade relations with India because of the sea trade via the Karachi port and the cross-border trade between Sindh and western and central Indian provinces. Normal trade relations with India and resolution of the Kashmir dispute would also lead to large benefits for people living in the Indian and Pakistani Kashmirs. The devastating earthquake of October 2005 in Pakistani Kashmir made the two countries open up the disputed Kashmir border for the flow of relief goods, saving hundreds of lives. If natural trade corridors that have previously existed in this area could be restored with normal political and trade relations between the two countries, then the potential peace dividends could be enormous.

Recommendations for the Future

In order to realize potentially large static and dynamic peace dividends,[23] both governments need to build on the foundations of the Composite Dialogue process. There has to be free movement of goods, capital, and most importantly of people—businessmen, investors, students, media persons, and skilled workers. Both India and Pakistan need to tackle their restrictive visa regimes—which still limit to three the number of cities that citizens of each country may visit per trip; which stipulate that entry and exit be made via the same port of entry; and which require (in most instances) reporting to police in the cities visited both when arriving and departing. At present, infrastructure and border facilities are grossly inadequate for handling trade volume growth. Additionally, the regulations that currently guide cross-border bilateral trade are geared to curbing—not promoting—trade. For instance, Indian and Pakistani trucks have to unload at the border while goods are carried by porters across no man's land areas and border gates. Similarly, the railway wagons used for trading goods on the Samjhota Express, which runs through Pakistan and India, are grossly inadequate. The Munabao-Khokrapar railway route, which also services stops in both countries, only operates for passenger traffic and not for trade in goods. Some of these issues have been taken up for discussion in recent negotiations between the two governments.

Pakistan must also negotiate with India so that there is a level playing field in areas where the Indian government provides subsidies, concessions, or special incentives to certain industries. For example, Indian farmers gain because of subsidies on electricity for agricultural use, which gives them a cost advantage in production compared to their Pakistani counterparts. Another example is the protection given to textile producers in India by the use of generally binding higher rates of specific taxes, even though the *ad valorem* tariff rates on most textile products are lower than Pakistan's tariff rates.

We also believe that Pakistan should grant MFN status to India. This would provide political mileage for Pakistan, as India has been able to deflect pressure to liberalize trade with Pakistan by pointing to the absence of formal MFN treatment. After granting this privilege, Pakistan would be able to raise more substantive issues, notably Indian non-tariff barriers, subsidies, and protective tariffs. Pakistan has already granted something close to de facto MFN status to India, if one considers the composition of both formal and informal trade. So this move may lead to substantive political gains. In sum, holding back the granting of MFN status to India is harming Pakistan in international fora and in its bilateral negotiations on economic and political issues.

In conclusion, there is much to be gained from liberalizing trade between India and Pakistan. Recent developments on the political and economic fronts show that this is already going on. We now need to build on the momentum. Sustained and high gains from bilateral trade liberalization, however, require that attention also be paid to freer movement of investments and people. Only such mobility will ensure that information flows and the two economies benefit from regional comparative advantage. Free trade in goods, without free movement of people and investments, runs the risk of creating trading monopolies, which would result in suboptimal gains from the expansion of bilateral trade.

Annex

Table A1: India's Trade with Pakistan and the Rest of the World (Value in $ Million)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Exports						
Exports to Pakistan	186.83	144.01	206.16	286.94	521.1	689.2
% Growth		-22.92	43.16	39.18	77.5	32.3
India's Total Exports	44,560.29	43,826.73	52,719.43	63,842.97	83,535.9	103,090.5
% Growth	21.0	-1.65	20.29	21.1	26.2	23.4
% Share of Pakistan	0.42	0.33	0.39	0.45	0.63	0.67
Imports						
Imports from Pakistan	64.03	64.76	44.85	57.65	95.0	179.6
% Growth		1.14	-30.74	28.54	60.9	89.1
India's Total Imports	50,536.46	51,413.29	61,412.13	78,149.61	111,517.4	149,165.7
% Growth	1.7	1.74	19.45	27.25	39.7	33.8
% Share of Pakistan	0.13	0.13	0.07	0.07	0.08	0.12
Total Trade						
Trade with Pakistan	250.86	208.76	251.01	344.59	616.0	868.8
% Growth		-16.78	20.24	37.28	74.7	41.0
India's Total Trade	95,096.75	95,240.01	114,131.56	141,992.58	195,053.4	252,256.3
% Growth		0.15	19.84	24.41	33.6	29.3
% Share of Pakistan	0.26	0.22	0.22	0.24	0.32	0.34
Exchange Rate	45.68	47.69	48.39	45.95	44.93	44.27

Source: Department of Commerce, government of India.

Table A2: Pakistan's Trade with India and the Rest of the World (Value in $ Million)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
			Exports			
Exports to India	55.4	49.2	70.7	93.7	288.1	293.3
% Growth		-11.19	43.70	32.53	207.5	1.8
Pakistan's Total Exports	9201.6	9134.6	11,160.20	12,313.30	14,391.0	16,451.2
% Growth		-0.73	22.18	10.33	16.9	14.3
% Share of India	0.6	0.54	0.63	0.74	2.0	1.8
			Imports			
Imports from India	235.09	186.5	166.5	384.4	551.7	801.9
% Growth		-20.7	-10.7	-130.9	43.5	45.4
Pakistan's Total Imports	10,728.40	10,339.50	12,230.30	15,591.80	20,598.1	28,580.9
% Growth		-3.62	18.29	27.49	32.1	38.8
% Share of India	2.19	1.8	1.36	2.45	2.7	2.8
			Total Trade			
Trade with India	290.49	235.7	237.2	478.1	839.8	1,095.2
% Growth		-18.86	0.64	101.56	75.7	30.4
Pakistan's Total Trade	19,930.00	19,474.10	23,390.50	27,905.10	34,989.1	45,032.1
% Growth		-2.29	20.11	19.30	25.4	28.7
% Share of India	1.46	1.21	1.01	1.71	2.4	2.4

Sources: Ministry of Commerce and Ministry of Finance, government of Pakistan.

References

Baroncelli, Eugenia. 2007. "The 'Peace Dividend,' SAFTA, and Pakistan-India Trade." In *The Challenges and Potential of Pakistan-India Trade*, eds. Zareen F. Naqvi and Philip Schuler. Washington, DC: World Bank.

Batra, Amita. 2004. "India's Global Trade Potential: the Gravity Model Approach." Working paper No. 151, Indian Council for Research on International Economic Relations, New Delhi.

Federation of Indian Chambers of Commerce and Industry. 2003. "Status Paper, India–Pakistan Economic Relations." New Delhi.

Government of Pakistan. 1997. "50 years of Pakistan in Statistics, 1947-1972." Report of the Federal Bureau of Statistics, Statistics Division. Karachi.

Government of Pakistan. 1996. "Pakistan-India Trade: Transition to the GATT Regime." Report of the Ministry of Commerce, Islamabad.

Nabi, Ijaz, and Anjum Nasim. 2001. "Trading With the Enemy: a Case for Liberalizing Pakistan-India Trade." In *Regionalism and Globalization: Theory and Practice*, ed. Sajal Lahiri. London: Routledge.

Naqvi, Zareen F. and Philip Schuler, eds. 2007. *The Challenges and Potential of Pakistan-India Trade.* Washington, DC: World Bank.

Sangani, Kavita, and Teresita Schaffer. 2003. "India–Pakistan Trade: Creating Constituencies for Peace." *South Asia Monitor* No. 56, Center for Strategic and International Studies, Washington, DC. Available from http://www.csis.org/media/csis/pubs/sam56.pdf.

State Bank of Pakistan. 2006. "Implications of Liberalizing Trade and Investment With India." Report from the Research and Economic Policy Departments, Islamabad. Available from http://www.sbp.org.pk/publications/pak-india-trade/.

Notes

1. We are using the definition of South Asia used by the World Bank. The countries in this region include: Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.

2. Percentages are calculated as exports plus imports of developing countries in each region as shares of their total exports plus imports.

3. Data are gross exports from developing countries in East and South Asia in current U.S. dollars, taken from the UN Comtrade database. All dollar figures in this essay refer to U.S. dollars.

4. Wherever we have used hyphenated years (e.g. 1997-98 or 2004-05), we mean fiscal years. Unless otherwise specified, calendar years are used without the prefix "fiscal years" or "FY," and without hyphens.

5. The report was presented to the Pakistan government's commerce ministry. The papers making up the report have been condensed and put together in the World Bank's edited volume, *The Challenges and Potential of Pakistan-India Trade*, cited in the list of references above.

6. Revealed Comparative Advantage methodology is an indicator of a country's intrinsic comparative advantage. In its original form, it was a measure of relative export performance by a country or industry, defined as a country's share of world exports of a good divided by its share of total world exports. It has subsequently been used in a broader sense to look at both imports and exports.

7. In the case of Pakistan-India trade, third-party trade is that which is channeled via third locations like Dubai or Singapore.

8. "Informal trade" here refers to bilateral trade that is not recorded as such in official statistics, because it moves through third countries (e.g. the United Arab Emirates, Afghanistan, or Singapore), is smuggled, or is undertaken by individuals carrying tradable items as personal baggage. Our estimates are based on field research in border regions of Pakistan, in Dubai, and in major Pakistani urban markets. The research was conducted by the Sustainable Development Policy Institute in Islamabad.

9. This includes an estimated value of informal trade between the two countries. We have assumed that the value of informal trade was $545 million in 2005-06, the same value as we estimated in 2004-05.

10. The India–Pakistan Composite Dialogue process began in January 2004 after a meeting of the Indian prime minister Atal Bihari Vajpayee and Pakistani president Pervez Musharraf. The eight-point agenda covers peace and security; Jammu and Kashmir; Siachen; Sir Creek; Wullar Barrage; terrorism and drug trafficking; economic and commercial cooperation; and the promotion of friendly exchanges in various fields.

11. Under a "positive list" approach, only those items on the list may be imported, and any item not on the list is banned. In contrast, items on a "negative list" are banned, and any item that is not on the list may be imported.

12. In 2005-06, the 773 items corresponded to around 1,650 tariff lines at the eight-digit level of the Harmonized System (HS) codes. With the latest addition of 320 items in November 2006, the list now covers around 2,000 tariff lines at the eight-digit HS code level. A number of aggregated categories are also included that cover a large number of tariff lines, such as laboratory equipment, pharmaceuticals, and HIV/AIDS drugs. In addition, a few regulations cover additional items that are allowed to be exported under bonded warehouses, export houses, and duty neutralization schemes.

13. These figures are based on the average of the bilateral trade data reported by Pakistan and India. It must be noted that there are considerable discrepancies between the trade data of the two countries—partly because of differences in the fiscal years. The consistent trend over the last 10 years is that Pakistan's trade

data underreports exports to India compared to Pakistan's imports in the Indian data and overreports imports from India compared to what Indian data shows as exports to Pakistan. It would be useful to sort out these discrepancies as part of Pakistan–India trade discussions, particularly as the differences are large compared to normal discrepancies in bilateral trade statistics.

14. Para-tariffs refer to trade regulations that can act as impediments to trade like tariffs do. These could be additional border charges and fees on foreign trade transactions. In many cases these regulations are levied solely on imports, but not levied in the same manner on similar types of domestic products.

15. Behind-the-border trade-related reforms usually refer to domestic policy measures that support trade. Examples could be major institution-building, customs reforms, and trade facilitation. Improvements in trade-related infrastructure and the provision of efficient and competitive trade-related services are other examples.

16. These figures are based on the share of merchandise trade (in millions of dollars) to GDP at current market prices (using the new Pakistani GDP series beginning in 1999–2000). The new GDP series was converted into U.S. dollars at the average annual exchange rates. Since the older GDP series was discontinued after 2002-03, we have estimated the data for the last four years by projecting the 2002-03 figures using the current growth rates of nominal exports, imports, and GDP at market prices in the new series.

17. These include India, Pakistan, and Sri Lanka as non-least-developed countries (non-LDCs), and Bangladesh, Maldives, Nepal, and Bhutan as least-developed countries (LDCs). Recently Afghanistan has been accepted as a new member of SAARC and an LDC member of SAFTA. China, Japan, Korea, Iran, the European Union, and the United States have been granted observer status in SAARC.

18. These agreements can be viewed on the SAARC web site: http://www.saarc-sec.org.

19. These issues are discussed in detail in Richard S. Newfarmer and Martha Denisse Piérola, "South Asia Free-Trade Area—Promises and Pitfalls of Preferential Trade Arrangements," in *The Challenges and Potential of Pakistan-India Trade*, eds. Zareen F. Naqvi and Philip Schuler (Washington, DC: World Bank, 2007), 29-54.

20. Pakistan has offered tariff concessions to India only on its "positive" list of importable goods from India. This is contrary to the SAFTA agreement, which stipulates that tariff concessions be given on all goods except those goods on the "sensitive" list that are to be identified by each country for least-developed countries (LDCs) and non-LDCs. India has termed this move as a non-tariff barrier by Pakistan and has hinted that it may review, and, in the worse case, possibly revoke the tariff concessions given to Pakistan.

21. *Doing Business in South Asia 2007* (Washington, DC: World Bank, 2007). Available from http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/0,,contentMDK:21217344~pagePK:146736~piPK:146830~theSitePK:223547,00.html.

22. We are referring here to *The Challenges and Potential of Pakistan-India Trade.*

23. Static refers to peace dividends at a point in time, such as right now. Dynamic peace dividends would be the gains from better trade and economic relations over a period of time, such as over the next 5-10 years.

PART IV

The Pakistan-U.S. Trade Relationship

PAKISTAN-U.S. TRADE: A BUSINESSMAN'S PERSPECTIVE

Abid Farooq

Pakistan has a history with America: a history of trade, a history of politics, a history of dialogue, but most of all a history of friendship. I hope that this friendship will be further cemented through mutual efforts and actions between the two countries, and especially through the collaboration of our respective private sectors and through the positive role they play.

Current Economic Scenario of Pakistan and Investment Opportunities

Pakistan's economic growth has always been dependent on the strength, existence, and availability of its inherent natural agricultural base resources and ample pool of labor.

Although its growth in the 1990s was shaky and uncertain, the relatively stable political situation and progressive economic reforms of the past five years have helped usher in very solid and visible growth in all important sectors of the economy, including manufacturing, services, and agriculture. Currently, Pakistan is in the midst of its strongest economic expansion phase. Its real gross domestic product (GDP) has grown at an average of 7 percent per annum,[1] including a very modest income per capita rise to U.S. $925[2] in fiscal year 2006–07 (though I shall not even dare compare this figure with U.S. per capita income).

Abid Farooq is a businessman based in Lahore. He is currently managing director of Ali Akbar Spinning Mills Ltd, and directs several other corporations in Pakistan as well. His firms specialize in the manufacture of cotton, cotton-blended yarn, knitted fabrics, and garments, among other products.

This very respectable steady economic growth has gained momentum, a development that can be attributed to Pakistan's keeping up with the rapid pace of competitive globalization—especially in Asia, where China and India are showing strong signs of further accelerated growth. Yet this increased momentum is largely due to Pakistan's structural reforms. The country's progressive reforms (such as those dealing with taxes, agriculture, finance, and governance, as well as fiscal transparency, privatization, and deregulation) have resulted in more than U.S. $6 billion of foreign investment[3] over the past five years. This strong investment record is an encouraging indication that international markets and investors now see ample lucrative opportunities in the manufacturing, services, and agricultural sectors of Pakistan.

With Islamabad's constructive economic policies, the telecommunications sector of the country has witnessed astounding growth. The combined teledensity of Pakistan (a measure of the number of telephone subscribers) increased from less than 4 percent in 2001–02 to about 40 percent of the total population in early 2007.[4] The total number of mobile subscribers increased from 2.4 million in 2003 to an impressive 34.5 million[5] in 2006. This increase in demand for mobile handsets has elevated Pakistan to the position of the world's fifth largest telecom market. There is an inherent, highly lucrative opportunity to invest in Pakistan's telecom sector; current investment is at about half a billion dollars.

Furthermore, with a population of over 160 million and a rapidly growing economy, Pakistan's energy requirements are huge and its energy supplies are becoming acutely sparse. Pakistan, though equipped with a well-developed infrastructure for energy, unfortunately faces a yawning gap in supply (2500 megawatts) that threatens the country's households and industries. Forty percent of Pakistani households have yet to receive electricity,[6] and judging from the critical role the energy sector plays in social and economic development, there is a tremendous opportunity for U.S. companies to set up independent power plants to tap this lucrative energy market. Pakistan's government has recently indicated its commitment to renewable energy sources, and a three-phase reform plan has been devised. According to the first phase of these energy sector reforms, the private sector will be invited to invest in various power projects until June 2008, in an effort to liberalize a sector long controlled by the government.

As mentioned earlier, the services sector has been one of the major benefactors of Pakistan's recent economic growth. Islamabad aims to attract investment in the Business Process Outsourcing (BPO) sector; at present there are over 150 international and domestic call centers in Karachi, Lahore, and Islamabad.[7] The Pakistan Software Exports Board, a government body set up to promote outsourcing, forecasts that the BPO industry will grow by at least 45 percent per annum. To assist this expected growth, the government has announced a 15-year tax holiday for setting up call centers.

Pakistan-U.S. Trade and Aid

If there is one country that has been a long-term and strong trading partner with Pakistan, it is the United States. Almost 25 percent of Pakistani total exports reach the United States; approximately 80 percent of these U.S.-bound exports consist of textiles and clothing.[8]

Pakistan also exports a number of food items to the United States. These products include cereal, beverages, coffee, tea, and edible fruit, which yielded a total export value of U.S. $44 million[9] in 2006. These exports, however, are challenged by tariffs such as general tax increases and peak season surcharges, which add significantly to freight costs. Additionally, non-tariff barriers—mainly U.S. Food and Drug Administration (FDA) regulations—further impede the growth of food exports. Because food shipments have to conform to FDA guidelines, costs and other resources required for FDA approval are too high for most exporters to bear. Furthermore, while the FDA has representation in India, it has no such presence in Pakistan.

While our trade surplus with the United States shows a healthy picture, it is also noteworthy that our imports from the United States are steadily increasing. Given the huge difference between our two countries' per capita income, Pakistan is managing to maintain its share of trade with its important trade partner.

Additionally, Pakistan receives abundant aid from the United States in various forms. One of the avenues of assistance is funding or grants for education and human resource development. I should say that Pakistan's private sector has made great progress with education. The last decade has witnessed an emergence of world-class private educational institutes that have higher levels of international recognition than governmental institutions.

Being an educator, I have long had a vision to establish a center of excellence for learning. This vision recently materialized in the formation of Knowledge Scape Global, a platform that has partnered with U21Global, a premium online graduate school based in Singapore. Moreover, we have recently acquired the rights to be an authorized affiliate for eCornell, the e-learning partner of Cornell University. It is a matter of deep pride for me to represent an American Ivy League institution in Pakistan. I reach out to the American community to support similar initiatives that provide opportunities of learning and education for the Pakistani people.

Pakistan's Textile Exports

Continued Challenges for Pakistan

As our government continues to implement the structural reforms mentioned earlier, it can be expected that further growth in services and perhaps also in the manufacturing sector will take place.

However, our continuously increasing trade deficit is expected to reach U.S. $14 billion[10] in 2008, and visible demand-led inflationary pressures will halt economic progress if the looming crisis in our dominant export earner—the textile industry—is not addressed on an urgent basis by our government and our largest trading partner, the United States.

Contrary to general expectations, our textile industry has not shown obvious promise of exponential growth in the post-Multi-Fiber Agreement (MFA) era, and hence Pakistan has not captured any real market share in the expanding global trade of textiles and clothing. The textile industry has been uncompetitive, and for various reasons: lack of skilled human resources, unreliable energy sources, highly competitive pricing by China, and India's superb marketing of its textile products.

I do not want our policymakers to be so mesmerized by the growth in the services sector, and by the unprecedented inflow of foreign investment, that they do not recognize the phenomenal efforts that must be made to gain and maintain market share in the extremely competitive world of textiles and clothing in such a way that Pakistan can still be a major player in Asia.

Pakistan's private sector has made investments of over U.S. $5 billion in the past six years in the textile industry, which have been used not only to modernize plants but also to expand for economies of scale. Unfortunately, in a span of just 18 months between 2005 and 2007, the cost of borrowing in Pakistan went up from 4 to almost 13 percent, while energy prices are showing signs of further increase because of the looming demand-supply gap.[11]

Our government and private sector had expected a true free trade environment in the post-MFA era and also expected that all WTO member countries would strictly abide by WTO laws. I refer specifically to laws that require WTO members to practice free trade in its true sense—no hidden subsidies, no non-tariff barriers, and no regional trade agreements that violate the comparative advantage of other nations. However, we all know that this is not the case, and that these laws have been broken.

Pakistan has a textile industry that boasts some of the most state-of-the art plants and machinery. Yet we face a huge crisis. A recent comprehensive report by the international textile consultant Gherzi[12] concludes that Pakistan's textile industry becomes uncompetitive when subsidies given by competitor nations kick in. I am referring here to situations such as when hidden subsidies are given by governments to their own cotton growers, and when non-tariff barriers are levied on nations like Pakistan.

The laws and fundamentals of free trade are being further tested and undermined by lawmakers themselves, who, due to geopolitical reasons, have made bilateral trade agreements even with countries with no background or economic advantage in textile products. How can we have a level playing field under these conditions?

Pakistan's Textile Exports and the United States

The way forward for enhancing further U.S. trade with Pakistan—at least for the foreseeable future—still lies mainly in textiles. The most obvious reason for this conclusion is that the United States will remain the largest market for textiles and clothing for Pakistan's product range. Our dependence as such cannot be denied.

Additionally, Pakistan's textile industry is responsible for employing almost 40 percent[13] of the country's total manufacturing sector. Growth and profitability in the textile sector are essential to the poverty alleviation drive of our government, adding positively to income per capita growth.

Given the strategic relationship between Pakistan and the United States, and given Pakistan's relentless support on all matters of importance for the United States, it may be appropriate for Washington to consider equitable market access for Pakistan's products. I use the word "equitable" because at the moment, the United States and European Union have signed various bilateral trade agreements with several Arab, African, and Latin American nations that emphasize preferential trade.

Pakistan's textile and clothing exports to the United States fall under the category of non-preferential supplies and are subject to effective rates of import duty between 9.47 (for textile exports) and 15.4 percent (for clothing exports).[14] By contrast, countries that have preferential trade agreements with the United States enjoy effective import duty rates between only 0.19 (textiles) and 2.52 (clothing) percent, which translates to a margin of preference[15] of about 9 (for textiles) to 13 (for clothing) percent on average. Even the world's most efficient producers cannot overcome such a disadvantage under such highly competitive conditions. Among developing nations, Pakistan has been at the forefront of adopting the rules and laws of the WTO, even at the risk of losing its market share in the short to medium term. Yet Pakistanis are the ones who must watch as the nations that discretely and blatantly continue unfair trade practices gain market share in the United States.

Ironically, Pakistan has a definite comparative trade advantage in textiles over many of the United States' trading partners. It is precisely because of the preferential trade agreements Washington concludes with other countries that our major export earner suffers drastically. It is difficult enough to grow in this highly competitive industry while dealing with the blatantly unfair trade practices of China and India. The Chinese government heavily subsidizes its textile sector, further distorting trade by sustaining an artificial currency rate that serves as a backbone for its burgeoning exports. And yet to make things worse, these preferential trade agreements completely exclude us, even while Pakistan has helped the United States strategically, and even as we remain a deserving trade beneficiary of that country.

Pakistan's textile industry is one of the largest importers of American Pima and medium-staple cotton. Most of the cotton is converted in the form of yarn, fabric, and garments, and then shipped back to the United States. Our current imports of cotton comprise over 2 million bales, worth approximately U.S. $440 million, with almost 35 percent of this total amount (worth U.S. $155 million[16]) coming from the United States. These figures are expected to grow. If special duty-free status were to be given to cotton shipments coming from Pakistan, then American cotton imports into Pakistan could increase substantially.

Imports of cotton from America could be further facilitated if a workable solution of warehousing infrastructure in Pakistan could be organized. Our private sector must engage (perhaps via the American Business Council of Pakistan or the All Pakistan Textile Mills Association) to address the reasons why the warehousing of American cotton is currently done in places like Dubai. By storing cotton in Pakistan, time lags and extra incidental costs could be avoided.

Conclusion

I remain cautiously optimistic that Pakistan is heading in the right direction for further economic growth. Yet Pakistanis must also be candid in expressing the fact that our internal inefficiencies and mismanagement of affairs have resulted in our lagging behind the likes of India and China in this highly competitive global environment.

If Thomas Friedman states that the world is no longer round, but flat, then I think Pakistan is somewhere in the middle. While nations such as India and China were aggressively building the educational and skills bases of their respective work forces, our decision-makers in Pakistan were completely ignoring the immense importance of adopting strong education and skills reforms on a truly effective basis. This has handicapped our work force's ability to meet the challenges found in the ever-growing need for efficiency and competence in every form of trade and service.

Even though the present government has addressed this matter through new education reforms, Pakistan will need reasonable amounts of time to catch up with other nations in South Asia.

At the risk of being slightly emotional, I might also add that the world is not fair. Pakistan is making tremendously genuine efforts through its actions and commitment to be known in the world as a truly peace-loving nation, and yet it is continuously labeled with a negative perception through the media—which negates our sincere efforts to get the international business community to form long-term partnerships with Pakistan's business community.

When I arrived in the United States to do my MBA program in the 1980s, my American friends asked me what kind of car I had back home. I jokingly replied that I actually had a camel. I felt for one or two moments that they may have believed me. Now, thanks to the likes of Google, you may very well know the model of the car parked in my garage—and yet we as Pakistanis still find it difficult to express who we are and our desire to grow as people with all the other progressive nations in the world.

In recent times, Pakistan has been on the world map as a nation playing a major part in fighting the War on Terror. This may give us some respectable degree of undesirable recognition. Ultimately, however, we, the people and the business community of Pakistan, would like to appear on the world map as a progressive and enlightened nation of sound economic strength.

The United States has truly helped and supported Pakistan to overcome many difficult challenges—both politically and economically—and given special assistance to us through aid. I would hope that we can together go one step further to establish a stronger bond, with a commitment from the U.S. private sector to further enhance trade.

Notes

1. *Business Recorder*, "Economic Survey 2006-07: Overview of the Economy," June 9, 2007. Available from http://www.brecorder.com/index.php?id=575691&currPageNo=1&query=&search=&term=&supDate=.

2. Ibid.

3. State Bank of Pakistan, "State Bank of Pakistan Annual Report for 2005–06." Available from http://www.sbp.org.pk/reports/annual/arfy06/.

4. "Economic Survey 2006–07."

5. Ibid.

6. Government of Pakistan, "Policy for Development of Renewable Energy for Power Generation: Employing Small Hydro, Wind, and Solar Technologies," November 2006. Available from http://www.pakistan.gov.pk/ministries/water-power-ministry/media/PakistanREDevelopmentPolicy-Dec092006.pdf.

7. Adnan Kehar, "Strategy for Increasing Exports of BPO" (prepared by Bearing Point for the Pakistan Software Exchange Board, September 2005). Available from http://www.pseb.org.pk/UserFiles/documents/BPO_Strategy_Feb072006.pdf.

8. Gherzi Institute, "Benchmarking and Incentive Study of Textile Products" (presentation made to the government of Pakistan, Islamabad, March 2007).

9. Study on Pakistan's food trade with the United States, Export Promotion Bureau, government of Pakistan, December 2006.

10. "Economic Survey 2006–07."

11. Gherzi Institute presentation.

12. Ibid.

13. Abid Farooq, "Pakistan US Trade & Investment Relations: Prospects of Expansion" (All Pakistan Textile Mills Association [APTMA] study, 2006).

14. Ibid.

15. Margin of preference can be defined as the difference between the duty payable under a given system of tariff preferences, and the duty that would be assessed in the absence of preferences.

16. APTMA study.

A PERSPECTIVE FROM THE U.S. BUSINESS COMMUNITY IN PAKISTAN: KEY ISSUES AND OPPORTUNITIES

Esperanza Gomez Jelalian

American businesses have had a strong presence in the Pakistan market for over five decades. Although the perception of Pakistan in the United States is often dominated by issues surrounding security and terrorism, a story that lacks attention from the mainstream media is that many American companies have successful operations and continue to explore opportunities for investment in Pakistan. Another reality that is not portrayed in the media is that Pakistan has achieved impressive macroeconomic results in recent years. Financial sector reforms, privatization of state-owned enterprises, and trade liberalization and deregulation have transformed the economy of Pakistan. The economic recovery has provided private sector confidence, contributed to large inflows of remittances and foreign investment, and ultimately led to higher growth.

Beyond the strategic reasons for U.S. involvement in Pakistan, American companies see untapped economic opportunities in the Pakistani market. American businesses are also actively engaged in multiple social and environmental programs to improve the quality of life in the communities in which they operate. Furthermore, following the earthquake that struck northern Pakistan in October 2005, five U.S. chief executives participated in a private-sector initiative established by President George W. Bush to encourage private donations to the South Asia Earthquake Relief Fund; the American private sector contributed over $150 million to the effort.[1] However, concerns about political instability and the negative perception

Esperanza Gomez Jelalian is executive director of the U.S.-Pakistan Business Council (USPBC). Launched at the United States Chamber of Commerce in 2002, the USPBC is the leading private sector association of American companies with business and investment in Pakistan.

of Pakistan continue to adversely impact inflows of American foreign direct investment (FDI) into Pakistan.

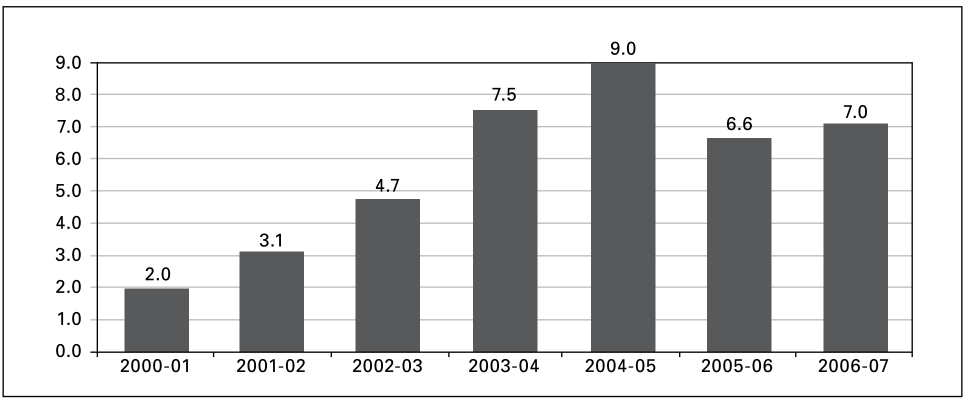
An Overview of the Pakistani Economy

According to most estimates, the Pakistan economy is expected to grow at 7 percent in 2007. As indicated in Figure 1, gross domestic product (GDP) growth in Pakistan has averaged nearly 7 percent for the last five years.

In order to sustain growth, the government of Pakistan has implemented a second generation of reforms that seek to strengthen institutions; improve the competitiveness of industry; facilitate the expansion of and an increased role for the private sector; build a robust competitive and innovative financial system; implement judicial, police, and civil reform; promote transparency in economic policymaking; and further strengthen tax administration.[2]

With a population of 160 million, of which about 100 million are below the age of 25, and with a labor force of 48 million, Pakistan offers a large pool of workers and consumers. The emergence of a growing

Figure 1: GDP Growth in Pakistan



Source: Government of Pakistan, Ministry of Finance, "Pakistan Economic Survey 2006-2007."

middle class in Pakistan, along with the availability of consumer credit and inflows of remittances, has fueled consumption demand and led to the expansion of the domestic market, which has emerged as a key driver of economic growth.[3] To address the shortage of skilled labor, Islamabad has implemented a comprehensive technical and vocational education initiative, as well as a large number of employment generation programs, such as the National Vocational and Technical Education Commission (NAVTEC) and the National Internship Program.[4] In addition, Pakistan has worked to improve the quality of education and to increase access to higher education, specifically in the fields of science and technology. As a result, nine new universities are being established in collaboration with leading world institutions.[5]

U.S.-Pakistan Trade and Investment Relations

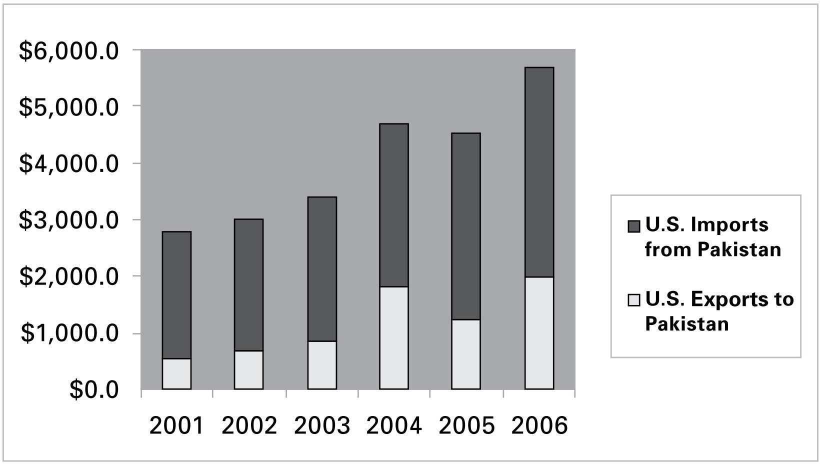
The United States remains Pakistan's largest trading partner. Pakistan's total exports in fiscal year 2005-06 amounted to $16.45 billion, of which 26.9 percent were to the United States.[6] As shown in Figure 2, total trade between the two countries amounted to over $5.6 billion in 2006—American exports to Pakistan totaled $1,989.1 million and Pakistan's exports to the United States totaled $3,672.2 million.[7]

Pakistan's government has also pledged to maintain an open and welcoming investment climate. Figure 3 shows that in FY 2005-06, total FDI amounted to $3.5 billion and portfolio investment amounted to $351 million, while total foreign private investment reached close to $3.9 billion. Pakistan attracted close to $7 billion in total foreign private investment in FY 2006-07. Total FDI amounted to $5.1 billion and portfolio investment reached new levels at the end of the fiscal year, topping off at $1.8 billion.

American Inflow of Net Foreign Private Investment (FPI)

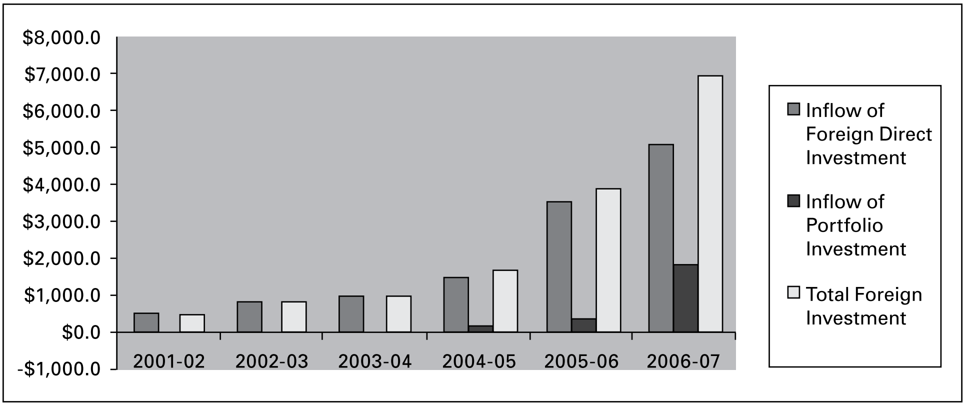
Historically, the United States has been Pakistan's largest investor, as it has contributed approximately 30 percent of the country's total foreign direct investment since 1990.[8] As shown in Figure 4, in FY 2005-06,

Figure 2: U.S.-Pakistan Trade Data in $ millions



Source: U.S. Census Bureau, Foreign Trade Statistics, "Trade in Goods (Imports, Exports and Trade Balance) with Pakistan."

Figure 3: Foreign Investment: Direct and Portfolio (in $ millions)



Source: State Bank of Pakistan.

American FDI to Pakistan amounted to about $516 million, representing about 14.7 percent of the country's total FDI, while portfolio investment reached $303 million, representing around 86.4 percent of total portfolio investment in Pakistan.[9] During the same period, the United States was the second largest source of FDI, after the United Arab Emirates, followed by Saudi Arabia, Norway, the United Kingdom, and Switzerland. The leading sectors of FDI flows during this period were information technology (IT) and telecommunications, power, oil and gas, financial services, trade, and construction.[10]

In fiscal year 2006–07, American FDI to Pakistan stood at about $913 million, representing around 17.8 percent of total FDI. Portfolio investment amounted to around $853 million, representing 46.8 percent of Pakistan's total portfolio investment. Total U.S. investment during this period amounted to over $1,766 million, representing about 25.4 percent of total foreign private investment.[11]

Figure 4: American Investment Inflows in Pakistan ($ millions)

Country	Fiscal Year 2005-2006		
	Direct	Portfolio (Private)	Total
USA	516.7	303.8	820.5
Total FPI	3,521.0	351.5	3,872.5

Country	Fiscal Year 2006-2007		
	Direct	Portfolio (Private)	Total
USA	913.1	853.4	1,766.5
Total FPI	5,124.9	1,820.4	6,945.3

Source: Government of Pakistan, Board of Investment.

U.S. Private Sector Presence in Pakistan

The U.S.-Pakistan Business Council (USPBC), based at the U.S. Chamber of Commerce in Washington, D.C., is the leading private sector association of American companies with business and investment interests in Pakistan. The council's mission is to expand trade and investment opportunities for U.S. companies in Pakistan and to enhance the business relationship between the two countries. The council seeks to strengthen and deepen dialogue between decision-makers in both countries and to promote and expand market access and a business-friendly environment for American companies in Pakistan. To that effect, the USPBC strongly supports the U.S.-Pakistan Strategic Dialogue, launched during President Bush's visit to Pakistan in March 2006, which is designed to strengthen the bilateral relationship in the areas of economic growth, education, energy cooperation, social sector development, and science and technology.[12]

The American Business Council of Pakistan (ABC), based in Karachi, represents 60 American companies in Pakistan, which operate in the following sectors: pharmaceuticals, IT and telecommunications, engineering, chemicals, food and beverage, energy, oil and gas, financial services, and personal care.[13] ABC members have collective investments of over $1.1 billion in Pakistan and cumulative revenues close to $3.3 billion.[14] Their companies contribute over $700 million in taxes, employ 41,000 persons, and indirectly employ nearly 1 million people through their agents, distributors, and suppliers.[15]

Leading American multinationals operating in Pakistan include companies such as: Abbott Laboratories, AIG, The Boeing Company, Cisco, Citi, The Coca-Cola Company, General Electric, Merck, Monsanto, Motorola, PepsiCo, Pfizer, Procter & Gamble, Shell, and Schering Plough. A number of small and medium-size U.S. companies maintain a presence in the Pakistani market, while other U.S. multinationals operate through their franchisees or through an exclusive local distributor. U.S. companies with franchise operations include: Sheraton, Best Western, Hertz, Avis, Pizza Hut, Domino's Pizza, Kentucky Fried Chicken, Subway, and Berlitz.[16]

What is the Government of Pakistan Doing to Attract FDI?

Pakistan is working to improve the quality and reliability of communications, energy, and other services to attract foreign private investment. It is also focused on improving infrastructure and making it easier to conduct financial transactions. According to the World Bank report *Doing Business in South Asia 2007*, which ranks 175 countries on the ease of doing business, Pakistan ranked 74th. It was also named runner-up reformer in South Asia, due to its implementation of reforms to simplify cross-border trade and to reduce corporate tax rates. Pakistan also ranked 54th for starting a business, and it is worth noting that Karachi was listed as the city with the most business-friendly regulations in the country.[17]

The government of Pakistan welcomes foreign investment through a package of incentives: all economic sectors are open to FDI; foreign firms are allowed 100 percent equity ownership in manufacturing and non-manufacturing investments; and full repatriation of capital, capital gains, profits, and dividends is allowed in all sectors.[18] Islamabad also encourages joint ventures through generous tax benefits. Areas expected to grow during the next few years are in the following sectors: oil and gas, power, IT and telecommunications, agriculture, health and pharmaceuticals, minerals, infrastructure, housing and real estate development, light engineering, fertilizer, textiles, construction, and tourism.[19]

Key Issues of American Companies in Pakistan

The following are some of the issues that the U.S. private sector would like to advance in order to unlock further American trade and investment opportunities in Pakistan.

Perception of Pakistan Abroad

One key focus area of the U.S. business community is to improve Pakistan's negative perception abroad. ABC, the American Business Council of Pakistan (the American Chamber in Pakistan), prepares an annual survey to identify its members' perception of the country's economic and business climate, as well as to assess the efficiency of relevant government ministries. According to the 2006 perception survey results, ABC members were optimistic about the business and economic climate in the country. However, many members expressed concern regarding the internal political situation, deterioration of the law and order situation, as well as the negative image of Pakistan abroad.[20] The U.S. business community has stressed to decision-makers in Pakistan the need to devise mechanisms that would enhance the country's image abroad and to brand Pakistan as a profitable business destination.[21]

U.S.-Pakistan Bilateral Investment Treaty (BIT)

Although substantive progress was reported prior to President Bush's visit to Pakistan in March 2006, the two sides failed to conclude a BIT. The negotiations at present are stalled; however, the U.S. private sector remains hopeful that the two parties will reach an agreement. The U.S. business community supports a BIT that incorporates high standards of protection for foreign investors in both countries. A BIT would create a stable, predictable investment climate that would in turn help attract investment as well as encourage existing investors to expand their operations in Pakistan.

The American business community also supports talks between the two governments under the Trade and Investment Framework Agreement (TIFA), which seeks to advance the U.S.-Pakistan trade and investment relationship.[22] The creation of Reconstruction Opportunity Zones (ROZs) in Afghanistan and in the border regions of Pakistan would be a great step in that direction. The ROZs initiative would grant U.S. duty-free treatment to goods produced in Afghanistan and designated areas of Pakistan. The goal is to stimulate trade and development; generate investment opportunities and job creation in the troubled border areas; as well as increase broader economic growth in both countries.[23]

Intellectual Property Rights (IPRs)

Strengthening intellectual property rights and enforcement in Pakistan has been a priority of both the USPBC and ABC. In 2005, Pakistan made notable progress on IPR issues, establishing an Intellectual Property Rights Organization (IPO) to centralize and coordinate property rights enforcement. The IPO was successful in closing numerous pirated optical disk factories. As a result, Pakistan was moved from the U.S. Trade Representative's (USTR) Priority Watch List to the Watch List.[24] Although Pakistan has made serious efforts to strengthen its IPR regime, American pharmaceutical companies continue to stress the need for data exclusivity laws to ensure protection of test data submitted to the Ministry of Health as part of the marketing approval process for pharmaceutical products, as required under the WTO TRIPS (Trade-Related Aspects of Intellectual Property Rights) agreement. In addition, according to USTR, Islamabad should create better linkages between health and regulatory approving agencies and patent authorities to prevent patent infringement during the pharmaceutical approval process.[25] In 2007, USTR will conduct an out-of-cycle review to examine Pakistan's progress in these areas.[26]

Data exclusivity is an important part of the legal regime that needs to be in place to promote growth, exports, and innovation in Pakistan's life sciences sector. Many countries with data exclusivity regimes have developed strong life science sectors, and Pakistan should be able to do the same. Pakistan has many of the attributes required to make it an attractive market for the life sciences: an English-speaking and well-educated work force, a talented overseas diaspora, and a low-cost base. Areas of opportunity in the life sciences in Pakistan include: clinical research, agricultural biotechnology, crop science, genetically modified foods, soil chemistry, chemical engineering, water resource management, and clean water solutions.

Tax Structure

U.S. companies operating in the IT sector continue to advocate for a reduction in the 15 percent sales tax on IT and related equipment, which includes all computer hardware. The IT industry is pushing for a removal of this tax, as it is hampering growth in a sector that the government is keen to develop.

American companies operating in the beverage sector have submitted proposals to the government of Pakistan seeking a tax reduction on carbonated soft drinks to levels of other competing beverages, such as fruit juices, teas, and bottled waters. [27] U.S. companies supply the overwhelming majority of carbonated soft drinks in Pakistan, comprising 95 percent of Pakistan's soft drink industry. In addition to a 15 percent sales tax, carbonated soft drinks are subject to a 50 percent excise tax on soft drink concentrate and a 12 percent excise on finished carbonated soft drink beverages. Recent economic studies about countries where similarly high taxes on soft drinks have been reduced have shown that any revenue decrease has been more than compensated by revenues generated from a higher volume of sales. A reduction in the excise tax in Pakistan would allow the industry to continue to expand operations, resulting in increased investment, direct and indirect employment, and tax revenue.

Leading Sectors for Export and Investment

With the privatization of Pakistan Telecommunication Company Limited (PTCL), the telecommunication services sector has grown at a rapid pace during the last four years and has significant potential for future growth. The latest figures provided by the Pakistan Telecommunication Authority indicate that the number of cellular subscribers reached over 63 million in June 2007.[28] One of the great private sector success stories in Pakistan over the past several years has been in the telecommunications sector—particularly cellular, as there has been a rapid and profitable expansion of mobile services. Motorola jump-started the cellular industry in Pakistan with the launch of GSM services nearly a decade ago. Today, Mobilink remains the largest cellular operator in the country. Motorola is now providing the infrastructure equipment for a WiMAX wireless broadband network that will provide broadband internet connectivity, high speed data and video streaming, and internet telephony.[29] The formal launch of the Wateen WiMAX network took place in mid-2007.

As the IT industry continues to grow, Pakistan's market for computers offers great opportunities for U.S. companies, whose brands are known for their quality and reliability. Companies such as Apple, Cisco, Dell, Hewlett Packard, and Intel have already established a strong presence in Pakistan. Most international IT-enabled service centers operating in Pakistan are from the United States and the United Kingdom; this business subsector is expected to grow by at least 45 percent in the next five years.[30] With an English-speaking, well-educated work force and a low-cost base, Pakistan offers great opportunities for American companies in this area.

Given Pakistan's growing demand for energy, the government is actively seeking investment in onshore and offshore exploration, development of explored wells, and construction of gas lines. The demand for oil and gas drilling equipment, chemicals, pipes, and petrochemical equipment offers great opportunities for American investors in Pakistan. Power demand is projected to grow in the next few years. This sector needs massive investment; specifically there will be a need for power generation, transmission, and distribution equipment.[31]

The air transport sector also offers great opportunities for U.S. investment. A plan for new international airports in Islamabad and Gwadar will require aircraft and aircraft parts, air traffic control, and ground support equipment.

Case Study

The aerospace industry in Pakistan stands out as an example of procurement transparency, integrity, and the ability of the government to streamline government rules vis-à-vis the private sector. As part of the Boeing Company's sale of eight 777s to Pakistan International Airlines, two Pakistani manufacturing facilities are now effectively producing parts for Boeing airplanes.

The opening of Boeing's manufacturing facilities at Pakistan Aeronautical Complex (PAC) and Precision Engineering Complex (PEC) in Pakistan has presented a unique opportunity to enhance exports and to create jobs and growth as manufactured goods are exported back to the buyer. PAC and PEC are now members of Boeing's global supply chain. At present, these facilities produce several parts for Boeing aircraft. In this effort, Boeing has provided training to PAC and PEC personnel, qualification of the complexes for numerous manufacturing processes, as well as the company's technical and management support.

As a single-source supplier of these components, Boeing relies on PAC and PEC to deliver quality parts on time and at competitive prices to the company's moving assembly lines of 777 aircraft in Seattle, Washington. Continuing to successfully transfer this experience across other sectors should be beneficial to the Pakistani economy.

Conclusion

Through its five-year road map, the government of Pakistan seeks to keep inflation under control, maintain a flexible exchange rate regime and fiscal prudence by keeping a low fiscal deficit, improve social indicators, strengthen the country's physical and human infrastructure, and sustain growth momentum. Islamabad is also committed to creating an investment climate—one that further boosts domestic and foreign investment—by completing the second generation of reforms.[32] The U.S. business community stands ready and willing to work with government officials of both countries to develop constructive solutions on commercial issues in the bilateral relationship. The American private sector supports the conclusion of a U.S.-Pakistan bilateral investment treaty. As more U.S. companies give serious attention to business opportunities in Pakistan, an investment treaty would further strengthen the bilateral partnership and help attract new investment as well as encourage existing investors to expand their operations. More importantly, improvement in the law and order situation and political stability would help Pakistan in its efforts to weaken the negative perception of the country abroad. Pakistan's ability to continue its path of strong economic growth should encourage private sector confidence and increase the inflows of foreign investment needed to create jobs for the Pakistani youth who will enter the work force in the coming years.

Notes

1. United States Agency for International Development, "South Asia Earthquake—February 2007 Update," available from http://www.usaid.gov/locations/asia_near_east/documents/south_asia_quake/SAEarthquakeWeeklyUpdate2007-02-23.pdf.

2. Salman Shah, "Pakistan's Economic Resurgence: Policies, Priorities and Opportunities" (presentation at U.S. Chamber of Commerce, April 13, 2007).

3. Government of Pakistan, Ministry of Finance, "Economic Survey 2006-2007: Overview of the Economy," June 8, 2007, available from http://www.finance.gov.pk/survey/sur_chap_06-07/overview_06_07.pdf.

4. World Bank, "The Prime Minister's Speech at the Inaugural Session of the Pakistan Development Forum 2007," April 25, 2007, available from http://siteresources.worldbank.org/INTPAKISTAN/Resources/ThePrimeMinisterspeech.pdf.

5. Ibid.

6. Commercial Service, U.S. Department of Commerce, "Doing Business in Pakistan: A Country Commercial Guide for U.S. Companies," February 16, 2007, available from http://www.buyusainfo.net/docs/x_2864206.pdf.

7. U.S. Census Bureau, Foreign Trade Statistics, "Trade in Goods (Imports, Exports and Trade Balance) with Pakistan," available from http://www.census.gov/foreign-trade/balance/c5350.html.

8. American Business Council of Pakistan, "About ABC," available from http://www.abcpk.org.pk/about.htm.

9. Government of Pakistan, Ministry of Finance, "Economic Survey 2006-2007: Growth and Investment," June 8, 2007, available from http://www.finance.gov.pk/survey/sur_chap_06-07/01-Growth.pdf.

10. Ibid.

11. Government of Pakistan, Board of Investment, "Country Wise Foreign Investment Inflows," available from http://www.pakboi.gov.pk/forign-invest.htm.

12. White House, Office of the Press Secretary, "Joint Statement on United States-Pakistan Strategic Partnership," March 4, 2006, available from http://www.whitehouse.gov/news/releases/2006/03/20060304-1.html.

13. American Business Council of Pakistan, "About ABC."

14. American Business Council of Pakistan, "Contribution to Pakistan's Economy," available from http://www.abcpk.org.pk/contpakeconomy.htm.

15. Ibid.

16. U.S. Department of Commerce, "Doing Business in Pakistan."

17. World Bank Group, *Doing Business in South Asia 2007* (Washington, D.C.: International Bank for Reconstruction and Development/The World Bank, 2007), available from http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/0,,contentMDK:21217344~pagePK:146736~piPK:146830~theSitePK:223547,00.html.

18. Government of Pakistan, Board of Investment, "Investment Policies," available from http://www.pakboi.gov.pk/invest.pack.htm.

19. Government of Pakistan, Board of Investment, "Investment Opportunities," available from http://www.pakboi.gov.pk/sectors.htm.

20. American Business Council of Pakistan, "2006 Perception Survey," available from http://www.abcpk.org.pk/abcpersurvey.htm.

21. U.S.-Pakistan Business Council, "U.S.-Pakistan Business Council Delegates Meet with Key Government Officials in Pakistan," April 26, 2006, available from http://www.uspakistan.org/2006_04_26_USPBC_press_release.pdf.

22. Government of Pakistan, Ministry of Commerce, "Joint Press Statement: U.S.-Pakistan TIFA Council Meeting," October 3-4, 2006, available from http://www.commerce.gov.pk/read.asp?newsID=165.

23. U.S. Department of State, South and Central Asian Affairs Bureau, "United States Pakistan Economic Cooperation Fact Sheet," March 4, 2006, available from http://www.state.gov/p/sca/rls/fs/2006/62595.htm.

24. Office of the United States Trade Representative, "2007 Special 301 Annual Report on Intellectual Property Rights," available from http://www.ustr.gov/assets/Document_Library/Reports_Publications/2007/2007_Special_301_Review/asset_upload_file230_11122.pdf.

25. Ibid.

26. Ibid.

27. "Naqi Akbar Chats with Rizwan Ullah Khan, Country Manager Coca-Cola Pakistan," *The Nation* (internet edition), April 17, 2006, available from http://www.nation.com.pk/daily/april-2006/17/bnews3.php.

28. Pakistan Telecommunication Authority, "Telecom Indicators-Mobile Cellular Services," available from http://www.pta.gov.pk/index.php?option=com_content&task=view&id=650&Itemid=603.

29. Motorola, "Wateen Telecom Launches WiMAX to 17 Cities in Pakistan in Nine Months: Becoming a World Leader in Advanced Wireless Broadband Networks," February 13, 2007, available from http://www.motorola.com/mot/doc/6/6819_MotDoc.pdf.

30. U.S. Department of Commerce, "Doing Business in Pakistan."

31. Ibid.

32. Shah, "Pakistan's Economic Resurgence."

THE PARADOX OF THE TOWEL: PAKISTAN IN U.S. STRATEGY AND TRADE POLICY

Edward Gresser

To understand the paradox of Washington's trade policy toward Pakistan, consider the humble terry-cloth towel.

Pakistan ranks with India and China among the world's leading towel manufacturers. The towel export business is a good one for Karachi-based producers, bringing Pakistan $300 million each year from sales to the United States alone. It is also good for urban Pakistanis seeking factory work. According to the Towel Manufacturers Association of Pakistan (TMA), the manufacture of nine tons of towels—enough to fill a standard 20x20x8-foot shipping container—puts 485 Pakistani men and women to work.[1] In 2006, American customs officials reported receiving over 800 million Pakistan-made towels, weighing 84,000 tons. This is almost 1,000 tons of Pakistani towels a month, implying that the American towel market keeps something like 50,000 young Pakistani men and women on the job.

Thus the terry-cloth towel business, superficially, seems a happy case study in implementation of point two of the March 2006 Joint Statement on United States-Pakistan Strategic Partnership. This item calls for a joint effort to promote prosperity in Pakistan by "facilitat[ing] Pakistan's economic growth through increased trade and investment links with the United States and within the region and the global economy."[2]

However, a closer look finds that Washington's trade policy is not facilitating Pakistan's success in the towel business at all. Instead, unintentionally—and probably with the guiders of American relations with Pakistan unaware of this effect—it makes the lives of towel manufacturers a bit more difficult and the jobs of their employees a bit less secure.

Edward Gresser is director of the Project on Trade and Global Markets at the Progressive Policy Institute.

First, the towels face a startling high U.S. import tariff penalty. The towels' value is $300 million a year when they reach U.S. borders. The 9.1 percent tariff imposed on each towel is about seven times the average American tariff rate. This 9.1 percent penalty means that $27 million in annual tariff penalties are imposed on the towels at the border—a figure that exceeds the $24 million levied on the entire $7 billion worth of annual imports of Norwegian goods. In fact, many of Norway's main exports—oil, smoked salmon, telecommunications gear, and medicines, or the analogues of the towels, linens, and clothes that dominate Pakistan's exports to the United States—have American tariffs permanently set at zero.

Second, Pakistan's rivals in the towel business often get lighter treatment. Pakistan ranks second as a source of American towels, dueling with two giant countries—China and India—recently freed from textile quota limits. Meanwhile, positioned a bit below Pakistan, but still placing among the top 12 sources, are five countries (Mexico, Canada, Israel, El Salvador, and Egypt) whose towels face no tariff at all. Egypt is now the fastest-growing towel exporter to the United States. Its exports have been doubling since Egyptian-made towels won an exemption from the 9.1 percent tariff in 2005, an exemption earned through a duty-free access program known as Qualified Industrial Zones (QIZs). Altogether, free trade agreements (FTAs) and duty-free preferences like Egypt's bring about $120 million worth of towels to American shores tariff-free each year. Pressed hard from both sides, the TMA has recently declared that Pakistan's "export-oriented towel industry is [in] the midst of the severest ever [sic] crisis."[3]

Towels are not an exceptional case; they are in fact wholly typical of the American trade relationship with Pakistan. In concept, the U.S. government stresses the importance of Pakistan's growth, economic development, and success in trade to Islamabad's overall strategic and security goals. In practice, the American trade regime hinders Pakistan more than it helps it. On the one hand, it treats Pakistani products far more harshly than those of wealthy countries, with typical tariff rates on Pakistani goods—towels, clothes, household linens, fabrics, and so on—above 10 percent. On the other hand, through FTAs and preference programs, Washington exempts from tariffs identical goods made in about 70 other developing countries.

What could explain this? And what might be done about it? This paper addresses these questions by looking at the intersection between Pakistan's economic goals and American strategic interests; at Pakistan's current place in the global economy; at the perverse effects of the American trade regime on Pakistani goods; and at measures consistent with the U.S.-Pakistan Strategic Partnership that might ease the harmful effects of U.S. trade policy on Pakistan's exports.

Pakistan in the Global Economy

The aspiration of the Strategic Partnership statement is a good one. Both governments believe economic growth, job creation, and development in Pakistan are valuable in their own right, and also likely to cool the "social temperature" and make the Pakistani public less vulnerable to radicalism and religious extremism. The two governments also believe that growth, employment, and development require a greater integration of Pakistan into the global economy; domestic policies aimed at a well-functioning internal market economy; universal primary education; and domestic political stability.

These theses have convincing support from experiences elsewhere in the world. Since the 1970s, Central America, China, and the ASEAN region have all left behind an age of endemic radicalism, conflict, and instability. They have done so in part through achieving success in exports of labor-intensive manufactured goods—textiles, consumer electronics, sports equipment, furniture, and the like—that create urban jobs for young and rapidly growing populations. Pakistan ought to be able to do the same.

Current Situation and Challenges

In some ways, Pakistan's prospects for following the path of these nations should be promising. Economic reforms in the 1990s and 2000s have eased business formation and access to capital; cut the cost of imported inputs; and helped to create a highly competitive textile industry. Pakistan's economic growth rate has been high—at 7 percent or so each year since the early part of this decade—and job creation has been strong.

However, some other facts of life make integration into the global economy more difficult for Pakistan than it was for Latin American and East Asian countries. Geographic and diplomatic realities are one obvious example. On Pakistan's eastern border are unresolved disputes with India. To the north it has dealt with the chaotic environment in Afghanistan between 1979 and 2001, followed by simmering insurgency. And to the west lies the uncertainty of Iran. Perhaps unsurprisingly, Pakistan trades less with its neighbors than do its peers in Southeast Asia, East Asia, Latin America, and even sub-Saharan Africa. Furthermore, Pakistan has enjoyed rapid trade growth in percentage terms, yet, as noted in Table 1, total trade remains low in comparison to peer countries.

With 2.2 percent of the world's people, Pakistan accounts for about 0.1 percent of the world's exports, and attracts a comparable fraction of foreign direct investment. The figures in Table 1 offer a snapshot of these current realities.

Table 1: Pakistan and its Peers, 2005

Country	Exports	FDI Stock	Population	Exports per capita
Thailand	$110 billion	$50 billion	65 million	$1690
South Africa	$51 billion	$69 billion	46 million	$1110
Turkey	$73 billion	$43 billion	72 million	$1010
Brazil	$118 billion	$200 billion	184 million	$640
Indonesia	$85 billion	$21 billion	218 million	$390
Nigeria	$44 billion	$35 billion	129 million	$340
Pakistan	$17 billion	$10.4 billion	152 million	$110
Bangladesh	$8 billion	$3.6 billion	139 million	$60

Sources: IMF Direction of Trade Statistics 2006 *for exports;* UNCTAD World Investment Report 2006 *for FDI stock;* World Bank World Development Indicators 2007 *for population.*

Moreover, Pakistan's exports are concentrated in a few countries and limited to a relatively narrow slice of goods. The United States, European Union, and United Arab Emirates together account for about two-thirds of Pakistan's export markets, meaning that increased competition in one market can have a very large effect on Pakistani trade on the whole. Indeed, textiles, which comprise one of the most competitive and globalized businesses in the world, account for about 75 percent of the value of Pakistan's exports.

Positive Trends

Nonetheless, though the hope of the Strategic Partnership in economics will not be easy to realize, trends have been quite positive for most of this decade.

To begin with, the regional environment has improved to some extent. With the end of sanctions on Afghanistan, Pakistan's exports to its northern neighbor—concentrated in cement, manufactured goods, and farm products—have jumped from $100 million in 2000 to $1 billion per year by 2005 and 2006. Pakistan's trade with India is still relatively low but also rising very quickly, with Pakistan's Export Promotion Bureau reporting 32 percent export growth in 2006. New markets in China are another important factor, as Pakistani exports to China and Hong Kong doubled to $1.6 billion between 2002 and 2006.[4]

Another positive development is Pakistan's thus-far successful transition to a quota-free world in textile trade. Trade data collected by the U.S. Census Bureau shows Pakistan's household linen exports rising by $250 million in both 2005 and 2006 (though beginning to slow in late 2006 and down in early 2007), surpassing both India and Mexico to place second among American sources of household linens. Pakistan's clothing exports have also been strong, at least with the temporary reimposition of quotas on Chinese clothes.

These realities have produced impressive results in Pakistan. Though foreign direct investment (FDI) stock is still fairly low, annual inflows have risen sharply, from an average of $460 million per year in the 1990s to $2.2 billion in 2005 and perhaps $3.5 billion in 2006.[5] Pakistan's merchandise exports have nearly doubled since the turn of the century, from below $10 billion in 2001 to $17 billion or more in 2006. Pakistan's services trade reports also show that Pakistan is emerging as a successful services exporter, with services exports at $3.8 billion in FY 2006—almost 25 percent of its merchandise exports. This figure is well above those typical for developing countries, and not far below that of EU members or even the United States.

U.S. Policy I: The Tariff System

In summary, Pakistan's place in the world economy is smaller than it ought to be, but seems to be growing quickly. This evolution should—and presumably is—welcome in the United States. But American policy is not really doing much to help it along. To the contrary, the U.S. tariff system and the realities of FTAs and preference programs seem perversely designed to make success for Pakistan harder to attain.

American customers now buy about $3.7 billion in Pakistani goods annually, or about a quarter of Pakistan's total exports. The vast majority of these goods fall into two categories: home linens such as towels, which totaled $1.8 billion in 2006; and clothes, which came in at $1.5 billion. Together, these goods account for 90 percent of American imports from Pakistan,[6] and probably directly employ 1 million or more workers in Karachi, Lahore, and several other urban centers.

However, these exports' reception from the U.S. Customs Bureau is remarkably chilly. Textiles and clothes in general face much higher tariff penalties in the United States than other goods. American clothing tariffs usually range between 10 and 30 percent, while other textile products usually get rates between 5 and 15 percent. As Table 2 shows, clothes and textiles accounted for about 5 percent—$100 billion out of $1.85 trillion—of U.S. goods imports in 2006, but they constituted 40 percent of U.S. total tariff revenue. Excluding goods imported duty-free through free trade agreements and preferences, clothes and textiles faced tariffs 11 times higher than those imposed on all other goods.

By specializing in these goods—and by supplying other goods that receive relatively high tariffs, such as luggage, sports equipment, and ceramics—Pakistan gets hit much harder than most countries. One way to illustrate this disparity is to compare tariff rates the United States levies on its top imports from Pakistan versus from wealthier countries. The

Table 2: Textiles and Clothes in the U.S. Tariff System, 2006

U.S. Tariffs			
Goods	**Import Value**	**Tariff Collection**	**Average Rate**
Clothes	$79 billion	$9.0 billion	11.4%
Other textiles	$22 billion	$1.2 billion	5.5%
All other goods	$1.754 trillion	$15.0 billion	0.9%
Total	$1.845 trillion	$25.2 billion	1.36%
U.S. Tariffs (Most Favored Nation, or MFN, only, excluding FTAs and preferences)			
Goods	**Import Value**	**Tariff Collection**	**Average Rate**
Clothes	$59 billion	$8.4 billion	14.3%
Other textiles	$18 billion	$1.2 billion	6.7%
All other goods	$1.114 trillion	$14.6 billion	1.31%
Total	$1.191 trillion	$24.2 billion	2.1%

Source: International Trade Commission dataweb, at dataweb.usitc.gov.

top 10 American imports from Pakistan account for slightly more than half of the dollar value of Pakistan's exports to the United States. These imports are, in order, cotton pullover shirts, towels, cotton button-down shirts, bed linens with printed patterns, carpets, cotton pants, bed linens without printed patterns, dustcloths, cotton socks, and cotton T-shirts. The tariff percentages on these goods are, respectively, 16.5, 9.1, 19.7, 6.7, zero, 16.6, 6.7, 4.1. 13.5, and 16.5.

By contrast, France's top 10 exports to the United States are medicines, large civil aircraft, turbojet parts, motor oil, small civil aircraft, artwork, turbojets, medicine, perfume, and wine. The tariff rates on these goods are zero, zero, zero, 0.1 percent, zero, zero, zero, zero, zero,

Table 3: U.S. Tariffs on Top 10 Imports from Pakistan, France, China, and Saudi Arabia, 2006 (Listed as Percentages)

Top 10 Import	Pakistan	France	China	Saudi Arabia
#1	16.5	0	0	0.1
#2	9.1	0	0	0.1
#3	19.7	0	0	0
#4	6.7	0.1	0	0
#5	0	0	0	0
#6	16.6	0	0	0.1
#7	6.7	0	0	0
#8	4.1	0	10	0
#9	13.5	0	0	0
#10	16.5	1.0	0	0

Source: International Trade Commission dataweb, at dataweb.usitc.gov.

Table 4: 2006 U.S. Import Totals, Tariff Revenues, and Rates from Pakistan, France, China, and Saudi Arabia

Country	Import Value	Tariff Revenue	Average Rate
Pakistan	$3.7 billion	$368 million	10.0%
China	$287 billion	$8.66 billion	3.0%
France	$37 billion	$367 million	1.0%
Saudi Arabia	$31 billion	$48 million	0.2%

Source: International Trade Commission dataweb, at dataweb.usitc.gov.

and 1 percent. Likewise, China's top 10 U.S.-bound exports are five varieties of computer accessories, plus video cameras, tape recorders, leather shoes, wooden furniture, and miscellaneous toys. Nine of these goods get zero tariffs, while one (the shoes) gets a 10 percent tariff. Saudi goods, principally crude oil and varieties of purified hydrocarbons, receive even lighter treatment. Table 3 shows the odd result.

Because of these disparities, Pakistani goods face a startling heavy penalty. For example, as shown in Table 4, the $3.7 billion in imports from Pakistan received a higher penalty in 2006 than the $37 billion in goods from France.

U.S. Policy II: FTAs and Preferences

This tariff structure is strikingly inequitable, penalizing light goods from Pakistan far more heavily than sophisticated wines and manufactures from France, diversified imports from China, or energy from Saudi Arabia. All the same, one would expect that such tariff discrimination would not affect the ability of Pakistan's textile and clothing industries to compete with their direct rivals. Yet here we run into the second problem.

Since the 1980s, Washington has created a large and diverse array of special trade policies, including preference programs, partial preference programs, and FTAs. Created with good intentions and often good results for the partner countries, they have unintentionally placed Pakistani producers at a disadvantage.

Altogether, the United States has 16 FTA partners. Another 60 countries have been exempted, fully or partially, from textile tariffs through the African Growth and Opportunity Act, the Caribbean Basin Initiative (CBI), the Hope for Haiti bill, the Andean Trade Preference Act (ATPA), and the QIZ program. Most of these preference programs have good developmental and/or strategic rationales, but they also place a few low-income Asian countries—Pakistan is joined by Bangladesh, Cambodia, Laos, Nepal, and Sri Lanka in this category—at a sharp disadvantage. The case of towels is one anecdotal example; the cotton pullover shirt, illustrated in Table 5, is another.

Table 5: The Pakistani Pullover Shirt and its Competitors

Shirt Source	2006 Import Value	Tariff Rate	Import Growth 2006
Central America	$1.7 billion	0% (CBI/CAFTA)	-0.4%
China	$1.0 billion	16.5%	+97.0%
Pakistan	$330 million	16.5%	+2.6%
Andean countries	$320 million	0% (ATPA)	+7.0%
India	$299 million	16.5%	+10.0%
Mexico	$272 million	0% (NAFTA)	-18.0%
Egypt	$61 million	0% (QIZ)	+32.0%

Source: International Trade Commission dataweb, at dataweb.usitc.gov.

This discriminatory effect is not an across-the-board one. A few Pakistani products are duty-free under the permanent American tariff system (though in 2004, a Most Favored Nation, or MFN, zero rate applied to just 6 of Pakistan's top 100 products, compared to an average of zero rates for 63 of the top 100 imports from the world at large). Pakistan is also eligible for some tariff exemptions under the Generalized System of Preferences (GSP). However, while this program is quite valuable to some middle-income and lower-middle income countries—Brazil, Thailand, Russia, and the Philippines are all examples—it is of little help to least-developed and low-income economies. Only 4 of Pakistan's top 100 products—flags, toenail clippers, jewelry, and a variety of cut stone, and together accounting for about 1.2 percent of U.S. imports from Pakistan—received GSP benefits.

Conclusion

So while foreign ministers and ambassadors ponder ways in which the United States can encourage Pakistan's growth, accelerate job creation, and integrate Pakistan more firmly into the global economy, the actual U.S. trade regime is working to frustrate these very objectives. Unintentionally—and unknown to all but a few specialists—Washington is replicating the paradox of the towel with a vast array of goods. It is imposing penalties on Pakistani products that are far higher than those applied to rich countries, thereby squeezing Pakistani businesses between big rivals in India and China and smaller competitors in dozens of countries freed from tariffs. Worse, duty-free treatment for goods from least developed countries not now covered by the existing preferences—a concept this writer strongly supports—would likely make the squeeze for Pakistan more painful, at least in clothing.

Clearly the status quo is not consistent with the aims of the Strategic Partnership statement. It is therefore surprising that U.S. policymakers have evidently not reached any consensus on efforts to change this status quo and have in fact turned down several opportunities to do so. A Pakistani appeal for tariff preferences in 2001 went unheeded. The George W. Bush administration did not endorse the tariff exemption program for Muslim countries proposed by U.S. Senators Max Baucus (D-MT) and John McCain (R-AZ) and Representatives Adam Smith (D-WA) and Cal Dooley (D-CA) in 2004. And at least so far, the proposed Reconstruction Opportunity Zones (ROZs) program in Afghan and Pakistani border provinces—a concept roughly similar to Egypt's QIZs—has not gotten beyond the drawing board.

Of course, U.S. trade policy is only one factor in achieving the aspirations of the Strategic Partnership statement. Pakistan's success in trade depends as well upon successful education and work force policies, continued improvement in the economic environment of South and Central Asia, and other factors. But these are areas in which American policymakers can offer only advice and technical help. By contrast, the U.S. government does control its own policy. At minimal cost—and in fact with some benefit to American families in shopping malls, who would enjoy somewhat lower prices—Washington can offer some tangible help to Pakistan by eliminating tariffs on Pakistani towels, clothes, and other manufactured goods. This would allow Pakistani exporters to compete on an equal footing with rivals in other developing countries, helping businesses like the towel makers remain healthy and able to employ their workers. This is fully consistent with the aspirations of the Strategic

Partnership, and it is high time that the Bush administration shifts course and brings policy into line with its stated goals.

Notes

1. Two hundred fifteen work on weaving machines, 65 women cover stitching, 10 work on the cutting machines, and 15 more check for quality and pack the towels for shipping. Other jobs require smaller numbers of workers.

2. Embassy of the United States, Islamabad, Pakistan, Press Releases, "United States-Pakistan Strategic Partnership, U.S.–Pakistan Joint Statement," March 4, 2007, http://pakistan.usembassy.gov/pakistan/h06030404.html.

3. "Recommendations for Trade Policy 2007-2008," Towel Manufactures Association of Pakistan, Karachi, April 30, 2007, http://www.towelassociation.com/Circulars/Trade%20Policy%202007-08.ppt#352,12,RECOMMENDATIONS FOR TRADE POLICY 2007-2008.

4. International Monetary Fund (IMF), *Direction of Trade Statistics Yearbook 2007* (IMF: Washington, DC, 2007), 372.

5. Anwar Iqbal, "Pakistan Lured $3.5bn FDI in 2006," *Dawn*, May 31, 2007, http://www.dawn.com/2007/05/31/ebr4.htm.

6. The balance is made up of furniture, toys, jewelry, and surgical and other light manufactures.

STRENGTHENING U.S.-PAKISTAN ECONOMIC RELATIONS: REALISTIC OPPORTUNITIES IN 2008 AND BEYOND

GARY HUFBAUER AND AGUSTÍN CORNEJO

American and Pakistan officials are busy drafting the text for Reconstruction Opportunity Zones (ROZs) and a bilateral investment treaty (BIT). Both are designed to promote employment, trade, and investment—especially along Pakistan's border with Afghanistan. In this paper, we survey the prospects for such "building blocks" that might, in time, lead to a comprehensive free trade agreement (FTA).[1]

From a U.S. perspective, security considerations trump the economic agenda. One can argue that from a security standpoint, the value of ROZs lies in the creation of legitimate employment, which would presumably reduce the appeal of warfare and drug production as a way of life.

Yet the economic case is also strong and compelling. Efforts to improve Pakistan's export performance are, in fact, timely and relevant. This is because sustained economic growth in Pakistan requires a continuation of rapid export expansion, which in turn raises the challenge of export diversification. New agreements between the United States and Pakistan could provide an arena for tackling some of these challenges. Despite rapid growth in Pakistan's exports to the United States in recent years, vast scope still exists for improving Pakistan clothing exports and other labor-intensive manufactures.

Past U.S. experience with free trade agreements and the Egyptian and Jordanian Qualified Industrial Zones (QIZs) suggests that the

Gary Hufbauer is the Reginald Jones Senior Fellow at the Peterson Institute for International Economics. **Agustín Cornejo**, who provided research assistance for this essay, is a doctoral candidate at the Graduate Institute of International Economics in Geneva. The views expressed here are the opinions of the authors and do not necessarily reflect the views of the Peterson Institute.

combination of permanent market access, an improved investment regime, and domestic incentives can provide a powerful engine for export growth. The pull could be stronger still if the ROZ initiative is accompanied by targeted financial assistance to the border regions.

Concentration in Pakistani Exports

In terms of their destinations, Pakistan's exports were more diversified during the 1980s than they are today. Since that time, the U.S. role as purchaser of Pakistan's total annual exports has boomed from just 5 percent in 1980 to 25 percent in 2006. Adding the European Union to this picture, the joint EU-U.S. share of Pakistan exports has climbed from just above 25 percent to over 50 percent. In terms of sectors, Pakistan has become more dependent on textiles and clothing, which today account for almost 70 percent of total merchandise exports, compared to around 55 percent in 1980. By comparison, nearly all other export categories—fish, leather, cereals, petroleum derivatives, medical instruments, and sporting goods—have failed to take off. Textiles and clothing account for about 90 percent of Pakistan's annual merchandise exports to the United States.

As a result of this concentration, American firms, investors, and consumers currently see Pakistan as a second-tier source of inexpensive textiles and clothing (T&C). The end of Multi-Fiber Agreement (MFA) quotas in 2005 opened a wide avenue for Pakistani sales in the U.S. market. Over the past 10 years, Pakistan's textile exports to the United States —chiefly several kinds of household linens—have tripled in value, reaching $1.8 billion per year, lifting Pakistan's share in the U.S. textile import market from 4 to 8 percent. Pakistan's clothing exports have also grown, doubling in value over the past decade; even so, Pakistani producers have not taken full advantage of their post-MFA opportunities. American retailers are simply not clamoring to source clothing products from Pakistan. The latter's labor costs are among the lowest in the world, but labor costs are just one aspect of competitiveness.

To fully realize the opportunities presented by the end of MFA, Pakistan will need to address deep-seated challenges. T&C tariff rates imposed by the United States are high, but some of the most important barriers lie at home in Pakistan rather than abroad in foreign markets. Pakistan has recognized its challenges, notably in the government's 2005-06 trade policy speech (Khan 2005).[2] The task ahead is to ensure full implementation of policy initiatives already announced.

Constraints on Pakistani Exports

A recent World Bank study of value chains (2006) examined the competitiveness of five actual and potential Pakistani export products. Several insights from this study can inform the debate on establishing ROZs in Pakistan—especially what needs to be done to ensure their success. Most of the obstacles identified in the World Bank study are of a general nature rather than product-specific. These shortcomings have effectively shut Pakistan out of potentially large export markets.

The World Bank authors pointed out that shipping times and freight costs place Pakistan at a disadvantage with leading competitors.[3] Other key constraints are frequent power outages (sometimes three per day); scarcity of trained workers (e.g., ginning engineers); lack of bank credit for small and medium enterprises; corruption; and inefficiency in the duty drawback[4] and tax rebate systems, which hurts small- and medium-sized enterprises new to export activity. While internal transport systems have been improved, long distances and poor road conditions are particularly detrimental to producers in the North West Frontier Province.

The Contribution of ROZs: Export Opportunities

Export processing zones (EPZs) are industrial zones, typically defined in geographical terms, with special incentives to attract foreign investors (e.g., duty-free imports of inputs, tax holidays, good infrastructure). Materials imported to the EPZs undergo some degree of processing before being re-exported.[5] Going beyond EPZs are Reconstruction Opportunity Zones (ROZs) or the Near East analogy, QIZs. In addition to the range of incentives granted by the home country to firms operating in EPZs, producers located in ROZs/QIZs receive preferential access to a designated foreign market, in this case the United States. The attractiveness of an ROZ/QIZ lies in the immediate savings on foreign tariffs.[6] This concession, however, typically comes with the condition that production be solely for export to the U.S. market, and that American and local authorities jointly exercise direct oversight over QIZ operations (Bolle et. al. 2006).

Benefits of ROZs in Pakistan

All these initiatives (EPZs, QIZs, and ROZs) represent a domestic response to some of the problems that plague export competitiveness in developing countries, including Pakistan. When properly established, EPZs and QIZs have helped attract foreign direct investment (FDI), promote exports, and create jobs.

One need not go as far as Jordan to find evidence of investor responsiveness to preferential regimes. Pakistan's own recent experience with EPZs also provides a wealth of readily available insights. According to the EPZ Database maintained by the International Labor Organization (ILO) (ILO 2006), Pakistan has established some 26 EPZs. Since their establishment, these zones have attracted $3.8 billion worth of domestic and foreign investment in activities such as electronics, chemicals, stuffed toys, precision mechanics, yarn processing, garments, leather, food processing, and plastics. EPZ employment runs at about 400,000 workers in about 300 firms, which generate substantial export revenue ($8.1 billion annually) through exports to the United States, Europe, and Southeast Asia (ILO 2006).

The Jordanian QIZ program stands as a successful and relevant precedent, and Egypt's more recent experience shows the benefits to a country that excels in labor-intensive manufactures. Since its QIZ was implemented in 1996, Jordanian exports originating in the QIZ have soared to surpass $1 billion annually, and EPZ employment runs at about 40,000 workers. Both in Jordan and Egypt, the success was built on exports of clothing that are subject to stiff Most Favored Nation (MFN) tariffs in the American market.[7] This feature makes the concept particularly relevant for Pakistan, which could underwrite the competitiveness of its clothing exports—especially since Pakistani investors have contributed to the Jordanian success story.[8] The concept could also be relevant for stimulating other labor-intensive manufactures, which typically face higher than average tariffs in the United States.

Tariff relief, however, is just one part of the equation. In addition to tariff relief, the United States has also granted QIZs more flexible rules of origin than typically found in free trade agreements.[9] For its part, Jordan exempted QIZ investors from income tax and provided good infrastructure. These are the basic elements to jump-start the ROZ initiative in Pakistan, but transforming the zones into success stories will require sustained effort across many fronts.

Beyond trade and employment creation, Graham (2005) points out that EPZs/QIZs make a significant contribution by informing debates on economic reform. EPZ/QIZs provide "controlled environments" for testing policy frameworks that are based on greater openness to trade and foreign investment. The Chinese EPZ experience indicates that the impact in terms of attracting FDI and fostering exports was large. But those benefits paled in comparison with the gains that accrued to China once the conditions prevailing in the zones were extended to the entire country. The case for openness may not be evident *ex ante,* and it may face strong entrenched opposition from domestic protectionist interests. In this context, EPZs/QIZs can be an important showcase for the benefits of globalization.

Challenges of ROZs in Pakistan

Past experience with EPZs and QIZs also provides important lessons that can inform other aspects of the current debate. Detractors of EPZs/QIZs raise valid points that identify the limitations of this type of development initiative. Detractors generally point out that, even where the EPZ has succeeded in attracting FDI and promoting exports, these achievements may leave a bitter taste. Unwanted side effects include the "footloose character of the investment" (firms may soon flee to another EPZ), a low "net-export" impact (few purchases of local inputs apart from labor), or the fact that domestic firms may simply move operations from established locations to the EPZ to enjoy the benefits. Kardoosh and Kouri (2004), for example, report that FDI in the Jordanian QIZs created few "backward linkages" and entailed little technology transfer. The authors attribute these shortcomings to the technological weakness of domestic firms, and their inability to ensure the reliable delivery of inputs in terms of quality, timeliness, and volume.

Many authors claim that proximity to dense local economic networks is the key to the success of EPZs (e.g., Graham 2005). This provides another warning, since locating EPZs in backward regions may make shortcomings all the more acute in terms of infrastructure, trained workers, transport, and distribution costs. In the case of Pakistan's ROZs, remote locations are saddled with the additional challenge of ensuring security for investors and workers. Making such ROZs attractive will involve considerably higher public expenditure, especially for infrastructure and security. To lure foreign investors to their EPZs and QIZs, many governments (including Jordan's) have provided better infrastructure than the domestic standard. This can be costly in peripheral zones, which tend to suffer from infrastructural deficits.

Last but not least, Pakistan's experience with EPZs has been the subject of questioning by the Committee on Employment and Social Policy of the ILO. To be sure, Pakistan is not the only country to be singled out for discrepancies between ILO conventions and practices with regard to the right to organize or certain forms of gender discrimination (ILO 2003). However, Democratic members of Congress have for months now insisted that trade liberalization and labor rights protections should go hand in hand, and are likely to raise the issue in the context of ROZ legislation.

These warning flags call for attention from both Islamabad and Washington. While these warning signs should help guide government action, they do not constitute valid arguments to back away from the ROZ initiative. One possible answer is to define Pakistan's ROZs not in terms of geographic boundaries, but rather in terms of export performance alone—or of other criteria used to define performance (e.g. employment, size of investment, amount of value added, and type of ownership).

The Role of Bilateral Investment Treaties

Negotiations for a BIT between the United States and Pakistan date back to September 2004. The original objectives remain valid today: strengthening Pakistan's economy, opening new opportunities for exporters and investors, and creating economic conditions to counter terrorism. All these objectives were mentioned in the press release announcing the commencement of negotiations (USTR 2004). To this date, however, protracted negotiations have not concluded an agreement.

Several "generations" of BITs have been signed over the past 30 years, and Pakistan has accompanied this process by concluding about 47 BITs.

Unlike most BITs previously signed by Pakistan, the current U.S.-model BIT is a deep agreement, comparable in scope and ambition to the investment chapters in American FTA agreements. These agreements define covered investments and investors very widely, and contain strong provisions on the right of establishment, national treatment, terms of expropriation, and the settlement of disputes.

The available (but sparse) econometric evidence suggests that FTAs have a stronger record in attracting FDI than BITs, and in fact, some econometric studies (e.g., Hallward-Driemeier 2003; Adams et al. 2003) have questioned the record of BITs in stimulating investment flows at all.[10] However, since the U.S.-Pakistan FTA remains a distant prospect, agreement on a BIT may be viewed by potential foreign investors as a desirable complement to the ROZ/QIZ concept. Elements of a BIT would reassure American firms that they would receive fair treatment from the government of Pakistan and Pakistani courts.[11] The combination of the ROZ/QIZ initiative and the BIT could provide a platform for increased FDI flows into new sectors aside from telecommunications, banking, and oil and gas.

Of course, the protection of and benefits to foreign investors gained from the BIT would not be limited to the ROZ/QIZ, but rather would be extended to most sectors in the economy throughout the entire national territory. While FDI flows to Pakistan have flourished in recent years—about a 95 percent year-on-year increase to reach $2.2 billion in 2005—the latest World Investment Report (UNCTAD 2006) still considers that Pakistan is punching below its weight (an "under-performer" in its own terminology) in terms of FDI attraction.[12] This means that efforts could be taken to improve the FDI climate in Pakistan.

Pakistan can pull FDI into the country by continuing the privatization process.[13] For example, it is estimated that 15 to 20 percent of the $6 billion inflows projected for 2007 could come from privatization. Targeted sectors for FDI include areas of complex regulatory action such as telecom, banking, oil and gas, power generation, and transport. A BIT could reassure new American bidders, as well as current holders of previously privatized assets, concerning the security of their engagement in Pakistan.

But perhaps the greatest service of a BIT with the United States lies in sending an unequivocal and positive message to foreign investors. In this sense it would constitute an important step in Islamabad's effort to lure foreign investors and the expatriate community as participants in Pakistan's development. An enduring change in foreign attitudes could ensure a more lasting flow of foreign investment than the one-time privatization of state-run companies.

References

Adams, R., P. Dee, J. Gali, and G. McGuire. 2003. "The Trade and Investment Effects of Preferential Trading Arrangements—Old and New Evidence." Productivity Commission Staff Working Paper, Australian Government Productivity Commission, Canberra.

Bolle, Mary Jane, Alfred B. Prados, and Jeremy Sharp. 2006. "Qualifying Industrial Zones in Jordan and Egypt." CRS Report for Congress Code RS22002, July 5, 2006. Congressional Research Service, Washington D.C.

Economist Intelligence Unit (EIU). 2007. "Pakistan: Business Environment at a Glance." EIU ViewsWire. May 9, 2007. Accessed through Factiva.

_________. 2007. "Pakistan: Country Forecast Summary." EIU ViewsWire. May 9, 2007. Accessed through Factiva.

Graham, Edward. 2005. "Do Export Processing Zones Attract FDI and Its Benefits? Experience from China and Lessons for Russia." In *Internationalization and Economic Policy Reforms in Transition Countries*, ed. Edward Graham, Nina Oding and Paul J.J. Welfens. Heidelberg: Springer Berlin.

Hallward-Driemeier, Mary. 2003. "Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit—and They Could Bite." World Bank Policy Research Paper 3121, World Bank, Washington D.C.

Hufbauer, Gary Clyde, and Shahid Javed Burki. 2006. *Sustaining Reform with a US-Pakistan Free Trade Agreement*. Washington D.C.: Peterson Institute for International Economics.

International Labor Organization (ILO). 2006. "ILO database on EPZs." Geneva: ILO. Available from http://www.ilo.org/public/english/dialogue/sector/themes/epz/epz-db.pdf.

________. 2003. "Employment and Social Policy in Respect of Export Processing Zones (EPZs)." Document number GB.286/ESP/3. Geneva: ILO Available from http://www.ilo.org/public/english/standards/relm/gb/docs/gb286/pdf/esp-3.pdf.

Kardoosh, Marwan A., and Riad al Khouri. 2004. "Qualifying Industrial Zones and Sustainable Development in Jordan." Paper presented at Economic Research Forum 11th Annual Conference, Beirut, Lebanon, December 14-16, 2004. Available (in draft form) from http://www.erf.org.eg/11conf_Lebanon/Trade/Kardoosh&Khouri.pdf.

Khan, Humayun Akhtar. 2005. "Trade Policy 2005-06." Speech delivered July 21, 2005. Government of Pakistan, Ministry of Commerce, Islamabad. Available from http://www.cpbc.info/Trade-Policy-2005-6.doc.

Malik, Ahmad Rashid. 2006. "Pakistan Jordan Economic Ties." *Business Recorder*, March 27, 2006 (accessed through Factiva).

UNCTAD. 2006. *World Investment Report 2006. FDI from Developing and Transition Economies: Implications for Development.* Geneva: UNCTAD. Available from http://www.unctad.org/TEMPLATES/WebFlyer.asp?intItemID=3968&lang=1.

United States Trade Representative (USTR). 2004. "United States, Pakistan Begin Bilateral Investment Treaty Negotiations." USTR press release, September 28, 2004. USTR, Washington D.C.

World Bank. 2006. "Pakistan: Growth and Export Competitiveness." Report No. 35499-PK of the Poverty Reduction and Economic Management Sector Unit, South Asian Region. World Bank, Washington D.C.

World Economic Forum (WEF). 2006. *The Global Competitiveness Report 2005-2006.* Geneva: WEF. Available from http://www2.weforum.org/site/homepublic.nsf/Content/Global+Competitiveness+Programme/Global+Competitiveness+Report.html.

Notes

1. In a study published in 2006 (Hufbauer and Burki 2006), the Peterson Institute examined the economic pros and cons of a free trade agreement between the United States and Pakistan. Whatever the merits of closer ties, an FTA is not on the horizon. Trade promotion authority has expired in the United States, while many Pakistani industrialists are not prepared to abolish tariffs and other protective measures.

2. The speech mentioned, for example, insufficient shelf life of fresh fruits and vegetables, unreliable quality of local cotton, and local difficulties in complying with foreign sanitary and phytosanitary (SPS) standards (SPS standards include a vast array of regulations relating to human, animal, and plant safety and health). The speech proposed a number of initiatives to deal with these problems.

3. Geography is sometimes blamed for Pakistan's transport disadvantage. However, China's success as an exporter—using world-class ports and shipping technology—shows that geography can be overcome in reaching the markets of Europe and North America.

4. Duty drawback refers to the refund or remittance—in whole or part—of the customs tariffs receipts charged on specific imports because the imported items are used as intermediate inputs in goods that are subsequently exported.

5. Some countries have defined EPZs in ways other than physical location, for example commodity, factory, single-company, or industry-wide zones. While

EPZs are often associated with labor-intensive manufactures (e.g., textiles or electronics), they cover a wide variety of products and production methods, sometimes with a high-tech dimension.

6. The preferential access component shares similarities with various unilateral preferences granted by the United States and other advanced countries to developing countries. Unlike unilateral preferences, however, QIZs are not subject to periodic legislative renewal or "competitive need" limitations. The renewal process introduces uncertainty and may cause businessmen to delay or forgo investment commitments.

7. Exports from Egypt's QIZs are dominated by rapidly expanding clothing items, but it is too early to tell what will be the contribution of QIZs to Egyptian exports of iron and steel products, aluminum articles, manmade fibers and yarns, or plastics. Joint exports of all these products have yet to reach $10 million.

8. Pakistani private investment in the Jordanian QIZs is responsible for the establishment of 11 industrial units and an estimated investment of about $40 million (Malik 2006).

9. The precise rules that determine the origin of goods that may qualify for the benefits available under the Jordanian and Egyptian QIZ programs are quite complex, and they essentially mandate a degree of production sharing between Israel, Jordan, and the West Bank/Gaza Strip. However, the rules are flexible in that they permit 65 percent of the value of the finished good to originate anywhere in the world. Bolle et al. (2006) provides a general discussion of rules of origin in QIZ programs.

10. While the warning is well-taken, such studies do not provide a decisive argument against the BIT initiative, since they do not reflect the complete policy package envisioned by authorities.

11. According to the WEF (2006), Pakistan's legal framework is not a paradigm of efficiency, transparency, and neutrality; in fact, Pakistan occupies one of the lowest positions in the global rankings of these indices.

12. The potential contribution of FDI to Pakistan's economy could be important in light of the weakness of domestic investment. In 2005, FDI inflows already accounted for 13 percent of gross capital formation in Pakistan. For 2006–07, the impact could be stronger.

13. The Economist Intelligence Unit (EIU) expects that Pakistan will remain actively engaged in the privatization process during 2009–2011 (EIU 2007), and that the privatization process will continue to boost inflows of foreign capital. Pakistan authorities have announced that they are considering the sale of a number of state companies such as the Pakistan Steel Mills, the National Investment Trust Limited, and Pakistan State Oil. However, opposition in the Pakistan Senate to the privatization program is mounting, and Karachi Electric Supply Corporation (KESC) is today singled out as a specific target for renationalization.

RECENT ASIA PROGRAM PUBLICATIONS

Pakistan Program Publications

Fueling the Future: Meeting Pakistan's Energy Needs in the 21st Century
Mukhtar Ahmed, Saleem H. Ali, Shahid Javed Burki, John R. Hammond, Dorothy Lele, Robert Looney, Sanjeev Minocha, Bikash Pandey, Sabira Qureshi, Asad Umar, Vladislav Vucetic and Achilles G. Adamantiades, Aram Zamgochian, 2007

Education Reform in Pakistan: Building for the Future
Shahid Javed Burki, Christopher Candland, Grace Clark, Ishrat Husain, International Crisis Group, Jonathan Mitchell, Salman Humayun, Irfan Muzaffar, Tariq Rahman, Michelle Riboud, Ahsan Saleem, Salman Shah, United States Agency for International Development, World Bank (South Asia Human Development Department), 2005

Islamization and the Pakistani Economy
Khurshid Ahmad, Shahid Javed Burki, Isobel Coleman, Parvez Hasan, Ishrat Husain, Charles Kennedy, Vali Nasr, Omar Noman, Saeed Shafqat, 2004

Asia Program Publications

Special Report No. 139 – Japan's Political Mess: Abe Failed, Can Fukuda Do Better?
Shinju Fujihira, Sherry L. Martin, Robert Pekkanen, Jun Saito, January 2008

Ten Years After: Revisiting the Asian Financial Crisis
David Burton, J. Soedradjad Djiwandono, Ilene Grabel, Worapot Manupipatpong, Jomo Kwame Sundaram, Robert H. Wade, Mark Weisbrot, Meredith Jung-En Woo, October 2007

Special Report No. 138 – Taiwan's Dilemma: A Democracy Divided Over National Security
Thomas J. Bickford, Elizabeth W. Hague, Shirley Kan, Vincent Wei-Cheng Wang, September 2007

Special Report No. 137 – More Than a Concrete Jungle: Urbanization in Japan
Theodore J. Gilman, Carola Hein, Ronald K. Vogel, Merry I. White, April 2007

Special Report No. 136 – The Policy Space Debate: Does a Globalized and Multilateral Economy Constrain Development Policies?
Carlos Correa, Heiner Flassbeck, Jomo Kwame Sundaram, Elaine Zuckerman, April 2007

Special Report No. 135 – The Chinese People's Liberation Army: Should the United States Be Worried?
Dennis J. Blasko, Bernard D. Cole, Kristen A. Gunness, Litai Xue, December 2006

Special Report No. 134 – Six-Party Stall: Are South Korea and China Part of the Problem or Part of the Solution?
Kerry Dumbaugh, Kirk W. Larsen, Sung-Yoon Lee, Bojiang Yang, November 2006

Special Report No. 133 – The Avian Flu Challenge in Southeast Asia: The Potential of Public-Private Partnerships
Tjandra Yoga Aditama, Peter Gourlay and Maryjane Lacoste, David Reddy, September 2006

Special Report No. 132 – Edging Toward Full Empowerment? South Korean Women in the Workplace and the Political Arena
R. Darcy, Seungsook Moon, Kyung-ae Park, Jean R. Renshaw, September 2006

Special Report No. 131 – China and Democracy: A Contradiction in Terms?
Richard Baum, Merle Goldman, Suisheng Zhao, Yongming Zhou, June 2006

Special Report No. 130 – One Year After the Tsunami: Policy and Public Perceptions
Roberta Cohen, Bambang Harymurti, Muhammad Qodari, Courtland Robinson, May 2006

Japanese Women: Lineage and Legacies
Margarita Estévez-Abe, Takashi Fujitani, Barbara Molony, Hitomi Tonomura, Chikako Usui, Merry White, October 2005

Special Report No. 129 – China's Economy: Retrospect and Prospect
Franklin Allen, Loren Brandt, Lee Branstetteer, Donald Clarke, Chang-tai Hsieh, Jikun Huang, Yasheng Huang, Nicholas Lardy, Peter Murrell, Barry Naughton, Jun Qian, Meijun Qian, Thomas G. Rawski, Scott Rozelle, Susan Whiting, Xiaodong Zhu, July 2005

Seabed Petroleum in Northeast Asia: Conflict or Cooperation?
Selig S. Harrison, Zhiguo Gao, Kim Myong Gil, Zhao Li Guo, Keun Wook Paik, Choon-Ho Park, Zhang Hai Qi, Kook-Sun Shin, Jilu Wu, Susumu Yarita, 2005

George W. Bush and East Asia: A First Term Assessment
Richard W. Baker, Chan Heng Chee, Catharin E. Dalpino, Evelyn Goh, Harry Harding, Jia Qingguo, James A. Kelly, Ilsu Kim, James A. Leach, Koji Murata, Jonathan D. Pollack, Robert Sutter, Nancy Bernkopf Tucker, Jusuf Wanandi, 2005

Special Report No. 128 – Japanese ODA at 50: An Assessment
Juichi Inada, Saori N. Katada, David Leheny, Yoshio Okubo, February 2005

Special Report No. 127 – "An Imperfect Country of Great Consequence": Indonesia and the Challenge of Global Terrorism
Ali Alatas, J. Stapleton Roy, January 2005

Special Report No. 126 – China's "Good Neighbor" Diplomacy: A Wolf in Sheep's Clothing?
Michael R. Chambers, John W. Garver, Dennis V. Hickey, January 2005

Special Report No. 125 – Taiwan's Constitutional Reform: Domestic Inspiration and External Constraints
Jiunn-rong Yeh, Jacques deLisle, Alan M. Wachman, November 2004

Special Report No. 124 – Active Society in Formation: Environmentalism, Labor and the Underworld in China
Guobin Yang, Ching Kwan Lee, Ming Xia, September 2004

Special Report No. 123 – A Billion Ballots for Democracy: Election Year in Indonesia
Jim Della-Giacoma, Meidyatama Suryodiningrat, Muhammad Qodari, August 2004

★★★★

A copy of any publication can be obtained free of charge by visiting the Asia Program online at http://www.wilsoncenter.org/asia. A more complete list of Asia Program publications may also be found online.

The Woodrow Wilson Center Asia Program
One Woodrow Wilson Plaza
1300 Pennsylvania Avenue, NW
Washington, DC 20004-3027
Ph: 202-691-4020 Fax: 202-691-4058
Email: asia@wilsoncenter.org, http://www.wilsoncenter.org

WOODROW WILSON CENTER PAKISTAN SCHOLAR PROGRAM

The Woodrow Wilson International Center for Scholars, in partnership with the Fellowship Fund for Pakistan, holds an annual competition for the Wilson Center's Pakistan Scholar Program. One Pakistan Scholar, either from Pakistan or of Pakistani origin, is selected each year to spend 9 months in residence at the Woodrow Wilson Center, in the heart of Washington, D.C., where (s)he will carry out advanced, policy-oriented research and writing.

The Woodrow Wilson International Center for Scholars is one of Washington's leading independent, wide-ranging, non-partisan institutes for advanced research, where vital current issues and their historical and cultural background are explored through research and dialogue. Created by the Congress of the United States as the nation's official memorial to its twentieth-eighth president, the Center seeks to commemorate through its residential fellowship program both the scholarly depth and the public policy concerns of Woodrow Wilson.

The Pakistan Scholar competition is open to men and women who are from Pakistan or who are of Pakistani-origin (from any country). Applications will be accepted from individuals in academia, business, journalism, government, law, and related professions. Candidates must be currently pursuing research on key public policy issues facing Pakistan, research designed to bridge the gap between the academic and the policymaking worlds.

For more information on this program, go to http://www.wilsoncenter.org/index.cfm?topic_id=1462&fuseaction=topics.item&news_id=100067

Previous Wilson Center Pakistan Scholars

Dr. Samia Altaf, 2007-08. "Improving Aid Effectiveness: A Case Study of the Health and Population Sectors in Pakistan"

Khaled Ahmed, 2006-07. "Sectarian Violence in Pakistan and Its Linkages to Iran, Saudi Arabia and the Gulf States"

Dr. Mushtaq Khan, 2005-06. "9/11 and the Pakistan Economy: A Look at the Impact on the Financial Sector"

Dr. Ayesha Siddiqa, 2004-05. "Military Inc.: The Political Economy of Militarization in Pakistan"