DAWN

Tariffs, trade and taxation

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ACCORDING to official sources, the recent decline of Pakistani exports is due to adverse global economic conditions. Others attribute this, inter alia, to the appreciation of the Pakistani rupee. Both these factors may be partially true but defy empirical evidence as single-factor explanations.

Indian exports have expanded by 62 per cent, Bangladeshi by 69pc and Sri Lankan by 21pc from 2010 to 2015. In clothing exports, Vietnam, Bangladesh and Cambodia recorded growth rates of

10pc, 6pc and 8pc respectively. Bangladesh's nominal exchange rate has remained unchanged and the real effective exchange rate shows 54pc appreciation since FY2010-11. The rupee appreciation is visible in India too. In Pakistan, the nominal exchange rate remained stable from 2001 to 2008 and export receipts doubled. Despite a depreciation of 51pc from 2008 to 2013, there was no corresponding increase in export value.

The declining trend of Pakistani exports is not recent. It began in the 1990s and, excepting the early 2000s, has worsened. Merchandise exports have declined from 0.18pc in 1990 to 0.14pc of the world export market in 2015, while India's share has tripled to 1.78pc and Bangladesh's has risen from 0.05pc to 0.2pc. Pakistan's exports — one-third of India's in 1990 — have fallen to a tenth; Bangladesh — once only one-third of Pakistan's — now exceed by almost $10 billion. The reasons for this decline are structural, cyclical and institutional.

Convoluted policies have damaged the competitiveness of Pakistani exports.

Structurally, the world demand pattern has changed while the composition of Pakistani exports has remained unchanged. Cotton textiles still account for almost 60pc of exports. Several tariff lines under GSP-Plus remain unutilised as we lack the capacity to supply the required manmade fibre-cotton mix. Low technological goods and nonparticipation in buoyant commercial services exports have constrained our capacity to respond.

Asian markets have increased their share in world markets while our exporters are still hung up on the EU and US. Production patterns have shifted from longer vertically integrated final goods to global value chains. Intermediate goods and components are procured from countries where the comparative advantage dictates lower costs with acceptable quality. Asia's share of global trade in intermediate inputs has risen from 14pc in 2000 to 50pc in 2012. The average journey length for Asian exports has fallen by 4.5pc with decreased transportation costs.

Manufactured product today has a much lower cost of actual fabrication than previously, and the cost of labour is declining per output unit. Most of the cost is incurred on manufacture-embedded services. Design, advertising, marketing, transportation, logistics, distribution, storage, financial services and insurance, and IT products and services make up most of the cost structure. Lean manufacturing and just-in-time inventory have further reduced unit production costs. Countries that have liberalised services trade, reduced tariff rates, facilitated cross-border trade and movement of skilled and expert manpower, and softened custom regulations have benefited from the global supply chain as well as manufacture-embedded services exchange.

Pakistan's score on both counts is almost nil. Despite our excellent political relations, we haven't made much effort to encourage Chinese manufacturers to relocate part of their production to Pakistan or integrate Pakistan-made parts and intermediate goods in their final assembly line by using the FTA.

Cyclically, the drop in international oil and gas prices were not passed on to Pakistani exporters so they might take advantage of cost saving and aggressively push products in new markets where they did not enjoy price advantage. Exporters had firm orders to deliver, but couldn't do so due to load-shedding. Political expediency demanded that shopkeepers and households be appeased at the expense of exporters. Naturally, those export orders were shifted to countries with more conducive conditions. These buyers will never come back to Pakistan; we have lost credibility in their eyes.

The decline is a typical example of coordination failure and lack of understanding of linkages and interdependencies among various policies. Tariffs on imports are driven purely by revenue mobilisation or protection of domestic import substituting industries. It is hardly realised that a restrictive import regime with tariff, nontariff and regulatory barriers, and cumbersome customs clearance procedures with arbitrary powers enjoyed by low-level officials amenable to corruption, would prevent Pakistan's entry into the expanding global supply chain.

High tax incidence on manufacturing output, especially on large-scale organised firms, has stifled transition of medium-scale firms to acquire economies of scale and reduce production and distribution costs to become competitive in the world market. A large segment of market demand is taken away from the organised firms by the unorganised sector, which enjoys a cost advantage of at least 16-17pc. The withholding tax regime is another distorting factor; it allows final settlement of income tax liability of various economic agents. Tax refunds have also become an albatross around the necks of the exporters. Their liquidity is drained due to refund delay, forcing them to borrow from banks for working capital needs. The refunds system is flawed; we should learn from Bangladesh's better functioning system.

As Pakistan's labour force is not properly trained and mostly unskilled, its productivity is low relative to other regional competitors. In the textile sector, an average Pakistani worker produces only 40pc of what his Chinese counterpart produces per day. Pakistan's productivity growth rate in the manufacturing sector from 2000 to 2010 was 2.3pc per annum, while China's was 8pc and India's 3.4pc. The gap has only widened.

The country's business climate needs to be improved by a cost-effective enforcement of property rights and contracts, streamlining the granting of NOCs, permits and licences and inspections by government agencies.

Finally, the Schumpeterian notion of creative destruction has found little resonance among policymakers and industry players. Artificial respiration has kept some subsectors and firms alive when they should have ceased to exist. These established, inefficient firms lobby for more concessions, tax exemptions and benefits, making entry of more efficient and dynamic firms difficult.

This combination of convoluted public policy and status quo-minded behaviour of major industry players has kept Pakistan from scaling the ladder of technological upgradation and diversifying its exports to meet the demands of dynamic sectors. Instead of artificial crutches to protect redundant firms, the government should invest in R&D and augment the supply of quality science, technology, engineering and mathematics graduates to move up the scale of the production frontier.

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Published in Dawn, July 10th, 2017