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Inefficiency in exports

  By Ishrat Husain

Pakistan’s merchandise exports have declined from 0.18 percent in 1990 to 0.14 percent of the world export market in the last twenty five years. India’s share has tripled from 0.57 percent to 1.78 while Bangladesh’s share has risen from 0.05 percent to 0.14 percent in the same period. Pakistan’s exports, which used to be only one third of India, have fallen to one tenth and Bangladesh, which used to lag behind with its exports being only one third of Pakistan’s in 1990, exceeded our exports level last year. At the turn of the millennium, 97 percent of merchandise exports used to finance the country’s imports but this ratio is down to 61 percent. Sharp depreciation of the Pakistani rupee since 2007-08 has not helped boost the demand for Pakistani exports. And while the currency depreciated by 55 percent, export growth was 24 percent only in the last five years. In the preceding six years, the currency remained stable while the exports more than doubled in dollar terms.

Not only has the export growth rate leveled down but the composition has also remained unchanged. Two thirds of exports are concentrated in a few agriculture raw material and labour resource- intensive products such as textiles, leather, rice etc. The country has taken no advantage of its location next door to two fast growing economies China and India as market concentration remains high. We are focusing on traditional, stagnant sunset sectors rather than the dynamic fast growing strategic products in the hi-tech and medium-tech sectors. Our share in hi-tech exports has remained unchanged since 1980’s at less than 2 percent while the low-tech exports now account for two-thirds of total exports relative to almost one half in the 1980s.

What factors explain this declining competitiveness of Pakistani exports? These can be divided into two broad categories. First, is the government policy weaknesses and macroeconomic factors and second is the firm inefficiencies and microeconomic gaps.

At the public policy and macroeconomic level, Pakistan has never followed an export growth-led strategy although lip service has been paid times and again. The taxation system penalises the formal, organised, compliant firms while allowing the informal and unorganised sector to evade taxes, placing the former at a competitive disadvantage. Economies of scale and benefits of agglomeration therefore elude Pakistani firms whose growth remains stunted. High rates of sales tax and custom duties act as a barrier for imports of raw materials, components, parts and accessories that go into the final fabrication or assembly of goods. The tax refund scheme for exporters is ridden with corruption and the genuine exporters stay out of the scheme and therefore do not expand into new activities for which there is growing demand in the world market. The permits, licenses, inspections and NOCs required by various federal, provincial and local government departments and the extra payments made add to the transaction costs. The import substitution mindset that protects the existing companies through high tariff rates, non-tariff barriers, exemptions and concessions in the form of specific Statutory Regulatory Orders (SROs), a highly complex and discretionary import classification system, has not allowed new, efficient and competitive firms to emerge or take roots. The playing field is titled too much in favour of inefficient entrenched, rent-seeking and rent-sharing companies. Tariff reforms carried out in early 2000s that had simplified and streamlined the tariff bands and reduced the maximum tariff rate have been reversed and made the trade regime too complex. Pakistan’s overall trade restrictiveness index is high and rising. By 2010 Pakistan had become the world’s seventh most protected economy.A World Bank study has estimated that a 1 percent rise in tariff complexity leads to a 13.2 percent decline in export growth. High value-added products that require imported raw materials and inputs cannot thus be manufactured or assembled in Pakistan and supplied to global value chains. Sub-contracting, outsourcing, tolling are the concepts that have not yet sunk in Pakistan.

Weak dispute resolution, and contract enforcement, prolonged and expensive judicial system and little protection of intellectual property rights are also some other impediments for business expansion and export diversification. Courts take more than a decade to adjudicate property and land disputes after exhausting an elongated chain of appellate system. Land acquisition procedures are cumbersome and outdated.

Turning to the microeconomic factors, a study carried out a few years ago showed that Pakistan’s textile sector productivity was only 40 percent that of China. Thus, there is a huge scope of moving to the efficiency frontier and reap huge gains both for the firm as well as the country. The size, scale of operations, market structure, formality and location are some of the considerations that affect productivity and profitability which, in turn, lead to expansion, value addition or diversification. A strong association is observed between productivity and variables representing the formal nature of firms. Organised firm shaving a larger market share seem to cope better with the negative elements of the business climate and thus show productivity gains. Innovation and skill variables are also significantly associated with productivity. At the aggregate level, therefore, average productivity is depressed because too many resources are being utilised by low productivity firms mainly in the informal sector. A large number of family owned businesses in Pakistan even in the organised sector are hesitant to provide full disclosure of their operations and maintain multiple books of accounts. They don’t attract any external capital as their reported balance sheets are not expanding and their financial ratios are pathetic. Those who had obtained loans from the banks due to their political connections were able to use their influence in getting these loans written off and thereby reaping a windfall gain. Many family owned businesses also rely on their own kith and kin for the supply of strategic human resources in place of qualified professionals. This inadequacy of engineers, accountants, managers, and marketing executives naturally leads to under performance and inefficiency. When aggregated, the economy performs well below its efficiency frontier and is unable to penetrate international markets because of lack of competitiveness. Entry for newcomers is discouraged by the existing entrenched business houses and the financial institutions. Only five percent of firms account for 76 percent of the exports. In the last five years, the shortages of power and gas have played havoc. Export orders could not be delivered or had to be diverted because of these shortages. New orders had to be refused because the exporters could not fulfill them on time.

The new government that is committed to liberalisation, deregulation and privatisation should initiate reforms that will enable Pakistan to enhance its export competitiveness, reduce its dependence on external aid and augment its foreign exchange resources. These should encompass openness to the world, lowering and simplifying tariffs, less intrusive bureaucracy, improvement in trade facilitation and logistics. In the first seven years of the millennium a more liberal trade regime had enabled exports to grow rapidly and doubled their value resulting in comfortable balance of payment position. There is no reason that this record cannot be surpassed.

This writer is a former SBP governor

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