Is there a future for export-led growth in Pakistan?

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NEWS

Pakistan is again in the midst of an economic crisis. The core issues of a balance of payments crisis, a halt in economic growth, soaring prices, increasing employment and rising poverty are interlinked and require fundamental reforms. However, the immediate problem is simple: Pakistan needs to export more and has financed growth over the last few decades with foreign borrowing, which must now be paid back. What should be just as simple is the answer: Pakistan is experiencing an export crisis and urgently needs a coherent policy to boost exports.

The continuous balance of payments problem in Pakistan can be described as a problem of balance of payments constrained growth, which means that whenever Pakistan grows at more than 4% per annum, we import so much more than we export that we run out of foreign exchange reserves. In many economies, this imbalance is made up through remittances or foreign investment. In the case of Pakistan, the former has stagnated and the latter is nonexistent. So, the only solution is to increase exports with a coherent export-based industrial strategy.

For decades, developing countries have heard the same story of how policy in general and industrial policy in particular don't work. Recent work on industrial policy looks at large-scale industrialisation and has failed to increase exports. Another policy was using export rebates and subsidised energy inputs, which no longer leads to export growth as specific industries now expect these to remain competitive. These are now effectively off the table in the face of IMF-mandated expenditure cuts. Another set of more successful policies used tools like reductions in tariffs on intermediate inputs for exporters, subsidised credit for exporters and tax refunds for exporters who prove that they have used imported inputs for export purposes.

A well-defined export-led industrial strategy must aggressively use the last set of tools mentioned above. Commercial banks have no incentive to lend to exporters if the interest rate remains high, meaning policymakers need to make credit available to exporters at lower rates. The State Bank's Temporary Economic Refinance Facility (TERF) programme and its financing scheme to promote solar energy usage by manufacturers are successful examples of this and should be aggressively expanded. At the same time, authorities should start lowering tariffs on imported intermediate inputs for exporters, which has been done successfully by other economies like India. The government should focus all expenditures on training by entities like TEVTA and all spending on education and infrastructure on export promotion. Also, as foreign markets start to tax imports based on emissions (with the EU Carbon Border Adjustment Mechanism coming into place over the next few years), the government needs to subsidise the transition by exporters to cleaner energy sources before Pakistani exports fall. Finally, the Pakistani authorities should start reducing regulations and red tape for exporters if they want to see investment increase and exports grow.

However, supply-side initiatives need to be coupled with policies to boost demand. Depreciation was supposed to take care of that since Pakistani goods became cheaper in foreign markets, even though our workers are effectively paid pennies for each good they produce. But a 50% depreciation in the rupee has only led to a 5-10% increase in exports. The reason is that the 50% depreciation was accompanied by at least a 50% increase in the costs of fuel for exporters (though it is greater since subsidies have also been removed), a 50% increase in the cost of imported machinery, and imported inputs and a doubling of the interest rate at which exporters need to borrow money after domestic prices skyrocketed. Also, foreign buyers renegotiated the dollar prices of the Pakistani goods they bought. It is time to accept that depreciation isn't the solution to our export problems.

So, policymakers must focus on other practical demand-side measures. First, the trade investment officers posted in foreign missions must be given product lists and export targets for their countries. The product lists need to be data-driven and identify countries and products that make up our current export destinations and export goods and new, higher value-added products. Policymakers can pair this with customs data and census of manufacturing industry data to identify firms that already produce and export these goods to help pair foreign buyers with Pakistani suppliers. Also, when our government negotiates trade agreements, we must gain market access for higher value-added export goods instead of raw materials and low value-added intermediate inputs. Finally, Pakistan has significant potential to export services like IT, health and education, which should be an integral part of any export strategy. I'm sure that we will hear the old mantra of 'picking winners', but modern evidence for industrial policy don't exports rise? One of the leading causes is the instability in the system. Economic and political instability drives away foreign investment and scares domestic producers from increasing their capacity and moving into higher value-added products. But if stability does return, policymakers must be ready to take advantage of this by pushing an export-driven industrial strategy in a big way. If not, we'll be stuck in the same trap for years.

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