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How to Boost Pakistani Exports through CPEC?

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INTRODUCTION:

Pakistan's economy lags behind on the export front for decades, which contributes to trade and current account deficit. Although the government has announced several industrialization policies in the past, but no significant change has been observed. Under the China Pakistan Economic Corridor (CPEC) framework, projects related to infrastructure, energy, Gwadar and industrial development are launched with the pristine objective to regain economic growth. Major structural shifts are expected that will overcome the basic bottlenecks of the economy. The manufacturing sector will also experience a change because of industrial cooperation with China through the development of nine special economic zones (SEZs) under the CPEC framework[4]. These SEZs are located in different regions all over the country, including Punjab, Sindh, Balochistan, Khyber Pakhtunkhwa (KPK), Azad Jammu and Kashmir (AJK), Tribal Area of KPK, (former FATA) and Gilgit Baltistan (GB).

The targets chosen for these SEZs are to upgrade the industrial sector, promote export and substitute import of Pakistan. The targets may be achieved through relocation of Chinese industries, up-gradation of technology and up-scaling the prevailing manufacturing units of Pakistan. These SEZs can be the possible export machineries for Pakistan in integration to the global value chain. However, special emphasis may

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be given while relocating certain industry from China to Pakistan. Industries where we have Latent Comparative Advantage (LCA) may be chosen[5]. This policy research has applied a well-known technique of Growth Identification and Facilitation Framework (GIFF) for Pakistan to identify those industries in which Pakistan has LCA and advantages of backwardness.

Prof. Justin Yifu Lin introduced the New Structural Economics (NSE) and the GIFF to identify the reasons of failing developmental theories in the low income and middle income developing countries. He held responsible, the policy which is based on targeting high growth technological sectors without having the knowledge of skills and endowments of the targeted economy. Prof. Lin argued that it is the comparative advantages (in one or many sectors) that can give you a competitive position in the market otherwise the convergence and development theories are of no use.

Developing countries can earn dividend of its backwardness to grow and converge to the higher income levels through an effective industrial policy. They should identify the industry where they have LCA through cheap labour and abundant natural endowments. This will give them highly competitive position in the international market and global value chain (GVC) because of their cost-effective production. Capturing market in the products where cost is low and margins are higher will lead to sustained dynamic growth which is the only path for a developing country to move to higher circles of income.

The GIFF technique involves six steps process[6]: **Step One: Choosing the Right Target.** At first, identification of those goods and services are made on basis of which economies of similar endowments have achieved higher growths and boost its

[5] LCA refers to comparative advantage in factor of production but lack proper infrastructure and business environment which increases the transaction cost with in a particular economy. (Justin Yifu Lin and Volker Treichel)

[6] Lin, Justin Yifu,2016. Applying the Growth Identification and Facilitation Framework to the Least Developed Countries: The Case of Uganda. CDP Background Paper No. 32 ST/ESA/2016/CDP/32 Washington DC, World Bank.

exports. This is done in following way. (a) Identify countries that were in same income level 20 years ago and have grown dynamically so that their per capita income has increased by more than 100 percent. (b) Identify products, exports and top performers in each country. (c) Study their patterns and identify those low capital-intensive products where these countries are losing market share because of losing comparative advantage in the international market. This will provide the list of potential industries where markets are open and apply effective industrial policy exports to those markets can be made. **Step Two: Removing Binding Constraints.** After identifying the potential industries, first focus should be made on the existing domestic industry producing similar products for either domestic demand or exports. Existing private firms should be facilitated and in addition policies and incentives to attract new entrants should be introduced. **Step Three: Attracting Global Investors.** Attracting FDI is always a key challenge for developing economies. Global investors are needed to bring into the industrial sectors identified in step one. **Step Four: Scaling-up Self-discoveries.** Focus on innovation is the need of the hour to remain in the market for long time. Industrial economies grow because of high spending in R&D and bringing new and innovative products into the market. Based on unique endowments of every developing country focus on the innovations is needed. Private firms as well should be supported to self-discover their strengths through innovative products and new technologies. Special economic zones need to be constructed with improved infrastructure to attract global investors and promote industrial agglomerations. **Step Six: Proper incentive structure should be devised for the right industry.** Incentive structure should be structured properly to compensate early entrants into the sectors identified. These incentives can be of different nature depending upon the condition of economy and industry.

Applying the GIFF for Pakistan, selecting benchmark countries was a big challenge. So, by applying the criteria of countries that have grown at a rate of 100-300 percent than us from the same stage we were 20 years earlier. These countries have shown greater economic performance for last two decades, especially China. We further filtered out those countries which were having similar endowments and were not manufacturing sector led, or export led economies by large. In last, we were left with Uzbekistan and China. These two countries have greater similarity with Pakistan both in the labor abundance and larger natural resource endowments. (See table; 01).

S.No	Country Name	GDP per Capita	Ratio to Pakistan	Growth Rate of Real GDP (2015)	Manufacturing, value added (% of GDP)
1	Pakistan	1434.69	1.0	2.6	13.42
2	Bhutan	2655.99	1.85	5.1	8.35
3	China	8069.21	5.62	6.4	30.79
4	Dominican Republic	6468.47	4.50	5.8	15.25
5	Lao PDR	1818.44	1.26	5.6	9.37
6	Uzbekistan	2132.11	1.48	6.1	12.12
7	Vietnam	2110.91	1.47	5.5	15.22
8	Kosovo	3552.38	2.47	5.1	12.29

TABLE 01: SELECTED INDICATORS OF COUNTRIES WITH GDP PER CAPITA (CURRENT US$) 100-300% HIGHER THAN PAKISTAN IN 2015[7]

Selecting the two benchmark countries (Uzbekistan and China) for growth, we apply the second step of GIFF to identify and compare the top ten tradable goods and services on back of which these economies outperformed the rest of the competitors and where Pakistan has potential comparative advantage today. This reveals the sectors where china and Uzbekistan are losing their market share. China in some labour-intensive sub-sectors because of losing its comparative advantages are losing its share in exports as well. Table 02 shows the details of the top exports in early growth period of China and their position today because of the loss of the backwardness dividend that it was extracting when it was at lower level of income. Further, we applied the pre-screening criteria on the sub-sectors where Pakistan has latent comparative advantages in one way or other. Primary purpose of the study was

[7] Data Sources: World Development Indicator-CD ROOM 2016. World Bank Group

to select those subsectors where there is potential for growth as well as feasibility for production.

S. No	Standard Insertional Trade Classification (SITC)	% of total Exports Value (1995)	% of total Exports Value (2016)
1	Leather Footwear	2.8	0.43
2	Trunks and Cases	2.5	1.19
3	Knit Sweaters	2.5	0.84
4	Rubber Footwear	2.4	1.02
5	Non-Knit Women's Suits	2.3	1.18
6	Radio Receivers	2	0.23
7	Office Machine Parts	1.8	1.23
8	Non-Knit Men's Suits	1.7	0.59
Total		18.0	6.7

TABLE 02: KEY EXPORTS OF CHINA

CPEC portfolio is expected to enhance the economy of Pakistan. The infrastructure and energy projects will capture the interest of the investors and will give increase to FDI as well as domestic investment. Secondly, the special economic zones will bring industrial agglomeration which will result in the innovations and high value-added products with reduced cost. This will make our products cost competitive in the global market and we will be able to increase our exports and will make us able to enjoy the benefits of reduced trade deficit.

POLICY RECOMMENDATIONS:

To optimally capitalize the industrial cooperation under CPEC and the industrial relocation from China to Pakistan the following recommendations are made based on GIFF analysis;

- SEZs that are expected to bring investments and relocation of industry from China should be devised with great care. We are having latent comparative advantage in certain labour abundant products which can enhance our exports. ***Footwear, Garments, video and radio equipment, trunks and cases, cotton yarn, iron, agro-processing business and steel paper production, dyeing/colouring materials, printing industry, glass and glass wear*** are some of the subsectors which can help boost our exports in future.

- These sectors may prove as competitive edge of Pakistan. This can be done by investing in these sectors and enhancing value addition with cost lower than competitors and capture the losing share of china in the global export market. For this a detailed supply and demand analysis is the needed which will answer many questions about why our Free Trade Agreements (FTAs) and other policies have not proven to be of high benefits.
- A close look at Pakistan employment structure reveals two salient features: one is that its employment is largely agro-based and other is informal sector attract more workers than formal sectors. The investment in capital shows that the situation is worse in 2000 as well as in 2015. The investment to GDP ratio is well below the average of developing as well as the low-income countries. The labor abundance nature of Pakistan has not benefitted the industrial sector because of ***capital scarcity*** and ***skills deficiencies***. This needs to be addressed under the industrial cooperation in CPEC.
- Pakistan is a natural resource-rich country. Its geographic location coupled with abundant resource and forests, are providing grounds for Pakistan to be strategically and economically important country. Rents have accounted for a substantial share of the contribution of natural resources to GDP. Pakistan is rich in natural resources which are not used up to the potential of these resources. In past 20 years rents from these resources has contributed less than of 0.6% of GDP in the year 1998 and highest of 2.1% in the year 2006. The ***alignment of manufacturing sector with the natural resources*** can result in ***export competitiveness***.