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Can trade diplomacy really deliver?

Pakistani governments have been trying to boost exports for a long time. Various 'export packages' have been experimented with, but too little or short-lived success, if any. More recently, at the envoys' conference last week, political leadership stressed on the need to improve trade diplomacy to boost exports. But focusing on trade diplomacy without fixing the overarching framework or putting the domestic production processes in order is akin to putting a cart before the horse.

That government will focus on product and market diversification is an oft repeated mantra. But the first question to ask is what has Pakistan got to sell in the first place; the second: why should any country buy from Pakistan and not from her peers. The answers to both questions are interrelated.

At the one end of the equation is the fact that Pakistan's list of efficiently produced goods does not run long. This country struggles to beat stiff competition in both basic products (such as sugar and rice) and in products where she is supposed to have competitive advantage (such as textile, leather, etc). This is on two accounts.

First, Pakistan's productivity has fallen sharply over the last few decades. What are the reasons behind the decline in total factor productivity (TFP)? Various scholars have offered various conclusions. Some attribute this weakness to macroeconomic instability, and weak financial sector. Others attribute it to low level of science and technology, and poor growth in the stock of capital. One can argue about the reasons behind weak productivity, but there is no argument that falling productivity is a major underlying problem that cannot be wished away or addressed merely through an 'export package'.

Second, exports will not find growth unless import tariffs are lowered. If firms are sitting pretty behind the wall of tariffs and sell inefficiently produced goods in domestic markets, then why will they need to export? One theory so goes that once firms will gain economies of scale through a captive local market with no or little competition from imports, they will grow and learn and then eventually create export surplus on marginal costing, and thereby earn dollars. Only that once firms start exporting on marginal costing, sooner or later they will be slapped with anti-dumping as it recently happened in the case of cement exports.

Granted that on some accounts the tariffs structure reflects muddled policy thinking. Take the case of packaged poultry industry. In an interview with BR Research last year, the founder of K&N's poultry group highlighted how imported ingredients for poultry feed and a host of raw materials needed to make value-added chicken products in Pakistan are heavily taxed, whereas value-added processed-chicken products are coming duty free or at low duty under FTA with Malaysia and China. (Memo: poultry feed is about 75% of the cost of value added processed-chicken, whereas imported ingredients cost about 55% of the poultry feed.) (See Brief Recording 'Why Pakistan's poultry exports aren't taking off?' published April, 21st, 2017)

This example shows that if tariff barriers are removed, local producers across many industries will not survive – even the ones that may have efficient operations. This leads to the other end of the equation – the factors external to the firms.

Here the key question to ask is can Pakistan really become a part of global value chain without regional integration. Because on closer look, global value chain essentially thrives on regional value chain. In some cases, it may be to source raw materials or semi-finished goods, in others, it is for selling finished goods. The US and the EU will not send raw materials to Pakistan, so she can produce and export back to the US and EU. Besides, whatever potential exists in such long-distance value chain has been captured by China. Liberalising regional trade, therefore, is critical.

The other aspect to external factors is the need to adopt a whole systems approach in fixing a sector. As Farrukh Khan, former President of Overseas Investors Chamber of Commerce & Industry, highlighted Kenya's growth in horticulture – a sector that was identified by McKinsey consulting firm as a sunrise sector for Pakistan in an exercise commissioned by the Planning Commission at the start of this decade. (See Brief Recording, October, 12th, 2018)

Farrukh pointed out that in addition to a lot of things that Kenyan government did to grow that sector, it changed the flight schedule to Europe to ensure that fresh flowers became available before the markets opened in the morning in Amsterdam. Similarly, when India decided to become a force in jewellery sector, they created a space for heavy private sector investments in training people in the sector to the extent that the Indian jewellery workers could compete with global jewellery workers. Pakistan may have a lot of gems, but those gems are exported as raw material or basic value added instead of exporting high value-added products.

The point being that fixing the overarching policy framework across the industries related to producing any commodity or service is what's needed to boost exports. Infrastructure spending, policies, taxes, tariffs and other nuts and bolts of the supply chain have to be aligned to support the industries before trade diplomacy can be expected to bear meaningful fruits.

In the same vein, along with the fixing of policy framework across the value chain, it would make more sense to focus on investment diplomacy rather than trade diplomacy because the former can help Pakistan get the most needed technological transfers across the value chain which can serve as one of the trigger points of export growth.

Then again, why would foreign investors come to Pakistan? Because Pakistan has cheap labour, pat comes the reply. But since when is cheap labour a matter of pride. Conceptually, labour is cheap because either they lack the skills demanded by the market, or they are in oversupply. In Pakistan's case it is both: among her peer economies Pakistan has arguably one of the highest growth rates in producing unskilled labour. But that can of worms is for another discussion.

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