FOSTERING TRADE AND INDUSTRY

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Trade and industry are closely linked, each catalysing the other. The inverse is also true, as the hindrance of one can act as an 'inhibitor' or 'retardant' for the other. For industry to thrive, it requires access to investment, technological advancements, and a competitive environment—factors that trade significantly contributes to. Similarly, for trade to flourish, an industry or a country must enhance its productivity, and there's no better way to achieve this than by adopting cutting-edge technology and a competitive environment.

Despite the apparent simplicity of this connection between trade and industry, it is not always evident to a vast majority. This is especially true when a country's industrial growth or international trade is underperforming. In such instances, one often observes a tendency to attribute the poor performance of one factor to the other. The media and academics often claim Pakistan's imports, especially from nations with whom it has free trade agreements, have resulted in the closure of numerous industries. Moreover, it is alleged that Pakistan's challenges in diversifying its export and manufacturing base stem from its inability to compete with the more competitive Chinese products.

By advancing this argument, we overlook three crucial points. Firstly, we absolve ourselves of responsibility for our industrial and trade policies, which fundamentally contribute to de-industrialisation and export stagnancy. Pakistan's industrial policies primarily aimed to manufacture products using local raw materials like cotton and promote import substitution. In pursuit of this goal, there was a consistent focus on encouraging low-value cotton-based products such as yarn, cloth, and apparel at the expense of others. Notably, the textile industry, the only sector with an independent Ministry of Textile Industry, received various tax and financial incentives, including duty-free imports of machinery, subsidies, zero-rated sales tax, and lower interest rates. The government's concentrated efforts secured market access and GSP plus benefits, allowing the industry to supply duty-free textile products to the EU market. All these incentives were mostly at the expense of other industries.

Secondly, a distorted view exists advocating the further promotion of import substitution, a policy preferred by many developing countries in the last century but abandoned in favour of export-led growth. This emphasis on import substitution shields various engineering industries, including automobiles and consumer durables such as washing machines, refrigerators, air conditioners, televisions, and other electronics, through high customs duties and additional import taxes. As a result of extensive protection, local manufacturers lack the incentive to improve product quality or explore markets outside their country, hindering economies of scale. Consequently, domestic consumers face higher

prices despite manufacturing often amounting to the simple assembly of imported components. Assemblers and their foreign investment partners profited from high tariffs and deliberately thwarted any competition from imports.

While we remained fixated on import substitution and textile promotion, fast growing developing countries transitioned to export-led growth and diversification. They embraced liberalisation, regional and global integration, and integration into global value chains. Pakistan started liberalising from the 1990s onwards, but progress was hesitant. It gained momentum from 1997, when customs tariff rates were reduced from a maximum of 65% to 25% (excluding autos and some other goods) over the next five years. However, after 2003, this process halted and partially reversed, particularly from 2008. The National Tariff Policy 2019-24 acknowledges this, stating that in the last ten years, "all the 20 fastest export growth economies have reduced import tariffs, while in Pakistan, the trend has been the opposite, with an 11% increase in import tariffs. Additionally, the imposition of regulatory duties has further elevated effective tariffs. Pakistan maintains the highest average weighted tariff among the 70 countries with annual exports exceeding USD 20 billion."

Regarding regional and global integration, Pakistan has entered into numerous free trade agreements (FTAs) with several countries, including Turkey, Malaysia, Indonesia, Sri Lanka, Mauritius, and China. Except for the FTA signed with China, none of these agreements has led to trade flows exceeding 5%. Even with China trade flows under the agreement account for 27% of Pakistan's imports and 8% of its exports (WTO data). Globally, free trade agreements typically require reduced duties and other restrictions on "substantially all trade," which is implied to be over 90% of existing trade. Despite criticisms blaming FTAs for our low level of industrialisation, the reality is that these agreements have had no impact on either trade creation or the liberalisation of the economy due to their shallowness.

What could have been done differently, or what could still be the way forward?

Firstly, we should promptly initiate unilateral customs tariff reforms to align our average tariffs with those of other regional countries. This reform would enable our industries to reduce their input costs and simultaneously facilitate Pakistan's move toward regional and global integration. Additionally, this approach would reduce the tariff advantage for some countries and bring more competitiveness.

Secondly, our trade and industrial policy should prioritise becoming part of Global Value Chains (GVCs). This method of attracting investment and promoting trade can facilitate a greater level of industrialisation. Specialising in producing intermediate goods or undertaking specific production activities at different stages allows us to eliminate the need to possess all industries involved in producing and exporting final products.

Thirdly, we must recognise that the trading destination has shifted from the West to the East. In the 21st century, China has become the leading trading partner for 130 out of 190 countries, whereas the U.S. and EU played this role for most of the 20th century. China's rise has dramatically benefited all regional nations, yet Pakistan, despite its close relationship with China for over 60 years, has yet to improve its international trade or industrialisation significantly. Pakistan is an exception to the aphorism 'a rising tide lifts all boats'.

It is not just China but the entire Asia-Pacific region that offers opportunities for Pakistan to enhance its economic relationships. The most viable strategy is to exert every effort to join the Regional Comprehensive Economic Partnership (RCEP), the world's largest trading bloc consisting of 15 countries in the Asia-Pacific region.

RCEP was recently established by China, so joining at this time, rather than later, when its rules of conduct have already been established, is more feasible.

Finally, we must recognise that we risk falling further behind regional countries with our current meagre growth rate. To maintain the current difference, we need to achieve a growth rate of at least 7% and to catch up, we must grow by at least 10% annually. Achieving such growth necessitates rapid industrialisation, contingent on much higher investments. Encouragingly, there are positive signals from several Middle Eastern countries indicating potential investments of over USD 50 billion in the next 4-5 years. Additionally, in the second phase of CPEC, China might invest a similar amount. Such substantial investments would introduce new technology and boost productivity, potentially elevating our overall growth rate.

A close linkage exists between trade, investment, and industrialisation. These three interconnected components are pivotal in shaping a country's economic landscape. Embracing openness and rejecting isolation is crucial for attracting investments and fostering rapid industrialisation. Over a billion people have been lifted out of poverty in the last two decades by this formula, and Pakistan can use it to create prosperity for its people.

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