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Editors' Introduction

Over the last few years, the Pakistani economy has faced a variety of challenges which has led economic managers to focus more on immediate problems at the expense of long term structural issues. The purpose of the Lahore School's Tenth Annual Conference on the Management of the Pakistan Economy was to help policy makers take a step back and look at some of the critical issues that Pakistan needs to face if it is to achieve growth in the medium to long term. Thus the central theme of the conference was 'Pakistan in the Global Economy – Opportunities and Challenges' and a range of key structural issues was discussed by a variety of experts. What made the conference unique was that many of these issues have not been discussed and debated thoroughly before in the Pakistani context. Some of the highlights of the conference were Asma Khalid's (from the State Bank of Pakistan) extremely insightful analysis of the parallel foreign exchange market in Pakistan (which has not been analyzed in depth before) as well as the call by many of the presenters for a well-formulated industrial policy in Pakistan. Similarly, the conference also focused on some key export sectors (such as garments) as well as strategies for improving Pakistan's export competitiveness and diversifying exports. Finally, some of the participants noted that in a rush to access new markets, Pakistan must tread carefully when agreeing to trade agreements with potentially large trading partners. As Pakistani policy makers sit and decide on economic strategies, it is absolutely critical that they pay very close attention to these issues.

The conference was divided into seven sessions, each with a distinct theme:

The first session of the conference looked at the foreign exchange market. Asma Khalid of the State Bank of Pakistan presented a comprehensive analysis of the parallel foreign exchange (FX) market in Pakistan. The paper focused on the importance of workers' remittances to the country and explained how the bulk of this inflow is transacted through the hundi/hawala network of informal moneychangers. The paper went on to place this network within the context of the larger FX market and showed how it interfaces with the interbank market. Finally the paper discussed how many hundi\hawala agents have evolved into formal exchange companies spelled out the importance and resilience of the parallel FX market emphasizing the need to push toward full amalgamation of this market with the formal FX market, and the key role of workers' remittances in Pakistan's macro-economy. This was followed by a paper by Rizvi, Naqvi, and Mirza who analyzed the exchange rate policies and exchange rate behavior of the Pakistani Rupee from 1961 to 2013, pointing out the divergence between stated exchange rate policy and behavior of the monetary authorities in practice. The authors find evidence of significant intervention up until 2007, which was followed by a period of 'benign neglect' since market forces led to a dramatic depreciation of the exchange rate and deterioration of economic conditions. Based on this history, the authors suggested that Pakistan return to a peg, or more realistically, a more managed float. Finally Rahim examined the issues that arise out of the depreciation of the Pakistani Rupee which include heightened expectations of future depreciation, capital flight, falls in the U.S. dollar-deflated wage, higher inflation, higher cost of foreign debt and interest rates, increases in the replacement cost of capital (complicating amortization), and lowering of the real value of savings. He emphasized the role of the exchange rate depreciations on the prices of tradable and nontradable goods and concluded that depreciations, by keeping down real wages, keep economies like Pakistan competitive in existing industries, but do not stimulate innovation.

The second session looked at the issue of Pakistan's competitiveness. The session began with a paper by Haque which examined the reasons for the poor growth of Pakistan's exports despite the extensive liberalization of the economy and its relative openness. Haque begins with the finding that the concentration of exports to is an incomplete explanation for poor export growth and after looking at the export performance of Pakistan's main export competitors suggests that Pakistan should increase productivity in the existing export sectors. He goes on to provide evidence that investment has been low and productivity growth has been slow over the last decade and suggests that government directed industrial policy is required to jump start the process of increasing competitiveness. Finally he emphasizes that the most pressing issues to be resolved is the energy crisis but also recommends upgrading and innovation. The second paper by Amjad looks at the major causes of Pakistan's stop-go growth cycles and comes to the conclusion that, to varying degrees, the foreign exchange constraint provides a major explanation for these cycles of irregular economic growth in the country, particularly since the 1990s. The third paper by McCartney provided a detailed history of textiles sector development and growth, focusing on its failures to graduate from low-value raw cotton and intermediate textile products. The paper begins by describing outside mitigating factors such as competition from China accompanying the end of the Multi-Fiber Agreement, the economic liberalization agenda pushed by the international lending organizations, and the high-volume, short lead-time requirements of retailers who direct the global value chains. McCartney goes on to explain how energy shortages and the poor state of education constitute serious binding constraints to productivity and suggests a realistic reform agenda in which the government subsidizes the costs and risks involved in acquiring new technologies. Finally, he suggests that Pakistan should take lessons from Bangladesh (a country with many of the same governance issues) where successful policies included back-to-back letters of credit and the delegation of certain customs certificates for raw materials and technology to the garment manufacturer associations. The fourth paper by Afraz, Hussain, and Khan look at the constraints facing small enterprises and the barriers to growth in two industries, electrical fans and sporting goods. The case study on the fan sector highlights the negative impact of low quality and lack of standardization on the abilities of smaller firms to export while large firms lack a large professional class which leads to a heavy reliance on family management. Other issues like the lack of research and development, seasonality of production, poorly educated workers, inadequate access to finance, reliance on second-hand machinery, inability to develop brand names, energy shortages, and lack of institutional support (through the government or industry associations) have a detrimental impact on both the fan sector and the sporting goods sector, as do factors such as access to formal long-term finance, low R&D, lack of branding, low investment in training workers, and vulnerability to exchange rate movements.

The third session focused on Pakistan's export performance and the characteristics of Pakistani exports. Chaudhry and Andaman presented a paper which identified some common patterns in the export-led development of the successful East Asian countries, including movement up the value chain and expansion in the extensive margin of trade (the number of different products exported) and described how these countries gradually moved up the quality ladder in existing product categories before entering new ones. They also discussed how Pakistan has remained stuck in the take-off phases of low-value added production and give the results of a cross country empirical analysis that show that domestic credit and imports (particularly capital imports) were the statistically significant determinants of high value-added exports. The authors also show that cross country evidence says that moving up in the stages of export growth was statistically related to tertiary education, higher domestic credit and lower interest rates, higher remittances and imports, and a depreciated exchange rate. The paper concludes with a warning about how high imports of consumer goods and FTAs in the absence of a coherent industrial policy could trap Pakistan in a cycle of low value-added textile exports by shutting Pakistani firms out new potential sectors before they even start to develop. The second paper by Chaudhry and Haseeb uses Pakistani firm level data to examine the differences between exporting and non-exporting firms in Pakistan. They find Pakistani exporters exhibit significantly higher total factor productivity (TFP) and are larger in terms of employment than nonexporters and (with a few exceptions) exporters had higher labor productivity and offered higher compensation to workers than non-exporters, but used more capital per worker and more imported inputs. They also find that the government's recent emphasis on developing the readymade garments sector is well placed since more than half the apparel producers in Punjab were exporting—and nearly all of their output (93 percent) while the capital-labor ratio and use of imported inputs in this sector was modest. They also find that exporters were relatively large employers with 400 workers on average and offered significantly higher compensation than nonexporting firms.

The fourth session looked at ways to build up Pakistan's technological capabilities, with an emphasis on these capabilities in the export sector. The first paper by Ehsan and Khanum gave an overview of the variety of requirements for two of Pakistan's most important export categories, textiles and rice. In textiles, the authors discuss regulatory, product-specific, customer-specific, social, and environmental requirements and in the area of rice, quality and safety issues were identified as critical issues. The paper also looked at the existing quality assurance infrastructure in each of the sectors and concludes with policy recommendations for moving these sectors forward. The second paper by Hamdani provided a road map for how Pakistan can emulate the process of technological "catch-up" undertaken by the East Asian tigers. The paper compared the growth trajectories of East Asia with Pakistan, focusing on differences in capital formation, progress in upgrading technological capabilities, and government policy toward industry, using the textiles/garments and steel industries as illustrative examples. Despite an initial bias toward capital intensive production, the author finds that Pakistan has fallen behind and he proposes that Pakistan raise its investment in productive capital, through domestic re-investment and greater FDI flows.

The fifth session looked at ways of diversifying Pakistan's exports. The first paper by Hamid, Nabi and Zafar looks at the textiles and garments (T&G) sector which accounts for 48% of total exports, 30% of value added in large scale manufacturing and 40% of industrial employment. The authors also discuss how the sector is expected to continue to do well because (i) Pakistan has been granted 'GSP Plus' status by the European Union opening a large market for Pakistan's T&G exports; (ii) China, because of rising labor costs and increasing technological sophistication of manufactured exports, is likely to reduce its share (about 40 percent in 2012) in the world garments market and (iii) as incomes rise in the fast growing large economies of China and India, their demand for textiles and garments will rise. The authors argue that for the sector to realize its potential, policies that shape the incentive structure faced by the industry need to be re-aligned. The second paper by Ahmed and Hamid examines historical trends in the diversification of exports in Pakistan. In particular the paper looks at the growth in exports in 'traditional' vs. 'nontraditional' industries and studies the degree of structural change in the export sector since 1972. The authors also explore the determinants of structural change in exports by looking at variables such as GDP growth, export growth, the real exchange rate, the growth rate of world trade, trade liberalization, and the degree of product concentration in the country's export base. The third paper by Memon, Rehman, and Rabbi uses a revealed comparative advantage (RCA) approach to look at trends in Pakistan's comparative advantage relative to the rest of the world over the period 2003 to 2012, and identifies industries of rising and falling advantage. The paper also looks at the comparative advantage and trade volumes between Pakistan, India, and China, and finds evidence of trade diversion; in some cases less efficient trade with China has pre-empted greater gains that could have been achieved through trade with India. The author also identifies industries that would be vulnerable in the event that Pakistan grants most-favored nation (MFN) status to India, including footwear, cutlery, plastics, paper, and pharmaceuticals. The fourth paper by Gul presented an overview of the current state of economic cooperation between Pakistan and Turkey. The paper goes on to discuss the major product categories of Pakistan's trade with Turkey and constructs three indices: a Trade Complementarity Index (TCI), Intra-Industry Trade Index (IIT), and Export Similarity Index (ESI) to further examine the possibilities of a preferential trade agreement between the two countries. The author suggests that Pakistan could enjoy significant gains from greater access to Turkey's markets due to its market size and access to the EU. The paper also finds that while they both export textile products to similar markets, Turkey operates at the higher end of the market while Pakistan's exports are concentrated in low-value added products which means that cooperation and joint ventures with Turkey could allow Pakistani firms to move up the value chain.

The sixth session looked at the role of imports in the context of Pakistan. The first paper by Tirmazee and Naveed provides an in-depth analysis of Pakistan's import demand function and the authors find that the inclusion of the terms of trade and foreign exchange availability in addition to the traditionally included real income and relative price variables greatly reduce the unexplained variability in imports embodied in the error term. The authors go on to find that, all four variables are significant and of the predicted signs in their long-run estimations, whereas in the short run only terms of trade and foreign exchange reserves significantly affect import demand. The second paper by Iqbal, Ghani, and Musleh ud Din provides an overview of Pakistan's trade with regional partners in SAARC and estimates an import demand function for Pakistan. The paper shows import demand to be price inelastic; further, in the long-run, the price elasticities tend toward zero. On the other hand the authors find that the income elasticity of imports increases, going from inelastic to unit elastic between the short and the long run. In the end the authors conclude that long run income rather than prices is the primary determinant of import demand.

The final session looked at Pakistan in the context of the world trading order. The first paper by Kaukab provides a history of the growth of regional trade agreements or RTAs. The author shows that historically the hubs of RTA activities were Europe (including the EU and Russia) and the United States while most countries in Central Asia, the Middle East, and Sub-Saharan Africa were involved in relatively few. The author also looks at how recently agreements are being signed between regions: Europe with Latin America, Latin America with Asia, Europe with Asia, among others and also finds that the EU is replacing nonreciprocal agreements with reciprocal ones in Africa. The author also discusses how Preferential Trade Agreements (PTAs) are a form of nonreciprocal trade agreement (where the "provider" gives market access without reciprocity from the "recipient") and how recently the United States and Europe again lead as providers while, surprisingly, a number emerging economies act as "recipients" in agreements with some countries, but as "providers" in others. The author also explains how mega-regional agreements could make Pakistan worse off due to the inclusion of countries like Vietnam producing competing products. The author concludes by recommending that Pakistan sign agreements with the more dynamic countries in Asia and Latin America. The second paper by Saeed analyzes how trade facilitation has contributed significantly to reducing costs and time in cross-border trade, and how World Trade Organization (WTO) members have adopted the new Trade Facilitation Agreement (TFA) at the last ministerial conference in Bali. The author goes on to note that WTO members are now gearing up to implement the commitments ensuing from the TFA in accordance with the special and differential treatment stipulated for developing countries. The paper then assesses the impact of the TFA on Pakistan's national trade policy and shows how the process of policy formulation in Pakistan should be adjusted so that the agreement can be promptly and correctly implemented on a sustainable basis. The final paper by Ahmad looks at how Pakistan's export strategy was forward looking until the 1960s, but that it has recently stagnated. In particular the author notes that Pakistan has failed to take advantage of its strategic location, especially since its ports should be serving as a transport hub for both China and energy-rich Central Asia with the rest of the world. The paper also presents some interesting possibilities for the development of Gwadar port as a transit point for Chinese exports that would rival Dubai and concludes that Pakistan needs to reduce tariffs further to become more integrated into global supply chains.

It should be noted that in the context of Pakistan, it is rare to find a source that analyzes such a vast range of issues which makes this special edition of the Lahore Journal of Economics a truly exceptional resource for policy makers, academics, students and analysts. The editors of the Lahore Journal of Economics hope, as do all the contributors, that policy makers in Pakistan pay close attention to many of the issues and lessons raised in these articles since these papers and proceedings are aimed at helping them develop long term policies that encourage economic growth and development in Pakistan.