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Editors' Introduction

As the Pakistani economy has stabilized over the last few years, the focus has turned towards restarting economic growth. This is a challenging task because of the structural problems faced by the economy as well as the global economic slowdown. This means that Pakistan's policymakers must move beyond the traditional growth strategy of export led growth and think of ways of expanding the country's manufacturing base. Keeping this in mind, the organizers of the Eleventh Annual Conference on the Management of the Pakistan Economy chose the topic of "Pakistan as a Regional Manufacturing Hub – Prospects and Challenges." The objective of the conference was to provide academics and policy makers with new ideas on growth strategies in the context of a changing global environment.

The conference was held on the 25th and 26th of March, 2015 and looked at both the macroeconomic and the microeconomic issues that have historically hampered the development of Pakistan's manufacturing sector as well as the prospects for future growth in the sector. The Lahore School gathered world-class academics, policy makers, practitioners and members of the business community to discuss these issues and lay the groundwork for a coherent industrial strategy.

The speakers presented on issues related to industrial policy, the strengths and weaknesses of the Pakistani manufacturing sector and the macroeconomic conditions that have helped and hindered industrial growth in Pakistan over the last few decades. The main papers presented are summarized below.

Professor Robert Wade (London School of Economics) began the conference with the keynote address. He offered a sharp critique of the shift in priorities of the major aid agencies from its earlier focus on growth-promoting investments in infrastructure, industrial, and agricultural development in the 1960s and 70s to the softer goals of reducing extreme poverty, governance, primary health care, and education starting in the 1980s. He noted that market liberalization was promoted as the main economic growth strategy in the ensuing decades and he attributed this sea change in the focus of development strategies that occurred in the 1980s to several factors: changing strategic priorities of the West following the end of the Cold War; the rise in awareness in the West regarding social and environmental protection issues; neoliberal economic thinking promoting deregulation and the superiority of market driven forces; and the domination of Western countries over international organizations including the World Bank. In response, Professor Wade discussed how developing countries have been both pressing for more say in the Bretton Woods institutions as well as bypassing them by borrowing for industrial development from alternate financiers including China's new Asian Infrastructure Investment Bank, the Corporación Andina de Fomento, and the BRICS' Contingent Reserve Arrangement.

Turning the focus on domestic constraints, Shakil Faruqi discussed how financial constraints have stalled manufacturing growth in Pakistan. Dr. Faruqi offered a first-hand account of the history of local development finance institutions (DFIs), often World Bank funded, and how investment incentives in India and East Asia have differed relative to Pakistan. He also discussed how unlike East Asia, and even India, Pakistan lost its domestic DFIs at an early stage because of Western pressure on the World Bank to end these programs in order to take pressure off of faltering industries in the advanced countries. He went on to explain how FDI and technical education also played key roles in the acquisition and assimilation of new technologies in East Asia. Finally Dr. Faruqi described some unsuccessful attempts to resuscitate Pakistan's DFIs and came to the conclusion that despite financial system reforms and privatization, most of Pakistan's financial resources are channeled to the public sector, leaving little credit to the private sector.

In the next paper, Akbar Noman reviewed the history of industrial policy and setbacks from the 1950s to the 1990s and discussed how development finance is key to raising Pakistan's investment rate. He suggested Pakistan's own PICIC or IDBP might be resuscitated, or that alternatively, Brazil's BNDES model, the Andes' Corporación Andina de Fomento or Development Bank of Ethiopia might be followed. Dr. Noman also noted the wide distribution of productivity within sectors in Pakistan, suggesting that technology transfer and implementation of low cost management techniques such as the Japanese concept of "kaizan" or continuous improvement can help to reduce this dispersion and raise sector productivities.

This was followed by an analysis of how policies of economic liberalization in Pakistan have failed to lead to any sustained economic growth. Matthew McCartney explained how the liberalization of Pakistan's economy, encompassing trade and financial reforms, began in the late 1980s on the belief that bad policies, rather than weak governance and institutions, were responsible for stagnant growth. In response, rather than witnessing the expected gains, Pakistan's macroeconomic indicators worsened. Growth rates fell by a third, and trade as a share of GDP inched up only slightly. Dr.

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McCartney then argued that Pakistan largely the followed the advice of donors in its economic reforms and maintained a rational exchange rate over an extended period of time but nonetheless was unable to realize the economic gains promised by the Washington Consensus.

Irfan ul Haque returned to the theme of industrial policy and presented a thoughtful history of industrial policy in Pakistan. Dr. Haque began by discussing how Pakistan's industrial policies to support its nascent industries were attacked almost from the beginning. Starting in the 1960s, these activist policies were blamed, without much proof, for most of the problems of Pakistan's manufacturing sectors. While some have proposed that the way forward is through improving supply-side conditions, such as the development of infrastructure, skills, and green technologies, Dr. Haque explained that these measures are insufficient unless other failures are addressed concomitantly, including weak management at the state and firm level, the lack long-term financing for enterprises, and excessive competition that is prematurely driving firms out of business before they have the chance to prove themselves. He also discussed how a successful industrial policy requires strong and committed leadership.

Naved Hamid and Maha Khan continued this discussion by examining the historical evidence to argue that Pakistan is at least on the brink of a premature deindustrialization, if it has not already begun. Evidence from cross-country studies indicate that the share of employment in manufacturing should peak at a minimum of 18 percent of GDP for a country to become non-poor; unfortunately Pakistan has not achieved a level much higher than around 14 percent. Dr. Hamid and Ms. Khan then suggested that balance of payments constraints, energy shortages, and imports from China have likely contributed to the most recent period of industrial stagnation. Their analysis of the sophistication of Pakistan's manufactures showed that there has been little upgrading on average since 1990; improvements in Sindh were matched by declines in Punjab.

In order to see the impacts of expanding the manufacturing sector, Azam Chaudhry and Maryiam Haroon studied the effect of firm entry on employment, education, and the number of hospitals in Punjab. The authors found that these impacts vary based on the size of firm that entered, the length of time that has passed since entry, and whether the firm entering was in an export-oriented sector. Specifically, their results showed that the entry of small firms led to short-term increases in employment; this impact on employment was slightly longer-lived in the case of entry by medium firms. On average, there was a significant decrease in the growth rate of employment after a large firm entered the market and this impact was greater than that of a small firm. While the entry of export-oriented firms had a significant impact on employment that was sustained over time, this effect was substantially smaller than in the case of other types of firms. The largest positive impact on primary enrollment was correlated with the entry of large firms, but it took almost four years for this impact to materialize. The entry of an export good producer also had a large, positive impact on primary school enrollment after about six years. Finally, the authors found that new firm entry had a significant, if marginal, impact on the number of hospitals and primary schools.

Looking at micro-level examples in the manufacturing sector, Theresa Chaudhry and Mahvish Faran's paper detailed the management, wage practices and organization of production in two of Pakistan's export-oriented sectors, electric fans and ready-made garments. The authors found that these sectors differed in many ways but shared characteristics such as piece-rate wages, family ownership/management, and informal or on-the-job training, which may be holding these sectors back from reaching their full potential.

Providing a regional perspective on the growth in Pakistan's manufacturing sector, Rajah Rasiah and Nazia Nazeer analyzed the stunted progress that Pakistan has made in raising manufacturing's share of GDP and in moving from low- to medium- and high-value added activities; in fact, the share of manufacturing in GDP, at less than 15 percent, was nearly the same in 2013 as in 1965. They contrasted Pakistan's poor performance in manufacturing growth and technical upgrading with that of Malaysia, Thailand, Taiwan, and South Korea. They also noted that limited upgrading that has taken place in Pakistan's most important sectors, textiles and garments, but that Pakistan could make significant progress if it enters sectors upstream (knitting/weaving machinery and dyes, designing) and downstream (branding).

Following on this theme of comparative industrial performance, Khalil Hamdani discussed how developing countries, particularly those in East Asia, have taken advantage of the opportunities afforded by economic globalization through the expansion of transnational corporations (TNCs), explosive growth in FDI, and the internationalization of production, the "fragmentation of production into global value chains". Dr. Hamdani also argued that Pakistan has mainly been a passive participant in the process of globalization (except for the cross-border movement of workers). He concluded by recommending that Pakistan should aim to become a more active player, seeking FDI to increase its role in global production networks, rather than the current types of FDI flows, which have tended toward market-seeking (producing goods for domestic consumption in Pakistan) and resource extractive industries.

Turning their attention toward the macroeconomic factors leading to slow manufacturing growth, Inayat U. Mangla and Muslehud Din argued that macroeconomic instability must also be considered as a factor in understanding Pakistan's lackluster performance in manufacturing, in particular by depressing private investment. Furthermore the authors suggested that macroeconomic stabilization policies have often failed to produce the desired results owing to a lack of coordination between monetary and fiscal policies. Though they found that recent macroeconomic indicators showed some improvement, they still concluded that fundamental weaknesses remained. In particular, they pointed to the fact that the recent improvement in the current account deficit was driven largely by a high inflow of remittances coupled with financial engineering such as payments from abroad.

Switching again to the micro-side, Imran Ahmad and Karim Alam presented data on the trends in credit to the manufacturing sector in general, and SME manufacturers in particular. While the nominal value of credit to manufacturing has risen since 2006, the authors found that the share of credit to the sector has fallen. In addition, the lion's share, at 60 percent of credit, went to just two sectors, textiles and food & beverages. When looking at credit to just SMEs, the authors found that again the textiles and food & beverage subsectors dominated. They also found that overall credit to SMEs fell and then partially recovered over the period 2009-2015. They concluded by noting that the State Bank of Pakistan had begun to take steps to increase lending to the SME sector, including revising the regulatory framework for lending to SMEs, establishing an e-Credit Information Bureau, and a secure transaction registry.

Hanns Pichler continued on the theme of SMEs and emphasized the critical role of small and medium enterprises (SMEs). He spoke on the experience of SMEs in Europe, where they dominate the industrial landscape, so much so that only 0.2 percent of firms are large. He also spoke of the resilience to volatility of SMEs and their important role in generating jobs, both as employees and as entrepreneurs. Dr. Pichler also discussed how SMEs can also be important sources of economies of scope and how SMEs must survive amidst market forces; in other words, they should not be coddled, but neither should they be overburdened by regulations. Finally, Dr. Pichler explained that appropriate institutions are needed to support SMEs, including business associations.

A special session focused on the opinions of industry leaders to determine what makes manufacturing firms succeed or fail. First, Mr. Mujeeb Rashid (CEO, Mitchell's Fruit Farms Limited) reviewed the business operations at Mitchell's, focusing on supply chain efficiencies through a Rolling Sales Forecasting System supported by the PDCA Concept. He explained that together with these efforts, training and development of staff was undertaken to improve skills and attitudes. The resulting internally generated value enabled the company to make new investments that strengthened both backward and forward linkages to growers and consumers.

This was followed by a presentation by Dr. Shahzad Khan (Director Marketing and Sales at Getz Pharma Pvt Ltd), who explained how Getz Pharma was the first and only manufacturing company in Pakistan and amongst few in the region to be certified by the Pharmaceutical Inspection Convention and Pharmaceutical Inspection Co-operation Scheme (PIC/S). He also described how Getz Pharma broke ground in 2015 on the largest pharmaceutical plant to be constructed in South Asia, which was being designed and being built to attain the WHO, U.S. FDA and EU certifications.

Finally, Mr. Sajid Minhas (CEO, Delta Garments) illustrated the importance of the garment sector in the context of economic growth. He began by explaining how the sector has the potential to be the engine of Pakistani textile export growth, and went on to explain how it is the largest source of creating low cost employment. Mr. Minhas also described how Pakistan's garments and made-up exports have grown over 20 percent in the last year and explained how duty free access to the EU through the GSP plus scheme had been a major cause for this increase. Mr. Minhas then went on to explain that the main weaknesses in the sector – at both the firm level and the sector level – was the lack of product diversification in the sector across product lines. Mr. Minhas concluded by talking about the need for a friendly import/export policy from the government which facilitates all, i.e. large, medium and small units, as well as new entrants.

Though the conference topic was complex, some important themes emerged from the presentations and discussions: First, there is a growing recognition amongst academics and the business community that a coherent industrial policy for Pakistan is required and this must be

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urgently undertaken by the government. Second, there is a glaring vacuum when it comes to any viable financing mechanisms for industries, which needs to be immediately addressed. On the urging of the Western financial institutions, all the development finance institutions in Pakistan were dissolved and the present financial sector is unwilling and unable to fill this gap. Third, policy makers and academics must interact with industries and firms at a micro-level to begin understanding the key constraints to growth they face; it is no longer sufficient to just blame energy shortages and lack of government policy for faltering manufacturing sector growth. Finally, the only way the manufacturing sector can practically grow is if it begins to focus on technology upgradation, innovation and productivity improvement. This has to be done by industry, academia, and government joining hands and incorporating these priorities into its industrial policy.

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.