Chapter 15

TRADE AND COMMERCE – BALANCE OF PAYMENTS

The external sector has long proved to be problematic for the Pakistan economy. Most episodes of the GDP growth have come to an abrupt halt because of deteriorating balance of payments (BoP). The underlying reason is that Pakistan's exports are relatively inelastic, while the country's elasticity of imports is high with respect to the GDP. An unsatisfactory export performance over several decades is essentially due to the fact that the export basket consists largely of items – such as the lower counts of cotton yarn and textile products that sit low on the value chain – which are not very responsive to income increases in the importing countries, and that a substantial share of exports is directed towards those markets, which are relatively slow-growing. This underlines importance of accelerating structural changes in the economy, especially the manufacturing sector.

The Plan aims to maintain a sustained BoP position for ensuring macroeconomic stability. Pakistan has a high degree of dependence on oil imports, essential industrial raw materials, machinery and equipment. To meet such requirements without excessive reliance on external borrowing, the Plan has outlined a strategy to build a competitive trade sector, which will be capable of generating robust growth in export earnings. Non-export resources will also need to be increased by attracting private transfers, especially workers' remittances. The capital and financial account will be strengthened by diversifying sources of financing, with greater recourse to non-debt-creating sources of financing.

Situational analysis

The BoP started worsening from 2006 with the worst crisis striking in 2008 when the current account deficit reached 8.5 per cent of the GDP (Table 1). This adverse situation coincided with the global financial crisis of 2008 and European Debt crisis of 2010. To make matters worse, prices of the crude oil and commodity escalated in 2008. The combination of these shocks compelled Pakistan to resort to an IMF Standby Arrangement in 2008.

Table-1: Key indicators

Indicator	Actual					
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
GDP growth (per cent)	5	0.4	2.6	3.7	4.4	3.6
Trade deficit (billion $)	-15	-12.6	-11.5	-10.5	-15.8	-15.4
(per cent of GDP)	-9.1	-7.8	-6.6	-4.9	-7.0	-6.5
CA deficit as per cent of GDP	-8.5	-5.7	-2.3	0.1	-2.1	-1.1

Source: *The State Bank of Pakistan*

The trade imbalance remained very high primarily because of lower export growth, which remained weak mainly because of the global economic slowdown and rising competition in the international market, particularly for textile exports. However, the domestic supply constraints, such as power outages and continuously deteriorating security also played a major part. The import bill remained high because of the international oil prices and other commodity prices. The relatively slow growth in imports during the last five years is a manifestation of weaker economic activity in Pakistan, and accounts for smaller deficits on the current account (as a per cent of the GDP). The disproportionate rise in imports in relation to exports resulted in slight increase of the trade deficit from $15 billion in 2007-08 to $15.8 billion in 2011-12 before declining to $15.4 billion in 2012-13. Policies can be used, which attempt to encourage consumers to switch their spending away from imports towards the output of domestic firms. The 'expenditure-switching' occurs if the relative price of imports can be raised, or if the relative price of exports can be lowered. For this, the measures include:

- Domestic inflation at appropriate level relative to trading partners
- Exchange rate at appropriate level relative to trading partners
- Government restrictions in the form of imposing tariffs or other import controls for reducing unnecessary import items

The current transfers continued to post huge surplus during the last five years, which almost offset huge goods and services trade imbalance. At the end of 2012-13, the current transfer surplus stood at $18.1 billion against $11.5 billion in 2007-08. The rise in the current transfers surplus was primarily on account of the robust growth in remittances, which increased from $6.5b in 2007-08 to $13.9b in 2012-13 coupled with payments for logistical support, which increased from $655 million in 2007-08 to $1806.5 million in 2012-13.

The current account deficit decreased sharply from 8.5 per cent of the GDP in 2007-08 to 1.1 per cent in 2012-13 mainly due to positive terms of trade. However, this substantial decline in the current account deficit was not supported by the financial account surpluses. Consequently, Pakistan had a run on its reserves, and it appeared that the country would not be able to meet its external obligations, which brought further pressure on the reserves and exchange rate. Pakistan, therefore, had to approach the IMF again for a BoP support in 2012-13.

Plan outlook and targets

The Plan for the BoP takes into account economy's structural features and potential trends in the volume of the global trade and international commodity prices. The Plan assumes that the law and order situation will improve, and policies will be put in place to address the energy crisis in a manner that will facilitate necessary investments, particularly in export-oriented industries. The Plan takes cognizance of difficulty in financing current account deficit and continuous pressure on exchange rate. However, reforms and efforts are applied, which will provide a sustainable position to the BoP.

The prospects of returning to the macroeconomic stability have improved during 2013-14. The available data shows revival of the industrial growth, contraction in the current account deficit, improvement in the foreign exchange reserves and relatively stable exchange rate. The government is committed to the stabilisation programme and has initiated steps to resolve some of the longstanding structural issues. On the global front too, there are indications that the worst will be over.

After a deep global recession, the economic growth has turned around. Substantial decrease in the price of crude oil and marginal decrease in the price of palm oil will reduce the import bill and relieve pressure on the current account balance. Pakistan is to benefit from the trade-related concessions, such as the GSP-plus initiative of the European Union. The key steps for the maximum use of the GSP-Plus facility will include: tariff reforms, tax rebate for value-added products, trade facilitation and uninterrupted supply of energy to export-oriented industry. On the financing side, major repayments are due in the next five years, including end of the Paris Club rescheduling grace period, which are likely to be more than offset by higher external capital inflows, particularly investment from China. Projections for the BoP (Table 2) have been set keeping in view the above-developments.

Table-2: Balance of Payments

($ million)

Item	Actual		Estimates		Projections	
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Current account balance	**-2,496**	**-3130**	**-1636**	**-2,891**	**-3,101**	**-4,129**
Balance on goods	**-15,355**	**-16,590**	**-16,617**	**-17,735**	**-19,498**	**-21,529**
Exports, fob	24,802	25,078	24,215	25,547	27,228	29,511
Imports, fob	40,157	41,668	40,832	43,282	46,726	51,040
Services balance	**-1,564**	**-2,657**	**-2,033**	**-3,313**	**-3,534**	**-4,101**
Income (net)	-3,669	-3,948	-4,291	-4,636	-5,028	-5,331
Balance on goods, services and income	**-20,588**	**-23,195**	**-22,941**	**-25,684**	**-28,060**	**-30,961**
Current transfers (net)	18,092	20,065	21,305	22,793	24,959	26,832
Workers' remittances	13,922	15,837	17,964	18,989	20,603	22,251
Capital account	**264**	**1,857**	**415**	**295**	**292**	**290**
Financial account, of which:	**-549**	**-5,553**	**-3,403**	**-7,246**	**-7,623**	**-7,320**
Direct investment in Pakistan	1,456	1,700	991	3,344	3,602	3,723
Portfolio investment (net)	-26	-2,762	-2,188	-800	-1,200	-1,150
General government	248	1,610	325	-922	1,357	9
Disbursements	2,530	4,349	3,161	3,842	3,405	2,340
Amortisation	-2,282	-2,734	-2,836	-4,764	-2,048	-2,331
Memorandum items						
Current account (percent of GDP)	-1.1	-1.3	-0.6	-1	-1	-1.2
Exports fob (growth percent)	0.3	1.1	-3.4	5.5	6.6	8.4
Imports fob (growth percent)	-0.5	3.8	-2	6	8	9.2

Source: *The SBP and Planning Commission*

The current account deficit is projected to remain in deficit at one per cent of the GDP during the Plan period. Exports are projected to grow at 3.6 per cent per annum, while imports will grow at five per cent per annum. Exports of services are expected to decline. The reduction in exports of services is largely due to the reduction in payments for the logistical support of the Allied Forces, which will decline as the role of these forces in Afghanistan has been scheduled to be phased out. However, services other than logistic support are assumed to grow substantially, mainly in the areas of computer and information technology, finance and insurance, and transportation and travel.

Workers' remittances are planned to grow by 10 per cent a year with policy measures to enhance human resource capacity to match demands in the international market. Due to these developments, the current account deficit will be about one per cent of the GDP. The financing requirements will be smaller, which envisages larger inflows of the FDI and FPI. It is being presumed that during the Plan period, Pakistan will be able to generate financial resources through both debt and non-debt instruments. It is based on the following assumptions.

- The law and order situation will be resolved largely, and the country's involvement in the War on Terror will be concluded successfully. It is expected that these two factors will pave the way for an increase in production and exports, which will also have effects on the FDI, tourism and other related sectors.
- Increase in the FDI will lead to an inflow of the advanced technology, expansion in services and growth in production.

Pakistan can benefit from advantage of difference in the production costs among countries. Some products, like electronics, require sophisticated technology, but have labour intensive final assembly; thus it is economical to perform this process in low wage countries. Concerted efforts will be made to branch out and expand exports besides putting emphasis on the services sector, dairy products, fruit and vegetables and labour-intensive areas of the small-scale industry. In addition to these by-products, untapped export markets will be explored. Nowadays, the services sector can perform without crossing borders; so there will be an emphasis on obtaining outsourced contracts from the industrialised world. Expansion of the e-services and e-commerce, such as telemedicine and telemarketing, will help earn foreign exchange. Export potential for the international markets will be taped by improving quality and standards of the commodities in compliance with global commitments. The following measures will be taken.

- Testing and certification facilities in Pakistan will be strengthened.
- Product standard relating to size, shape, chemical residues and packaging has to be overhauled.
- Marine fish harvesting technology will be upgraded, besides post-harvest handling and processing methods to meet quality standards.

Policies and strategies

The Plan envisages an external finance strategy to finance the projected current account deficits and accretion of foreign exchange reserves through a combination of equity and external debt flows. The ratios of foreign savings to investment and growth in foreign exchange earnings from exports of goods and services, remittances and other private transfers are two fundamental variables on which depends the long-term sustainable level of the BoP. Considering these two factors, the annual current account deficit should fall in the range of 1-2 per cent of the GDP.

The financing of the current account deficit is very sensitive to the state of political stability and the predictability of the economic policies. These two factors, in turn, ultimately hinge on the continuity of the system of governance and confidence of investors. The role of debt-creating and non-debt-creating capital inflows has changed substantially during the last few years, and the long-term inflows will enhance current account vulnerability in the long run. These inflows affect the real exchange rate, which in turn compromise the competitiveness of the economy and consequently, reintroduce structural trade deficits.

Exports of goods strategy

The Plan envisages a comprehensive strategy to increase market share in the world trade, which is insignificant at 0.15 per cent presently. This will be achieved by making export development a central plank of the economic policy. Particularly, efforts will be made to enhance export competitiveness through diversification of products and markets, improved product quality, certifications of products and process standards, and higher value-addition.

- The Plan recognises need for the textile sector to adjust to realities of the world market for restoring its competitiveness through an enhanced productivity to reap benefits of the GSP-plus types of arrangements. Economic policies will be geared towards encouraging major investments in both plant and equipment, and human skills.
- Product and market diversification will be expanded to the new promising areas, where Pakistan's presence is minimal in the international trade, such as IT exports, agricultural and livestock products.
- Import duties will be reduced, particularly on imported raw material, components and machinery.
- Export-oriented enterprises will be encouraged to invest in skills essential to raise their productivity and competitiveness.
- Export-oriented industries will be given priority in providing uninterrupted supply of energy.

Services development strategy

The export policy will give particular attention to the export of services by seeking enhanced market access to them. A strong services sector can not only become a fairly significant contributor to the export mix over time, but more importantly, it can provide critical support to merchandise exports. In this regard, the major steps are:

- Pakistan to expand its trade diplomacy to achieve greater market access for its services exports, particularly under Mode-4 of the Services Delivery.
- Encourage participation of the Pakistani IT companies in the world expos
- Encourage expansion of broadband infrastructure and webhosting infrastructure
- Enforce implementation of laws related to electronic communication and transactions, acceptance of electronic documents, signatures and privacy of information
- Policies to manage services, which align with the best global standards and practices
- Envisioning of the Trade in Services Development Agency (TISDA) For development and export of services
- Develop an integrated area tourism development plan to cover the requirements of hotels, resorts, golf courses, recreation shows, and others through the public-private partnership, and on BOT and BOO basis
- Give preferential treatment in taxation to the Information Technology, being service industry
- For ensuring high reliability of connectivity to the outside world, develop additional submarine cable and overland route

Transfers

Workers' remittances have historically provided significant support to the BoP. Policies to enhance these inflows will focus on surveys to assess demand for various skills in different countries. Based on the identified demand, programmes for the capacity-building and skill development will be initiated. Such policies will not only help migration of the skilled labour with large earning and remittance capability, but also boost domestic production through provision of the market-based skills. The steps for increasing remittances include:

- Reducing the cost of sending remittances
- Tightening of anti-money laundering policy
- Increasing the number of skilled manpower
- Involvement of the Islamic banking and other small banks in the remittances business
- Strengthening of the Pakistan Remittance Initiative (PRI)

Attracting Foreign Direct Investment strategy

The FDI is an important source of non-debt creating inflows, which has positive impact on technological upgradation and economic development. The FDI in Pakistan has been concentrated mainly in natural resources, import substitution industries, telecom and banking services. The Plan aims to make concerted efforts for attracting the FDI, especially in the export-oriented industries by removing the anti-export bias from policies, and improving the logistics and ports operations. To facilitate foreign investors, One-Stop Shop will be established. The FDI opportunities will be explored in the infrastructure, energy and other areas besides improving global competitiveness and 'ease of doing business'.

Regional cooperation strategy

Pakistan is a member of two regional groups – South Asian Association for the Regional Cooperation (SAARC) and Economic Cooperation Organisation (ECO) – but the intra-regional trade has not been promoted in a substantial manner. Divergent reasons can be attributed to this, which include: political differences, failure to develop requisite infrastructure and protocols for overland trade at a large scale, resemblance in the trade structure, lack of comparative advantage in the capital intensive and high value-added products (normally imported in the region). The following recommendations have been made for enhancing regional cooperation and market integration:

- **Vertical specialisation:** Trade complementarities, within the region, can be developed provided countries achieve vertical specialisation through production-sharing arrangements since the specialisation will enable them to reap economies of scale by concentrating on a specific production process in the value-addition chain, and will also allow the regional trading partners to strengthen their ties too.
- **Joint marketing initiatives:** Most of the South Asian countries are direct competitors for their exports, and these can forge a mutual alliance to protect their interests for the marketing of their competing exports products. It will be useful for the promotion of the mutual economic cooperation in the region, which will allow them to reap benefits of improved export opportunities.