Institute of Developing Economics Advanced School
Institute of Developing Economies (JAPAN External Trade Organization)

Trade Policies and Liberalization in Pakistan

Lessons from Japan

By
Saad Abdullah Paracha

Institute of Developing Economics Advanced School
Institute of Developing Economies (JAPAN External Trade Organization)

Trade Policies and Liberalization in Pakistan

Lessons from Japan

By
Saad Abdullah Paracha
9th Batch Overseas Fellow (Pakistan)

A dissertation submitted to the Institute of Developing Economics Advanced School (IDEAS) in partial fulfillment of requirements for the award of Post Graduate Diploma in International Development.

March 2000, Chiba, (Japan).

Contents

List of Appendices

Acknowledgement

I would like to deeply acknowledge the cooperation and guidance given by my advisor, Mr. Hisaya Oda, Researcher at Institute of Developing Economics, Chiba, Japan. His resourcefulness and considerate but frank suggestions helped me all the way in the completion of my dissertation.

I am also grateful to my friend and cousin, Fasihullah Paracha, for effectively coordinating the page making of my dissertation. As for the actual formatting and page making, I could not trust anyone but my old time friend, Mehdi Ali Khan. He has been a constant support for me throughout my academic and professional career. The visual quality of this report is all due to his expertise.

CHAPTER ONE

Introduction

Theoretical Perspective

The opening of a foreign trade ......some times works as sort of industrial revolution in a country whose resources were previously under developed.

(John Stuart Mill, 1846)

The study of foreign trade and international finance is among the oldest and most controversial branches of the discipline of economics. It dates back to the sixteenth century and Europe's mercantilist passion for Spanish gold. It flowered in the eighteenth and nineteenth centuries as modern economic growth was fuelled and propelled by the engine of international trade. The greatest minds in economics - Adam Smith, David Ricardo, and John Stuart Mill - provided the basic concepts and insights that endure to this day. Trade is an important stimulator of economic growth. It enlarges a country's consumption capacities, increases world output, and provides access to scarce resources and worldwide markets for products without which poor countries would be unable to grow. Trade tends to promote greater international and domestic equality by equalizing factor prices, raising real incomes of trading countries and making efficient use of each nation's and the world's resource endowments (e.g. raising relative wages in labor-abundant countries and lowering them in labor-scarce countries). Trade helps countries achieve development by promoting and rewarding the sectors of economy where individual countries possess a comparative advantage whether in terms of labor efficiency or factor endowments. But it is, at the same time, argued that the fact that trade may promote expanded export earnings and even increase out put levels does not mean that it is an unambiguously desirable strategy for economic and social development. It all depends on the nature of the export sector, the distribution of its benefits and it's linkages with the rest of the economy. It is, therefore, important the relevant trade policies should be adopted by various countries suitable to their conditions. The role of trade in overall development should be thought out and clearly established.

Trade Liberalization

Trade liberalization refers to the removal of obstacles to free trade, such as quotas, nominal and effective rates of protection, and exchange controls. Trade optimists argue that trade liberalization generates rapid export and economic growth. This is because free trade provides a number of benefits like promoting competition, improved resource allocation, generating pressure for efficiency, attracting foreign capital & expertise and generating foreign exchange. World Bank's World development report 1987 supports this view by bringing in relevant experiences of various countries (appendix a, b). The available data at that time suggested that the economic performance of the outward oriented economics has been broadly superior to that of inward oriented economics.

Current issues in international trade

With the development of communications and technology, world is becoming a global village now. The term globalization, with many interpretations and meanings, is becoming an issue for most. And throughout the early decades of 21st century, trade will continue to drive global integration, especially among developing countries.

In this context, trade is important for the developing countries for many reasons.

Firstly, it is frequently the primary means of realizing the benefits of globalization by providing countries with access to markets and new technologies. Secondly, the continuing reallocation of manufacturing activities from industrial to developing countries offers ample opportunity to expand trade not only in goods, but also in services, which are becoming increasingly tradable. Thirdly, trade is intertwined with another element of globalization - the spread of international production networks. These networks break up sequential production processes and spread them across national borders. Fourthly, the growth of trade is firmly buttressed by international institutions (WTO etc).

International trade flows are penetrating deeper into the workings of developing economics, affecting the overall economic structure in general and income distribution in particular. Trade in goods and service has grown twice as fast as global GDP in the 1990's and the share attributable to developing counties has climbed from 23 to 29 percent. Underpinning this surge in the trade flows is the, among other things, growing commitment developing economics have shown to liberalize their trade regions. But, at the sometime, this push for trade reform is meeting with increased resistance, especially in industrial economies, where adjustment to the competitive pressure of the international market place can be a painful process. Therefore sustaining this liberalization process will be difficult specially if it has to be equitable.

This process is expected to produce both winners and loser. The real test will be to harmonize the gains, loses, and also produce a reconciliatory situation. The liberalization is bound to come, posing many challenges, which need addresal in future. With the coming of WTO, trade liberalization will be regulated, monitored, and promoted. The member countries are bound to follow the process. The challenges will be to promote transparent trade policy regimes, build technical capacity in trade matters in developing countries, and sustain the momentum for trade reform. On the other side many challenges will be posed for policy makers to utilize the liberalization to attain social and economic development.

Case of Pakistan and Objective of the Study

At the time of Independence in 1947, Pakistan had very little industry and was predominantly an agricultural economy. During the early formative years, Pakistan's economic policy emphasized import substitution although efforts were also made to promote exports. Largely as a consequence of the inward looking trade policy that Pakistan followed until recently, the country's participation in World trade has been very small (0.15% in 1995). In 1993, exports comprised only 13% of GDP while imports represented 19%. A particular feature of Pakistan's exports is the heavy dependence on products belonging to the cotton group. Other significant exports include leather products, rice, fish, and carpets. The highly concentrated export structure has made the country's trade vulnerable to external distortions and restrictions and in particular to restraints under Multi Fiber Agreement of the GATT. Machinery, Chemicals, petroleum, and petroleum products transport equipment and edible oils are the main import items. Pakistan's largest trading partner in both exports and imports is the European Union, with a share of close to 30% followed by United States, Japan, and Hong Kong. The shares of North America and Asian export has increased in recent years, while those of eastern Europe, the republics of the former Soviet Union - the middle East have declined.

The global processes of liberalization, privatization and openness have also swept Pakistan into their fold, and the structural Adjustment Programs now implemented in more than 80 countries, has become the mechanism through which these policies are followed. In the 1980's Pakistan initiated a comprehensive macroeconomic and structural reforms program which put the country on the path of reliance on market forces and a more substantial opening of the economy to the outside world. This was done mainly for the following reasons. It was believed that the fast import substituting policies had insulated the country from foreign competition and generated a strong anti-export bias in resource allocation and increased inefficiency. Further, the agricultural sector had borne the brunt of the import substituting strategy since it helped to finance the industrialization drive through resource transfers and suffered artificially low prices in the domestic market as well. All the initiatives in this field were complimented by the Govt.'s resource to the World financial institutions for financial bailouts. IMF, World Bank have prescribed open policy prescription for the ills facing Pakistan.

In addition to the conditions mentioned above, it is also believed that there are strong links between trade strategy and industrial performance cum direction and ultimately economic development. Pakistan's industrial development in the past is a poof of this link. Therefore, trade policy becomes a very important subject in the economic development.

Given the reasons stated above, this report aims to study the trade policy regime in Pakistan. It will bring out the challenges faced by the trade sector in Pakistan. It will also bring out the issues in trade liberalization in Pakistan. Having done this, the study will review the Japanese trade policy over the years to find out relevant lessons for Pakistan. It will conclude with comparative analysis and trying to suggest some policy implications.

CHAPTER TWO

Pakistan's Trade Policies & Issues

Historical Perspective

Pakistan's export growth averaged 11 percent per annum over the period 1984/85 to 1995/96, compared with an average annual growth rate of 20 percent for High performing Asian Economics. There are a number of areas in which policy would have to be improved if Pakistan's exports are to be provided a fair and equal opportunity to grow as exports have from competing countries.

The foundations of the anti-export bias of policies in Pakistan lie partly in resource endowment of the country at the time of Independence and partly in the history of economic decision making since that period. Having inherited very little industry but substantial agricultural resources, the tax and incentive structure that evolved was such that revenue depended on export taxes on agricultural products (e.g. Cotton & Jute) and import duties on imported manufactured goods. It also hand the intended effect that domestic producers of manufacturers could buy domestic agricultural raw materials at below world prices and sell their products domestically at above world prices. This resulted in large protection of import substitutes and a tax on exports. Domestic policy has continued to reflect it's import substitution character till the present times although much progress has been made in reducing the incentives for import substitution and reducing the tax on exports.

Credit policy, operating through financial institutions, also favored import substitution projects. Banks and tending institutions found it much easier to lend for products expected to sell in the familiar domestic market than for exports. DFIs (Development Finance Institutions) which operated foreign funded lines of credit to finance industrial investment took the cue from the nature of Government policies, approving projects mainly in cement, fertilizers, sugar, and defense industries. The textile industry, the only exception in the export sector, received credit allocations but even their source of financing later dried up.

Pakistan's industrial base suffers from a lack of world market competitiveness due to a number of structural issues. Business, in general, is managed by families and relatives with little professionalism. The result is that quality control management, marketing know how, and the adoption of new technology suffered, thus putting Pakistan's products at a great disadvantage in the competitive expert markets. The high level of domestic protection also discouraged improvement of products. Poor labor skills reflecting low levels of education and training further constrained the ability of industry to produce competitive products. The lack of investment in infrastructure during the 1980's further disadvantaged industry and agriculture in Pakistan vis-à-vis the world markets. The inadequacy of power alone added substantially to business costs. It is no surprise that today there is hardly a single Pakistani trade mark which has established a niche in the world markets.

Recent Tariff Reform Policies

Prior to the late 1980's, Pakistan's trade policy emphasized import substitution behind high tariff and non-tariff barriers. Starting in 1988, Pakistan became engaged in a broad program of economic reform, a chief component of which has been significant trade liberalization. Since then, while success in implementation and targets has varied subsequently, the broad thrust of the objectives and strategy have remained unchanged.

Objectives of Tariff Reform

The prime objective of tariff reform has been the rationalization of the tariff structure to enhance the efficiency of existing domestic activities, especially in the manufacturing sector, and to improve resource allocation in the years ahead. In the process, tariff reforms intends to reduce the bias against exporting activities and reduce distortions in the domestic price structure which would result in a more equitable incentive structure for import competing activities. Consideration must also be given to reducing the burden of protecting domestic industry on final consumers and users of protected goods and activities. The attainments of these objectives will improve the growth potential of the country and increase employment opportunities.

Reflecting the above philosophy underlying the trade regime, trade policies in the recent years have tried to address the following broad objectives:

1. Prepare Pakistan's industrial base for a freer global trading system emerging from the Uruguay Round Agreements.

2. Stimulate exports by facilitating easy access to raw materials, intermediate goods, and machinery.

3. Encourage efficient and competitive import substitution.

4. Impart greater transparency by minimizing administrative controls.

5. Simplify and streamline export/import procedures to make them user friendly.

6. Ensure availability of essential commodities in the domestic economy

7. Adopt tariff measures instead of quantitative restrictions

8. Facilitate the transfer of technology into the country

9. Liberalize controls in the economy and place greater reliance on market forces to promote efficiency and growth.

10. Provide a stable economic environment through greater continuity in policy implementations

While trying to achieve these objectives, the process of tariff reform has been constrained by concern over limiting the revenue impact of tariff changes. In view of these considerations, tariff reform aims for a tariff structure whose adverse revenue impact could be compensated by other feasible tax measures over the period of the reforms.

Pakistan's Export Promotion System

Pakistan has pursued an export promotion policy in some form since the late 1950s. However, these export incentives paled in comparison to incentives for domestic production and economic policy, in general, was biased in favor of import substituting activities. For Pakistan, 1988 was a watershed year in economic policy making. During that period, the country turned decisively away from inward-looking policies toward trade liberalization and effort promotion. While considerable progress has been made in the design and implementation of these policies, reflected in substantial growth in export earnings, there is much scope for improvement both in the design and implementation of trade liberalization and export promotion policies.

Current basic export promotion policies

Currently there are four schemes designed to mitigate the disadvantages that Pakistani exporters face duet to the anti-export bias inherent in the country's import protection strategy. In general these schemes are conducted to permit exporters access to imported inputs at world market prices.

a) Temporary import scheme-concessional imports for export oriented manufacturing.

b) Duty Draw Back Scheme-rebates at fixed rates for custom and excise duties levied on inputs used in the manufacture of specified export products often the product has been exported.

c) Refund of sales tax-improvement in procedures related to sale tax refund for export oriented goods.

d) Export Processing Zones-special zones for export oriented industry

Trade Finance for Export Activities

There are four export finance schemes potentially available to exporters in Pakistan.

a) State Bank of Pakistan export finance scheme—this scheme provides short term pre-shipment and post-shipment finance in local currency to direct exporters except for products given in the negative list. Part I of this scheme is made available against actual export transactions. Part II of the scheme is granted on the basis of previous export performance. Other than this difference, the terms and conditions of part II and I are similar, including applicable loan period; export proceeds realization obligations, interest rate, and commercial banks' spread. The annual interest rate is 13 percent, maximum loan period is 5 months, and the loan can be used for both pre and post shipment finances. The total loans outstanding under this scheme as of 1996 was Rupees 32.8 billion (US$820m) out of which the shares of part I and II were 37 percent and 63 percent respectively. The total outstanding loans could not have financed more than US$2.0b of exports during the year, or about 25 percent of the country's total exports and 33 percent of the eligible exports.

b) General working capital loans of Commercial Banks—Exporters who cannot have access to SBP's Export Finance Scheme can apply for the general working capital overdraft facilities of commercial banks at the market interest rate (up to 22-23%), provided they can meet the collateral requirements of banks. Even if such exporters are willing to pay high interest rates, loan amounts cannot exceed 50 percent of the collateral value. Confirmed export letters of credit are not accepted by the commercial banks as collateral and the exemption for exporters of one percent excise duty levied on commercial bank loans in case of SBP's export finance scheme is not available in this case.

c) Commercial banks' post shipment finance—according to the foreign exchange control regulations of SBP, exporters must surrender their export earnings to the SBP, and export proceeds must be realized within 120 days of export shipment. In case of delay in receiving payments from abroad, exporters may need access to finance to meet SBP's requirements to avoid penalties. Even exporters who have utilized the SBP's Export Finance Scheme may face a crunch since the loan period for the total pre and post shipment period cannot exceed five months. Commercial banks offer a loan facility called the finance against foreign bill purchased, in local currency with a market interest rate (ranging recently between 16 and 22 percent).

d) Short term foreign currency export finance from abroad—The SBP has recently permitted exporters, on the basis of confirmed export orders or letters of credit, to obtain directly or through authorized dealers, short term foreign currency loans from off-shore banks. These loans are intended to meet pre and post shipment finance needs for a period of up to 180 days. Repayment of principal and interest can be made from export proceeds. In the event of non-realization of export proceeds, loans can be serviced with Foreign Export Bearing certificates or from deposits in a foreign currency account. This scheme has been utilized in a few isolated cases.

Related financing programs

a) Export credit insurance/guarantee and pre shipment export finance guarantor—To supplement the above-mentioned finance schemes, the Pakistan Insurance Corporation offers export credit insurance guarantee to protect exporters and banks against the risk of non payment by foreign buyers. The corporation also offers banks protection against the risk of non-performance by manufacturers and exporters. The resources available with the corporation are insignificant. As a result the schemes are almost failures.

b) Investment finance for exporters—The difficulties exporters face in accessing investment finance from commercial and investment banks are even greater than those encountered in obtaining export finance. There is no foreign currency term finance scheme, using Pakistan's foreign currency resources, available to exporters to expand productive capacity. In view of the lack of success in obtaining offshore short-term credit lines for export finance, the outlook for offshore term finance looks equally discouraging.

Challenges & issues in trade

Issue linked to trade liberalization

In the series of attempts for liberalization, the 1993 tariff policy is considered to be comprehensive and well articulated. It aimed at simplification of tariff regime and also other specific measures. An analysis of its implementation has important lessons for trade liberalization in Pakistan. On the whole, the implementation of the proposed tariff changes was below the targets set out over three years, and although significant gains were made in some areas, a few of them could not be sustained due to policy reversals. More importantly, the reform had neither a visible impact on resource allocation nor a safeguarding effect on existing industry and it remained hostage to continuing difficulties in the fiscal area and to a lack of institutional and policy support.

Following issues can be identified in the area of trade liberalization in Pakistan:

1. Effective protection to local domestic industry against imports is very large and there is great variation in effective protection between activities. The anti exports bias in resource allocation remained strong.

2. Excessive protection of domestic industry has generated potential for increasing inefficiencies, waste and decline in quality. The burden of protection of domestic industry is borne by the domestic users and final consumers since domestic prices of protected items are maintained above the world market prices.

3. Numerous duty rate slabs and exemptions result in complicated tariff regime which is detrimental to investment and foreign trade.

4. The practice of giving concessions and exemptions through statutory Regulatory Orders (SROs) has diverted the attention of producers away from quality control and marketing efforts towards seeking profits through exemptions. Different effective duty rates on inputs depending on end-use has promoted rent seeking.

5. The high nominal rates of duty encourage under invoicing, smuggling, and misdeclaration of quality and quantity of goods.

6. The tariff regime discourages investments by raising the cost of capital and investment and subsequently also the cost of Production.

7. Numerous exemptions and concessions have shrunk the base of import duties with the result that most of the revenue is general from a limited number of products.

8. The complicated tariff structure gives customs officials wide ranging discretionary powers which breeds corruption.

9. All these factors have been complemented by policy and commitment changes.

10. The plight of private industry was worsened by a number of additional policy weaknesses. For instance, the tariff reform committee failed to follow it's own advice and never announced a clear phasing out of tariff. As a result the industry could not plan accordingly.

Furthermore, a supportive credit policy to help industry restructure in response to tariff changes was never put together. Most importantly, industrial profits were unduly squeezed when maximum tariffs on final products were reduced, but tariffs on raw materials and inputs were not reduced simultaneously since the later were important source of tax revenue.

The key question to be answered for Pakistan, given the country's recent liberalization experience is: To what extent should further liberalization be pursued and how can the country better structure liberalization measures that are fair, least disruptive for the private sector, and minimally restrictive on revenues.

Issues linked to Uruguay Round & WTO

The Uruguay Round Agreement presents Pakistan with both an opportunity and a challenge. As one of the original members of GATT, Pakistan is a member of the WTO and, consequently, a signatory to all of the major accords established under the aegis of UR. Greater market access to developed country markets, due to lower tariff rates and more limited usage of non-tariff barriers, offers a variety of opportunities for Pakistan to expand it's export base and diversify it's export markets. The most rewarding opportunities for Pakistan are likely to materialize over the medium term as further trade liberalization expands the world's markets in those areas for which Pakistan has a advantage (e.g. Agriculture, Textiles, labor intensive services).

Nevertheless, Pakistan will have to compete with other exporters from both developed and developing countries, especially in products currently under quantitative restrictions, in an increasingly aggressive global market. Pakistan's ability to succeed in this new environment is predicted, in part, on it's capacity to improve competitiveness of it's own goods, systematically expand and find new markets for these goods, and remain committed to it's global trading system obligations. A further set of challenges relates to the constraints that the WTO rules place on each member country's trade policy alternatives. New rules dealing with the use of subsidies and a more accelerated program for reducing tariff will place increased pressure on Pakistan to ensure that its own set of trade rules conforms with WTO expectations.

More specifically the challenges can be identified in the following areas:

Trade liberalization

Opportunity–Improved market access
Challenge–Pakistan's commitment to liberalize and improved quality of goods
Opportunity–UR Agreement on Agriculture and reduction in domestic agricultural Protection.
Challenge–Resulting impact on world prices of agricultural commodities
Opportunity–end of Multi Fiber Agreement and phasing out of quotas
Challenge–Competition on price and quality

New Issues

Opportunity–General Agreement on Trade in Services
Challenges–Obligation to open its service sector to foreign competition
Opportunity–Trade related Intellectual property rights
Challenge–Burden of modifying it's existing intellectual property protection laws to comply with the requirements of the TRIPs Agreement.

Trade Rules

Opportunity–Arrangements related to subsidies and countervailing duties, wherein Pakistan can continue to subsidize exports for some time.
Challenge–The time is not enough for Pakistan to continue export subsidizing policy as part of long term industrial growth strategy.
Opportunity–Anti Dumping Measures, Safeguards and Dispute Resolution mechanism.
Challenge–Pakistan may face problems for it's export and it was to create it's own relevant legislation.

Institutional issues

The primary benefit to Pakistan of WTO is the formalization of the trading system that this new institution represents. It now provides a forum for the developing countries like Pakistan to press their own international trade agenda, and the strengthening of the dispute resolution mechanism represent a tool by which countries will be held accountable to the increasingly rules-based trading system. As a member of the WTO, Pakistan must fulfill a series of obligations to which it committed during the Uruguay round. Some of these mandates will require the elimination of certain types of policies deemed contradictory to the letter of the UR agreement. Other requirements carry a longer implementation time frame, mostly due o Pakistan's developing-country status, but are processes, which can be initiated now in order for Pakistan to meet its future commitment deadlines. Not only do some of these commitments require modifications to existing domestic legislation, but many also will demand new implementation procedures and enforcement guidelines. Finally, as a member of the WTO, Pakistan faces institutional requirements mostly related to notification procedures. Pakistan has to work with the Trade policy Review Body. Then Pakistan has to deal with various barriers, changes in its deletion program according to TRIMs and a long list of notification requirements. Then Pakistan has to create an inquiry point with the responsibility of providing relevant information related to WTO requirements. Pakistan also has to modify its present import valuation system used by the custom authorities in line with WTO bindings. Furthermore, Pakistan has to engage in ongoing multilateral negotiations under WTO on various outstanding issues. For Pakistan they include textiles and services sector, environment, labor standards, investment and competition policy. Doing all this in an effective manner is very demanding and Pakistan surely needs technical assistance to develop its capacity.

Issues linked to diversification of Pakistan's export base

Pakistan is not a major player in international trade, and in fact, can be considered under represented as a trading nation based on it's share of the world's exports and imports, when compared with the degree of openness of other developing countries. It accounted for merely 0.15% of world exports and 0.26% of world import in 1995. Furthermore, Pakistan's export earnings have fluctuated dramatically over the 1980 - 95 period due to world economic conditions and, more importantly, short falls in the output of major export items.

It has been widely acknowledged that Pakistan's export base is extremely narrow, in that the cotton accounts for the majority of export earnings (57 Percent). The cotton group together with three other items, namely leather (7.4 percent), synthetic textiles (7.1 percent), and rice (5.4 percent), make up 77 percent of the export earnings. The high degree of export concentration and dependence on this group of products for export earnings raises the threat of instability. Not only is Pakistan subject to price fluctuations in the international market for these commodities, but it also is affected by the ongoing negotiations between the industrialized and developing countries in what are deemed politically and economically sensitive industries. These industries have been afforded relatively high levels of protection in the developed markets, which in some cases actually has restricted Pakistan's export capacity. Furthermore, a Poor cotton or rice crop in Pakistan itself will have a dramatic impact on export performance.

Pakistan's export base is relatively un-diversified and concentrated in relatively low value -added products. While manufactured goods as percentage of GDP have increased from 43 percent in 1980 to 64 percent in 1995, thus improving the level of value added in the economy as a whole, the bulk of manufactured items fall into the category of traditional, labor intensive processed goods.

The combination of a narrow export base concentrated in low value - added products represents a serious issue for Pakistan. In essence, no trade policy changes or sophisticated policy changes or sophisticated policy implementation schemes will play a significant role in promoting trade in Pakistan if the country's export base retain it's current status. What is required instead is a major focus on Pakistan's competitive strengths and a consequent diversification of it's export base and upgrading of its productive capacity based on these inherent capabilities. Trade policy reform and appropriate implementation programs will then be able to facilitate an export expansion strategy based on good fundamentals.

Issues linked to the promotion of export

Weak macroeconomic foundation

The foremost prerequisite for the success of any export promotion policy is a sound macro-economic environment characterized by low inflation and sustainable fiscal and external imbalances. Above all, a successful export policy requires that the exchange rate policy establishes and maintains the competitiveness of the country's products. In addition to a sound macroeconomic environment, a growing export sector needs the support of a sound financial system, a reliable and adequate physical infrastructure network and a strong foundation of human resources that provide the skills, know-how and entrepreneur-ship which can take advantage of the enabling environment. Macroeconomic developments in the last few years have had an adverse impact on export performance of Pakistan.

Following are some of the characteristics of this weakness:

a) High interest rates, inflation and inadequate access to cheap credit.

b) Govt.'s effort to raise revenue, through regulatory duties, para-tariffs and other temporary measures squeezed the export profits.

c) Deficiencies in physical infrastructure, energy resources and human resource development.

Limited Success of existing export promotion Schemes

The domestic enabling environment for many of Pakistan's competitors is much more supportive of exporters than is the case in Pakistan. Some of the Pakistan's competitors operate in virtually free-trade environment wherein imported inputs are free of duty and there are no distortions between sales for export and sales for the domestic markets. Strong export promotion programs also support them.

The present programs in Pakistan are considered to be suffering from two types of problems:- First, these schemes do not provide a truly free trade environment because the schemes fail to achieve their potential due to limited accessibility and permitted exceptions, both regulated and discretionary; and second, there is a lack of a modern and systematic approach to duty-free administration. That is the reason why schemes are under utilized.

The duty and indirect tax exemption schemes have some structural flaws, which makes them impractical and unutilisable. The procedures are cumbersome and time consuming. The time frame allowed for exporters using imported inputs under these schemes is very restrictive. Polyester yarn, which is a vital input for the entire textile industry, is excluded from these exemption programs. Similarly these schemes are inaccessible to indirect exports (who produce inputs or final products) and to the small and medium industry exporters.

Export finance

Credit policy in Pakistan is not fully guided by market forces. Credit is directed to some priority sectors by setting targets, while the state Bank of Pakistan helps sustain concessionary lending rates to others, including exporters. The Government in selecting particular industrial sectors for venture capital investment formally and informally guides the DFIs and the commercial bankers. Since there is no separate institution for financing investments in exporting activities, such policies have an adverse impact on the future potential for growth in exports. The SBP export finance scheme covers only 25 percent of total exports. Currently only direct exporters have access to SBP export finance while indirect exporters are excluded.

Export supporting policies

(i) Textile quota management policy: Until the MFA is incorporated fully under the auspices of the WTO in 2005, the current high concentration of Pakistan's exports in textile products (more than 60 percent) lends importance to Pakistan's domestic textile quota management policy. Prior to 1997, lack of transparency, discretionary allocations, excessive allocations in some categories and non-availability of even underutilized quotas in other categories characterized the textile quota management policy. The result was that trading in quotas had become more lucrative than exporting, adversely affecting the exports, and discouraging new entrants into the textile export business. The premium or price of quotas in most categories was so prohibitive that it made exporting for non-quota holders unprofitable. Corruption in the allocation and distribution of quotas was naturally high. When individual exporters suffered, so did the country's total exports. Pakistan was able to fully utilize the quotas in only a very few categories. Quota restrictions have indeed constrained Pakistan's textile exports, but this is true only in 3 or 4 categories according to local sources. In view of these deficiencies, he govt. in 1997 announced a three-year textile quota management policy with a view to making the allocation system transparent and non-discretionary. It is designed to make quotas available to genuine exporters on the basis of past performance while encouraging value-added. Since the institution of the new policy, quota premiums have come down sharply in domestic market. The MFA is a double-edged agreement. On the one hand it limits the access of competitive foreign producers (like Pakistan) to the domestic markets in Europe, US, and certain other markets. On the other hand, its phasing out opens those markets to competition from all suppliers, placing a lot of pressure on exporters from countries like Pakistan to ready themselves for competition from other sources like China and southeast Asia. A proper management of Pakistan's textile quota policy can contribute importantly to encouraging efficient production in Pakistan in preparation for the year 2005 as the MFA finally winds up according to the current agreement on textiles.

(ii) Export Promotion Bureau: The EPB was established in 1963 as an attached dept. of ministry of commerce. The primary function of EPB was to facilitate and enhance Pakistan's exports. The EPB was expected to provide support service to the export sector focusing on standard promotional activities like market research and information, participation in the international fairs and exhibitions, organizing fairs in Pakistan, and sending trade delegations abroad. A govt. review in 1997 found that EPB had performed poorly, gauging on Pakistan's continuous reliance on traditional exports and markets. The EPB was seen to have become an overgrown bureaucracy, without the trained and skilled personnel who could perform the duties assigned to the institution. In view of this assessment, EPB was earmarked for reform and reorganization.

(iii) Role of Commerce and Trade Group and trade missions abroad: in 1967, a specialized service known as the trade service of Pakistan was organized to monitor the country's foreign trade sector. This service was later converted into the commerce and trade group under the administrative reforms of 1973. According to some earlier notifications, posts in a number of govt. departments were set aside for the service in view of its specialized nature of work. With the passage of time, neither has the staff of the C&T Group been trained to keep up with the role assigned to them, nor have the posts been assigned exclusively to them.

(iv) Investment Policy: Tariff policy remains one of the most important policy instruments to influence resource allocation or investment decisions, by impacting relative prices and profitability in the country. However, its impact is eroded to a large extent by the Govt.'s credit policy and by its investment policy administered through the Board of investment. The BOI was established as "one stop shop" to tap the opportunities for investment in Pakistan. The BOI performs a facilitating and coordinating role for both domestic and foreign investors to meet all their genuine needs. The BOI launched a worldwide campaign of investment promotion and projecting Pakistan as an investor-friendly country. While the role of BOI is commendable, it is unfortunate that in its zeal to attract FDI, the BOI has offered tariff and other concessions to foreign investors in some cases that have jeopardized the competitiveness of Pakistan's export sector in a serious manner. More coordination is needed to avoid this in future.

Pakistan is extremely weak in the provision of support services that can help exporters identify market opportunities and make quick inroads. The critical weakness is in the public institutional mechanisms that can better prepare exporters to participate in an increasingly complex global trading environment. Policy, consequently, needs to be formulated that will put in place improved institutional settings that can aid export development.

CHAPTER THREE

Japan's Trade Experience & Policies

Japan has today emerged as one of the largest trading nations in the world. In 1998 Japan was ranked as number two on the world GNP ranking. It also has very high per capital incomes and consequently high quality of life. Japan, Limited by it's natural resources, has achieved this status by developing its trading position through developing it's industries. That is the reason why Japan has been studied more often than any developed country for the lessons it might offer to countries getting their own development process started.

This chapter aims to give an overview of the Japanese experience in trade development and policies adopted for the purpose.

Patterns of long term growth

Modern Japan has known two periods of radical economic reform: that implemented in the year 1968 - 85 by the newly established Meiji Government and that carried out during the immediate post war period, 1945-50. There are three major characteristics associated with the long-term growth pattern of the Japanese economy. First, the main engine of growth has been the active importation of foreign technology. Second, domestic savings mainly financed Japan's growth and the dependence on the foreign capital was rather limited. This was due partly to increase in the saving rate over time and partly to the isolated geographical position of the country. The third characteristic of the long-term growth pattern was a significant growth in agriculture either concurrently or prior to the growth of industry. Japan also made a lot of investments in the Human Resources development. So before the world war, Japan had already established a relatively developed market economy and a fairly competitive industrial sector. But it was the post-war period in which Japan really took off and attained the position that it enjoys today in the world economy. Let us see the policies related to the trade Sector in post war Japan.

After the War (1945-55)

After Japan's defeat in the War, the right to determine important economic activities fell under the strict and direct controls of Supreme Commander for the Allied Powers (SCAP). Japan, thus started its reconstruction under the strict vigil of outside powers. The things began to change with the passage of time and with consequent events in the International arena. In 1955, when Japan joined GATT, its exports amounted to only 2.4% of total world exports (excluding centrally planned economics), and it's exports of industrial products amounted to 4.2% of total world exports of industrial products. These shares were much lower than in the 1930's. In 1955, Japan was gradually recovering from the destruction and disorder resulting from the defeat in world War-II. It was still a small, late comer industrializing country, with a GNP per capita and a wage level much lower than those of the developed countries. It's main export were labor intensive products produced by cheap labor using out of date equipment. Its imports were largely limited to such necessities as industrial raw materials, fuel, and foodstuffs.

Liberalization and High Growth (1955-67)

The first significant change in the relatively closed structure of the Japanese economy took place in 1955, when Japan because a member of GATT. A large number of import quotas were removed during this time. Before this, in 1949, the dodge plan had already laid the foundations for post-war recovery of Japan. The major principles of the plan were balanced budget through increased tax receipts, wage stabilization, price controls, credit limitations, and replacement of multiple exchange rate system by a single rate of 360 yen per U.S.Dollar.

Govt.'s philosophy was to achieve economic independence, which implied having balance of payments equilibrium on the country's own strength, without need of foreign aid. Realizing that imports of raw materials would be crucial to pursue higher economic growth, the Govt. considered sustained growth in exports as essential. On account of the over valued Yen, raw material import requirements were dearer, for this reason, export promotion was pursued all the more vigorously. This policy of export promotion continued till the late 1960's. Policy instruments utilized for export promotion included both direct and indirect subsidies, provision of low-interest loans for promising industries and preferential tax treatment of income from exports and for explanation of new export markets. Specifically, investments that upgraded equipment export oriented industries, were subject to carry high depreciation rates. These measures served to reduce production costs and provided incentives for higher out put and exports. Provision of finance was one of the important elements of export promotion.

This was achieved relatively easily because of Govt.'s command over the country's banking and financial institutions. In fact, in the post-war years, private banks were highly regulated and had little autonomy in important matters such as setting of interest rates and allocation of credit to various sectors. In addition, the Govt. provided the most needed basic infrastructural facilities such as roads, ports, railways, power, telecommunications etc. These contributed considerably towards reducing production and transportation costs, and enabled timely delivery of final goods. Moreover, although in the beginning, the anti-monopoly law was in operation, exporters' associations were allowed to form cartels. Later, in the 1960's merging of firms into big enterprises was also permitted to encourage fewer, but financially stronger, firms.

To restrain imports to the minimum, imports of raw materials and machinery essential for domestic production were given priority, Government, in fact subsidized such imports. At the same time, consumer goods and goods having domestic production capabilities were severely controlled. Overall Govt. used the tariff policy for promoting exports and for development of the domestic industrial base. In particular low rates were set for products or raw materials of established export industries. This helped to foster greater competition, while also making available the inputs required for export production

MITI's Role

The administrative set-up in Japan is such that each industry is under charge of a government office, department, or section of a Ministry. Such an office, called a "genkyoku", was interested in ensuring stable growth of its "own" industry. Therefore, each of these offices favored protectionism and operated a licensing system to control the firm's activities. However, the Government gradually accepted the liberalization measures, since they came to recognize exports as the means to achieve further growth and expansion of industries.

In 1949, the Ministry of Commerce and Board of Trade were abolished, and replaced by the Ministry of International Trade and Industry (MITI), with its first Minister proclaiming that the chief objective of MITI was to transform Japan into a leading world exporter.

To accomplish this, it was necessary to attain a substantial increase in industrial output, rationalization of enterprises and upgrading of technical standards. MITI had considerable powers, it was responsible for scrutinizing and recommending all investment loan applications to the Japan Development Bank, it had control over the resources of fiscal Investment and Loan Program, and it was the sole arbiter in determining the allocation of foreign exchange. However, in general, MITI applied its authority with considerable professionalism and care. Its involvement with individual industries has been described as a “curvilinear trajectory”, being intensive during an industry’s infancy, less so when industry natures, and more widespread as the industry declines.

To streamline its decision-making process, MITI regularly amassed information through an extensive network. Work was delegated to specific divisions, whose staff liaised both formally and informally with their counterparts in the private sector. These MITI-industry exchanges were commonly mutually informative. They continue to be so.

MITI also frequently invoked administrative guidelines to elicit entrepreneurial cooperation. The form of guidelines ranged from gentle hints to explicit requests, which lacked the force of law, but they were usually complied with, since enterprises wanted to continue receiving MITI’s goodwill. The administrative guidance enabled rapid responses to a changing economic scenario. In this context, it may be mentioned that large enterprises on their part, recruited retired senior civil servants to top levels in their enterprises through the process of “amakudari”, which gave to the enterprises an effective channel of communication with the Ministries.

Owing to the above mentioned pragmatic, responsive trade policies, along with an efficient institutional set-up to implement these policies, very high and rapid growth was achieved in Japan during 1955 to 1966, referred to as the “high growth era”. In fact, Japan’s exports of certain textile products and other light manufacturing products to USA increased so sharply around 1955, that USA requested Japan to “voluntarily” restrict its exports of these products to USA for a certain period.

During this period, Japan accounted for about 2.5% of total world exports and about 4.2% of world exports of industrial goods. Its main exports were labor intensive products such as textiles (cotton and silk), miscellaneous light industry products, sewing machines, and inexpensive cameras, produced by cheap labor using traditional equipment, while imports mostly consisted of essential items such as industrial raw-materials, fuel, and foodstuffs. However, due to the production that had been made available to several industries, certain sectors such as steel, shipbuilding, machinery and chemicals had already acquired advanced technology and were expending rapidly.

During the late 1960’s with the advent of the Kennedy Round (1964-67), tariffs were reduced further, although the Government was still inclined towards protectionism, especially for manufacturing industries. Fortunately for Japan, by this time, manufacturing industries had come up successfully increasing their international competitiveness, which helped to reverse the existing trend of the balance of payments towards a surplus. With this development, and under pressure from the Kennedy Road, the Government introduced an 'import liberalization' program from 1964, which gathered further momentum in 1969. Thus, all import quotas were removed. In fact, all restrictions on foreign exchange transactions relating to current account were removed, followed by a gradual relaxing of controls even on capital-account transactions. The latter opened the gates for inward direct investment from abroad.

While undertaking tariff reductions, however, the Government was simultaneously, able to raise the rates on many manufactures such as machinery and computers, and on some agricultural products such as dairy products, beans, and seaweed. Also, while abolishing quotas, in certain cases the Government introduced a new system of 'tariff-quotas' to restrict imports. This involved setting tariffs at high levels for imports beyond a given amount. In general, the major principle behind tariff revision was to set low tariffs on primary commodities and on producer goods; and higher rates for consumer goods and on products which had good prospects for development in Japan.

Summary of the Trade Liberation Process

The process of trade liberalization and capital liberalization in Japan in the 1960s had several basic features. First politicians, officials, and businessmen did not quite understand at least in early stage the theory that liberalization would benefit the Japanese economy by improving resource allocation and promoting competition. Rather, they thought that liberalization of imports and inward direct investment were a necessary sacrifice for Japan to become a member of the international countries of Western Europe and North America.

Second, the government took great care not to trigger rapid change in liberalization program. Liberalization proceeded in a gradual and piecemeal fashion; liberalization measures were introduced first in those areas where political and social opposition was weak. It took a long time, therefore, for trade liberalization, capital liberalization, and liberalization of foreign exchange controls to be nearly completed or to finish the first stage.

Third, the pace of liberalization was much influenced by the strength of external pressure for liberalization. In those areas where liberation was requested by a foreign country with a strong negotiating power vis-a-vis Japan, and in periods when such pressures were strong, liberalization proceeded relatively fast. There were strong tendencies in Japanese society to resist foreign pressures and to preserve the status quo as much as possible unless forced to give it up.

Fourth, liberalization was carried out gradually and in a piecemeal fashion in order to avoids disorder in the areas affected. Policy measures were often meticulously designed down to minute details. This was made possible by the genkyoku administrative system and the many competent and honest bureaucrats operating it. For example, sometimes the government liberalized only several subgroups of commodities under a BTN four-digit group. Or it introduced a tariff-quota system, a new mechanism adopted in the 1961 revision of the tariff law, when abolishing an import quota, setting a second-stage tariff rate at a quite high level for imports over a given amount. Also, the government gave various forms of adjustment assistance to industries adversely affected by liberalization.

Fifth, there were few cases where liberalization was reversed after implementation. This is because liberalization was cautiously and meticulously prepared and was implemented in stages. The government has only rarely reversed the liberalization of trade by rapid increase in imports. Japan's liberalization of imports and inward direct in vestment was slow but steady.

Transition Period (1968-75)

As a result of the rapid growth of the economy, there was a gradual increase in wage levels. These trends, coupled with the induction of advanced technology, led to three important changes taking place in Japan during 1968-75: (i) its share in total world trade more than doubled, from a level of about 2.5% in the late 1950s; (ii) the composition of its exports changed markedly - while the share of products heavily dependent on cheap unskilled labor such as textiles, light industry products, etc. declined, the share of products of heavy engineering industries such as steel, machinery and automobiles, increased considerably. With respect to imports, the share of raw materials for textiles declined, and the share of fuel increased. The share of machinery first rose then declined from the late 1960s. Thus, Japan's comparative advantage changed from that based on labor-intensive products to that based on high valued-added engineering products, utilizing advanced technologies, leading to a highly developed industrial structure. (iii) Since 1968, the balance of payments tended to become positive. This was, in part, due to greater stability of wholesale prices and stable or even declining prices for exports, especially for manufactured products, which in turn, was result of the technological progress that was strongly biased towards increasing productivity in tradable industries.

In order to reduce the balance of payments surplus, the Government introduced a series of Yen-Defense Policy packages from 1969 onwards. The packages included removal of several import quotas on items such as automobile engines, telephone exchange equipment, and computers. The Government also reduced tariff rates on most processed agricultural products, manufactures, and mining products. By 1975, Japan's tariff rates were the lowest among all developed countries.

Between 1968-72, Japanese exports, especially to US, expanded rapidly, which heralded the start of Japan-US trade conflicts. Export of steel was the most serious issue, as by this time, Japan had developed strong international competitiveness on the basis of modern technology, locational advantage, and large size of domestic market. Other items involved in the conflict were footwear, electric and electronic machinery, and color television sets. The Japanese producers responded to these developments by replacing exports of their products by direct investment and production in the USA. This trend later spread to video tape recorders and motor vehicles.

Recovery and Growth (1976 onwards)

Following the Start of Tokyo Round in 1975, covering both tariff and non-tariff barriers, the Japanese Government carried out the first round of tariff reductions in advance of the time schedule. This was partly in response to the increasing trade surplus, and partly due to the recognition that Japan had a lot to gain from World-wise multilateral free trade. Japan's trade policy, which in the part, tended towards mercantilist strategies of promoting exports and restricting imports, began to change towards freer trade under a free-competition market-oriented philosophy. Since 1980s, in fact, Japan has been implementing several import promotion measures, such as reduction/elimination of tariffs, removal of importing procedures and other regulations, dispatch of import promotion missions abroad, and opening of import fairs in Japan. Japan's trade policy on agricultural imports was a major exception to its newly emerging free-trade policy. However, under the Uruguay Round Agreements, Japan has undertaken certain minimum access commitments.

In the meantime, the oil crisis in 1973 and the resulting inflation led to a negative real GNP growth in 1974. In this year, the Government issued a 'long-term Vision on Industrial Structure', which interalia, announced a change in policy instruments from active protection and promotion of industry maximum use of market-mechanism, shift from capital-intensive and energy-intensive industrial structure to knowledge-intensive and energy-conserving one, promotion of alternative sources of energy, and promotion of international cooperation. Thus, Japan was able to recover the earliest from the stagflation due to early adjustments of oil and energy related prices, and a tight monetary policy that helped to stabilize wholesale prices by 1975, and consumer prices by early 1976. Production picked up again led by an expansion of exports. By late 1975, steady growth path of about 5% per annum was achieved. Although, this was only half of the rate registered in the 1960s, it was still higher than that of the other developed countries. The stagflation following the second oil crisis was more widespread. The value of world trade dropped during 1981 to 1983, and to decrease unemployment, protectionism rose again. Despite this unfavorable international environment, the performance of Japanese economy was better - the rate of growth was fairly stable at 4 to 6%, which was higher than the others. During the peak years of the two oil crises, i.e. in 1974 and 1980, Japan recorded balance of payments deficits of about 1% of GNP. However, the position promptly recovered.

One of the factors responsible for this recovery was the change taking place in Japan during this period, in the composition of its trade. With respect to exports, the relative demise of labor-intensive textile continued, accompanied by reduction in intermediates such as steel, resulting from increasing energy costs, and increases in competitors in NIEs. The share of machinery products rose, along with the share of automobiles and other transportation equipment and precision instruments. During 1980-85, net exports accounted for 42% of the annual increase in GDP. By 1992, manufactured goods constituted 97% of Japan's total exports. As regards imports, the share of mineral fuels in total imports rose to almost 50% in the early 1980s, despite economizing in energy consumption in individual sectors and shift in the industrial structure in response to high-energy prices. Food imports accounted for 12-15% and raw materials for manufacturing industries about 20%. Thus, fuel food and raw materials accounted for 80% of imports.

Another important factor behind the remarkable growth in production and trade has been the rapid increase in domestic expenditure on research and development since 1975. In fact, in 1981, the national indices of R&D expenditures were the highest in Japan compared to other developed countries. Another major feature was that this rapid expansion was not dependent on the Government sector, but was funded mostly from private-sector outlays. Government spending as a proportion of total R&D expenditures was about 30% before 1970s, which is lower than other developed countries. This proportion has further reduced since then. In 1980, it was smallest among the major countries. Policy measures to support R&D have included favorable tax treatment for incremental R&D expenditures, and subsidies for selected projects.

Since 1982, Japan has recorded an increasing trade surplus, which is another source of conflict with major developed countries. In 1984, Japan had a current account surplus in relation to GNP of 2.9%, while USA had a current account deficit of 2.6% vis-a-vis GNP. The low level of imports was attributed to various 'non-tariff restrictions, such as system of Government procurement, and closed structure of the distribution and industrial organization. The latter tended to discriminate against imports by depriving foreign producers of any marketing outlets in Japan. Sometimes, local distributors subjected the foreign goods to higher mark-ups, compared to domestic goods. Moreover, high land acquisition costs prevented entry of many foreign manufacturers to conduct business in Japan directly.

Comparative advantage in Japan

Japan has been strongly competitive in the world market since the later half of the 1970's in the industries with the following characteristics:

- *Processing industries, especially the fabricating and assembly type manufacturing industries with production processes consisting of parts, production, and assembly.*

- *Use of technology for mass production of standardized products, reflecting the large domestic market in Japan.*

- *Strict quality control to obtain uniformity of quality, a low proportion of deficient output and relatively problem free use.*

- *Differential products, requiring a marketing and service network and fine textured maintenance service for users.*

- *Fields in which continuos cost reductions are made by accumulating small improvements in production process and product design.*

- *Product planning and development and accumulation of small improvements of products responding to the needs and preferences of users and to changes in their preferences.*

- *Organizational skills in arranging stages and steps of production and in closely coordinate the timing of production and transportation.*

- *Cooperation and coordination among firms in different fields and of different sizes (including the sub-contracting system, but not necessarily restricted to it) and among engineers specializing in different areas.*

Cultural influences

Cultural influences have played an important contributing role in Japan's economic development. The development objectives were formulated in the light of situational imperatives in Japan. They included late development, lack of natural resources, a large population, and the need to trade and the constraints of international balance of payments. But the kind of commitment to these objectives, rare as it is, found its source in the cultural influences in Japan. They are said to be derived from at least three sources, including a strong sense of national identity, the vertical principle of organization, and the work ethos. The strong sense of national identification is due in part to a degree of ethnic, linguistic, and social uniformity. Also because of its geographical isolation, Japan has no close ethnic or linguistic ties with any of its neighbors. This is the reason that the sense of belonging is all directed to the Japanese State. Some important links may also be observed between Japan's economic performance and its work ethos. Japanese people are hardworking, efficient and disciplined. The advantages of longer work hours, superior workmanship, and greater voluntary compliance with contracts are far from trivial. The advantages of a superior work ethos are numerous and their combined impact is perhaps critical in determining both the level of productivity and its rate of increase. Finally, the vertical principle of organization also plays an important role in Japan's economic performance.

CHAPTER FOUR

Comparisons & Conclusions

International comparisons are sometime difficult to make and much more difficult to replicate. The reason is that the complete milieu in which factors interact is different. But comparisons are useful in drawing certain generalized lessons for the benefit of those in need of it. Let us first try to compare the Japanese and Pakistan's experiences in trade sector. We may then be able to draw certain lessons.

At the outset it must be said that Pakistan started off at much backward position than Japan after independence. So the initial conditions (in 40's) were different for both the countries. Pre-war Japan had substantial position in the world economy. Japan had already made significant investments in human resource development, education, and technology. Everything worked under the watchful eyes of the govt. Post war Japan had to overcome the war destructiveness and start its journey. The case for Pakistan was entirely different. It got independence from the British after the second world war ended. It had almost no industrial base and the agriculture relied on traditional practices when Pakistan was starting to develop its industrial base, Japan was rebuilding and further developing its existing setup. Pakistan started off with import substitution policies. Japan started off with their policies but a lot earlier. So there is a clear difference of timings for the two countries.

The other difference lies in the results achieved by both the countries by their protectionist policies. Japan was able to improve on the imported technologies by innovations. Japan developed its heavy and chemical industries efficiently. In Pakistan, the protectionist policies did not result into developing of efficient industries. The industries were not compelled to compete internationally and to develop and innovate. In Japan the nature of protection awarded kept on changing with the passage of time in accordance with the changed international situation and suitable export oriented policies. This did not happen in Pakistan and protection was awarded to inefficient industries irrespective of age.

Another feature is that Japan continued to broaden the base of its exports. Pakistan was not able to do this significantly. The transition from primary commodities exporting to secondary commodities exporting country did not take place swiftly in Pakistan. In fact it is not significant.

Research and development play an important role in developing the industry. This has always been neglected in Pakistan both by govt. and the private sector. This was not the case in Japan. The high proportion of privately funded R & D expenditures in total expenditures in Japan was a major factor responsible for rapidly increasing productivity compared to low productivity levels in Pakistan.

In the same way, Japan invested, timely and effectively, in the supporting sectors of trade and industry. They include infrastructure, communication, and power.

Last, but not the least, Japan followed a consistent and thorough policy for a long period of time. This did not happen in Pakistan. The rapid changes in the govt. and political disturbances did not let the development to take root.

Having said this, it can still be argued that Japan has plenty to offer to Pakistan in term of useful lessons. The Japanese model of trade liberalization and policies was not presented so as to choose it as a model for Pakistan. Since the situational imperatives are all so different. The purpose was to illustrate the impact of trade liberalization and how the policies can effect the development of relative sectors. Other lessons that can be drawn from the Japanese experience are the commitment and necessary continuity of policies. The lesson of sequence of policy reform and adjusting it to the national and international conditions is another important one. Most important of all is the manner in which implementation of the policies took place in Japan. It was exemplary in thoroughness.

Options for Pakistan

What are the options for Pakistan now? Many changes have occurred in the international trading arena since Japan started its development path. Those lessons cannot be replicated in entirety. Let us examine the choices and policy options available to Pakistan.

Trade Liberalization

The importance of trade liberalization has been brought out in the introductory chapter. What Pakistan needs to do is to find out the proper mix of policies.

Some of the questions could be the extent of liberalization given the export and production base of the country. This question has to be analyzed in the context of international condition and commitments. Another important crosscutting consideration would be the internal situation of Pakistan. The policy opted for should also lead to devising and implementing supporting policies. One more consideration would be to the speed of policy reform implementation.

Export Promotion

The trade liberalization agenda of a country is not separable from its market based trade-expansion strategy. Furthermore, the production base must be present before a country can begin to strive for a greater share of the ever-growing export markets. Export led strategy is suitable because of the experiences of countries who have followed this policy. Those countries experienced remarkable growth rates with the increase in exports, the growth rates sharply increased after adoption of this policy and they were able to sustain these gains.

How to do it?

Enacting a trade policy reform, which expands and diversifies exports is not an easy task. Given the experiences of Japan and other countries, it can be said that export-oriented expansion is a process that takes several years; relying on an established production base first and expanding from there to new production platforms which have higher value-added capture potential.

All this must take place while simultaneously carving out market niches overseas and gradually gaining acceptance in these markets.

Some of the strategic options for Pakistan are :

1. Improve the competitive position of Pakistan's trade sector

a) Continue with effective liberalization measures: In order to improve the competitiveness of the export sector's production environment, the prices of inputs and machinery used in production need to be close to world market prices. Firms that face low tariffs and indirect taxes are more competitive from a cost standpoint since their cash flow is not as negatively affected as those firms, which face high transaction costs, even if full duty drawbacks are provided. So improvements should be made in current duty drawback package. On of the difficult decisions for Pakistan was whether to make large tariff changes at the beginning of the reform period to send a strong signal of commitment for change or to gradually phase in the tariff changes to allow industry to adjust with minimal costs. Both considerations were crucial to the success of the reform package. In the end it is better to decide in the favor of a balanced phasing. Tariff reforms announced earlier should be pursued as planned with additional strengthening of institutions that support the reform process, and moving quickly to remove discretionary policy changes.

b) Pay special attention to cost reduction policies: One Way of becoming competitive in a particular industry is becoming the most efficient producer within that industry by producing at lower cost vis-à-vis competitors. In reducing cost, upgrading factor efficiency, establishing adequate physical and social infrastructure, ensuring an adequate supply of human resources, etc are all crucial ingredients for efficiency and, therefore, cost reduction. The lending rate also needs to be lowered but through a change in overall fiscal deficit of the govt. The export incentives need to be streamlined in order to be effective

c) Link incentive structure to quality improvement: Unless a country projects a positive image in terms of the quality of its products, it is extremely difficult to gain market share in the increasingly competitive global markets. Quality should be a key focus in any export-led industrialization with the appropriate institutional structures in place to ensure conformance to various quality standards. For this purpose, establishment of a Export quality standards Program is a must.

d) Maintain a competitive exchange rate policy: this is an area of policy that must, by necessity, be coordinated with all other macroeconomic considerations. While international successes and economic theory itself, suggests that a fairly valued or slightly undervalued exchange rate might provide an incentive for exports, as is suggested above, the ramifications of this type of exchange rate policy must be modeled out to the rest of the economy to test its impact.

2. Accomplish rapid institutional change for a supportive trading environment.

a) Reform existing institutional platforms: concessions in tariffs should not be used to compensate for other disadvantages suffered by regions, groups of industries, or specific products. If a disadvantage, for which compensation is being designated, is considered to be a distortion by policy makers, then policy action should be directed at removing that particular distortion rather than creating another distortion in the domestic price structure through compensation. For this purpose Statutory Regulatory Orders should be made more effective by limiting their future usage to rectify inevitable anomalies in changes proposed in tariffs from time to time. Any proposed reforms should be implemented with commitment. This will be continuously tested by segments of the economy, which bear the brunt of the adjustment costs. The implementation strategy must develop a momentum that can overcome the inertia generated by vested interests, while responsive to the genuine problems of the adjustment process.

b) Create new global market activism: the establishment of a strong trade authority is crucial to achieving one-stop-shop status in helping exporters. Therefore it is important that the current role of Export Promotion Bureau in trade related matters be widened. In addition to this all the activities of the govt. in this field may be coordinated in a better way not only within the system, but also with the private sector.

3. Focus on changing market conditions, trends, and opportunities throughout the Global economy.

a) Provide an enabling environment for the development of exports: It is imperative that Pakistan takes quick steps to provide incentives targeted to the enhancement of value-added production. This may include focusing on non-discretionary tax incentives on promoting value-added export activities. Pakistan has to begin the creation of an export market intelligence service linked with the Export Promotion Bureau. Establishing links between buyers and export firms are critical to stimulating export growth. Pakistan should also initiate an FDI attraction program to support the development of export sectors and push new product development. Targeting niche areas in specific industries with concerted follow-up activities is critical to ensuring success. Pakistan should initiate market strategy for its high potential products. In addition, there is a strong need to firm up the foundations for the formation of Export Processing zones in Pakistan.

The Japanese experience brings out the important role played by the govt. This is an important lesson for Pakistan. The govt. has to plan with a vision, implement with dedication, and work in collaboration with others to achieve the desired goals in development of the country and prosperity of the people.

BIBLIOGRAPHY

Literature Cited

1. Ahmed, Viqar & Rashid Amjad, The Management of Pakistan's economy (Karachi: Oxford University Press, 1984).
2. Alam, M. Shahid, Governments and Markets in Economic Development Strategies: Lessons from Korea, Taiwan, and Japan. (NewYork: Praeger Publishers, 1989)
3. Asian development Bank, Pakistan: Industry and Trade Sector study, 1997.
4. Drysdale, Peter & Luke Gower (Ed), The Japanese Economy, Part I (London: Routledge press, 1998).
5. Government of Pakistan, Trade Link Pakistan: An agenda for liberalizing trade & promoting exports, 1998.
6. Government of Pakistan, Economic survey of Pakistan, 1998-99.
7. Inoguchi, Takashi & Daniel L. Okimoto (Ed), The Political Economy of Japan: The changing international context (California: Stanford University Press, 1988).
8. Teranishi, Juro & Yutaka Kosai (Ed), The Japanese Experience of Economic Reforms (NewYork: St. Martin's press, 1993).
9. Todaro, Michael P., Economic Development, 7th edition (NewYork, Addison-Wesley, 1999).
10. Worldbank, World Development Report, 1987 & 1992-2000.
11. Zaidi, S. Akbar, Issues in Pakistan's economy (Karachi: Oxford University Press, 1999)