



June 2010

Impact of Manufacturing Trade Liberalization on Economic Growth and Employment in Pakistan

Key Points

a) Manufacturing exports in Pakistan are characterized by high concentration in a few commodities, high dependence on a few destinations and low-technology-intensity.

b) NAMA negotiations have negatively affected the livelihoods of workers working in the manufacturing sector by affecting their employment, wages and working conditions.

c) There is need for an active role of government to strengthen the industrial base and competitiveness of the manufacturing sector by protecting the infant industry.

This policy brief discusses the implications of manufacturing trade liberalization for Pakistan. It particularly addresses the following questions:

- How have manufacturing trade reforms affected the manufacturing trade and economic growth?
- How have World Trade Organization (WTO) rules related to manufacturing trade affected the human development in Pakistan?
- What has been the role of domestic policies manufacturing trade?

State of manufacturing trade in Pakistan

Liberalization of manufacturing trade: Till 1970s, Pakistan followed the policy of import substitution industrialization. The process of manufacturing trade liberalization started in 1980s and was strengthened by the structural adjustment programme of the IMF and the World Bank. After the establishment of WTO in 1995, manufacturing trade was further liberalized.

During 1990-94 both manufacturing exports and imports increased at a steady rate, however, exports performed slightly better than imports (see figure 1). Pakistan's manufacturing trade suffered during the East Asian crisis. However, exports recovered after 1998, while imports recovered after 2001. Because of good performance of textile and clothing (T&C), exports performed better than imports. Since 2003, both exports and imports had increased rapidly, however net manufacturing exports started to decline. In 2005, imports outpaced the exports because of sharp increase in the imports of machinery and transport equipments and chemicals. After 2006 growth of exports, particularly of T&C, suffered because of phasing out of MFA due to low level of competitiveness. The situation has been deteriorated further after the US removal of quotas from China in January 2009. Since 2005 net manufacturing trade has gone down significantly,

putting a heavy burden on balance of payments, increasing dependence on external debt and enhancing pressure on exchange rate.

Diversification of manufacturing trade: Manufacturing exports in Pakistan are characterized by high concentration in a few commodities, high dependence on a few destinations and low-technology-intensity. The dependence of exports on T&C and low skill, low-technology intensive and resource-based products to USA and the EU are the mainstay of manufacturing sector. According to the *Industrial Development Report 2009*, since 1990s the share of medium- and high-technology exports in manufacturing trade has increased significantly in the world, indicating a reduction in the share of low-technology exports. In Pakistan, situation is reversed where high- and medium-technology exports account for only 8.7 per cent of manufacturing exports, compared to Malaysia (72 per cent), China (57.5 per cent) and the world (62.4 per cent). Such a low proportion of technologically sophisticated exports shows the poor state of national industrial performance. Pakistan ranks 64th in the UNIDO Competitive Industrial Performance (CIP) index out of 122 countries, while the ranks for Singapore, the Republic of Korea, Malaysia and China are 1, 9, 16 and 26 respectively.

Impact of manufacturing trade liberalization on human development

- **Non-agricultural market access (NAMA):** NAMA negotiations aimed to reduce or eliminate the industrial tariffs to improve the market access for these goods. The resulting manufacturing trade liberalization was expected to reduce poverty in developing countries by boosting employment and pushing wages. However, these negotiations have negatively affected the livelihoods of workers working in the manufacturing sector by affecting their employment, wages and working conditions. Increased casualization, high wage inequality, lack of proper social safety nets and poor human development status has increased the vulnerability of the poor working people. Moreover, the negotiations have also affected the state

About Mahbub ul Haq Human Development Centre

Under the umbrella of Foundation for Human Development in Pakistan, Mahbub ul Haq Human Development Centre was set up in November 1995 in Islamabad, Pakistan by the late Dr Mahbub ul Haq, founder and chief architect of UNDP Human Development Reports. With a special focus on South Asia, the Centre is a policy research institute and think tank, committed to the promotion of the human development paradigm as a powerful tool for informing people-centred development policy, nationally and regionally.

government's strategy towards protecting the infant industry.

- **On employment:** Manufacturing sector is the second largest sector to employ the labour force of Pakistan. However, job creation in the sector has been almost disappointing. According to International Labour Organization (ILO), it increased from 11 per cent in 1995 to 14 per cent in 2002, and declined to 13 per cent in 2008. Moreover, 40 per cent of the workers were working excessive hours. The main factors responsible were lack of skill among labour force and poor performance of manufacturing sector. Most of the job creation has been in the informal sector which is characterized by poor working conditions, lack of social protection, low labour productivity and absence of regulatory framework. According to *Pakistan Employment Trends 2007*, in 2006 64 per cent of the manufacturing sector workers in Pakistan were employed in the informal sector.
- **On women's employment:** The manufacturing sector in Pakistan is also an important source of employment of women. The competitiveness pressure has deteriorated job conditions and has widened the wage differential between men and women. Although the share of female workers in manufacturing sector increased from 10.1 per cent in 1999-2000 to 19.6 per cent in 2005-06, the share of wage employment increased from 8 per cent to 13.8 per cent only; while the share of 'own account workers' and 'contributing family workers' increased from 12.9 per cent to 28.2 per cent and from 17.6 per cent to 44.5 per cent respectively. Similarly, the ratio of male to female real wages in manufacturing sector decreased from 56.2 per cent in 1997 to 40.5 per cent 2007. So, although manufacturing trade liberalization has improved gender employment, it has worsened their working conditions.
- **On small and medium enterprises (SMEs):** In Pakistan, about 90 per cent of manufacturing enterprises are SMEs and they provide employment to 80 per cent of the labour force. The sub-sectors like cotton weaving, surgical instruments and sports can reduce poverty by employing the poor unemployed workers. Most of the SMEs in Pakistan face a number of problems such as

lack of access to credit, complicated labour laws, worsening law and order situation, low productivity, and inadequate infrastructure. In a liberalized trade regime there is a need for government to assist SMEs to improve their competitiveness.

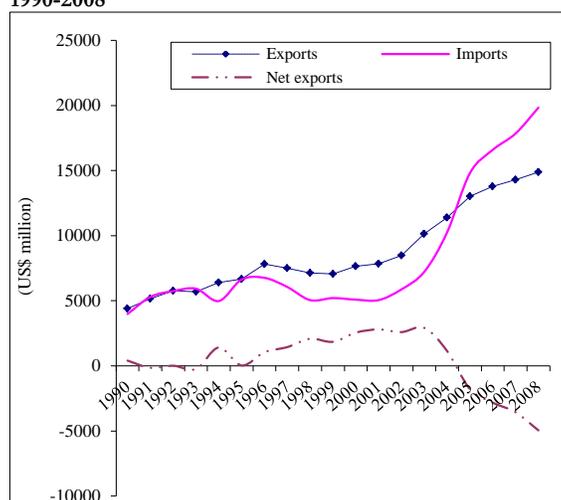
- **On textile and clothing:** In Pakistan, 40 per cent of the manufacturing sector workers are employed in the T&C sector. T&C trade had been governed by the Multifibre Arrangement (MFA) since 1974. The agreement phased out in 2005. Since then the sector has been integrated with the NAMA framework. The quota free trade has increased the competition in the T&C exports. Pakistan has low level of competitiveness as compared to other neighboring countries. As a result, China, India and Bangladesh have benefited from free trade regime while Pakistan has not. Pakistan's T&C sector exports have been declining since 2007. In 2009, they decreased by US\$1 billion, negatively affecting employment in the country. The majority of the T&C sector firms are SMEs. They lack modern technology and skilled labour force and so are unable to meet the environmental and labour standards under the 'Sanitary and Phytosanitary' and the 'Technical Barriers to Trade' Agreements.

Policy recommendations

1. There is need for an active role of government to strengthen the industrial base and competitiveness of the manufacturing sector by protecting the infant industry.
2. Instead of following the policies of subsidy provision and currency devaluation, Pakistan needs to improve the competitiveness of the manufacturing sector by improving skills and upgrading technology, and by removing structural constraints like improvement of physical infrastructure, product and market diversification, provision of energy, and improved financing system. In this context, industrial and trade policies should have a special focus on informal sector.
3. Instead of focusing entirely on T&C sector, government should also improve the competitiveness and exploit the export potential of other manufacturing sectors such as leather and leather garments, surgical and medical instruments, pharmaceutical, engineering goods, sports goods etc.
4. The most important step is to build a strong knowledge base, establish university industry linkage, and create independent public sector institutions which can advise and monitor the implementation process of industrial and trade

- policies.
- Pakistan needs to promote its trade and social links with other South Asian countries and work as a group to ensure that the WTO allows developing countries to pursue appropriate industrial and trade policies.

Figure 1 Trend in manufacturing trade in Pakistan, 1990-2008



Source: WTO.

This policy brief is drawn on the findings of *Human Development in South Asia 2009: Trade and Human Development*. The author, Nazam Maqbool Cheema, is a senior research fellow at MHHDC.

Themes of the Report of Human Development in South Asia

- 1997 The Challenge of Human Development
- 1998 The Education Challenge
- 1999 The Crisis of Governance
- 2000 The Gender Question
- 2001 Globalisation and human Development
- 2002 Agriculture and Rural Development
- 2003 The Employment Challenge
- 2004 The Health Challenge
- 2005 Human Security in South Asia
- 2006 Poverty in South Asia: Challenges and Responses.
- 2007 A Ten-Year Review
- 2008 Technology and Human Development in South Asia
- 2009 Trade and Human Development

Other Books on Human Development

- 1995 Reflections on Human Development by Mahbub ul Haq
- 2002 The South Asian Challenge by Khadija Haq (editor)
- 2003 Readings in Human Development by Sakiko Fukuda-Parr and A. K. Shiva Kumar (editors)
- 2008 Pioneering the Human Development Revolution: An Intellectual Biography of Mahbub ul Haq by Khadija Haq and Richard Ponzio (editors)

Mahbub ul Haq
 Development Centre
 42-Embassy Road G-6/3, Islamabad, Pakistan
 Tel:92-51-2271228
 Fax:92-51-2822794
 Email: hdc@comsats.net.pk
 Website: www.mhhdc.org