Remarks on “Globalization and Pakistan” at the Strengthening Participatory Organization (SPO) Conference on Understanding Pakistan

Islamabad, June 28, 2004

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It is a pleasure to participate at this conference, which is especially useful for a foreigner like me who has been in the country for a relatively short period of time. Let me say, however, that there has been much interest in learning about Pakistan abroad for a long time, given especially the strategically important position and rich cultural heritage of the country. And we have gathered at the IMF a large volume of institutional knowledge about the country and its economy during the already long period of our relations with Pakistan. As many of you would know, these relations have included more recently financial assistance on highly concessional terms under the Poverty Reduction and Growth Facility. We at the IMF have increasingly welcome the opportunity to share our perspective with as broad elements of civil society as possible; and this is another reason why I am here.

My remarks this morning will focus on three themes: 1) how to understand “globalization”?
2) what have been the implications of globalization for Pakistan? and 3) how to ensure that the returns from globalization for Pakistan are positive and maximized?

1. “Globalization”

Let me start by reminding you that globalization refers to the on-going economic integration process worldwide. The process is not new of course, and started almost as soon as mankind began to trade. It experienced, however, through history a number of “bursts”, such as at the
time of the Great Explorers, the Industrial Revolution, the Colonial Experience, and more recently, the Transport and Communication Revolution, through which the world has progressively “shrank” as far as the economic space and time is concerned. While it is true that state ventures (or adventures) have at times driven the process, e.g. the colonial conquests, the globalization process has largely reflected market forces, specifically, the exploitation by large and smaller businesses in the world of benefits from trade in commodities, goods, services, capital, and even labor, and of opportunities for new investments and markets. Through increasingly extensive and intensive trade relations, countries have been able to best utilize their respective comparative advantages and achieve other dynamic economic gains. Taking advantage of opportunities for new investments and markets has benefited both advanced and developing countries, the reward being higher growth for both and speeding up of the “catching up” process for the developing world.

Why then you will ask, do so many people seem to oppose globalization?

Well, let me first answer by pointing out that the apparent strength of the anti-globalization movement is probably inflated by the fact that the globalization opponents have been more vocal than its supporters.

Second, it has reflected the greater organization of a number of groups which are at their core often representing various vested interests. By definition, vested interests do not like change and competition; but change and competition is an essential and inescapable part of the globalization process. Hence, the economic gains from the North American Free Trade Agreement (NAFTA) may be viewed as a threat by the US manufacturing worker. Though, as a result, the vast majority of US consumers can buy more cheaply appliances and other
goods, and the Mexican workers have more opportunities to be employed and earn a decent wage. In return, high-technology US companies have more opportunities to produce and export their goods and services to Mexico, also providing more highly paid jobs to American workers, at least to the skilled ones.

Finally, some critics have not so much opposed globalization itself, but rather questioned the way economic policies have sometimes supported the process, especially in developing countries.

*Globalization is, however, here to stay.* The clock cannot be turned back because turning it back would hurt the standards of living of the vast majority of consumers. The main issues really are how to *make the process yield the maximum amount of benefits for the majority of people?*

This boils down to *how make the rules of the game fair for all and take into account the countries’ specific state of development?* This is not an easy task: first, there are likely to be market failures/imperfections, which might tilt the benefits from globalization towards certain groups or countries. For instance, the often weaker and less transparent capital markets of developing countries might put them at a disadvantage and present significant risks of instability under a free capital mobility regime. Also, government interventions (or lack of) in individual countries might interfere with would-be-positive outcomes of globalization in various ways to the detriment of other countries, or to groups of people in these countries. These include subsidy policies, tariffs and non-tariff barriers, as well as divergent labor, health, and environmental standards. The depressing impact of agriculture
subsidies in developed economies on international commodity prices and thus the terms of trade for many developing countries is well known. Workers in developed economies have often complained that under globalization they have to compete with countries where labor standards are much less demanding, or ignored.

*Essential rules of the game are thus: rational and liberal trade policies foremost, yes; but also, an understanding of the implications of still emerging market institutions and of initial conditions for the appropriate pace and sequencing of liberalization in developing countries; phasing out of subsidies; a consensus on labor, health, and environmental standards; and social safety nets to help the vulnerable deal with the impact of changes inherent to the globalization process.*

2. Pakistan and globalization: so far

Let me turn now to the impact that globalization has already had on Pakistan. It is globalization which has allowed Pakistan to use its cotton production and abundant labor to produce massively more added-value textile than it needs for its population, and to export it all over the world. The foreign exchange earned has allowed Pakistan to pay for the imported inputs of other segments of its industrial production, as well as its construction and services sectors. It is globalization which has offered millions of job opportunities for Pakistani abroad, in the Middle East and elsewhere; remittances from these workers are sustaining their families and also increasingly financing, through the Pakistani banking system, private domestic investment and thus economic growth. It is globalization which has allowed surplus capital in industrial countries to come to Pakistan to finance the development
of its oil, gas, and power industry, and more recently, the rapid expansion of its telecommunication industry. The transfer of technology with these investments will benefit productivity for years to come.

In this context, it is worth pointing to the past failure in many developing countries of the import substitution development strategy, which fundamentally was an attempt to pick and chose from globalization, so to speak. Picking, in particular, on the transfer of some technology to develop domestic industrial and manufacturing sectors whose output could substitute for other imports. But ignoring basic economic principles including laws on comparative advantages, with the result that those sectors could only survive through the imposition of high duties on top of an overvalued exchange rate. Silencing external competition, and its useful role. And hampering the export sectors on which the import substitution industries relied for foreign exchange to pay for imported inputs. Anemic growth rates and balance of payments pressures were generally the outcome. Fortunately, Pakistan avoided the worst forms of that strategy. Don’t get me wrong, industrial diversification and move towards higher value-added productions must be part of the catching up process for the developing countries, as the experience of Korea and other Asian Tigers has shown. And some temporary government interventions might help as a palliative to market failures and institutional weaknesses. But by enlarge the catching up process has to be, and can be, mainly driven by market forces rather than administrative interventions by the government.
3. Pakistan and globalization: looking forward

Finally, let me say a few words on what Pakistan would need to focus on to maximize for itself the benefits from further globalization:

*Maintaining macroeconomic stabilization* is critical to create for the private sector a macroeconomic environment conducive to production and investment decisions. This means low inflation and a relatively stable exchange rate, which requires sound macroeconomic management, in particular a sustainable fiscal deficit which does not “crowd-out” the private sector, as well as a cautious monetary and credit policy which does not inject excessive liquidity in the economy. The link between macroeconomic stabilization and economic growth is well established by the empirical evidence.

*Continuing with an outward oriented trade policy.* There is considerable empirical evidence to suggest that countries, developing countries in particular, which manage to increase the volume of trade (both exports and imports) as a share of GDP grow faster and increase their standard of living faster. A liberal trade policy (no export taxes, low import duties, and no non-tariff barriers) will support such an outcome. The main reasons being that such policy will allow resources in the economy to be put to the more productive uses and make it possible for international competition to play its role in creating incentives for productivity and quality improvements, also resulting in higher value-added. In this context, it is worth noting that Pakistan has long been a more open economy than its larger neighbors, and made significant progress in further liberalizing its trade regime (the 2004-05 budget includes further measures in this direction). Yet, trade as a share of GDP has changed little in the past
ten years, remaining at around 30 percent. In comparison, in the ten year period to 2000, total trade of goods and services grew from 17 percent of GDP to 31 percent of GDP in India, and from 34 percent of GDP to 49 percent of GDP in China. This would suggest that an outward oriented trade regime is a necessary but not sufficient condition to achieve the results experienced by Pakistan’s larger neighbors.

*Presenting the private sector with a legal, regulatory, and tax environment enabling* production and investment decisions. First of all, the “rule of law” must apply. Property rights have to be clear and enforceable, as do commercial and debt contracts; government red-tape (regarding licensing, registration, etc.) has to be kept to a minimum; direct and arbitrary government interventions in the operations of private sector activities have to be banned; tax policy has to be economically coherent, simple and predictable, offer a leveled playing-field, and administered in a transparent way; the regulatory environment for the operations of utilities, banks, and financial markets has to aim at the highest international standards; and corruption has to be severely controlled. In many of the above areas, there have been significant improvements in Pakistan during recent years, e.g. the recent strengthening of financial supervision, and the progress towards making civil servants more accountable, etc. … You will agree, however, that despite these considerable improvements, much work remains to be done. Provided further improvements in the security situation and political stability, this should make it easier to attract foreign direct investments to Pakistan, and speed up the catching up process, as the example of best transition country cases of Eastern Europe has shown.
Further developing the administrative, physical, and human infrastructure of the country.

There is a role for government here because market forces alone are unlikely to produce this infrastructure in sufficient amount. The competition implied by globalization means that traded goods and services must meet certain international standards (health and security, in particular), and government interventions might be necessary to make it possible to meet these standards. Competition also necessitates better physical infrastructure, in the transport, water management, and power areas, in particular, to improve efficiencies and decrease costs, and to extend the opportunities for productive activities throughout the country, including rural areas. Notwithstanding the possible role for the private sector in the provision of infrastructure, government involvement is likely to remain key. The same applies to health and education. There is little doubt that Pakistan, given its abundant labor resources, could be part and beneficiary of the “outsourcing revolution”, not just for producing cheap goods but also more expensive services, such as in the information technology field. This, however, is likely to require a more educated and better empowered labor force. Government has to assume the responsibility for improving education standards on a broad base, especially in the technical fields. Of course, to implement these tasks, resources have to be mobilized, including domestic resources. This is why it is so important for Pakistan to broaden its tax base and improve its tax revenue collections in a least-distortion fashion as possible.

All these are big challenges, and it will take time to fully meet them. Policies supportive of globalization might need to take such a timeframe as well as existing institutional weaknesses into account. But the benefits from economic integration should not be in doubt.