

Pakistan Business Council

Terms of Reference for a Study on:
“Revival of Manufacturing – Trade Aspects”



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Terms of Reference

“Revival of Manufacturing – Trade Aspects”

1. Introduction and Background

Pakistan needs to follow the export driven growth model so successfully pursued in the recent past by the ASEAN Countries and currently by China and India. For this model to be successful not only does the Country require market access for its products and services, it also needs to have in place a vibrant and competitive manufacturing sector.

While the Government of Pakistan has strived and continues to strive for increased market access (WTO, FTAs, the proposed ROZs etc.) for Pakistani products, the necessary manufacturing base to avail these trade concessions has not developed. Granting preferential market access to our competitors has led to some domestic industries such as ceramics, toys, light engineering / consumer durables, stationery among others losing major parts of their domestic market. On the other hand textiles, which are our main export, do not appear to have had the quantum jump in exports that was being predicted when access was granted to our domestic markets.

Various reasons have been identified at a number of forums as being responsible for this lack luster performance of our manufacturing sector, some of which include: poor hard infrastructure, an entrepreneurial mindset that has neither comprehended, nor incorporated the liberalized economic realities of the 21st

Century, a shortage of skilled & trained manpower, outdated technology, inefficiencies in the value chains, insufficient emphasis on marketing, outdated labor laws, the overall image of the Country etc. Though any or all of the above, as well as some others which have not been listed, may be responsible, this Assignment will focus specifically on the impact of the “liberalized trade regime” (WTO, FTA, ATT) on domestic manufacturing and help develop a Policy Framework whereby manufacturing becomes the engine of growth for the economy.

2. Description of the Assignment & Desired Outputs

This Assignment has been conceptualized as having five deliverables each with their own sub components. The five components (and there could be a sixth component – that which focuses on the administrative lapses relating to trade) study the impact of the “liberalized trade regime” brought about by the signing of the WTO /FTA/ATTA. The scope of work in each component is briefly discussed below:

A. The impact of the WTO on Pakistani manufacturing.

Though the WTO promotes free trade, it also acknowledges that Countries have the right to protect their domestic industries. The extent of the protection however should not result in Pakistan being non complaint with its International Trade Obligations. This component of the Assignment will:

- I. Identify the “mechanism” used by the GoP for determining the “applied tariff” on imports and suggest a “scientific” method for determining the import tariffs keeping the stage of the product in the value chain; this will mean application of different tariffs for raw materials, semi-finished product and finished product. Also determine why in most cases the applied tariffs are significantly lower than the “Bound Rates”.
- II. Narrow down 2 or 3 industries where significant idle production capacity exists and domestic firms have lost market share in the recent past to cheaper imports. Also identify cases in which overprotection may actually have harmed industry.
- III. Do a detailed analysis to determine whether the industry lost market share on account of lowering of tariff or other factors such as unethical business practices of local businessmen / foreign companies.
- IV. Where market share has been lost purely due to the lowering of tariffs, a model case will be developed for approaching the Government of Pakistan for a revision in tariffs within the WTO Regime.
- V. Where market access has been possible either as a result of Trade liberalization and/or WTO, a detailed analysis to why Pakistani firms have been unable to achieve desired market penetration. Non Tariff Barriers in major markets to be studied and a strategy for overcoming the same to be developed.

- VI. A detailed review of the role of the National Tariff Commission under the WTO and its response mechanism to anti dumping complaints by industry.

B. The Impact of FTAs on Domestic Manufacturing:

Pakistan at the moment has three operational Free Trade Agreements (Sri Lanka, China & Malaysia), with a number of other FTA under negotiation. Though the volume of trade has increased with the partner countries, the exports of our manufactured goods do not appear to have had the expected quantum jump. This component will address the following:

- I. A brief review of the FTA partner identification, the negotiating process and the rationale behind the selection or otherwise for the seeking or granting preferential access to an item. The contribution of the private sector in the FTA negotiation process.
- II. Identification of 2 maybe 3 industries which should have apparently benefitted from greater market access but have not. This analysis will cover the FTA signed with China and Malaysia
- III. A detailed analysis of the failure of Pakistani companies to penetrate both the Chinese and the Malaysian markets with special emphasis on the Non Tariff Barriers.
- IV. A model case will be developed for approaching the Government of Pakistan for using the remedial mechanism available in the FTA to rectify the situation.

C. The Impact of the Afghan Transit Trade Agreement on Domestic

Manufacturing:

In 1965 the governments of Pakistan and Afghanistan signed the Afghan Transit Trade Agreement (ATTA) to facilitate the duty free transit of Afghan imports through Pakistan. There appears to be conclusive evidence to suggest that this transit facility is being grossly abused with major portions – actual quantities as yet undermined – of the imports destined for Afghanistan being eventually consumed within Pakistan.

The PBC is aware that a revised ATTA is currently under negotiation, as well as ROZs being established just across the border, and the Government of Pakistan is rather keen to provide favorable concessions to Afghanistan for transit rights to the Central Asian Republics (CAR). PBC wants to be involved in the ATT negotiations or at a minimum, be allowed to give its input to ensure the facility is not abused as in the past to the detriment of GoP revenues and the manufacturing sector in the Country. Some of the issues which will be covered in the component are:

- I. An analysis of the current list of products destined for Afghanistan under the ATTA along with a recommendation of type of restrictions that could be imposed, to prevent abuse of the facility to the detriment of GoP revenues and local industry. Emphasis will be placed on industrial raw materials destined for non-existent manufacturing facilities in Afghanistan and imports of high value

consumer durables for which a limited market exists in that Country.

- II. This subcomponent will identify and then do a detailed analysis of two maybe three industries which are claiming to have lost competitiveness due to abuse of the ATTA. If abuse of the ATTA is found to be a major contributing factor, policy options which are allowed under Pakistan's international obligations will be identified.
- III. The potential impact on Government of Pakistan revenues versus gains to Pakistani industry by linking the ATTA with transit access through Afghanistan to the Central Asian Countries needs to be assessed. This is especially important as Pakistan may not at the moment be enjoying preferential market access and hence need to have transit / trade agreements with the Central Asian Countries which we are eventually trying to reach through Afghanistan. These markets may not have the potential envisaged due to heavy proliferation of Iranian, Turkish and Chinese products in these markets.
- IV. While PBC appreciates that Pakistan has to conform to its international treaty obligations, the safeguards under these treaties as they relate to the protection of revenues of the governments of Pakistan and Afghanistan need to be incorporated. Safeguards which are incorporated in transit agreements in other parts of the World need to be evaluated. Various administrative measures like negative lists, collection of custom duties on behalf of the Afghan

Government, quantity restrictions and other options need to be identified, each option supported by the relevant international laws.

D. Impact of Proposed ROZ on Pakistani Manufacturing:

The United States as part of its strategy on the War on Terror is in the process of legislating duty free market access for Reconstruction Opportunity Zones (ROZ) on both sides of the Pak Afghan border. Current information on the ROZ is for the most part sketchy especially with regard to the type of products manufactured in the ROZ which will have duty free market access in the US. There is however considerable anxiety in Pakistan that unless the necessary safeguards are put in place, these ROZ may become another conduit for the smuggling of duty free raw material and components into Pakistan. This deliverable will address the following:

- I. A review of the proposed ROZ legislation with the aim to clearly identifying the provisions relating to market access, especially the locations, the types of products to be manufactured, the mechanics for market access into the USA etc. Special emphasis will be placed on identifying whether the market access provided by the ROZ will have any meaningful positive impact on Pakistan's exports to the US. If the answer is in the negative, what measures should be taken to make the legislators in both the US & Pakistan aware about the minimal impact that the ROZ will have on increasing Pakistani exports to the US.

- II. The negative impact that these ROZ can have on existing manufacturing in Pakistan especially if units in these ROZ are allowed duty free imports of raw materials and components. In addition this section will dwell of the safeguards that need to be built in the legislation to prevent wanton misuse of the ROZ.
- III. An analysis of whether the ROZ will stonewall the Government of Pakistan's efforts to obtain an FTA with the USA. There is considerable apprehension that by unilaterally allowing ROZ, the US Government will no longer be willing to allow market access through an FTA. Signing a wide ranging FTA with the USA is a major Government of Pakistan's trade & Foreign Policy initiative.

E. Attracting Export driven FDI into Pakistan:

Pakistan has been unable to attract Foreign Direct Investment (FDI) into its export based industries. This failure to attract FDI into textiles, leather, food processing etc., has meant that Pakistan for the most part has been unable to move beyond the export of commodities and semi-finished products.

This deliverable will look at:

- I. The reasons why Pakistan has been unable to attract meaningful FDI in areas in which export competitiveness can be built.
- II. Identification of sunrise industries which can benefit from FDI and a policy framework for attracting FDI in these industries.
- III. A greater analysis on how our FTA can be used as a conduit for export driven FDI.

F. Malpractices in Imports

Whereas these are primarily due to administrative lapses, e.g. under invoicing and mis-declaration at import stage, delayed response to anti dumping complaints etc., they may have an impact on the WTO/FTA/ATT study that is being undertaken. To the extent these may impact any of the above; the proposed recommendations may incorporate corrective measures.