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Moving on to Export-Led Growth – Some Financial and Institutional Issues for Pakistan

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Abstract

Following Pakistan's recent Stand-By Arrangement with the International Monetary Fund (IMF) there is a growing realization that the country needs to identify and implement appropriate restructuring measures that can break the recurrent cycles of economic crisis. Several economists have advocated shifting the economic policies' emphasis to export-led growth from the traditional import-substitution. Such a reorientation would not only require economic adjustments, but also political, social, and cultural changes. The paper focuses on the implications of such a transition for the political, economic and financial institutions. I lay out the institutional changes necessary to effectively support the economy's reorientation toward export-led growth. The paper focuses on the following areas in which public policy can create a supporting and complementary environment for export growth: (1) exchange rate policy, (2) trade and long-term financing for upgrading export capacity, (3) strengthening country's competitiveness, (4) capital flows and foreign direct investment (FDI) and (5) fiscal discipline. The political and cultural dimensions of the needed policies for each area are discussed. The paper concludes that to enable export-led economic growth, Pakistan needs an integrated long-term strategy that incorporates measures to strengthen financial, political, and social institutions.

Introduction

As of today, Pakistan is under a 9-month Stand-By Arrangement (SBA) with the International Monetary Fund (IMF) for approximately USD 3 billion, to support the country's economic stabilization program. The SBA is expected to provide a "policy anchor for addressing domestic and external imbalances and a framework for financial support from bilateral and multilateral partners." It "offers Pakistan an

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opportunity to regain macroeconomic stability and address these imbalances through consistent policy implementation," (IMF, 2023). However, the program's conditionalities have imposed significant costs on the public, including exchange rates adjustment, sharp increases in fuel and power rates, and widespread price hikes.

The IMF facility being sought—the twenty-third program that the country has negotiated over its existence—is being concluded against the background of the country's dire economic conditions and a near-default experience. The current account deficit for FY 2022 was six times larger than the prior year (FY 2021), leading to another balance-of-payment crisis. By July 2022, the Pakistani Rupee had reached an all-time low against the U.S. dollar, having lost more than a third of its value in the first seven months of FY2022. The State Bank of Pakistan's (SBP) reserves plunged to less than USD 4 billion, barely adequate to cover a month's worth of imports, while the domestic inflation exceeded 30 percent.

Although it has long been acknowledged that the Pakistan's twin imbalances require a long-term fundamental restructuring of the economy, the Government of Pakistan seems to be relying on the same remedies and policies that have proved ineffective in the past. The stabilization package implemented after each round of the IMF bailout, consisting of the usual fiscal and price adjustments, offer temporary relief but, to no surprise, fail to break the vicious cycle of excessive import consumption, foreign debt, partial defaults, and IMF bailouts.

There is a growing realization that in-depth discussions are needed to identify appropriate restructuring measures that can break the cycle of bailouts. Among the suggested remedies, many economists advocate shifting to export-led growth, rather than the traditional import-substitution emphasis. Such measures would not only require economic adjustments, but also political, social, and cultural changes. In a globalized economy, understanding the culture of export markets, and the quality and service expectations of customers in global supply chains is crucial. Fostering a culture of entrepreneurship, innovation, and creativity through education and a supportive civic society is essential.

The paper focuses on the implications of transitioning to an export-led growth model for both, the public and private financial sectors, as well as political and economic institutions. We analyze the strategies and policies necessary to ensure that financial and policy-making institutions can effectively support the economy's reorientation toward export-led growth. The paper focuses on the following areas in which public policy can create a supporting and complementary environment for export growth: (1) exchange rate policy, (2) trade and long-term financing for upgrading export capacity, (3) strengthening country's competitiveness, (4) capital flows and foreign direct investment (FDI) and (5) fiscal discipline. The political and cultural dimensions of the needed policies for each area are discussed.

The Case for Export-Led Growth

Pakistan has historically been import-dependent, and this trend is likely to continue. Figures 1 and 2 (see Appendix) show the value of imports and exports in USD, and as percentage of GDP for the past 63 years. Over this observed period, imports have consistently outpaced exports, resulting in a chronic trade deficit. If we extend the data back to 1947, the year of Pakistan's independence, the observed relationship between exports and imports would remain unchanged. In 2022, the country's imports amounted to USD 82.28 billion, a 31.32 percent increase from USD 62.66 billion, in 2021, which had already increased by 19.74 percent compared to the previous year (2020).

In contrast, Pakistan's exports for 2022 were USD 39.42 billion, a 25 percent increase from USD 31.55 billion in 2021. The significant gap between the imports and exports over the two-year period, resulting in a substantial current account deficit, marked the beginning of the current foreign exchange (FX) crisis. The country's high-income propensity to import strains the balance-of-payments during periods of economic growth, resulting in recurring foreign exchange crises. This poses a constraint on the economy's overall growth.

Pakistan's dependence on imports has deep-rooted causes. Some of the underlying factors contributing to the country's high import propensity include the following:

1) Pakistan has become increasingly reliant on imports for essential goods and services. The demand for such imports, especially energy, is likely to continue to increase in the future (Mangla & Uppal, 2014). Even products seemingly produced domestically have high indirect import content. For example, the agricultural sector relies heavily on fertilizers produced from local natural gas, which is a substitute for imported gas/furnace oil. Pesticides and agricultural machinery also have a significant import component. Moreover, imported finishings are widely used in the construction industry—even brickmaking is energy-intensive.
2) Consumers have developed a strong preference for foreign products due to their perceived higher quality or brand appeal. This is primarily a byproduct of globalization, which has led to a convergence of lifestyles across countries and an insatiable demand for imported goods.
3) Foreign products often incorporate technology that is not yet available for local production. This can provide a competitive edge to local producers. Imported technological products are also essential for transitioning towards higher value-added exports.

4) Foreign Direct Investment (FDI) necessitates repatriation of profit or servicing of debt later, whether it is in the form of equity or debt—thus increasing the demand for foreign exchange in the future.

The Million Dollar Question—how do you pay for the imports? Given the inexorable demand for imported goods and services, the right way forward for the country would be to shift to an export-led growth strategy. During a similar balance-of payments-crisis in the 1960s in India, the late Prime Minister Jawaharlal Pandit Nehru, reportedly exhorted the nation to either "export or perish" (Ganguly, 1972). The slogan could not be more relevant to Pakistan today. Further, it remains to be seen what the implications of implementing such a shift in economic policies would be. We also need to be cognizant of the possible institutional impediments in implementing this strategy.

Exchange Rate Rationalization

Considering that the country will most likely remain import-dependent, foreign exchange policy needs to reflect the projected demands on hard currencies, like the U.S. dollar and euro. Maintaining a fair exchange rate, which accurately reflects its expected scarcity value, should be the first step in encouraging exports and curtailing domestic consumption of imported products.

Our Dutch Disease. Contrary to the logical implication above, there is empirical evidence that the Pakistani rupee suffers from "chronic overvaluation", (Ahmad, H. 2009). Pakistan's economy has been afflicted by Dutch Disease, caused by unrequited transfers and foreign aid.1 The country has been receiving inflows of hard currencies from sources other than exports of goods and services, such as workers' remittances and foreign aid. Figure 3 (see Appendix) shows the remittances received from Pakistani workers abroad, over the past 20 years. Remittances have nearly equaled exports, which significantly distort the foreign exchange markets. During the war in Afghanistan (2001-2021) a large portion of the funds allocated by the coalition also flowed into and through Pakistan.

Thus, under this variant of the Dutch Disease, the unrequited remittances cause an appreciation of the real exchange rate and loss of competitiveness in Pakistan's exports. Imports are encouraged while exports are penalized. Simultaneously, this phenomenon can lead to an increase in the share of the non-tradable sectors in the economy, such as real estate. When the overvaluation of local currency continues for a prolonged period, it results in the shift of capital out of the export sector and into other non-tradable sectors. Makhlouf & Mughal

[1] The term originally referred to natural resource discovery but has been used in reference to "any development that results in a large inflow of foreign currency, including a sharp surge in natural resource prices, foreign assistance, and foreign direct investment".

(2013), Javaid (2009) and Ahmed H. (2009) find empirical support for the Dutch Disease hypothesis for Pakistan.

Exchange rate policy must be consistent with the reality of the country's chronic dependence on hard currencies. This implies that the exchange rate should not only reflect its fair value notwithstanding the Dutch Disease but may also need to be adjusted in favor of the export sector. The current managed-float policy appears to focus on the overall balance of payments, to keep a stable level of foreign reserves. Yet, the country has experienced declining foreign exchange reserves over recent years. To create a level playing field for the export sector, the managed-float regime should instead focus on the current account balance minus the transfer payments. Such a policy would imply an FX rate higher than the market rate, i.e., a lower value of the rupee compared to its market value. There would be a concurrent and steady buildup of foreign exchange reserves, which may prove to be beneficial in other ways as well. First, it will positively impact the exports, and at the same time a stronger dollar will also discourage excessive import consumption and help with energy demand management. Second, a steady increase in the FX reserves will provide more confidence to the foreign investor, which may be crucial for attracting the required FDI to the country. Third, an increase in the FX reserves will help sterilize foreign exchange inflows, thereby mitigating domestic inflation. Fourth, a steady increase in FX reserves, commensurate with the growth in the country's exports and GDP, is necessary to support trade transactions.

Managing the Dutch Disease involves sterilizing the excess foreign inflows on account of transfers, purchasing the FX, and converting these into FX reserves.2 There are examples of other countries following this strategy. Exchange rate policies followed by China and India, two countries with robust growth in exports, have led to steady increases in their foreign exchange reserves which are currently reported at USD 3.2 trillion and USD 600 billion respectively (equivalent to approximately 14 and 9 months of imports, respectively). Some evidence suggests that China manages its currency to be undervalued in pursuit of an export-led growth strategy. The steady increase in the Indian FX reserves also points out to a slight undervaluation of the INR.

Implementing the indicated foreign exchange policy would have implications for fiscal policy. It would require financial resources, which could be challenging given Pakistan's historical fiscal deficits.

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[2] Faltermeier et al. (2017) conclude that FX intervention is a beneficial policy to counteract the loss of competitiveness during a Dutch disease episode. Bussolo et al. (2007) find that remittances appear to lead to a significant real exchange rate appreciation. The authors also explore policy options that may somewhat offset the observed effect.

The overvaluation of the rupee not only hurts the exporters, but it also disadvantages hardworking ex-patriate workers and their families. Conversely the beneficiaries of this policy appear to be the urban elites and upper-middle-class consumers, who enjoy cheaper gas, energy, and other imported luxuries.

Role of Finance in Export Promotion

Finance plays a central role in facilitating international trade. Due to the significant lag between production and payment receipt for exports compared to domestic sales, exporters require larger working capital financing than domestic firms. This also makes them more susceptible to credit risks and defaults from foreign customers.

According to an Asian Development Bank (ADB) survey (ADB, 2023), thirty-four percent of those surveyed, report "lack of access to finance" as the most important barrier to export (Figure 5, Appendix). The survey also estimates the global trade financial gap to be about USD 2.5 trillion, or 9.7 percent of the total world trade in 2022 (Figure 6, Appendix). According to a WTO report (WTO, 2016) up to eighty percent of trade is financed by credit or credit insurance, but coverage is not uniform. A lack of trade finance is a significant non-tariff barrier to trade, particularly (but not exclusively) in developing countries.

To expand into international markets and remain competitive, exporters must invest in physical capital and technology, especially for higher value-added products targeting more sophisticated consumers. Production processes have become increasingly capital intensive, involving large-scale automation and robotics to ensure product quality. Access to finance can severely constrain exporters' ability to invest in plant, machinery and human capital, hindering their growth and competitiveness. Recognizing the crucial role of finance, governments worldwide support exporters in various ways, such as concessionary loans, insurance and guarantee programs.

The SBP offers two such primary programs to support exporters: the Export Finance Scheme (EFS) and the Long-Term Finance Facility for Plant & Machinery (LTFF). EFS provides short-term working capital loans, while LTFF offers long-term loans for investing in machinery and equipment. These schemes involve substantial outlays, with EFS providing loans totaling USD 3.8 billion dollars per annum between 2015 and 2017.

Defever, Riaño & Varela (2020) evaluate the impact of the two SBP facilities, EFS and LTFF, on firm-level export performance and conduct a cost-benefit analysis. The study shows that the firms benefiting from these loans are substantially larger (and exporting a large share of products) than the average exporter and are concentrated in the textiles, clothing and apparel sectors. The study also finds that both, EFS and LTFF, had a significant and positive impact on the export sales of participating firms between 2015 and 2017, (EFS increasing exports by 7 percent and LTFF increasing exports by 8.7 percent to 11.2 percent).

However, the authors note that while these schemes have helped expand exports of individual firms (*intensive margin*), neither scheme has helped in expanding the range of products being exported nor the number of destination countries (*extensive margin*). A comparison of these findings with similar studies in other developing countries show that most of the interventions have a stronger impact by way of expanding the number of exporters, products and destinations.3 A back-of-the-envelope cost-benefit analysis of both schemes reveals that from a fiscal standpoint, EFS and LTFF offer an expensive way to increase tax revenues because they offer loans to firms at negative real interest rates. However, the schemes do appear to be more effective in generating foreign exchange inflows.

A similar study by Zia (2008) investigates the impact of removing subsidized credit on exports of affected firms. The study finds that while "privately-owned firms experience a substantial fall in their exports, the performance of large, publicly listed firms is largely unaffected by the policy changes." It seems unnecessary to provide subsidized credit to financially unconstrained firms, which receive approximately half of the loans.

Pakistan reportedly has one of the most protectionist trade policies in the world. A recent report by the World Bank (2021) argues that the country's trade policy has an anti-export bias, since it incentivizes production for domestic rather than export markets, by affording greater import protection to businesses.4 There is growing evidence that trade promotion policies are driven by political considerations rather than economic merit. Several studies have also documented the extent of elite capture within Pakistani institutions. Malik and Duncan (2022) examine the drivers of trade protection in Pakistan and find that sectors with exposure to politically powerful businesses have disproportionately benefitted over the last 20 years, through a complex mix of tariff and non-tariff measures.

To expand the export sector's access to short-term and long-term finance, financial resources from both the public and the private sector would be needed. Creating enough fiscal space through prudent public financial management is essential for implementing export promotion strategies. This would also relieve the "crowding effect" on private financial sector institutions allowing them to allocate more resources to the export sector. Export financing strategies also have implications for capital controls and FDI policies.

[3] For example, Volpe Martincus & Carballo (2008) find that export promotion actions are associated with increased exports, primarily along the extensive margin, both in terms of markets and products.
[4] Kohn et al. (2016) find that financial frictions reduce the impact of trade liberalization, suggesting that they constitute an important trade barrier. Kohn et al. (2023) find that low financial development substantially limits both the aggregate and welfare gains from tariff reductions.

Given the over-stressed state of the public finances, the question is whether the required financial resources can be channeled into the export sector.

The State of Pakistan's Competitiveness

The share of Pakistan's exports in GDP has declined from 17.2 percent in 1992 to 10.4 percent in 2022. One major factor contributing to the decline in the country's exports is its decreasing relative competitiveness. Figure 7 shows (see Appendix) the Global Competitive Index for Pakistan in comparison to a selected group of countries.

The weakness of the export sector is also evident in other indicators, such as relatively low entry rates for new exporters, who struggle to expand and scale their product or services over their life cycle. Consequently, exports remain undiversified and lack sophistication.

A World Bank (2021) report notes that the slow export growth has made the Pakistan economy increasingly inward-oriented, which has adverse implications for its foreign exchange, employment, and productivity growth. The country's weak export competitiveness is reflected in its lack of diversification into higher value-added activities. Firm-level analysis indicates that substantial barriers exist for new firms to enter the export market and to scale up their operations. According to the report, the three main causes of Pakistan's stagnant exports are: (1) a tariff policy with an anti-export bias characterized by the world's highest effective tariffs, which has led to protectionist policies aimed at import substitution and domestic market focus; (2) inadequate support services for exporters, particularly long-term finance for plant expansions and market to reduce information costs for individual firms; and (3) low productivity among Pakistani firms, hindering their ability to compete effectively in global markets.

Achieving local-market competitiveness is a pre-requisite for achieving competitiveness in the global markets. A strong local competitive advantage can then be leveraged for foreign market expansion. The local completeness fostered by productivity, innovation and efficiency is only achievable in a competitive economic environment, which contradicts protectionist policies.

Exporting in a Globalized World

In today's globalized trading environment, supply chains have become complex and interconnected across national boundaries. Expanding exports involves participating in global value chains (GVCs). Public policy, then needs to facilitate local firms in engaging with these global networks by reducing import duties and improving the ease of doing business.

A joint report of the Asian Development Bank and Islamic Development Bank Institute (ADB/IDB, 2022) notes that Pakistan has the lowest GVC participation rates globally. However, the Pakistan economy stands to benefit enormously from adopting a more outward-oriented development strategy. The report recommends the following: (i) diversifying exports beyond textiles, which currently dominate the export sector but are often stuck in low-value-added segments and rely heavily on foreign processing; (ii) investing in human capital to maximize the economic returns from GVC opportunities, and expand service exports; (iii) providing institutional support to ensure that the wellbeing of groups adversely affected by opening up to GVC is not compromised, and; (iv) continuing to pursue new trade agreements to lower barriers to trade, exchange information, and establish mutual trust.

In the globalized trading framework, multinational corporations (MNCs) are the main agents for facilitating access to value-chains. Therefore, developing strategic alliances with MNCs is critical. MNCs can also help firms gain access to the markets, facilitate trade financing and investments, and introduce technology to enhance productivity (Lovo & Varela, 2020).

Pakistan's stagnant and narrow-base exports have hindered the development of strategic alliances with MNCs. The export pattern suggests that "Pakistan has turned more inward oriented since the turn of the century" which poses a challenge as greater integration into the global marketplace is closely linked to faster productivity growth (World Bank PUD 2021). The inward orientation and isolation are also evident in the cultural and political spheres. Government export policies appear to be focused on certain traditional items and industrial sectors, neglecting the broader cultural and political dimensions of international trade.

A study by Salinas (2021) finds that four economy-wide factors—governance, education attainment, infrastructure quality and open trade policies (horizontal policies)—foster more diverse and complex non-commodity exports. Improving these areas can create conditions conducive to diversification and boosting complex or higher-value-added exports. The study underscores the need to shorten effective geographic distance by enhancing connectivity through better transportation logistics, reducing trade policy barriers, enhancing trade facilitation, and utilizing communication technologies. Salinas (2021) also suggests that industrial policy interventions may be less effective or even detrimental.

The Salinas (2021) study expands upon the traditional "gravity model" of international trade, which explains the volume of trade between countries as a product of their economic masses but inversely related to their geographical distance. Other studies have modified the model by substituting psychic or cultural distance for geographic distance, emphasizing the role of social and cultural proximity in promoting trade between countries. Export policy makers need to ensure that the country avoids cultural and political isolation, which can hinder trade expansion.

There is promising potential for expanding exports of *knowledge-based* products and other services. To realize this export, the country must invest in human capital development to increase its pool of skilled and technical labor and promote greater participation of women in this sector. For manufactured products, technological advancements have led to large scale automation and robotics, which require substantial long-term investments in upgrading machinery and equipment.

Foreign Direct Investment

A notable feature of FDI is its inherently cyclical nature: all foreign exchange inflows now will later necessitate foreign exchange outflows. If the FDI comes as a foreign debt, there would be debt servicing obligations in the future. If the FDI comes in the form of equity, there would be corresponding repatriation of profits and initial investment in the future. The upshot is that FDI will increase the demand for FX in the coming years; therefore, the litmus test of FDI should be whether it increases the country's FX earnings through expanding exports. In many cases, FDI is not an additional foreign exchange infusion in the economy, as most of it carries a demand on the FX with it in the form of import of plant machinery and other services denominated in FX. Therefore, FDI-funded projects need to be carefully evaluated in terms of their export-building capacity.

Typically, FDI comes in as an expansion of trade between a local firm and its foreign partner. At a certain stage, the foreign entity may decide to expand its international operations by investing in physical facilities in a foreign country. This materializes as mutual trust as business relationships deepen, and as the foreign firms seek to globalize. Therefore, it is imperative to consider the factors that are paramount to the decision-making processes of foreign investors.

Primarily, foreign investors seek an "investment-friendly environment." This is not different from what a domestic investor seeks. A pertinent question, therefore, is whether domestic investors are actively investing in Pakistan? There are indicators suggesting that, conversely, domestic investors may be divesting from the country. Additionally, some evidence hints at the possibility of FDI being a form of "round-tripping" by domestic investors. That is, first, the funds flow out of the country, and then are channeled back into the country using "fronting" tactics.

The foremost consideration for all investments, foreign or domestic, is capital safety. Foreign investors seek assurances of repatriation of earnings and initial capital. The likelihood of funds being blocked and the political risks, ranging from outright expropriation to unforeseen changes in laws affecting cashflows, are primary considerations. Another major consideration is foreign exchange risk, an inherent component of foreign investment decisions. When the investors perceive the local currency as depreciating in an uncertain yet predictable manner, they will either expect a hefty risk premium or not invest at all.

Cultural factors considerably influence FDI flows. Several studies document that cultural or psychic distance between countries of origin and destination is a key determinant of FDI. Unfortunately, for Pakistan, country brand has been adversely affected from perceptions such as being the most dangerous country. To attract FDI, Pakistan must actively work on repairing its brand image.

Capital Controls and FDI. Measures to facilitate FDI are closely linked to capital control policies. There is considerable discussion regarding capital flight from the country. Besides illicit financial flows by political elites, multinational corporations can also contribute to capital flight by manipulating transfer prices and exploiting loopholes in tax codes.

However, there is a fundamental contradiction between attracting foreign capital and simultaneously imposing restrictions on its flight from the country. This trade-off can potentially negatively impact foreign direct investment by putting restrictions on capital transfers. There are innumerable ways for capital to flow out, for example, through over-invoicing, under-invoicing, smuggling, and use of cryptocurrencies. Therefore, capital controls should prioritize targeting illicit income and gains. Additionally, the country needs to actively address its tax base erosion. However, coercive measures to curb capital flows are likely to be counterproductive. A possible solution is to focus on the sources of illicit capital by implementing stricter measures against money laundering and tax evasion (Arezki et al., 2013).

Beyond illicit transfers, several legitimate reasons exist for firms and individuals to transfer capital outside the country. These reasons include transfers motivated by portfolio rebalancing, flight to safety, expanding foreign business operations, and maintaining funds abroad for business purposes. It is also important to note that there are compelling reasons for foreigners to transfer their capital to the local country, such as foreign portfolio investment motivated by optimizing risk-return positions.

Prioritizing prudent macroeconomic policies which yield a stable and market-based FX rate are likely to be more productive. Political risk affects both domestic and foreign entities, often contributing to capital flight. Therefore, ensuring long-term political stability, which fosters a stable and reliable legal environment, should be the priority.

Creating Fiscal Space – Prudent Fiscal and Debt Management

The preceding discussion on export expansion measures shares one common element, i.e., the need for "fiscal space", which refers to the government's flexibility to reallocate resources toward export promotion policies. Prudent fiscal and debt management is essential for creating a stable macro-economic environment which is the cornerstone of any healthy economy.

On the contrary, Pakistan's persistently large and growing fiscal deficits, reaching 7.9 percent of GDP in FY 2022, severely limit the ability of the government to implement export promotion strategies. The chronic large budget deficits have led to an unsustainable accumulation of public debt, reaching 78 percent of GDP in FY 2022. Several studies and reports have highlighted the importance of rationalizing and reducing Pakistan's fiscal deficit to achieve fiscal and debt sustainability (Uppal & Mangla, 2018; Uppal & Khalid, 2019).

More recently, the World Bank Federal Public Expenditure Review (PER) analyzed the key drivers of Pakistan's fiscal deficits and provided detailed recommendations for regaining fiscal and debt sustainability. The review, however, notes that "despite the development of strategies and proclaimed intentions over the last two decades, successful outcomes remain to be attained."5 The report revealed that "tax policy reform is at risk of being influenced by a diverse set of stakeholders whose priority is not the restoration of fiscal sustainability in Pakistan." Pakistan's current tax system provides preferential treatment to a range of economic and political interest groups through concessions, exemptions, and other policy measures. Elites exert influence and resist reform through a variety of channels, including mobilizing their political connections, threatening to obstruct businesses, or by staging public protests. In doing so, they create a system where narrow interests determine policy and public interest is undermined. Additionally, it fosters a situation where policy outcomes weigh heavily toward the wealthy than the bottom 40 percent." As argued in Dercon (2022) the World Bank review underscores the need for the country's elites to recognize that tax reform is in their own self-interest, and that "they stand to gain more from a stable and fast-growing Pakistan with an equitable and efficient tax system than under the status quo."[6]

The World Bank's (2020) Systematic Country Diagnostic Report extensively discusses elite capture in Pakistan (see Figure 8). This issue was reiterated in a World Bank (2022) report which stated that, "the elite capture has stunted the development of key markets that regulate the allocation of productive factors (markets for land, capital, and labor) in Pakistan." Over the course of the country's history, these elite groups, with their historical advantage in controlling higher endowments of land, physical and human capital, have not supported policies which could have addressed factor market failures, as this would have weakened their own economic power and their grip over state resources." Consequently, the report concludes that,

[5] World Bank 2023, Chapter V, pp. 26.
[6] Ibid.

"the effectiveness of reforms crucially depends on alleviating public governance environment constraints and ensuring incentive compatibility."

Pakistan's public debt management policies exacerbate its fiscal problems. The country's over-reliance on short-term domestic and external financing instruments leads to growing gross financing needs and increased solvency risks. The shallowness of the country's domestic debt capital market hinders efforts to lengthen the maturity structure of public debt or lower the exchange rate risk. A well-functioning domestic debt market is crucial for mobilizing long-term financing and reducing rollover and exchange-rate risks. Systematic assessment and management of contingent liabilities arising from domestic and foreign public debt can help reduce Pakistan's debt exposure through pre-emptive strategic risk management.

Currently, approximately seventy percent of all the domestic public debt is held by the domestic banking system, exposing the banking system to significant sovereign debt risk. However, the banks' funding structure reliant on deposits and other short-maturity funding sources constrains their ability to lend long term. Consequently, the under-developed state of the domestic debt capital market has become an obstacle to diversifying the investor base and realizing the potential of long-term domestic borrowing.

Conclusions

To transition to export-led development strategies, Pakistan needs an integrated and long-term strategy that incorporates measures to strengthen economic, political, and social institutions.

First, the country needs to pivot to creating and maintaining a stable macro-economic environment, which hinges on restoring fiscal balance. Fiscal policy is a key driver of macro-economic stability and can create the fiscal space necessary to implement reforms strategies for transitioning to export-led growth. Due to persistent large fiscal deficits, the private sector has been crowded out, hindering its ability to meet short and long-term financing needs or requiring it to do so at a high effective cost. These fiscal deficits are the primary cause of high inflation rates. Often referred to as "the silent killer of finance," inflation hampers the development of financial institutions and markets, particularly in dealing with long term securities.

Second, macroeconomic risks are amplified by a fiscal policy that runs persistently runs large deficits. The public debt has a high share of external borrowing and relies on short-term debt instruments. There is room to build an integrated debt management function. A systematic assessment of contingent liabilities and development of risks management strategies can help prevent financial crises. Developed financial institutions and markets offering depth and liquidity can support fiscal and public debt management by extending the maturity profile of debt and lowering the interest rate and exchange rate risk.

A comprehensive strategy for development and implementation requires public–private dialogue. No meaningful structural change is likely to be acceptable or implementable without the involvement of all stakeholders. To develop effective export promotion policies, current and potential players in the export sectors need to be engaged, without compromising the interests of the public and the country. For this, public decision-making processes must be rooted in the people.

This raises a fundamental question regarding the development of economic policies and strategies. It needs to be assured that export-led growth aligns with the interests of the general populace. Political failure, governance issues and corruption can lead to elite-capture by vested interests. There is evidence suggesting that such elite capture lies at the heart of most of the decision-making in Pakistan.

Alavi (1972) was the first scholar to analyze the oligarchical control over the state of Pakistan, positing that, in the absence of a dominant social class the bureaucratic-military complex came to control its inner core, leading to post-partition Pakistan became an 'over-developed state.' Ahmed (2023) examines the extent of political and bureaucratic capture in public sector resource allocation in Baluchistan, providing empirical evidence on how the political and bureaucratic elite disproportionally allocate public sector funds for misappropriation and/or political patronage. A paper by Ahmed (2017) focuses on state capture and the extractive behavior of Pakistan's elite. Using the rational-actor-dilemma framework, the paper concludes that "Pakistan in its current essence and manifestation is fundamentally a captive state—beholden to elites of Pakistan."

Sound policies are likely to emerge through open and transparent processes, informed by evidence and informed discussions. Rational public policies implemented in a stable political and economic environment are essential for export growth. Export promotion policies should reflect a market orientation, reinforced by leveraging public relations, soft power, and public diplomacy tools.

Lastly, the role of cultural factors in export growth cannot be overemphasized. The core of economic progress lies in innovation, risk-taking and entrepreneurship. These three traits thrive in cultures that incentivize and cultivate them within their populace, rewarding and celebrating those who embody them. In international trade, cultural closeness plays a significant role. Unfortunately, Pakistan's society seems to be drifting in the opposite direction.

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