

Editors' Introduction

In April 2009, the Centre for Research in Economics and Business (CREB) of the Lahore School of Economics hosted the Fifth Annual Conference on the Management of the Pakistan Economy on the theme, "Growth, Trade and Development." The Centre's Director, Naved Hamid, invited a number of prominent speakers including academics, economists, current and former government officials, and other experts to present a combination of research and policy papers, which can be broadly grouped under two major headings: i) Pakistan's Growth and ii) Trade and Development in Pakistan. These topics were selected because of their timeliness, given the increasing macroeconomic pressures facing the country, in particular those arising from the exchange rate and inflation, and the impacts on poverty that could result. The papers presented at the conference are summarized below:

Growth

Azam Amjad Chaudhry's paper analyzes the growth rates of total factor productivity (TFP) in Pakistan over the period 1985 - 2005 and compares to TFP growth rates in other developing countries. Using Cobb-Douglas and translog specifications for the aggregate production function, he finds that TFP growth averaged 1.75% in agriculture and 2.4-2.5% in manufacturing (depending on the specification). Given that TFP growth for the economy as a whole has averaged only 1.1% over the period, it is clear that economic growth in the country has been driven mainly by the accumulation of inputs, rather than productivity advances. International experience has shown that TFP growth is often led by the development of human and physical capital (including infrastructure), financial development, technology absorption, and openness, creating a roadmap for future areas of reform for Pakistan.

Trade and Development

Theresa Thompson Chaudhry's paper measures economy-level microeconomic flexibility by calculating the annual speed of adjustment in labor at the firm level in India and Pakistan for the years 2000 - 2001. In sectors including chemicals, food processing, and garments the two countries had similar rates of adjustment. Gross estimates of the proportion of the gap between actual and desired employment (over all firms in the sample) were 0.45 for India and ranged from 0.2 - 0.5 for Pakistan.

The paper contributed by Imran Ali and Adeel Malik traces the development of industry in Pakistan starting from the (pre-colonial) 18th century, through British rule, highlighting the consequences of Partition

(which led to a weak base for future development), and the evolution of policies of independent Pakistan up until today. The authors in particular focus on the interplay between government and powerful interest groups, such as trading communities (pre-Partition) and leading business families (in the current period).

Hamna Ahmed's paper is a twofold study: (i) to estimate the equilibrium real exchange rate (RER) from a long-run perspective and calculate the degree of overvaluation for the period 1972–2007, and (ii) to test the Dutch Disease hypothesis concerning the effect of capital flows on the RER in Pakistan. After filtering out temporary capital flows (including portfolio investment and short-term foreign assistance), she finds a good fit for the model of RER determination, with the effects of permanent capital flows, government consumption and openness all having the expected signs. Based on the results, the degree of RER misalignment is calculated and periods of overvaluation (1977-83, 1996-99, and 2002-present) are identified. The results also suggest that the Dutch Disease hypothesis holds in the case of Pakistan, such that remittances and FDI flows appear to have contributed significantly to the high degree of misalignment since 2001.

Musleh-ud-Din's paper empirically examines the prospects for expanded trade between Pakistan and China by means of an augmented gravity model in the tradition of Rose (2004). This analysis is pertinent in light of the free trade agreement signed between the two countries. He finds that trade could potentially increase by a factor of 1.85. The paper also calculates a trade specialization index (to look at comparative advantages) and the Grubel-Lloyd index (to gauge the potential for intra-industry trade). Given the patterns of comparative advantage identified, bilateral trade between the two countries may be heavily tilted in favor of China, for at least the short term.

Irfan-ul-Haque's paper provides an overview of the multitude of bilateral and other regional preferential trading agreements that have proliferated in recent years. He criticizes these agreements on the grounds that they are inherently contrary to Most-Favored-Nation (MFN) treatment the founding principle of the GATT/WTO, contributing to trade diversion and generally weakening the multilateral trade negotiation process. The causes of the rise in bilateral and regional trading arrangements are explored and it is argued that they represent a danger to the trade and growth prospects of smaller economies, including Pakistan. The paper discusses the various preferential trade agreements entered into by Pakistan (including SAFTA), and the status of economic relations with China, the US, EU, and the GCC. In concluding, the paper provides advice to policymakers that may help promote the economic interests of Pakistan internationally, including macroeconomic adjustment, productivity improvements, product quality

standardization, and leveraging its “strategic” position in geopolitics for favorable treatment in its major markets.

Sikander Rahim’s paper discusses the difficulties that developing countries have encountered since independence when faced with high tariffs from more developed countries. The textile industry, a crucial sector for South Asia provides is an important example of this phenomenon. In this context, the paper also examines the prospects for the upgrading of developing countries from the production of simple goods to more complex goods, including capital equipment. Given the low-wage countries’ disadvantage as latecomers to R&D, it is suggested that they make use of sub-contracting opportunities with developed countries to gain access to the latest technologies.

Dushni Weerakoon’s paper discusses how the slow pace and limited extent of liberalization under the South Asian regional trade integration process has led to greater efforts (and progress) in promulgating bilateral agreements. While the bilateral trade agreements that Sri Lanka has signed with India and Pakistan are similar, the narrow range of products traded between Sri Lanka and Pakistan has meant that the gains of liberalization have been limited. On the other hand, Sri Lanka’s agreement with India has led to significant increases in trade volumes and foreign direct investment. The prospects for greater South Asian economic integration through a multilateral process appear limited in the near term, as most countries in the region have become increasingly focused on developing greater linkages with East Asia. On the other hand, bilateral agreements with India have helped to expand trade in the region, even though the smaller countries have put in place longer “negative lists” (products exempted from liberalization) for imports from India than on India’s imports from the same countries.

Finally, Zareen Naqvi’s paper deals with the difficult issue of Pakistan-India trade. Political tensions between the two countries, in addition to decades of import-substitution policies have contributed to the low level of trade today. Empirical analyses show that the trade potential is 2-4 times the current levels. Given the earlier progress made under the Composite Dialogue Process (CDP) process, Naqvi recommends that it be restarted, and that Pakistan consider granting Most Favored Nation Status to India. In the best case scenario, the possibility of an FTA with India may be explored.

To conclude, we, the editors, hope that this Special Edition of the *Lahore Journal of Economics* can help to inform the policy debates taking place nationally and internationally regarding trade and development in South Asia generally, and Pakistan in particular.