Summary Revised (07-02-2014)

More and Better Jobs for Pakistan: Can the Manufacturing Sector Play a Greater Role?

Rashid Amjad[1] and Anam Yusuf[2]

(*Paper presented at the Special SARNET session at the 55th Annual Conference of the Indian Society of Labour Economics, 15-17 December, New Delhi)*

The central issue that this paper analyses is the role the manufacturing sector can play in reviving and sustaining growth while generating more and better job opportunities as it has done in the fast-growing East and Southeast Asian economies. Indeed, it is believed that employment in manufacturing—relative to other sectors and forms of employment—can generate not just more but better and decent employment opportunities in terms of wages, degree of social protection, a voice at work, and protection of workers' fundamental rights.

With a labour force growing at between 3 and 3.5 percent and an economy mired in stagflation—with growth averaging just over 3 percent during 2008-13, together with double-digit inflation—Pakistan faces a daunting challenge in providing not just more but better jobs to its young entrants into the labour force. While reviving economic growth and restoring macroeconomic stability remain the top priority of the government and policymakers in the immediate future, the real medium- to long-term challenge is to move the economy onto a trajectory of not just high, but also inclusive and sustainable, growth.

Current Labour Market Situation

The unemployment rate at 6.4 per cent of the labour force in 2012-13 must be considered as high given that most people of working age must earn a livelihood and the virtual absence of a comprehensive social protection system or effective safety nets. Data also reflects a growing informal economy, estimated in 2011-12 at 73 per cent of the non-agricultural employment and continuing discrimination in the labour market against females in terms of wages and conditions of work..Even though there has been a significant rise in female labour force participation rate, the absolute figure at just over 24 per cent in 2011-12 still remain abysmal, implying that there is an overall low ratio of employment to working-age population. This low employment ratio also strengthens the argument that the demographic dividend cannot be reaped as Pakistan passes through the demographic transition, if those of the working-age population do not enter the labour market besides the lack of remunerative and decent job opportunities for those who do.

Manufacturing Sector

An area of concern is that, while manufacturing has served as a major driver of Pakistan's economic growth in the past, this role is now showing distinct signs of slowing down. After rapid growth during 2002-07 at an average of over 8 percent this growth has come down drastically to less than 3 percent during 2008-13.

---

[1]Professor of Economics and Director, Graduate Institute of Development Studies, Lahore School of Economics. He is former vice-chancellor of the Pakistan Institute of Development Economics (PIDE), Chief Economist/Member at the Pakistan Planning Commission and served for many years in the International Labour Organization.
[2] Research Fellow, Graduate Institute of Development Studies, Lahore School of Economics.

In contrast to the manufacturing sectors contribution to economic growth its share in the total labour force after rapidly growing in the 1950s and 1960s has slowed down and stagnating at around 12 to 15 percent over the past few decades. Within manufacturing, the formal or large-scale manufacturing sector—the harbinger of the creation of better employment opportunities—has contributed a very small portion of the jobs generated, around 15 percent despite accounting for over 80 percent (in 2005-06) of the value-added generated in this sector. With a further slowing down in manufacturing, especially large-scale manufacturing, even this limited capacity will be curtailed. measures that will help revive the role of manufacturing—especially large-scale manufacturing

However, even for the relatively limited number of jobs created especially in large-scale manufacturing the sector's potential to generate better and decent jobs has been seriously impaired. The declining bargaining position of workers, widespread hiring of contract workers in place of regular employees, governments' indifference to upholding existing labour laws, the absence of labour inspection. protection coverage have all contributed to poor-quality jobs being created even in the organised large-scale manufacturing sector. The presence of a small-scale, mainly informal and undocumented sector and the large pool of available unskilled labour at low wages acts as a dampener on the creation of better and decent jobs in the large-scale manufacturing sector. In this sense, Pakistan may have reverted to the Lewisian stage of economic development.

Indeed, our findings suggest that the high growth rate of population and the labour force in Pakistan, together with the declining trend in economic growth in the last two decades (which has decelerated sharply in the last five years) is primarily responsible for the lack of creation of remunerative and decent employment in Pakistan. As regards manufacturing, the duality between the large, mainly formal and documented part of the economy and the small and household, mainly informal and undocumented economy has been accentuated. The much faster growth of the latter has been driven by the ready availability of unskilled labour, resulting in the creation of low-quality and low-productivity jobs in poor working conditions. The employment generating capacity of the large-scale manufacturing sector has been seriously curtailed by very high and increasing capital intensity, driven mainly by the adoption of modern technology but also an incentive structure such as an overvalued exchange rate as well as need to produce high quality goods in an extremely competitive global economy.

Failure to diversify and move towards higher-value added products

Besides the fact that most employment generated in the manufacturing sector has been in the informal small-scale sector and that growth has considerably slowed down in recent years due to the global recession, energy shortages and low investment it suffers from two major structural weaknesses.

The first is the failure to move to higher value-added sectors with almost 50 percent of product share being contributed by textiles (25 percent) and food and beverages (23 percent). This has meant that it has not been in a position to take advantage of sectors that have driven global trade, such as electronics,during the period of rapid expansion in world trade.

Second, Pakistan scores relatively low on export sophistication with exports mainly in the low technology and low commodity ends of the sophistication spectrum. Almost half its exports are classified as primary, resource based or low technology.

The reasons for this are varied. The first is that the tariff structure has favoured the production of low-value added products eg. cotton yarn rather than ready-made textiles and garments. The second is the low quality of its labour force and availability of skilled workers. The third is the failure to invest in new technologies and to attract foreign investment which has kept away due to security concerns and the law and order situation.

Policy Recommendations

The major conclusions and policy recommendations that emerge from this study are as follows:

Reigniting economic growth under an IMF programme

More, and especially better, jobs can only be generated in a growing economy. Sustained economic growth has, however, remained elusive due to recurring foreign exchange crises resulting from unsustainable fiscal and balance-of-trade deficits. Pakistan has had to resort to IMF support to avoid default and has been under 11 different IMF programmes for more than 25 years. The present Sharif government entered into an Extended Fund Facility (EFF)programme soon after coming into power in September 2013. Before that, the PPP government had entered into a Standby Agreement (SBA) with the IMF in October 2008, which it then abandoned in June 2011.

Two key questions are, first, whether economic growth can be ignited under a strong stabilisationprogramme that the IMF conditionalities as well as current macroeconomic imbalances dictate; and second, if the economic reforms under this programme will succeed in leading to higher and sustainable growth.

At least on the performance of the economy in the last 25 years, the answer to both questions appears on balance to be negative. Except for a short-lived spurt during FY2003–FY2007, economic growth has failed to pick up. Even this spurt can be traced largely to increases in foreign aid inflows post-9/11, manifold increases in remittances, and the global trade boom rather than to the reforms undertaken in the preceding three years as part of an IMF programme. In fact, the series of reforms undertaken in the last two decades as part of different agreements entered into with the IMF have not resulted in generating sustainable growth. Nor have they resulted in bringing about the needed structural changes, which, among others, would have made the economy less vulnerable to external shocks. Pakistan's economy faltered in the face of the rising global price of oil and foodgrains in 2007 even before the financial crisis unfolded in 2008. India and other South Asian economies were able to better deflect the global financial crisis, even if the Indian economy has slowed down more recently.

The international financial institutions' (IFIs) (see World Bank, 2013) view is that reforms were not fully implemented and, when undertaken, were wrongly sequenced. This criticism is partly justified: except for the one instance in the early years of the Musharraf government, Pakistan has never fully gone through the cycle and completed any of the other ten IMF programmes. However, many economic reforms were initiated as part of these programmes.

Our view takes a somewhat different approach. We do not argue against economic reforms that will make the economy more efficient—by relying more on market-driven forces—and more globally competitive. Indeed, we support many of the suggested reforms. However, we argue that economic reforms per se are not sufficient to ignite growth in the economy. The binding constraint to Pakistan's growth is the collapse in investment and policymakers need to concentrate on reviving investment that could then be the basis for reigniting growth and leading to sustainable and higher economic growth.

This would require:

(i) Giving the highest priority to attaining peace on the country's western borders and, through this, improving the security and law and order situation, which has been adversely affected in turn

(ii) Restoring domestic and foreign investors' confidence as a result of the above; fully opening up trade and investment flows with India by granting it MFN status (Non-

Discriminatory Market-Access Regime) while putting in place safeguards to allay fears that it will not use NTBs (Non-Tariff Barriers) against Pakistan's major exports.

(iii) Maintaining a high level of public sector investment, primarily the Public Sector Development Programme (PSDP), rather than reducing it drastically as stipulated in the IMF programme (given the high PSDP multiplier impact on the economy[3]) through cuts in nondevelopment expenditure, including subsidies on fuel and support for highly loss making state-owned enterprises

(iv) Reducing interest rates from the current double-digit level (10 percent) rather than increasing them as recently done in November 2013 under the current IMF programme; it is worth keeping in mind that monetary policy has proved ineffective in containing inflation in the face of unsustainable and extremely high fiscal deficits being financed by State Bank borrowing (i.e., printing money)

(v) Overcoming the energy gap by adjusting prices and reducing theft and other leakages

(vi) Providing better economic management and reducing corruption, which has become rampant in recent years.

Resurrecting the manufacturing sector

The emphasis in this paper is on the manufacturing sector and we have clearly shown that it has the potential to serve as a major driver of economic growth and create more and better jobs. However, this will require concerted action in a number of areas as outlines below.

Tapping the growing forces of demand for manufacturers

The domestic market is growing, driven by rapid urbanisation, remittances, an emerging middle class—estimated in 2010 at around 25–30 percent of the population —and growing rural incomes. Pakistan's GSP-plus status granted recently by the EU (effective from January 2014) and new export market opportunities, especially in garments as China moves into higher-value added goods, will further boost demand in the manufacturing sector. There is also considerable potential in exploiting economies of agglomeration and connectivity through the spread and better use of information and communication technology, which has been relatively neglected in the past.

Overcoming the skills constraint

Investing in education and skills remain the two most neglected areas of Pakistan's economic development. The only improvements are in higher education: enrolment has increased almost fivefold in the last ten years, especially female enrolment, which is now almost half of the total 1.4 million enrolled. Additionally, the Punjab government has taken a number of recent initiatives for skills development, though their overall coverage of the total labour force is still limited.

Our analysis of the market for skills and the factors leading to skill mismatch in the labour market leads us to conclude that the problem emanates not just from the supply side as is normally diagnosed. The demand for skills is considerably constrained by both the low returns on investment in skills and the current widespread labour hiring arrangements (covering almost 70 percent of organised manufacturing), which encourage the use of contract workers, especially in the organised large-scale manufacturing

---

[3]The fiscal multiplier of a cut in the national PSDP equivalent to 1 percent of GDP leads to a 2 percent decline in GDP in the same year.

sector. Employers are reluctant to pay for higher skills or to invest in skills development, given that a large part of their labour force consists of contract workers hired through contractors.

Tariff reforms

Will increased foreign competition in the domestic market and the search for new higher value-added products in the export market help increase investment in skills by employers and encourage them to move away from contract labour to hiring permanent employees? Theoretically, this should happen. Unfortunately, despite considerable tariff reforms, progress remains slow and disappointing. The structure of Pakistan's manufacturing sector is still heavily biased towards lower value-added, mainly consumer goods and exports in low-technology products.

It is true that the far-reaching tariff reforms introduced post-1997 have, to some extent, been reversed post-2008 in the face of an unsustainable balance-of-payments situation. Under the current IMF programme, some of these measures are to be rolled back and the government has committed to reducing and rationalising the revised tariffs as well as removing SROs that act as a major restriction on imports and favour specific importers-cum-producers.

The results are yet to be seen, but the fact remains that there is little agreement among policymakers on the adoption of a suitable tariff and exchange rate regime that would foster a "desirable" structure of industrial growth. A powerful lobby believes that such a desirable structure means giving preference to the growth of industries that produce high value-added engineering and related machinery through high tariff barriers and cloaked quantitative restrictions (under SROs). This is in sharp contrast to what we can broadly term "free trade" advocates (which includes the IFIs) who believe that "uniform and low tariffs" will result in an efficient and competitive industrial structure.

Given the strong vested interests that have built up, an easy solution to this conundrum may not be possible, at least not in the foreseeable future. In these circumstances, we recommend a second-best solution on the lines suggested by a recent study on tariff policy for the Planning Commission.

These measures include:

- Where SROs are becoming permanent, they should replace the statutory tariffs.
- Tariffs in the 0 to 10 percent range should be unified; where customs duties concessions are given, they should be available to everyone, including traders and importers.
- Tariffs in the 10 to 20 percent range should be reduced so that most raw materials are available in the 10 percent range.

In addition, the following guidelines should be agreed on:

- When targeting the growth of higher value-added sectors (e.g., engineering, including automotives) and affording them protection, this should be done through tariff adjustments and not SROs (Statutory Regulatory Orders). This protection should be time-bound and the set target dates strictly enforced.
- Government organisations or bodies set up to foster the growth of specific industries, e.g., the EDB (Engineering Development Board), should be gradually wound up. The Chambers and Associations of producers in these sectors are now very well developed and can directly deal with

the Ministries of Industries and Commerce. This will help reduce corruption and micromanagement, which results from the current arrangements.

- Eventually, government policies should concentrate on the development of human capital rather than on targeting specific industries. This should take the form of giving much higher priority to education and skills development in terms of investment and supporting services.

- It is extremely important to include workers' representatives in skills development bodies at the federal and provincial level as well as at the local or district level. Most of the current bodies (e.g., NAVTEC at the federal level or TESDA in the Punjab) have no formal representation of workers.

Raising productivity in small-scale manufacturing

There are currently around 4.5 million workers in small-scale and household manufacturing, that is, around 75 percent of the labour force in manufacturing produces less than 20 percent of the sector's value-added. For many of the enterprises operating in the small-scale and informal economy, this is reflected in the very low productivity per worker. In many cases, it is well below the minimum wage and indeed many of the workers employed live below the poverty line.

In no other sector of the economy will investment in building an educated and skilled workforce have a higher return. The resulting growth in output and productivity—the latter boosted through concerted efforts and incentives to upgrade skills—will create both more and better jobs. This sector can then serve as a major driver of economic growth and manufactured exports by producing and exporting new products to new global markets.

But how is this to be achieved? The major thrust must be on increasing primary and secondary enrolment and improving the quality of the education imparted. The second area is skills development as proposed earlier but with a specific focus on small-scale and unorganised enterprises. The focus of government support for this sector—including that of government-supported organisations such as the Small and Medium Enterprises Development Authority (SMEDA) and other provincial bodies—needs to change. There is far too much emphasis on targeting particular industries, including for exports, where the focus is also mainly on large enterprises.

There is clearly a justification for such interventions, and these have helped encourage growth and productivity in particular industries and specialised products. The focus needs to shift to creating a better and more conducive environment for this sector and removing obstacles to the growth of all enterprises, i.e., relatively large as well as small and microenterprises in this sector.

Specifically, this means reducing the anti-small-scale bias in tariff policy (which results in the high cost of raw materials); providing infrastructure facilities, including space, for firms to operate; providing transportation and connectivity services; and, most important, providing access to finance, which, for most small firms, is a binding constraint to their expansion. From just a micro-interventionist vision, policies in favour of this sector should analyse the macro-environment in which they operate and then suggest, support, and help implement specific policy changes and interventions that would support the growth of the small-scale sector.

Case Studies

Automotive Industry

The automotive sector comprising the assembly of cars, motorcycles/rickshaws, tractors, trucks, buses and parts of manufactures has been one of the fastest growing sectors of the economy and one which this study has identified as one of the leading sectors that can create more jobs but also has the potential of creating better jobs. The growing middle-class has led to a large increase in the production of motorcycles which reached 1.7 million in 2011-12.

Some of the measures suggested to improve efficiency as well as sustain high growth include: (i) tariff rationalisation and removal of non-tariff barriers; (ii) increase domestic competition in car manufacturing; (iii) increase export competitiveness through these measures and investment in skills development: and (iv) when MFN status is granted to India car manufacturers would require continued protection under a strict time frame while the motorcycle industry is confident that it can compete successfully in the Indian market.

Garments Industry

Pakistan has not taken sufficient advantage of it being a major world producer of raw cotton and yarn to be a significant global player in garments and apparels. It now has the opportunity to do so.

First the grant of GSP-Plus status by the EU starting January 2014 could make possible an increase in garment exports by US 500 to US $ 750 million annually. Second is the major demand opportunity created in global markets as China moves out of the garment sector. Its share in global exports is US $ 130 billion of a world market of US $ 350 billion growing at around 5 percent per annum. This does not include imports by China once it moves out of garment production which would be considerable.

Suggested measures based on recent studies to take advantage of these opportunities in a fast changing global market for Pakistani firms include: (i) moving to become own-design manufacturers; (ii) upgrade technological capability and increase access to skilled labour by setting up specialised training institutes; (iii) work in clusters to take advantage of the economies of agglomeration including easier accessibility at one site to foreign buyers (such as the setting up of an “Apparel City” near Lahore; (iv) upgrade equipment especially in CAD and CNC cutting and computer aided machinery; and finally most importantly (v) improve safety and working conditions especially appropriate design of buildings and installation of machinery etc. to prevent fire outbreaks as well as installation of fire-fighting equipment as well as sufficient number of safety exits for the work force if fire breaks out. Periodic labour inspection by the Department of Labour should be carried out working closely with factory owners.

Creating more and better jobs

The creation of more jobs in manufacturing needs a two-pronged strategy (“walking on two legs”): encouraging the growth of labour-intensive manufacturing as well as moving up the value-added ladder. We have spelled out a number of measures for achieving this, including specifically for two subsectors—garments and automotives.

The aim, however, is not just to create any jobs but more productive, remunerative, and decent employment that results in an adequate income to cover basic needs, a degree of social protection, a voice at work through democratically elected representatives, and respect for workers’ fundamental rights. Even though this may not be immediately possible for the vast majority of the workforce, the real challenge lies in determining how to move in this direction.

First and foremost is the revival of economic growth, including in the manufacturing sector, which, as our study shows, still has considerable potential for higher growth and job creation. With the labour force growing at 3–3.5 percent, the economy must grow at around 8 percent to productively absorb new entrants into the labour force, and even higher to increase the incomes and living conditions of the unemployed and of those living just above or below the poverty line.

Second, a concerted effort must be made to reduce the high growth rate of population. At around 2.1 percent, it remains among the highest in the region and could turn out to be even higher once the Population Census is held, which has not been done since 1998.

Third, as distinct from other studies (e.g., World Bank, 2013), which hold that higher economic growth will result in jobs, we have argued that, while economic growth is a necessary condition, it is by no means a sufficient one. For productivity growth to translate into higher wages and incomes and improved living conditions, it is necessary to build strong and well functioning labour market institutions, and for elected governments to overtly protect workers' rights and make good on their commitment to social justice by providing basic education, health, and adequate and affordable social protection to workers. In this context, some of the specific measures that this paper supports include:

(i) Strengthening workers' organisations that allow workers to effectively bargain with their employers through democratically elected representatives to ensure fair and liveable wages and better and safer working conditions

(ii) Reintroducing labour inspection to ensure safe conditions of work while putting in place measures that prevent factory inspectors from unduly harassing employers

(iii) Fixing minimum wages through a tripartite dialogue and agreement, and strictly enforcing minimum wages in the organised sector—this could gradually be extended to the small-scale and, eventually, the informal economy

(iv) Extending social protection to all workers in large-scale manufacturing, finding ways to cover contract workers, and extending this gradually to firms in the small-scale sector

(v) Inducing informal sector firms to register and enter the formal/documented economy.

This paper also shows that, if Pakistan is to be an effective player in the global market for manufactured goods, it should carry the credentials that its goods are produced in an environment that respects human rights and protects basic workers' rights. On a positive note, there are already signs that employers are becoming much more conscious and actively working towards creating such an environment. A case in point is the setting up of the garments city near Lahore to attract buyers and investors who are moving away from destinations where cheaper goods are produced at very low wages and in very poor and hazardous working conditions. This move by employers also reflects the importance they are giving to taking full advantage of the GSP-plus status granted by the EU to Pakistani imports; they are fully aware of the conditions related to respect for human rights and workers' basic rights that need to be met to ensure this status is regularly extended.

This may well be, therefore, an opportune time in Pakistan to raise the pillar of "more and better jobs" as an integral part of national economic policy.

References

World Bank. (2013). *Pakistan: Finding the path to job-enhancing growth: A country economic memorandum* (Report No. 75521-PK). Washington, DC: Author