

EU-Pakistan Trade Relations: The Role of GSP Plus Status and Pakistan's Enhanced Access to EU Markets

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Abstract

The Generalised System of Preferences (GSP) Plus is an instrument through which the European Union (EU) intends to encourage not only free trade with the developing countries by providing them tariff free access to the EU markets, but also promote sustainable development. The GSP Plus status has also benefitted Pakistan in attaining tariff-free access to the EU markets for most of its export items. This has increased Pakistan's exports to the EU by more than 47.25 per cent, especially textile exports which have risen by 66.6 per cent since 2013. This paper analyses to what extent the GSP Plus has helped in enhancing Pakistan's exports to the EU and removed the constraints that affect the EU-Pakistan trade relations while putting forward recommendations for enhancing EU-Pakistan trade relations in the future. If fully utilised, this paper argues, the GSP Plus status has the ability to earn some extra foreign reserves for a country like Pakistan which is already facing a severe current account deficit, public debt and balance of payment issues.

Keywords: GSP Plus, European Union (EU), Pakistan, Trade Relations, Trade Tariffs, EU-Pakistan.

Introduction

In December 2013, Pakistan was awarded the Generalised System of Preferences (GSP) Plus status aimed at providing tariff free access (on two thirds of all product categories) to European Union (EU) markets. The primary aim of the GSP Plus scheme is to accelerate economic growth in the developing countries by supporting their export sector. Through the GSP Plus scheme, the EU intends to encourage sustainable development in the developing countries. The countries awarded with GSP Plus status get easier access to the EU markets as their exports benefit from generous tariff

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preferences. However, the countries awarded with GSP Plus status are subject to comply with 27 core conventions of the United Nations (UN) on environmental protection, good governance, and human, labour, children's and women's rights.¹ The GSP Plus status given by the EU does not extend automatically instead the countries must be eligible and fulfill all the requirements in order to obtain it. Some of the requirements are: a) The country should not be categorised as an upper-middle or high-income country by the World Bank; b) The country should not have a non-diversified economy i.e., its seven largest GSP sections of imports represent more than 75 per cent in value of its total imports and its exports should not surpass 2 per cent of the European Union's global GSP imports.² Since Pakistan meets these criteria, it was granted the GSP Plus status in 2013.

Most studies in Pakistan that have been carried out to gauge the impact of GSP Plus status on Pakistan's exports have focused mainly on textiles. As there is a dearth of literature on the EU-Pakistan trade relations and the impact of GSP Plus in increasing Pakistan's exports to the EU, this paper analyses the impact of GSP Plus status in enhancing EU-Pakistan trade relations. The paper will address the following research questions:

- a) Has GSP Plus status helped to increase Pakistan's exports to the EU?
- b) What are the constraints and limitations that affect Pakistan-EU trade relations?
- c) How can trade relations between the EU and Pakistan be enhanced in the future?

This paper consists of four sections. The first section of this paper consists of theoretical framework. The second section gives a brief overview of the EU-Pakistan trade relations. The third section examines the constraints and limitations that affect EU-Pakistan trade relations. The fourth section of this paper offers policy recommendations and conclusions.

¹ European Commission, *Report on the Generalised Scheme of Preferences Covering the Period 2016-2017*, Brussels: European Commission, 2018.

² "A Road Map For Optimising Pakistan's GSP Plus Status," *The Pakistan Business Council*, 2014, <http://www.pbc.org.pk/research/a-road-map-for-optimizing-pakistans-gsp-plus-status/>

Theoretical Framework

Promulgated by the two economists, Bertil Ohlin and Eli Heckscher, in the early 1900s, the Factor Proportion Theory explains how a country could gain comparative advantage by producing products out of the factors that were in excess supply in the country. They stated that since the factors which are in great supply compared to their demand are cheaper and *vice versa*, the countries would export goods that required resources that were in huge supply and, hence, cheaper production factors³ while importing goods made of resources that were in short supply, but higher demand.⁴ This can be clearly witnessed in the case of countries like Pakistan, India, Bangladesh and China whose economies are labour-intensive as they have large pools of cheap labour and developed labor-intensive industries like garments and textiles.

In 1990, Michael Porter also contributed to the evolution of international trade theories by coming up with a new model to explain national competitive advantage. Porter's theory has helped to understand the competitive advantage that many countries have in international trade. According to Porter, national competitiveness in any particular industry is dependent upon its capacity and ability to up-grade and be innovative.⁵ Therefore, explaining why certain countries have an edge over others in certain industries.

Porter identified four main determinants in his theory which were: local market demand conditions; firm's strategy structure and rivalry; local suppliers and complementary industries; and factor conditions.⁶ Local market demand refers to the nature and size of the customer base from which the demand initiates and encourages technical innovation and product improvement. The nature of rivals in an industry and the level of technical knowledge they possess can also greatly encourage innovation as competition results in businesses looking for the ways to increase

³ Giancarlo Gandolfo, *International Trade Theory and Policy* (Berlin: Springer, 2014).

⁴ Ibid.

⁵ Micheal E. Porter, "The Competitive Advantage of Nations," *Harvard Business Review*, 682 (1990): 73-93.

⁶ Ibid.

production through development of technological innovations. Local suppliers and complimentary industries refer to the upstream and downstream industries that facilitate and encourage innovation through exchanging ideas.⁷ The factor conditions consist of those elements which, according to Porter, a country's economy can create for itself, such as, infrastructure, a large pool of skilled labour, capital and technological innovation. All these determinants then decide how much market share a country's products will be able to gain in the international market.

EU-Pakistan Trade Relations: An Overview

Over the years, the EU and Pakistan have emerged as increasingly important trading partners. The EU constitutes Pakistan's largest export destination with 34 per cent of Pakistan's exports being absorbed by the EU market in 2018⁸, while the US, China and Afghanistan provide markets for 16 per cent, 9 per cent and 8 per cent of Pakistani exports respectively.⁹ The EU accounts for 10 per cent of Pakistan's total imports and is the third largest source of imports, after China (23 per cent) and the United Arab Emirates (UAE) (14 per cent).¹⁰ In 2004, Pakistan and the EU signed a cooperation agreement to govern their bilateral trade relations.¹¹ In 2007, the EU and Pakistan set up a sub-group on trade in order to encourage the development of bilateral trade under the Pakistan-EU Joint Commission, which provides a forum to discuss trade and policy issues that hamper trade between the two parties, such as, individual market access.¹² Pakistan's exports to the EU mainly consist of clothing and textile items (80 per cent) while it imports chemicals and pharmaceuticals (15.5 per cent), transport equipment (16.5 per cent) and machinery and appliances (25.5 per cent) from the EU member countries.¹³

⁷ Ibid.

⁸ The Pakistan Business Council, *Trade with the European Union (28) – 2018*, 2019, <https://www.pbc.org.pk/research/trade-with-the-european-union-28-2018/>

⁹ "Pakistan Economic Survey 2017-18," Ministry of Finance, Government of Pakistan, 2018.

¹⁰ European Commission, *Report on the Generalised Scheme of Preferences Covering the Period 2016-2017*, Brussels: European Commission, 2018.

¹¹ European Union, Pakistan, <https://ec.europa.eu/trade/policy/countries-and-regions/countries/pakistan/> ,

¹² "Countries and Regions – Pakistan," *European Commission*, March 1, 2018, <http://ec.europa.eu/trade/policy/countries-and-regions/countries/pakistan/>

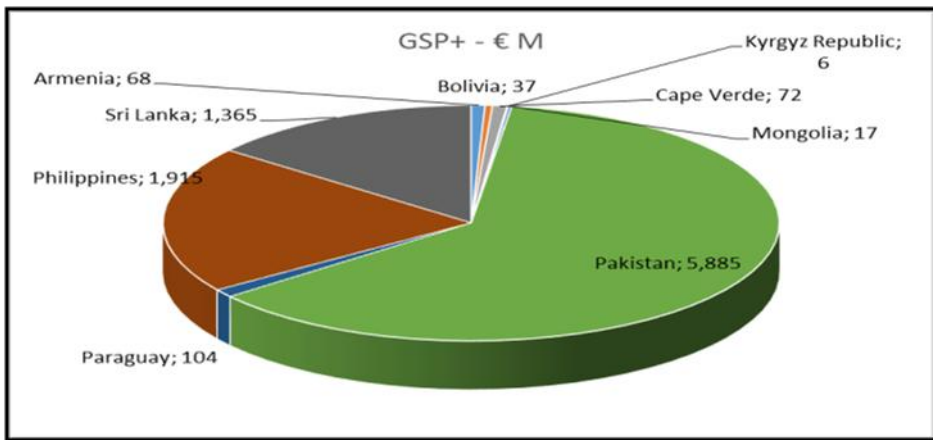
¹³ Ibid.

a) *Impact of GSP Plus Status on EU-Pakistan Trade*

Since January 2014, Pakistan’s exports to the EU have increased substantially owing to its GSP Plus status. During 2013-2017, Pakistan’s exports to the EU increased from €4.52 billion to €6.67 billion, an increase of 47.25 per cent.¹⁴ Of these, 76 per cent are covered by GSP Plus, making Pakistan one of the largest GSP Plus beneficiaries.¹⁵

The figure below shows the value of preferential imports to the EU from GSP Plus countries in 2018. The largest share of 62.2 per cent of all GSP Plus imports to the EU came from Pakistan, followed by the Philippines, Sri Lanka, Paraguay, Cape Verde, Armenia, Bolivia and Mongolia.¹⁶

Figure No. 1
GSP Plus Preferential EU Imports in 2018
(thousand EUR)



Source: European Commission,
https://trade.ec.europa.eu/doclib/docs/2018/january/tradoc_156536.pdf

¹⁴ “Pakistan Economic Survey 2017-18,” Ministry of Finance, Government of Pakistan, 2018.

¹⁵ Ibid.

¹⁶ European Commission, *Report on the Generalised Scheme of Preferences Covering the Period 2018-2018*, Brussels: European Commission, 2020.

Between 2013 and 2017, the largest increase in exports to the EU was witnessed by textile garments and hosiery sector which rose by 92 per cent followed by a 71.66 per cent increase in home textile goods, a 17.34 per cent increase in carpets and rugs and a 13.80 per cent increase in cotton and intermediary textile goods.¹⁷ The value added sectors showed growth during the past five years. The table below shows this rise in Pakistani exports after GSP Plus was awarded.

Table No. 1
Pakistan's Textile Exports to EU
(2013-17)

Sector	2013	2014	2015	2016	2017	Impact of GSP+ (%)
Textile Garments and Hosiery	1,398.6	1,830.5	2,281.6	2,467.3	2,685.2	92.00
Home Textiles	980.0	1,270.9	1,456.3	1,564.1	1,682.4	71.66
Cotton & Intermediary Goods of Textiles	738.8	765.1	792.4	805.1	840.8	13.80
Carpets	30.3	31.6	37.2	37.9	35.6	17.34
Grand Total	3,147.7	3,898.0	4,567.4	4,874.5	5,243.9	66.60

Source: Pakistan Economic Survey 2017-18,
http://www.finance.gov.pk/survey/chapters_18/08-Trade.pdf

Pakistan's exports of footwear, plastics and leather have increased significantly under GSP Plus. Footwear exports to the EU increased by 25.88 per cent, leather by 6.68 per cent and plastics by 26.84 per cent during 2013-2016, as shown in the table below:

Table No. 2
Pakistan's Non-Textile Exports to EU
(2013-16)

¹⁷ "Pakistan Economic Survey 2017-18," Ministry of Finance, Government of Pakistan, 2018.

Row Labels	Pak exports to EU (million Euros) 2013	f Pak exports to EU (million Euros) 2014	Pak exports to EU (million Euros) 2015	Pak exports to EU (million Euros) 2016	Impact on Value since 2013 (%)
Footwear	56.29	72.93	77.38	70.86	25.88
Leather	418.54	460.02	470.86	446.49	6.68
Plastics	45.18	76.72	60.72	57.30	26.84

Source: Pakistan Economic Survey 2016-17,
http://www.finance.gov.pk/survey/chapters_17/08-Trade.pdf

Most of this increase in exports to the EU was due to increase in Pakistan's exports to the United Kingdom (UK). Pakistan's exports to the UK surged from US\$1,432 million to US\$1664.7 million showing a growth of 16.25 per cent during 2013-2019.¹⁸ Pakistan's exports to Germany and Spain showed a tremendous growth under the GSP Plus scheme. Exports to Germany increased by 18 per cent from US\$1272.3 million, while those to Spain rose by 54 per cent from US\$602 million to US\$928.3 million during the same period.¹⁹ Spain has now turned into the third largest market for Pakistani goods in the EU. Pakistan's exports to Italy went up by 24.5 per cent from US\$632.91 million to US\$788.2 million during 2013-2019.²⁰ Exports to The Netherlands increased by 54.5 per cent from US\$628 million to US\$970.2 million and those to Poland rose by 151 per cent from US\$102 million to US\$255.8 million.²¹ Similarly, exports to Portugal rose by 17 per cent from US\$155 million to US\$180.6 million during the same time period.²² The GSP Plus has played a significant role in enhancing Pakistan's trade ties with the Eastern European countries and opening new avenues for Pakistani exporters in Europe.²³ Pakistan's exports to Bulgaria, Czech Republic and Slovakia rose by more than 50 per cent while exports to Romania grew by 16 per cent from US\$22 million to US\$25.5 million during 2013-2019.²⁴

Furthermore, Pakistan needs to expand its relations with other EU countries as well, not just with the UK, in order to ensure strong support

¹⁸ Ministry of Commerce, Government of Pakistan, 2020.

¹⁹ Ibid.

²⁰ Export figures of 2013 are from The Pakistan Business Council while those of 2019 are from the Ministry of Commerce, Government of Pakistan, 2020

²¹ Ibid.

²² Ibid.

²³ Mubarak Zeb Khan, "Exports to EU Grow...," *Dawn*, January 14, 2018.

²⁴ Export figures of 2013 are from The Pakistan Business Council while those of 2019 are from the Ministry of Commerce, Government of Pakistan, 2020.

in the EU parliament for preferential agreements like GSP Plus in the future in the backdrop of Brexit which has been finalised in 2020.

EU-Pakistan Trade Relations: Constraints and Limitations

Prior to the GSP Plus status, Pakistan witnessed a sharp decline in its export performance. According to the World Bank estimates, Pakistan's share in the world exports reduced from 0.18 per cent in 1990 to 0.13 per cent in 2015. During the same period, Pakistan's competitors showed a substantial growth in their share of world exports: Bangladesh's share in world exports grew from 0.06 per cent to 0.19 per cent; India's from 0.61 per cent to 1.65 per cent; and Vietnam's share grew from 0.14 per cent to 1.17 per cent.²⁵ From 2015 to 2016, the highest decline in Pakistani exports was recorded since Fiscal Year 1981-82 as its exports declined by 13 per cent.²⁶

a) Pakistani Goods Lack Competitiveness in International Markets

The major constraint that Pakistani producers are facing is a shortfall in energy supplies. In the past few years, the industrial sector has been operating at less than 70 per cent of its full capacity due to a longstanding and ongoing energy crisis. Many Pakistani textile industries have relocated to the places where energy is cheap and readily available such as Bangladesh and Sri Lanka; while some have shut down their businesses completely. Those industries, which are still operational, employ alternative measures resulting in higher energy costs which increase their production costs and ultimately their prices in the international markets. These high-priced products fail to compete effectively in the international market and lose out to the comparatively low-priced Bangladeshi, Indian, Chinese or Vietnamese goods in the EU markets.²⁷ The exporters face severe challenges in retaining and enhancing their market share in international markets. Figure no.2 below shows that, in 2013, Pakistan lost about 35 per cent of its export sales due to electrical outages. It is expected that, in the coming years, the energy crisis will lessen due to the new energy projects

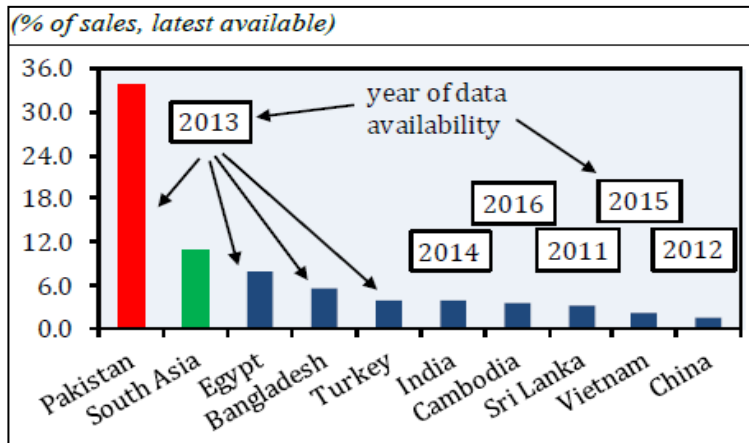
²⁵ Asif Mahmood and Waqas Ahmed, *Export Performance of Pakistan: Role of Structural Factors*. SBP Staff Notes, State Bank of Pakistan, 2017.

²⁶ Ibid.

²⁷ Shaista Alam, Qazi Masood Ahmed and Muhammad Shahbaz, "Exchange Rate Volatility and Pakistan's Exports to Major Markets: A Sectoral Analysis," *Global Business Review*, 2017: 1507-1519.

installed under the China-Pakistan Economic Corridor (CPEC). However, the energy prices have increased after the austerity measures imposed by the PTI government under the bailout package by International Monetary Fund (IMF).

Figure No.2
Value Lost Due to Electrical Outages



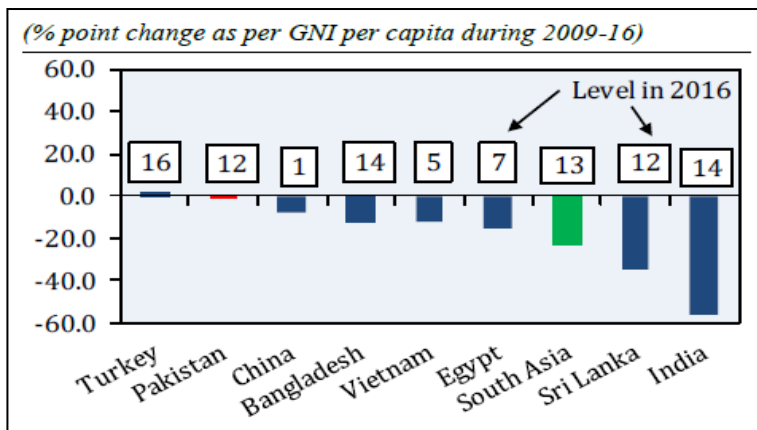
Source: WDI-World Bank,
<http://www.sbp.org.pk/publications/staff-notes/SN-2-17-Export-Prefor-Pak.pdf>

Another concern for the exporters is the tax regime and tedious customs clearance procedures. The garment industry is subject to higher duties on raw materials compared to other countries, ultimately making the end product more expensive in the international markets. The number of days it takes to get custom clearance with goods stuck at Karachi port further increases the prices of Pakistani exports in the EU markets. Dollar et al, in their study conducted in 2006, also stress the need for encouraging investment and minimising bottlenecks (such as timely custom clearances, fewer power outages, lower interest rates, etc.) in order to increase the number of exporters.²⁸ The cost of doing business in Pakistan is

²⁸ David Dollar, Mary Hallward – Driemeier and Taye Mengistae, “Investment Climate and International Integration,” *World Development*, 2006: 1498–1516.

proportionately high and its lengthy permit procedures and legal requirements discourage more firms from entering the export sector. Figure no. 3 below shows that other countries like China, Vietnam, Sri Lanka, India, and Bangladesh significantly reduced their cost of setting up new businesses between 2009-2016; only Turkey and Pakistan have seen no progress in this regard.

Figure No. 3
Cost of Business Start-up Procedures



Source: World Development Indicators,
<http://www.sbp.org.pk/publications/staff-notes/SN-2-17-Export-Prefor-Pak.pdf>

In October 2017, a conference was organised by the Sustainable Development Policy Institute (SDPI) on “Achieving Export Competitiveness in Pakistan” in which Former Federation of Pakistan Chambers of Commerce and Industry Vice President, Adnan Jalil raised concerns regarding falling exports by stating that the federal government was unwilling to engage with stakeholders when framing relevant policies.²⁹ He also shed light on the gaps within the taxation and tariff system and stressed the need to reduce the loopholes in the system that encourage corruption.³⁰ In order to encourage exporters, not only institutional rigidities need to be

²⁹ “Joint Efforts of Public, Private Sectors a Must for Exports Revival,” *Nation*, October 20, 2017, <http://nation.com.pk/20-Oct-2017/joint-efforts-of-public-private-sectors-a-must-for-exports-revival>.

³⁰ *Ibid.*

minimised, but the government needs to take all stakeholders on board before drafting export policies. It also needs to provide sound policy initiatives in the form of reduced cost of doing business in order to enhance the competitiveness of Pakistani goods in the EU market.

Pakistan is considered the least innovative nation because its industrial sector is resistant to change and adapting to the changing world trends. According to the Global Innovation Index, Pakistan ranks at 109 out of 126 countries, seven ranks above Bangladesh while India maintained its regional superiority by moving up to 57th position in 2019 from 60th position in the previous year.³¹ Similarly, there is a lack of institutional and physical infrastructure in order to support economic activity. According to the Global Competitive Report 2017-18, Pakistan ranks 110 out of 137 countries in terms of infrastructure just one rank above Bangladesh, while India ranks 66.³²

Despite the fact that textile and clothing exports form a reasonably large proportion of Pakistan's export revenue, the textile sector has not developed in tandem with international standards and trends, especially if compared with the growth of similar sectors in other countries like Turkey and Bangladesh. In 2013, a study titled "A Comparative Analysis of the Garments Sector in Pakistan" found that the over-reliance of Pakistan's garment industry on low value products as exports is mainly due to lack of competitiveness. They examined 234 Pakistani garment manufacturing firms, located in Karachi, Lahore, Faisalabad, and Sialkot, and compared them with those located in Bangladesh and Turkey.³³ The relative quality of the garments manufacturing across Turkey, Bangladesh, and Pakistan was gauged based on the indicators of competitiveness, such as, cost of production, product mix, diversity of export destinations, expertise of the

³¹ *The Global Innovation Index Report*. Cornell University, INSEAD and the World Intellectual Property Organisation, 2018, <https://www.globalinnovationindex.org/gii-2018-report#>

³² World Economic Forum, *The Global Competitiveness Report 2017-18*. Geneva: World Economic Forum, 2017, http://www3.weforum.org/docs/GCR2016-2017/05FullReport/TheGlobalCompetitivenessReport2016-2017_FINAL.pdf

³³ Hussain et al, *A Comparative Analysis of the Garment Sector of Pakistan*, Final Report, International Growth Centre, 2013, <http://cdpr.org.pk/images/publications/firms/garments-sector-comparative-analysis-report.pdf>

work force, and the effectiveness of government policy.³⁴ Although Pakistani firms have shown remarkable progress in the recent years, they still lag behind the firms from other countries on major indicators of competitiveness such as export diversification, design manufacturing and value added goods.

Unlike other countries in the region, Pakistan has not invested much in research and development to improve the performance of its export sector. Pakistan's regional competitors have focused significantly on structural reforms to promote exports, such as, focusing more on research, education and market diversification, which eventually played a key role in increasing their exports.³⁵

The lack of modern technology and modern business techniques has resulted in the production of sub-standard goods unable to meet international standards.³⁶ Pakistan's inability to undertake proper market research in order to explore new markets and identify niches in international markets has also discouraged its firms from fully exploiting its GSP Plus status in the EU markets. Pakistan also lacks a coherent strategy to improve its business environment. Thus, as explained by Porter, in order to attain a competitive advantage in international trade, it is very important to achieve technological advances and to innovate.

b) Over-Reliance on a Limited Number of Goods

Pakistan heavily relies on a few items for exports such as clothing and textiles, surgical items, sports and leather goods. Its inability to diversify the country's export basket has seriously hampered its economic growth resulting in supply driven exports to the EU rather than demand driven.³⁷ This has discouraged Pakistani exporters to capture market share in the EU markets. Pakistan's economy heavily relies on textile and clothing industry as shown in the Figure no. 4 below. About 80 per cent of Pakistan's exports that entered the EU markets in 2016 were clothing and textiles.

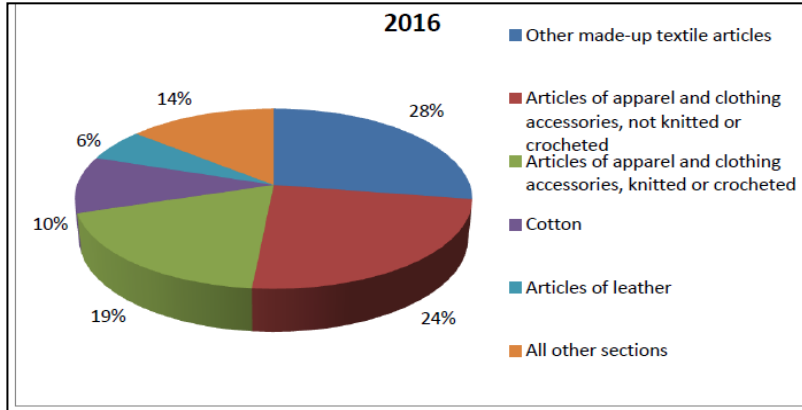
³⁴ Ibid.

³⁵ Asif Mahmood and Waqas Ahmed, *Export Performance of Pakistan: Role of Structural Factors*, SBP Staff Notes, State Bank of Pakistan, 2017.

³⁶ Ibid.

³⁷ Trade Related Technical Assistance Programme, "Enhancing Pakistan's Trading Benefits from the Proposed EU GSP Plus Scheme."

Figure No. 4
Pakistan's Product Diversification of
Exports under GSP Plus Status



Source: European Commission 2018,
<https://op.europa.eu/en/publication-detail/-/publication/30d71cb6-20a4-11e9-8d04-01aa75ed71a1>

The over-reliance on one commodity, especially textile and clothing, such as in the case of Pakistan, can be detrimental for its export sector stability. The failure of a single crop i.e., cotton not only affects the external balance of payments but also the local economy.³⁸ The increasing changes in the rainfall and seasonal patterns due to climate change and global warming can seriously damage crops as witnessed in the 2010 and 2011 floods in Pakistan.

If compared with Bangladesh, it is visible that Dhaka has achieved tremendous economic development by restructuring its export sector. It brought significant structural changes to its export composition over the years. Having focused purely on jute products until the 1990s, Bangladesh shifted towards the export of apparels and transforming its resource based export structure to a manufacturing based export structure. Between 1970s-1980s, the ratio between Bangladesh's primary and manufactured exports was 90:10; by the end of 2010, this ratio had reversed to 10:90.³⁹ Due to these structural changes, Bangladesh was able to significantly increase its

³⁸ Ishrat Hussain, *Globalisation, Governance and Growth* (Fiction House, 2015).

³⁹ Mustafiz-ur-Rahman, "Trade Benefits for Least Developed Countries: The Bangladesh Case," *Department of Economic & Social Affairs*, 2014.

exports from US\$1,718 million in 1991 to US\$27,027 million in 2013.⁴⁰ In the light of this experience, it is clear that Pakistan needs to bring about serious structural reforms in its export sector.

Moreover, exports under the GSP Plus scheme are subject to capping mechanism in which the maximum annual growth is restricted to 17.5 per cent in all sectors (13.5 per cent in ethanol and 14.5 per cent in textiles) in order to get the benefits of zero duty.⁴¹ This serves as a voluntary export restraint (VER) which discourages Pakistani exporters from exporting more textile items to the EU. Therefore, relying mostly on textile exports will discourage Pakistan from fully utilising its GSP Plus status.

Pakistan relies heavily on resource based exports rather than exporting finished goods. Its export base is dominated by raw materials or semi-finished goods. The major structural shortcoming of Pakistan's textile industry is that a significant part of high quality processed yarn is exported instead of having value added to it. The Asian countries like Japan and South Korea import yarn from Pakistan and then convert it into high value goods which enables them to sell their products at much higher prices in the EU market.⁴² These countries are not cotton producers but they have transformed their textile industry in the dynamic value-added sector according to the demand of textile items in the EU market.⁴³ Unlike Pakistan, most of its competitors and the regional neighbours successfully switched from primary commodities to high value added items in the last two decades. For example, the share of Pakistan's manufactured exports in its total exports increased only 16 per cent compared to its regional competitors whose average increase was 43 per cent over the past two decades.⁴⁴ There is, therefore, a severe need to diversify Pakistan's export portfolio in order to capture various market niches existing in the EU.

⁴⁰ Ibid.

⁴¹ "Continuation of GSP Plus Status: PBC for Ensuring Compliance of 27 Conventions," *Business Recorder*, June 26, 2014, <https://www.pbc.org.pk/wp-content/uploads/PBC-for-ensuring-compliance-of-27-Conventions.pdf>.

⁴² Abdul Ghafoor Awan, "The Impact of Generalised Scheme of Preference (GSP+) on Pakistan's Textile Exports," *International Journal of Economics, Commerce and Management* 3, no. 1 (2015).

⁴³ Ibid.

⁴⁴ Mahmood and Ahmed, *Export Performance of Pakistan: Role of Structural Factors*.

c) *Exchange Rate Volatility and Increased Political and Economic Instability*

Another major constraint that Pakistani exporters face in the international and EU markets is exchange rate volatility and the massive depreciation of the Pakistani rupee. In 2017, a research conducted by Alam et al. investigated the impact of Pakistan's exchange rate volatility on bilateral sectoral exports with its major trading partners: the US, Saudi Arabia, the UK, Germany and Japan. Their results indicate that there is a long-term relationship between the variables indicating that exchange rate volatility has a favourable and consistent effect on the sectoral exports of Pakistan in the majority of cases. On the other hand, Mustafa and Nishat's results show that the volatility of the exchange rate has a negative effect both in the long and short run with major trading partners, especially the US and UK.⁴⁵ This means that exchange rate volatility has not benefitted in increasing exports of Pakistan.

Although the State Bank supported the rupee in daily market operations for years, it devalued the currency due to balance of payment pressures,—falling foreign reserves, and a widening current account deficit. This devaluation of the rupee from 105.4 per dollar in 2017 to 154.24 per dollar in 2020 benefits the exporters as their products become cheaper in the international markets but hurts those firms that rely heavily on imported machinery and raw materials as their cost of production will increase leading to higher product prices.

The exporters however, are not much impressed by this devaluation of rupee by the State Bank. According to M.I. Khurram, a major knitwear exporter in Lahore, currency devaluation only increases the cost of doing business as the prices of raw materials, energy and transportation rise.⁴⁶ Hence, the volatility in exchange rates discourages the investors from investing in industries producing export items as the risk and level of uncertainty is much higher compared to other business opportunities.

⁴⁵ Khalid Mustafa and Mohammed Nishat, "Volatility of Exchange Rate and Export Growth in Pakistan: The Structure and Interdependence in Regional Markets," *Pakistan Development Review* 43(4) February 2004:813-828.

⁴⁶ Nasir Jamal, "Devaluation Alone Won't Help," *Dawn*, March 26, 2018, <https://www.dawn.com/news/1397470>

d) Human Rights Violations Affect Trade Relations

The EU places strong emphasis on improving human rights conditions and it is one of its external action objectives. The EU uses GSP Plus status as a tool to encourage compliance to the 27 UN core conventions regarding human and labour rights, environment protection and good governance in developing countries. After every two years, the EU reviews the status of human rights in the countries to which it has granted GSP Plus status. In 2010, Sri Lanka lost its GSP Plus status due to alleged human rights violations, carried out in 2009 at the conclusion of decades of civil war. This severely affected the ready-made garment industry in Sri Lanka: an industry that plays a significant role in poverty alleviation by employing thousands of workers from poor families.⁴⁷ Similarly, in 2017, many economists and analysts were concerned that Pakistan might lose its GSP Plus status due to continuous human rights violations that were happening in the country. Fortunately, this did not happen and Pakistan's GSP Plus status was renewed by the EU parliament for the next 2 years till 2020. The credit for this goes to the Government of Pakistan for fully cooperating with the EU in sharing information on the steps it has taken to comply with the 27 UN Conventions.

The GSP Plus Review Report that was presented to the EU Parliament, in 2017, appreciated that Pakistan had achieved substantial progress in legislative and policy side by introducing legislative laws on women, children and labour rights. However, it condemned Pakistan's inability to fully implement those laws and stated that custodial torture, the application of the death penalty, the increased clampdown on freedom of expression, extra-legal killings, the enforced disappearances continue to occur; the strict and non-transparent registration process, forced and child labour, the denial of unionisation prevails and the environment continues to being polluted.⁴⁸ It suggested that Pakistan should enhance its efforts to ensure implementation and enforcement of its own legislation.

⁴⁷ Jayatilleke S. Bandara and Athula Naranpanawa, "Garment Industry in Sri Lanka and the Removal of GSP Plus by EU," *World Economy*, 2014, <http://onlinelibrary.wiley.com/doi/10.1111/twec.12182/full>

⁴⁸ European Commission, *Report on the Generalised Scheme of Preferences Covering the Period 2016-2017*, Brussels: European Commission, 2018.

Pakistan should not turn a blind eye to the fact that human rights conditions in its territory have deteriorated. Considering the importance that the EU gives to the promotion of human rights, it is very important that the Government of Pakistan should take significant measures in order to protect its minorities and underprivileged groups if it wants to retain its GSP Plus status.

Policy Recommendations

Pakistan severely needs to diversify its export portfolio since relying solely on textiles can hamper its export sector, resulting in an increased balance of trade deficit. Pakistani exporters need to undertake extensive market research in order to explore new markets and identify niches in the EU market where Pakistani goods can easily penetrate. This will help in diversifying Pakistan's portfolio of export goods instead of heavily relying on a few items. The Pakistani diaspora can also play an important role in exploring and enhancing new trade opportunities between the EU and Pakistan. With the advent of social media, e-businesses are now flourishing and can provide great many opportunities for Pakistan's small scale entrepreneurs to export their goods to the EU. Hence, the government needs to focus on diversifying its export base, exploring new markets, and encourage e-commerce with the EU.

The export industries need a major overhauling. They need to encourage the use of modern technology, new research and innovations, and methods of production, with an emphasis on workers' training and the development of their skills. Small and Medium Enterprises (SMEs) should be encouraged to become a part of the value chains of larger companies⁴⁹ and removing the bottlenecks (such as timely custom clearances, fewer power outages, lower interest rates, etc.) in order to increase the number of exporters in a country. The provision of an uninterrupted supply of electricity and duties on raw materials for export-oriented industries should be lowered to ensure competitiveness in the international market.⁵⁰ The provision of GSP Plus status to Pakistan will not ensure sustainable market access to the EU unless the government ensures that the products being exported meet the market

⁴⁹ "A Road Map For Optimising Pakistan's GSP Plus Status," *The Pakistan Business Council*, 2014, <http://www.pbc.org.pk/research/a-road-map-for-optimizing-pakistans-gsp-plus-status/>

⁵⁰ Ibid.

demand and the packaging and quality standards set by the EU.⁵¹ Thus, the government should provide subsidies and incentives to exporting firms to encourage technological innovation and remove bottlenecks if it wants Pakistani goods to compete effectively in the EU markets alongside goods from countries like China, Bangladesh, India, Italy, and Romania.

Trade diplomacy should be used as a tool to facilitate the exporters in building linkages with distributors that can help Pakistani producers in accessing the European markets. There must be interaction at government level, facilitating B2B dialogues, trade fairs, and interactions between buyers and sellers.⁵² This will help in determining the exact needs of buyers and in placing orders according to their specifications, as well as a follow-up on production. Innovative marketing techniques, like display centres in the various EU member countries, can also help in encouraging trade diplomacy.

Furthermore, Pakistan needs to work on its soft diplomacy in order to promote a positive image of Pakistan abroad. There is a significant need to lobby at the highest levels within the EU member countries in order to promote interaction with trading and media blocs, and to counter any negative anti-Pakistan rhetoric. A commendable effort was witnessed on the Pakistani government's part, in 2017, when brightly coloured buses depicting Pakistani culture were driven on busy London streets. More such initiatives are needed. The Pakistani cinema, which is now coming out of a recession phase, can also help in improving Pakistan's image abroad.

The government specifically needs to encourage gender mainstreaming especially in the textile and apparel industry which provides a base to its export sector in order to encourage female participation in the labour market.⁵³ Pakistan already lags behind in the number of women employed in the textile sector when compared with other major textile exporting

⁵¹ Abdul Ghafoor Awan, "The Impact of Generalised Scheme of Preference (GSP+) on Pakistan's Textile Exports," *International Journal of Economics, Commerce and Management* 3, no.1 (2015).

⁵² Sialkot Chamber of Commerce and Industries, "Pakistan-Germany Trade Relations," 2016.

⁵³ Trade Related Technical Assistance Programme, "Enhancing Pakistan's Trading Benefits from the Proposed EU GSP Plus Scheme," 2012, <http://trtapakistan.org/wp-content/uploads/2012/04/Policy-Recommendation-GSP.pdf>

countries. This will help Pakistan in improving its position on the Gender Gap Index and increase household incomes in urban areas.

Finally, Pakistan needs to take the recommendations of the treaty monitoring bodies on situation of human rights in Pakistan seriously and should prepare an action-oriented strategy in consultation with civil society and human rights organisations in order to effectively implement them.⁵⁴ Failure to do so would not only deprive the Pakistani citizens of their basic constitutional rights but also put Pakistan at risk of losing its GSP Plus status.

Conclusion

The GSP Plus scheme has significantly enhanced Pakistan's exports to the European Union market with the textile industry being its major beneficiary. The Pakistani government needs to ensure that it overcomes the hurdles and reduces the constraints that are affecting the EU-Pakistan trade relations. These include the lack of competitiveness in international markets, the over reliance on a few export items, the exchange rate volatility and human rights violations. It can be stated that, if fully utilised, the GSP Plus status has the ability to earn more foreign reserves for a country which faces a severe current account deficit, huge public debt and balance of payment problems. The GSP Plus status awarded to Pakistan by the EU may not be permanent. Hence, Pakistan needs to ensure that proper policies are implemented and investment is made to enable its export sector to become more competitive.

⁵⁴ Reema Omer, "Crucial Human Rights Review," *Dawn*, January 22, 2018, https://epaper.dawn.com/DetailImage.php?StoryImage=22_01_2018_008_004