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The hidden price of protectionism: Pakistan's tariff trap

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Since Pakistan's independence in 1947, protectionist policies have been the hallmark of the country's economic strategy. In the initial years of Pakistan's existence, the government was beset by the daunting challenge of creating a self-sustaining economy in a nation with limited industrial capacity. To achieve this, tariffs were introduced to shield local manufacturers from well-established

foreign competition and contribute to the economic development of the newly born nation.

During the subsequent decades, these protectionist measures formed the bedrock of Pakistan's industrialization efforts. Imposing high tariffs on various imported products made them more expensive and less attractive than domestically produced alternatives. These strategies ultimately sought to curb dependence on imports and foster the development of domestic industries, particularly in sectors such as textiles, steel, and machinery. These early efforts laid the groundwork for what was hoped to be a robust, self-sustaining industrial base.

Nevertheless, the advent of globalization in the 1980s and 1990s introduced new challenges for Pakistan's economy, which were compounded by pressures from international financial institutions like the International Monetary Fund (IMF) and World Trade Organization (WTO). Attempts to reform tariff policies under IMF agreements sought to reduce tariff rates, simplify tariff structures, and bring Pakistan's trade policies in alignment with global norms.

Despite these efforts, Pakistan's current tariff policy continues to be characterized by the imposition of tariffs on a wide range of imported products. For businesses reliant on imported machinery or raw materials, these additional costs reduce profitability and undermine growth. Domestic industries, protected from international competition, also have less motivation to innovate or improve their offerings. Ultimately, the absence of foreign competition leads to Pakistani consumers primarily having access to overpriced yet lower-quality domestic goods. Over time, inflation of goods due to tariffs undermines economic dynamism and results in stagnation.

The benefits of trade, unconstrained by restrictions, have long been recognized by economists, particularly through David Ricardo's model of comparative advantage. Per this model, free trade enables a country to fully leverage its comparative advantages, allowing it to produce those goods at a lower opportunity cost than its trading partners. This, in turn, lowers production costs, and augurs productivity, thereby enabling consumers and businesses to access a wide variety of goods at lower prices.

The absence of free trade can lead to the accumulation of market inefficiencies, evident in Pakistan's current tariff regime. According to the World Tariff Organization, Pakistan imported goods worth PKR 14.48 trillion (US $70.8 billion); of these, only 31.1% of imports were duty-free. The remaining imports worth PKR 9.98 trillion, constituting 68.9% of total imports, were subject to tariffs. While the average tariff on these goods was 8.7%, this average obscures significant disparities. A substantial portion of imported goods – 39.1% – faced high duties of over 15%, with an additional 2.3% subjected to extreme duties that exceeded three times the national average rate. An analysis by the Pakistan Institute of Development Economics (PIDE), revealed that the imposition of these tariffs alone, raised the cost of imports by approximately PKR 1.36 billion in 2022.

Even though tariffs are the most visible form of protectionism, the implementation of non-tariff barriers (NTBs) adds another layer of complexity to Pakistan's trade environment. NTBs, like import quotas, stringent customs procedures, and licensing requirements add significant compliance costs for businesses. Though less transparent than tariffs, these barriers can be quite burdensome, because they create unpredictability and inefficiency in the trading process. In Pakistan, NTBs affected roughly 33.1% of all trade in Pakistan, resulting in an additional PKR 412 billion in costs that businesses must absorb.

Thus, according to PIDE's analysis, the combined impact of tariffs and non-tariff barriers (NTBs) cost Pakistan's economy approximately PKR 1.77 trillion in 2022. This staggering amount, represented 0.6% of Pakistan's GDP and 8.5% of its trade volume, showing that this cost ripples through the entire economy, affecting everything from the price of consumer goods to the cost of production in key industries.

The existence of such a high level of protectionism severely curtails the competitiveness of domestic businesses. This leads to a vicious cycle where businesses due to becoming uncompetitive against foreign firms, call for even more protectionist measures. Not only does this undermine innovation, but it also leads to a reduction in individual and corporate incomes, consequently decreasing potential sources of tax revenue. The burden of these policies is not evenly distributed across the economy, with sectors dependent on imported inputs being impacted disproportionately. These industries face higher production costs, reduced margins, and diminished investment prospects, limiting their ability to expand and compete at the global level.

With a per capita cost of PKR 7,516, the ultimate victims are the Pakistani people, with protectionism acting as a tax on the average citizen, decreasing disposable income and aggravating the already high levels of poverty and inequality. Inefficiencies introduced by protectionist policies lead to stagnation of living standards, along with undermining growth, reducing innovation in the local industry, and weighing heavily on the country's future.

Given the substantial economic costs associated with tariffs, Pakistan must reassess its current policies, which prioritize protection over competition. Reducing excessively high tariffs will be instrumental in bringing down the cost of consumer goods and inputs. The increased purchasing power of consumers along with the higher investment by businesses in new technologies and production processes will lead to higher quality products and greater efficiency. However, non-tariff barriers will also need to be rationalized through the simplification of customs procedures, enhancing transparency in trade policy, and reducing unnecessary regulations to enhance trade efficiency.

While tariffs and NTBs, may have been instrumental in protecting domestic industries in the early years of the country's creation, these policies have become a relic of an economic strategy that no longer serves the country's best interests.

Therefore, for the country to attain its full economic potential, a fundamental overhaul of trade policy is needed. By lowering tariffs and minimizing non-tariff barriers, Pakistan can provide a conducive environment for open trade, ultimately leading to sustainable growth and improved living standards. A competitive trade environment is also likely to boost efficiency in the heavily protected agricultural sector and within manufacturing, particularly in the leather and machinery industries. Not only will these reforms provide a much-needed boost to the economy, but they will also position Pakistan as a key player in the global market, equipped to handle the challenges of the 21st century. The need for reform is clear and the time to act is now.

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