THE NEED FOR TRADE POLICY REFORMS IN PAKISTAN

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For decades, Pakistan's inward-looking trade policy regime has constrained economic growth and export performance.[1] High tariffs, pervasive import bans, complex regulatory duties and extensive red-tape have led to serious distortions in the economy. These policies might have served a purpose in the past, but are now fundamentally misaligned with Pakistan's development needs and changing global economy. There is an urgent need for comprehensive reform to liberalise trade, boost competitiveness and enable export-led growth.[2] This article analyses the flaws in Pakistan's existing trade policies and makes a strong case for why overhaul is essential by presenting more evidence on how distorted incentives have bred inefficiencies and stifled the economy.

THE FAILURE OF IMPORT SUBSTITUTION AND PROTECTIONISM

Pakistan's trade policy approach has historically centred on import substitution industrialisation (ISI) and protecting the domestic industry through high tariffs and non-tariff barriers.[3] This was rooted in a view that imports were 'bad' and threatened domestic production and employment. While ISI met with some early success, the policy outlived its utility as inefficiencies became entrenched.

Several factors contributed to the failed promise of ISI beyond the 1960s. First, the negative impacts of prolonged protection – lack of competition, weak incentives for innovation and low productivity – became more apparent over time. According to Pakistan Institute of Development Economics, the average total factor productivity has stood at just 1.5% for the last decade of 2010-20.[4] Second, Pakistan shifted its focus to capital-intensive industries like automobiles, chemicals, iron and steel that created limited jobs compared to labour-intensive light manufactures. Third, inward orientation led to the fragmentation of domestic markets and sub-optimal industry scales. Finally, the complex bureaucratic controls required to manage ISI led to high transaction costs and rent-seeking.

As a result, manufacturing remained confined to a few protected enclaves, while high-productivity export sectors failed to emerge. This functioned to foreclose opportunities from labour-intensive industrialisation that drove growth for Pakistan's peers. Despite billions invested in subsidies and tariffs, output and export competitiveness remained disappointing. By the early 2000s, ISI had clearly exhausted its potential.

Pakistan still maintains a high average tariff rate (12%), where the auto industry is the most protected industry with more than 45% protection rate.[5] Additional para-tariffs, regulatory duties and complicated import licensing rules are imposed on many goods.

These legacy policies continue imposing inefficiencies in the economy. Market prices are inflated compared to global benchmarks because the domestic producers increase market prices as high as tariff rates on imported products. Domestic industries lack incentives to become competitive because they make high profits without any innovations, and only 0.16% of the GDP is invested in research and development activities by the domestic industry in Pakistan.[6] Hence, the domestic industry has no incentive to expand to the international market, the so-called anti-export bias, which is the key reason for stagnant exports.[7] On the other hand, consumers face limited choice and over-priced goods impacting welfare, and the producers maximise their welfare at the expense of consumers welfare.

EMBRACING TRADE OPENNESS AS A GROWTH STRATEGY

Marginal liberalisation provides no clear pathway to dismantling the residual complex of import bans, tariffs, and quotas inherited from the inward-looking era. And new barriers have been added through regulatory duties and standard-setting. This underscores the need for a more paradigm policy shift that embraces trade openness and global integration as the roadmap for high growth.

There are several compelling arguments for why orthodox import substitution has run its course. First, no country has sustained rapid development in modern times while restricting trade and foreign technology. Export pessimism is inconsistent with success of East Asia, China and more recently Bangladesh. Second, imported inputs and machinery help raise productivity, speed up industrialisation and enhance competitiveness. Third, leveraging Pakistan's youth bulge and growth opportunities requires tapping global value chains. Fourth, enlarged domestic markets via linkages with the global market facilitates economies of scale. Finally, ending monopolies through competition drives specialisation, innovation and private investment.

With the right policy framework, expanding trade and investment can catalyse growth, exports and employment - rather than undermining it as commonly perceived. This is the lesson from emigrants to growth leaders like China and Vietnam. But the transition requires phasing out legacy protectionism and embracing openness more decisively than attempted thus far. The principles and specific contours of such an outward-oriented reform agenda are discussed below.

PRINCIPLES FOR A TRADE POLICY REGIME ORIENTED TOWARDS

Pakistan must move towards a trade policy regime aligned with global norms and designed to expand commerce. This requires streamlining restrictions, improving transparency, simplifying procedures and embedding liberalisation. Some useful guiding principles are:

- Import liberalisation should be comprehensive and meaningful rather than piecemeal or marginal. All products of trading partners should get market access unless very sensitive.

- Policy changes must have longevity and withstand political pressures. Reversals, exemptions and adjustments should be limited once a roadmap is announced.

- Non-tariff barriers and para-tariffs need to be phased out rather than used to cushion tariff reduction. Technical barriers should not create hidden protectionism.

[1]https://pide.org.pk/research/unveiling-the-myth-of-import-substitution-policy-in-pakistan-policy/
[2]https://pide.org.pk/Research/PIDE-Reform-Agenda-Report.pdf
[3]https://pide.org.pk/research/the-effective-rate-of-protection-in-an-input-output-framework/
[4]https://file.pide.org.pk/uploads/rr-057-sectoral-total-factor-productivity-in-pakistan.pdf
[5]https://pide.org.pk/research/ranking-of-industrial-protection-in-pakistan/
[6]UNESCO institute of Statistics, 2023.
[7]https://file.pide.org.pk/pdf/Policy-Viewpoint-14.pdf

- Protective tools like safeguards and anti-dumping duties should be applied very selectively and based on evidence. Automatic recourse to these measures should end.

- Documentation, processes and border management should be simplified.

- Trade policy reorientation needs coordinated action across ministries and agencies. Holistic perspective should override narrow interest of revenue maximisation through import tariffs.

- The private sector must have a structured role in trade policy formulation, review and oversight mechanisms. Business inputs ensure practicality.

With these principles in mind, a reform agenda encompassing tariffs, market access and trade infrastructure is discussed below.

PHASING OUT IMPORT TARIFFS IN A GRADUAL AND TRANSPARENT MANNER

Import tariffs are central to the protectionist edifice and need systematic rationalisation. One approach could be:

- In the first two years, maximum tariffs for all products should be reduced to 15% or the current average tariff of around 12% in equal quarterly installments. This eliminates prohibitive duties protecting few industries.

- Over the following three years, all tariffs should be brought down in equal quarterly installments to reach a uniform low rate of 5%.

- This low uniform tariff should be maintained for 3 years before a final phased reduction to 0% across the board. Or some minimal tariffs for revenue purposes.

Such gradual tariff harmonisation down to zero protection over 8-10 years provides adjustment time to industry. The phasing should be pre-announced so that business can adapt.

STREAMLINING NTBS FOR MARKET ACCESS

Beyond tariffs, non-tariff barriers (NTBs) like licensing, standards certification, and product testing also impede imports in Pakistan. While some NTBs are justified on technical grounds, they are often misused to create hidden protectionism. These restrictions need streamlining.

Import bans and restrictive licenses on consumer goods, industrial raw materials and intermediate goods should be abolished based on a strict review. SPS (Sanitary and Phytosanitary) and TBT (Technical Barriers to Trade) regimes should be framed to meet genuine health/safety objectives, without scope for discretionary restrictions. Mandatory registration/permits simply to import should end - with greater reliance on post-import monitoring if required.

Conformity assessment infrastructure and capacity for testing and certification needs major upgrading to ensure NTB regimes are not abused. Prospective importers should have modern labs, qualified inspectors and transparent systems for checking product compliance rather than relying on arbitrary decisions of regulators.

THE WAY FORWARD: A MORE OPEN PAKISTAN

Trade policy reforms along the above lines would steadily dismantle the anti-export bias of the prevailing regime. Directing strategy towards enhancing competitiveness rather than protecting industry would revitalise exports and growth. With its youthful entrepreneurs, Pakistan has the potential to achieve sustained growth through a trade-focused strategy that taps global opportunities.

Of course, the transition will not be without costs and structural adjustments. But a phased process accompanied by safety nets to support displaced workers can smoothen the short-term impacts. The efficiency gains, competitive pressures, technology access and investments that openness facilitates will lift growth onto a higher trajectory.

Mobilising political will and building public consensus for a major policy overhaul remains a challenge. Entrenched vested interests benefitting from restricted trade may resist change. But the massive economic dividends for consumers and the wider economy far outweigh the benefits to protected firms. Astute policy communication and advocacy is needed for the paradigm shift - along with institutional mechanisms to lock-in reforms and prevent policy reversal. The need of the hour is embracing deeper integration with the region and the world to tap new sources of productivity, exports and growth. The policy reform prescriptions outlined here offer a practical template for enabling such a transformation.

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