



# THE INDUSTRIAL IMPERATIVE IN PAKISTAN

## Choosing Between a 'Trading Shop' and a 'Global Factory'

Shujaat Farooq

Today the industrial policy is experiencing a significant change as global structural shifts increasingly necessitate state intervention. Intensifying great-power competition, supply chain vulnerabilities, national security priorities, and the green transition have collectively exposed the limitations of free market concepts. Consequently, the erosion of the rules-based international order is compelling governments to take a more assertive role in steering industrial development and ensuring economic resilience.

### FREE MARKET ORTHODOXY

For decades, the World Bank and western economies maintained that the state's role should be limited to facilitation—upholding basic institutions while promoting free trade, privatization, and minimal intervention.

The developing world was counselled toward liberalisation policies. This paradigm aligned with Western interests, as open markets in developing economies ensured access to cheap labor and raw materials.

Recently, the World Bank has acknowledged in its report that its earlier stance underestimated the value of industrial policy, implicitly recognizing that economic doctrine is shaped by geopolitical considerations. Its latest position affirms that industrial policy should form part of every nation's policy toolkit, reflecting a shift that also enables advanced economies to adopt more interventionist strategies in response to rising competition from East Asia. The critics consider that this U-turn is more like an institutional adjustment to new political realities due to geopolitical context as Western economies now need an industrial policy

## PAKISTAN'S INDUSTRIAL POLICY

Over the last past four decades, Pakistan has gone through deindustrialisation with a rising a share of services sector at the cost of production activities both in agriculture and industry. Manufacturing's share in GDP has declined from 17.5% in 2005 to around 12% in 2024, contributing to a persistent fall in the export-to-GDP ratio. Had the country maintained its 1999 export-to-GDP level of 16%, current exports would likely be nearly double the present range of USD 30–32 billion.

Over the last two decades, Pakistan's global export market share has significantly eroded, while Bangladesh has doubled its share and Vietnam's has expanded sevenfold. This stagnation is largely attributable to a revenue-centric tariff policy that fails to differentiate between raw materials, intermediate goods, and finished products. This lack of distinction has fueled import growth and neutralized the potential benefits of trade agreements, which have generally been underutilized as strategic tools for export expansion.

Table: Sectoral share of various sectors in GDP (in %)

Year	Agriculture	Mining & Manufacturing	Construction	Electricity and Gas Distribution	Services
1950-60	48.5	10.7	2.1	0.3	38.4
1961-70	40.4	15.4	4.0	0.8	39.4
1971-80	33.7	17.0	4.5	2.6	42.2
1981-90	27.6	17.1	4.3	2.6	48.4
1991-00	25.5	17.8	3.8	3.9	49.1
2000-10	23.0	19.4	2.2	2.5	53.0
2011-20	20.3	16.2	1.9	2.5	59.2
2021-24	23.2	13.8	2.4	2.4	58.2

Source: Author's Compilation

Furthermore, high input costs continue to undermine the price competitiveness of Pakistan's predominantly low-value-added exports. This weak export foundation is reflected in the country's investment-to-GDP ratio, which remains a modest 16%, compared to 31% in Bangladesh and 37% in Sri Lanka. Addressing these structural imbalances—particularly in tariff and trade policy—is essential to restoring industrial competitiveness and attracting higher levels of investment.

The tax systems are complex and high and disproportionate to the manufacturing sector that contributes just 12% in GDP but pay near to 60% of the tax burden. The corporate tax is almost

double to regional competitors and number of taxes are almost 15-folds high to Hong Kong.

The country will continue to be plagued by high unemployment and challenges of trade deficit if we continue to import consumer products for which a manufacturing base no longer exists, nor there appears to be a plan to create, to leverage on a large domestic market of 250 million consumers. In a nutshell, the industrial policy by and large has failed to make the country competitive internationally despite concessions and subsidies. A number of industries have enjoyed concessions at the cost of market distortions and imperfections. The regulators could not act as a facilitator by improving human capital, infrastructure and removing market barriers to make the businesses ease.

Policy formulation in Pakistan has largely been reactive, often driven by crises rather than long-term efficiency considerations, resulting in structural distortions. For instance, the Independent Power Producers (IPP) policy of 1994, while addressing immediate energy shortages, contributed to persistently high energy costs and the buildup of circular debt. More broadly, many policies have taken the form of aspirational wish lists, lacking clear targets, effective monitoring mechanisms, and accountability frameworks. Over the past decade, several initiatives—including the Auto Industry Development and Export Policy 2021–26, SME Policy 2021, and the New Energy Vehicles Policy 2025–30—have been introduced, yet their economic outcomes remain largely unassessed and unclear.

The recently introduced National Tariff Policy (NTP) 2025–30 represents a shift toward a more competitive, export-oriented framework by rationalizing tariff structures, reducing duties on raw materials, and phasing out Additional Customs Duties (ACD) and Regulatory Duties (RD). However, its effectiveness will depend on complementary reforms, particularly in lowering energy costs, reducing regulatory burdens, and simplifying the tax regime to create a genuinely enabling business environment.

## LEARNING FROM EAST ASIA

Pakistan's policy makers must learn from various East Asian economies, particularly South Korea, Hong Kong, Vietnam, Cambodia and others. As like other developing countries, these economies almost opted same policy instruments with a greater success. Their policies largely focused on macroeconomic stability, low price distortions, trade openness, and letting comparative advantage guide which industries developed. In most of these economies, the government intervened systematically to foster industrial development. With a clear vision the government however targeted and subsidised credit to selected sectors by mobilizing investment resources into those sectors that state had decided to develop.

Various economists considered the East Asian miracle was due to an authoritarian approach but supported with high quality institutional governance, powerful technocratic bureaucracy and shielded from political pressure. The principle of shared growth and a business friendly environment was opted. Besides human capital formation, the policies tended to focus on rapid productivity growth through openness, innovation and technology.

## TOWARDS A RAPID INDUSTRIAL REVOLUTION

It is imperative for the country to decide whether to remain trapped in a low-value manufacturing structure where exports are narrowly concentrated in a limited range of products and markets or to transition toward higher participation in global value chains, as demonstrated by countries like Vietnam.

A coherent industrial policy must clearly define and align the roles of federal and provincial governments to effectively support industrial development. Equally important is the provision of long-term policy consistency to build investor confidence. Among the various areas requiring alignment, the integration of trade and taxation policies is particularly critical to fostering industrialization and enabling sustainable economic transformation. Few recommendations may be noted;

**The Fiscal Policy** should follow the equitable distribution of the taxation burden through a broader tax base. The policy should also promote capital formation and consolidation to facilitate scale, competitiveness and investment. Tax rates need to be brought down to be regionally competitive as income tax rate on business above 50% along with super tax would erode the investment.

**Reduce Tax tax collection agencies:** there are multiple tax agencies at federal and provincial level and most of the tax collection reforms are limited to tax digitization rather than focusing to improve digital economic infrastructure, i.e., POS deployment, digital payments restaurants. Taxes should be on profits as opposed to any other proxies of profit, further the number of taxes need to be reduced and multiplicity of tax authorities be rationalized through the creation of a National Tax Authority.

**Cascading import duty on raw material:** the country must implement the National Tariff Policy 2025-30 by allowing the industry to import raw material and export the finished goods by maximizing its position in the global value chain.

**Human capital formation:** despite claims of a vast talent pool, Pakistan significantly trails its peers on the human capital. High learning poverty, rising graduate unemployment, low female labor participation, and chronic malnutrition have created a skilled labor shortage that stifles industrial productivity. To reverse this, science and mathematics must be mandatory from early education, and technical vocational training should be expanded through private-sector management. Universities must prioritize employable STEM graduates to meet the needs of modern manufacturing which now centers on research, design, and engineering and to supply the ICT professionals required for a robust digital economy.

**Institutional Framework:** the institutional focus should be on simplification, unification and digitization of business through one-window facilities. Policies need to encourage value addition, quality and branding. Strengthening economic governance requires devolving authority, decentralizing fiscal resources, and empowering local governments with autonomy while ensuring accountability for results. The state should withdraw from commercial activities and enable the private sector to operate on a level playing field. Its primary role should be to deliver essential public goods and services efficiently and cost-effectively.

In conclusion, a predictable policy environment and a business-friendly climate are essential for industrial growth in Pakistan. By ensuring long-term stability and reducing bureaucratic friction, a leaner government can build investor confidence, attract both local and foreign capital, and foster a competitive industrial sector capable of driving sustained economic expansion.

Shujaat Farooq is Dean (Research), at the Pakistan Institute of Development Economics

