

7-2014

# Trade Policy Reforms in Pakistan

Shahid Karim

*Shahid Karim*, [shahid.karim@siu.edu](mailto:shahid.karim@siu.edu)

Follow this and additional works at: [http://opensiuc.lib.siu.edu/gs\\_rp](http://opensiuc.lib.siu.edu/gs_rp)

---

## Recommended Citation

Karim, Shahid. "Trade Policy Reforms in Pakistan." (Jul 2014).

This Article is brought to you for free and open access by the Graduate School at OpenSIUC. It has been accepted for inclusion in Research Papers by an authorized administrator of OpenSIUC. For more information, please contact [opensiuc@lib.siu.edu](mailto:opensiuc@lib.siu.edu).

# TRADE POLICY REFORMS IN PAKISTAN

by

Shahid Karim

BBA., Shaheed Zulfiqar Ali Bhutto Institute of Science and Technology, 2007

MBA., Shaheed Zulfiqar Ali Bhutto Institute of Science and Technology, 2010

A Research Paper

Submitted in Partial Fulfillment of the Requirements for the

Master of Science

Department of Economics

in the graduate school

Southern Illinois University Carbondale

December 2014

RESEARCH PAPER APPROVAL  
TRADE POLICY REFORMS IN PAKISTAN

by

Shahid Karim

A Research Paper Submitted in Partial

Fulfillment of the Requirements

for the degree of

Master of Science

in the field of Economics

Approved by:

Dr. Sajal Lahiri

Graduate School

Southern Illinois University Carbondale

July 07, 2014

AN ABSTRACT OF THE RESEARCH PAPER OF

SHAHID KARIM, for the MASTER OF SCIENCE degree in ECONOMICS, at Southern Illinois University Carbondale.

TITLE: TRADE POLICY REFORMS IN PAKISTAN

MAJOR PROFESSOR: Dr. Sajal Lahiri

This paper examines the trade policy reforms in both import and export sectors of Pakistan and provides a critical analysis of the measures undertaken during various regimes to liberalize the economy. The paper discusses the relevant theoretical and empirical research and attempts to evaluate the existing tariff structure under various trade liberalization regimes and substantiate, with the statistics in view of the trade theory, relevant reports and research papers. Alongside it also discusses the tax reforms relevant to trade policy, while briefly discussing key concerns and challenges faced by the policy makers in both formulation and implementation of tariff reforms, such as, lobbying of special interest groups, government revenue constraints and illegal trade across the borders. Finally, it gives an account of export sector and discusses reasons for its weak performance despite government interventions.

## ACKNOWLEDGEMENTS

I would like express my sincere gratitude to my research adviser Professor Sajal Lahir for the invaluable guidance before and during the completion of my Master's research paper. I am privileged to having worked under his tutelage and developing a deep appreciation for the subject, which I hope will guide me at every stage in my academic and professional career.

Finally, I would like to remember my late father for his love, affection and for everything that he has done for me.

## TABLE OF CONTENTS

CHAPTER	PAGE
ABSTRACT.....	i
ACKNOWLEDGEMENTS.....	ii
LIST OF TABLES.....	iv
LIST OF FIGURES.....	v
CHAPTERS	
CHAPTER 1 - INTRODUCTION.....	1
CHAPTER 2 - LITERATURE REVIEW.....	3
CHAPTER 3 - TARIFF REFORMS.....	5
CHAPTER 4 - EXPORT PROMOTION POLICIES.....	12
CHAPTER 5 - CONCLUSION.....	17
REFERENCES.....	19
VITA.....	21

## LIST OF TABLES

TABLE	PAGE
Table 1 .....	7
Table 2 .....	8
Table 3 .....	10
Table 4 .....	11
Table 5 .....	14

LIST OF FIGURES

FIGURE	PAGE
Figure 1 .....	9

## 1. INTRODUCTION

International trade has been an increasingly important tool for achieving economic growth. Pakistan, among many developing countries has already embarked on policies for trade liberalization *inter alia* economic reforms to minimize both the direct and indirect barriers to trade and pave way for the economic development . Historically, Pakistan adopted protectionist and import substitution policies with objective to achieve self-sufficiency and shelter its domestic industry from foreign competition. Major policy reforms were introduced in 1988 in the name of *Structural Adjustment and Stabilization Programs* (SAP) to rationalize the tariff structure and improving the efficiency of domestic manufacturing. By 2003 the maximum tariff were brought down to 25 percent<sup>1</sup>; while owing to the WTO obligations all traditional quantitative restriction were eliminated by the same year.

The liberalization reforms continued and drastic changes were made in agricultural sector to eliminate government monopolies and interventions to boost the exports. This was followed by real exchange devaluation of about 20 percent between 2003-2007 which caused exports to grow at 110 percent in nominal USD in 2008 compared to 2002 level. However, some of the reforms, notably of agriculture, wheat, sugar and fertilizers were retracted after the financial crises of 2008. The list also includes rigorously implementing anti-dumping and local content requirement policies. (Pursell et al: 2011).

The challenges for trade reforms generally come from the concern for the loss of tariff revenue from reduction of trade taxes and this issue has been addressed by proportionately increasing the direct taxes to offset the revenue loss. The paper also aims at discussing the issue

---

<sup>1</sup> This excludes the outliers, such as automobile and alcoholic beverages.

of smuggling and illegal trade in Pakistan due to porous borders with neighboring countries, such as Afghanistan, Iran and India.

## 2. LITERATURE REVIEW

Pakistan like many other developing countries started to move away from the ISI strategy and embarked on trade liberalization programs starting in late 1980s and efforts to reduce tariffs and other indirect trade taxes continued till 2006. Significant efforts were ensured to liberalize trade during this period and maximum tariff of 225 percent in 1990-1991 was slashed down to 25 percent by 2003 resulting in average tariff rate of 11 percent compared to 65 percent in 1990-1991. However, the pace of these reforms have been relatively sluggish and in 2008 there was a backtracking on some of the policies, and as a result, a number of Regulatory Duties (RDs) were introduced on top of the Custom Duties (CDs). Pursell et al (2011) believe that Pakistan started relying more and more on Statutory Regulatory Orders (SROs) from 2006 that provided exemptions and partial exemptions from normal tariffs, while they increased tariffs on other tariff lines to complicated the tariff structure. Moreover, the authors believe that preferential trade agreements, especially with China and other South Asian Countries under SAFTA, both implemented from January 2006 resulted in further complication of the tariff structure. Other key factors obstructing the way for trade liberalization include, the concern for impact of tariff revenue and effect on special interest groups that lobby for protectionist policies. However, subsequent studies<sup>2</sup> have showed that under certain conditions reducing tariffs would be welfare improving rather than welfare reducing and these studies have provided rationale for reduction of tariffs.

Lahiri et al (2000) calculated the optimal tariffs for intermediate input of steel in industrial manufacturing and noted that the then existing tariffs were very high. Based on the findings of their theoretical model the authors believed that further reduction in tariffs on steel

---

<sup>2</sup> Kenzo Abe. (1992), Lahiri and Nasim. (2005), Lahiri et al. (2000), Naito (2005), Keen and Ligthart. (2002) Woodland (1982), Hatzipanayotou et al. (1994)

was desirable to stimulate the manufacturing sector and preventing the cross-border smuggling. In a similar paper Lahiri and Nasim (2005) discuss the welfare effects of replacing tariffs by consumption tax in a revenue-neutralizing way and suggest that reducing tariffs on intermediate goods and increasing consumption tax is welfare improving. Similarly, Naito (2005) suggests that growth, revenue and welfare gains could be attained by combining consumer-price-neutral tariff and tax reforms for growth enhancement with additional rise in the consumption tax on the less distorted good. These results hint that many of the tariff rates fall on the decreasing (right) side of the Laffer curve<sup>3</sup>. According to an estimate, for example a 10 percent reduction in tariff on sheet steel would increase the imports of sheet steel by 18 percent; hence a reduction of tariffs would unambiguously increase the tariff revenue rather than decreasing the tariff revenue.<sup>4</sup>

The results of theoretical findings related to the loss of tariff revenue are further substantiated by the empirical study of Pritchett and Sethi (1993) which shows that tariff rates and tariff revenues were unrelated. The authors compared the official tariff rates with collected rate of tariffs (import tax revenue to import value) and noted that differences in official tariff rates only explain a quarter of the variation in collected rates and increase in official tariff rate above a certain level shows no increase in the collected rate, rather it decreased in some cases when tested for Pakistan, Jamaica and Kenya. The paper noted that for Pakistan the mean collected rate for the 899 items with a tariff rate of 80 percent is 51 percent with a standard deviation of 31. Strikingly, one quarter of the 80 percent tariff rate items paid duty less than 21 percent whereas for 495 items having 100 percent tariff rate paid less than 7 percent. The authors explain that import value decreases with increase in tariff rates because of under-invoicing/smuggling and due to presence of exemptions. Pursell et al. (2011) argue that

---

<sup>3</sup> The Khaldun-Laffer curve is a graphical representation of the relationship between possible rates of taxation and the resulting levels of government revenue

<sup>4</sup> S. Lahiri et al. (2000)

smuggling and under-invoicing in Pakistan is stronger for consumer durable goods due to lack of provision for sales tax credit that is applied to the use or resale of imported intermediate goods. M. Pitt (1981) showed that smuggling is welfare-increasing vis-a-vis the non-smuggling situation. However, in Pakistan smuggling is prevalent also because of the porous borders that are practically impossible control on a full scale, especially, with Afghanistan that historically remained a free-trade economy.<sup>5</sup>

The protectionist policies in Pakistan also effected the export performance of the manufacturing sector and led to inefficiency in domestic production that prevented the country from realizing full potential in its export.<sup>6</sup> Even though tariffs were reduced under liberalization regimes the duties on imports of intermediate inputs used in production of exportable acted as direct taxes on exports. Lahir and Naseem (2006) using a theoretical framework calculated optimum export rebate given as a refund of duties that had been paid on the imported inputs. The authors argue that increasing rebate to exporting sectors increases national welfare when the government becomes less revenue constraint.

### 3. TARIFF REFORMS

The trade policy *inter alia* economic policies is central to the economic development of any country. In early days, it was generally believed that a trade policy based on import substitution, was necessary to strengthen the domestic production of import competing goods and this provided the rationale for imposing various types of trade taxes. However, protectionist policies didn't contribute much to the desired goals of achieving higher national welfare and therefore many developing countries started to move away from the protectionist policies and introduced reforms based on greater openness to trade and reduction of tariffs and trade taxes.

---

<sup>5</sup> Pakistan shares a 1640 miles long border with Afghanistan, mostly comprised of high and rough mountain terrains.

<sup>6</sup> Museleh et al. (2007)

Pakistan remained no exception to these policy changes over time. It was only in late 1980s when it started to move away from Import-Substitution strategy for Industrialization (ISI) and embarked on trade liberalization programs. These liberalization efforts continued till date and there has been much progress in terms of eliminating trade barriers existed in form of tariffs and quantitative restrictions. Pakistan also became a member of World Trade Organization (WTO) in 1995 and both with the recommendations from World Bank and IMF efforts for streamlining the tariff structure continued and resultantly, these barriers were minimized. For instance, the maximum tariff was brought down from 225 percent in 1990-91 to 25 percent in 2003 and all type of quantitative restrictions were eliminated. The purpose of this paper is therefore to critically evaluate the trade and tariff reforms with an emphasis on the changes in the tariff structure over time. Table 1 gives a historical account of changes in tariff structure as a result of Structural Adjustment Program (SAP) undertaken during 1988-89. The government was able to slash maximum tariff of 250 percent down to 110% percent in 1996-97 as a result the simple average tariff rate reduced from 41% to 25.5%. This was still far from desirable reduction in maximum rates primarily on account of auto sector tariffs that remained excessively high.

Table 1

*Changes in Pattern of Tariff Structure<sup>7</sup>*

Year	Tariff Rate (%)		
	Minimum	Maximum	Average (Un-weighted)
1987-88	13.3	250	40.7
1988-89	16.1	155.2	36
1989-90	10	128.6	39.7
1990-91	12.6	151.2	39
1991-92	12.1	181	32.6
1992-93	17.7	270.1	35.3
1993-94	13.4	166.7	34.7
1994-95	0.3	128.6	21.6
1995-96	0.5	110.3	25.5

The period between 1996-97 to 2003-04 marks a crucial epoch of drastic trade liberalization in the history of Pakistan. The simple average rate of industrial tariffs steadily decreased over time from 20.2 percent in 2001-02 to 17.9 percent in 2004-05 followed by a reduction of maximum tariff slabs to 5. However, the normal maximum tariff was raised to 50 % (excluding automobile sector) and the maximum tariff slabs increased to 9 during 2009-10. As a result of these further reforms tariff rates continuously along with import restrictions. Table 2 exhibits the disaggregated tariff structure measured in terms of Effectively Applied Rate. It can be seen that the tariff rates decreased over time. Also, it is evident that mostly the consumer goods and manufacturing sector enjoyed a higher protection.

---

<sup>7</sup> Iqbal and Siddiqui (2001) based on CBR Year Book, 1995-96.

Table 2

*Sector-wise changes in Tariff Structure*

PRODUCT CAT.	Effectively Applied Rate (%)								
	2001	2002	2003	2004	2005	2006	2007	2008	2009
Manufactured goods, ores and metals	20.34	17.25	16.86	16.16	14.6	14.76	14.85	14.09	14.63
Ores and metals	12.93	11.52	10.67	10.5	10.1	10.07	9.66	8.11	7.82
Manufactured goods	20.62	17.46	17.08	16.37	14.75	14.91	15.01	14.29	14.86
Chemical products	17.05	15.55	15.14	13.75	11.48	11.55	11.2	10.74	11.78
Machinery and transport equipment	20.19	16.64	16.2	15.51	14.09	14.36	13.75	13.06	13.45
Other manufactured goods	23.1	19.22	18.9	18.58	16.88	16.94	17.52	16.7	17.2

Source: UNCTAD Statistics

The most important of the trade taxes on imports is the custom duty levied on the foreign goods coming into a home country. Besides acting as an important tool for import substitution custom duty remains a key source of revenue and despite rationalization of tariff structure and broad-basing of taxation in Pakistan in the recent year, the customs duty still shares a major chunk in revenue generation for the country. The share of custom duties in direct and indirect tax revenue remained as high as 12 percent and 19 percent (39 percent in 1990-91), respectively, for the year 2011-12.<sup>8</sup> On the other hand the governments reliance on direct taxes, such as, sales tax remained increasing over time to recompense the government from the loss of revenue associated with reduction of tariffs. Moreover, there is also an increasing trend in collection of direct taxes that historically remained very low. The total revenue from direct taxes from as low as Rs.100 billion in 1999-00 exceeded the mark of Rs.700 billion in 2012-13 (38.2 percent share in total revenue). Figure 1 juxtaposes the change in relative shares of custom duties and sales tax in total tax revenue.

<sup>8</sup> FBR Year Book, 2012

Figure 1

*Relative Share of Custom Duty and Sales Tax in Total Tax Revenue*

Source: *Handbook of Statistics on Pakistan Economy, SBP*

A careful analysis of the structure of custom duties reveal that only fifteen commodities forms the majority share in total gross receipts, with automobile sector at top of the list followed by the POL products. This situation raises concerns regarding the concentration of tariffs in few industries exhibiting stronger protection and lack of implementation of the liberalization reforms in these sectors. This could be further substantiated from the existing maximum custom duty on vehicles which to date remains as high as 100 percent.<sup>9</sup> In terms of tariff rates there were total 6969 number of tariff lines for the year 2013 whose range wise distribution is given in Table 3.

<sup>9</sup> Source: Pakistan tariff budget 2013-14, Federal Board of Revenue.

Table 3

*Range Wise Distribution of Tariff Structure*

Duty Range (Percent)	No of Lines	Percent of Lines
Duty Free	441	6
Less than 0.1	0	0
0.1 - 05	2358	34
5.1 - 10	955	14
10.1 - 15	494	7
15.1 - 20	884	13
20.1 - 25	1113	16
25.1 - 30	369	5
30.1 - 35	267	4
Over 35	88	1
Total	6969	100

Historically, the distribution of tariff rates remained varying for each duty range. In 2001-02 about 10 percent tariff lines were in the range of less than 5 percent which steadily increased to 17 percent in 2002-03 and 25 percent during the year 2004-05. Similarly, about 32 percent of the tariff lines fell in the duty range between 5 to 10 percent in 2001-02 which due to reduction of tariffs over time decreased to 26 percent and 21 percent for the years 2002-03 and 2004-05, respectively. Consequently, the tariff range over 25 percent also showed a steady decline from more than 39 percent in 2001-02 to about 36 percent in 2004-05

Pakistan also signed various preferential trade agreements with different regional organizations such SAFTA and free trade agreements with China, Sri Lanka, Iran etc. Table 4 summarizes the average tariff rates as a result of these trade agreements based on WTO's tariff data for the year 2011.

Table 4

*Preferential and Free Trade Agreements*

Tariff Regimes Granted by Reporter (Excluding MFN)	Average of Maximum AV Duty
Free Trade Agreement duty rates for Bangladesh, Bhutan, Maldives and Nepal under the South Asian Free Trade Area (SAFTA)	5.13
Free Trade Agreement duty rates for India and Sri Lanka under the South Asian Free Trade Area (SAFTA)	9.29
Free Trade Agreement for China	8.74
Free Trade Agreement for Malaysia	8.97
Free Trade Agreement for Sri Lanka	2.29
Preferential duty rate for Mauritius	3.02
Preferential duty rate for the Islamic Republic of Iran	13.84

The average tariff rates under these agreements are much lower than that of the overall averages, i.e., 15.1 percent in 2011 and 14.8 percent in 2012 and 2013. Moreover, the imports from these countries are not subjected to regulatory duties. Although these country specific tariff rates are expected to promote trade and economic development, they also complicate the tariff structure by adding more layers to the existing range of duty rates. Complications also arise due to various kinds of exemptions given to individuals and businesses such as full or partial /reduced exemption from withholding tax on imports. As per world bank almost 60 percent of imports were exempted or given partial exemption equivalent Rs 128 billion as tax expenditure during the year 2011-12. Similarly, due to implementation of the regulatory duties in August 2008 on top of the custom duties also contributed to the complexity of the tariff structure. For instance, with a 5 percent custom duty the importer has to pay a total 29 percent import tax when accounted for the associated sales tax, special excise duty and income withholding tax.<sup>10</sup> The share of regulatory duties in total (HS) tariff lines is over 6 percent varying from 5 to 50 percent of cif prices with an average of 17.4 percent in 2008. The recent trade policy has however

<sup>10</sup> Pursell et al: Pakistan Trade Policies (2011)

announced its commitment that by the end of 2016-17 it will implement MFN tariff rate of four slabs and eliminate SROs to stimulate to stimulate growth and competition.

Another concern for the policy making was the tariffs on intermediate which cause anti-export bias by hampering the economic efficiency of the domestic industry. In order to tackle this problem reducing the import taxes on machinery has been one of the prime objectives of the trade policies. Except for the imports related to fresh fruits (HS 08) most intermediate products are given exemption from the regulatory duties and range of tariffs on these intermediate inputs is between 0 to 5 percent. This could be one of the reasons why consumer durable goods are subject to higher tariffs than industrial inputs. Although the cuts in import taxes on raw inputs increases domestic competition and discourages the local production and the government has to weigh associated costs and benefits from such a policy initiative. According to a study<sup>11</sup> published by Ministry of Commerce (2007) it is believed that consequent to the changes in tariff structure the cost structure of all industrial sectors have undergone drastic change, especially, from reducing input tariffs, that is, productivity gains from reducing input tariffs is higher than that of reducing output tariffs. However the report does not specify any relevant study to substantiate the claim but it appears plausible according to the economic theory that lower costs lead to higher production efficiency.

#### 4. EXPORT PROMOTION POLICIES

Export promotion has been at the heart of the trade liberalization policies in Pakistan. Historically, the exports have been performing poorly on account of *inter-alia* import substituting policies, including over-valued exchanged which caused anti-export biases. The protectionist policies have provided strong disincentives to exports by increasing the profitability of import substitutes relative to exports and induced shift of recourse from export sector. Another

---

<sup>11</sup> Study on Effective Protection of Manufacturing Industries In Pakistan, Ministry of Commerce 2007.

type of anti-export biases existed due to the escalation of tariff structure - lower tariffs on intermediate inputs and higher tariffs on processed goods has led to an increase in the effective protection of import substitutes. For instance, the maximum tariff rate for intermediate goods is 05 percent compared to 25 percent tariff rate on intermediate goods that are locally manufactured. The presence of these policies have continuously deteriorated the balance of trade over time. At a broader level it can be observed that exports share in total trade increased from 35 percent in 1985-86 to 48 percent in 2002-03 which eventually reverted back to 35 percent in 2012-13. However, in value terms the gap between imports and exports kept widening and peaked to USD 21.3 billion in 2011-2012 which decreased to USD 20.5 billion in 2012-2013. Exports grow at an average of 4.6 percent annually from 1987-88 to 2012-13 compared to 6.6 percent growth in imports.

The structure of Pakistan's exports is highly concentrated in just three sectors, with cotton related exports alone contributing to the about 50 percent in the total exports, followed by rice and leather exports each having a share in total exports of 8.8 and 4.8 percent, respectively, for the year 2011-12. The government's statistics indicate that the share of these three items has been declining over time from 71.5 percent in 2006-07 exhibiting some degree of diversification in overall exports. The intense competition from China, India and Bangladesh in world market for Pakistan's textile products coupled with domestic issues of law and order, power shortages and exchange rate fluctuations are key challenges for Pakistan's exports making diversification more desirable in the long run. One of the avenues for enriching the structure of exports is through promoting services exports and so far services export has not been encouraging even though it contributes to 55 percent of the country's GDP.

Pakistan's share in world's export has remained stagnant at 0.2 percent for during the last two decades (1989 to 2009). However, at disaggregate level the exports registered varying rates of growth. The Table 5 shows the relative share of each category in world's export with major contribution coming from manufactured goods of Textile and Leather items. It is pertinent to note that due to lack of technological advancement exports remained highly concentrated either in commodities or manufactures involving low-end technology, such as apparel and clothing accessories. For this reason export of machinery and transport equipment remains a major concern which has not shown any improvement with zero percent share in world's exports during the last two decades despite government interventions and incentives given time to time to boost industrialization.

Table 5

*Pakistan's Share in Worlds Exports at Disaggregate Level<sup>12</sup>*

Category	1989-94	1995-99	2000-04	2005-09
Food and live animals	0.20	0.30	0.30	0.40
Beverages and tobacco	-	-	-	-
Crude materials, inedible, except fuels	0.30	0.20	0.10	0.10
Mineral fuels, lubricants and related materials	-	-	-	0.10
Animal and vegetable oils, fats and waxes	-	-	0.10	0.20
Chemicals and related products, n.e.s	-	-	-	-
Manufactured goods classified chiefly by material	0.60	0.60	0.60	0.50
<i>Leather, leather manufactures</i>	2.10	1.40	1.30	1.50
<i>Textile yarn, fabrics, made-up articles</i>	2.60	3.00	3.10	3.40
Machinery and transport equipment	-	-	-	-
Miscellaneous manufactured articles	0.30	0.40	0.40	0.40
Articles of apparel and clothing accessories	1.00	1.00	1.10	1.20
Total	0.20	0.20	0.20	0.20

<sup>12</sup> Figures are based on SBP Research Bulletin, Vol. 6, No. 2, 2010

Historically, the weak performance of exports and growing burden of foreign debt have been key concern for the policy making. Incentives were given the industrial sector in order to deal with these issues and promoting industrialization to achieve economic growth. One of the first major incentives was the Export Bonus Scheme started during 1960s to subsidize manufactured goods by providing bonus vouchers and which also introduced multiple exchange rates. One study estimates that this scheme accounted for more than 80 percent of total subsidies (Kemal: 1978). This scheme was discontinued in 1972 after devaluation of the Pak rupee. Meanwhile, preferential credit was also made available to exporters on case to case basis to help meet their financing needs. The major policy initiatives were introduced in form of the rebate scheme started during 1960s and Export Refinance Scheme (ERS) which kicked off in 1973 to facilitate the non-traditional and emerging commodities. Later on all manufactured goods were included in 1977 to allow exporters avail credit facility at subsidized rates that were lower than the market rates by 0.5 percent in 1994 and 7.4 percent in 1994; the gap however reduced to a fixed rate of 2 percent in 2004.<sup>13</sup> Similarly, rebates and refunds are given mainly on account of duties paid the exporters on raw inputs used in manufacturing of exportable goods.

According to Lahir and Nasim (2006) these duties have acted as a direct tax on exports and caused anti-export biases. The authors observed that when government is less revenue concerned increasing rebates is welfare improving. Despite the tariff rationalization reforms started in 1987-88 the rebates were expected to decline; however their share as a fraction of total exports remained increasing till 1992-93 and reaching as high as 5.82 percent of exports. However, the impact of these incentives on exports remains a still a concern. In their time series analysis Haque and Kemal (2007) investigated impact of these subsidy schemes in Pakistan and

---

<sup>13</sup> These figures are based on the study of Haque and Kemal (2007).

noted that the results were insignificant and recommended to policy reforms should reassess the existing export promotion schemes.

Among various other challenges for promoting exports the menace of over-invoicing in export sector remained customary in Pakistan, which exploited these incentives given to the exporters. Mahmood and Azhar (2001) discusses the associated financial loss caused by the illicit practice of over-invoicing and undermined the effectiveness of the export promotion policies in Pakistan. The study recommends that in order to safeguard other exporters who are not involved in the illegal practice of over-invoicing the government should take appropriate steps in form of increasing scrutiny and documentation of individual cases entitled for rebate scheme.

The creation of Export Promotion Zones (EPZs) via EPZ ordinance in 1980 was another effort to accelerate the pace of industrialization in Pakistan and to enhance the volume of the exports by providing an enabling environment to both domestic and foreign investors. The major incentives give to businesses operating in these zones included: Duty-free import of machinery, equipment and material; exemption from national import and exchange control regulations and exemption from sales tax on input goods including gas and electricity. These special zones also enjoy certain facilities such as, availability of water, gas, electricity and peaceful environment (which are basics for any industrial unit in Pakistan). Currently, there are 10 EPZs out of which 08 are operational.

In line with above export promotion policy adopted from time to time the Strategic Trade Policy Framework 2012-15 highlights further commitment to improve the country's export performance. The major aspects of this framework include, facilitating the development of e-commerce, establishment of Export Import Bank (EXIMBANK) and providing full (100 percent)

and partial (50 percent) subsidies on cost of plants and machinery to improve the cost efficiency of firms operating in Pakistan. Moreover, the government also aims at exploring new markets to export its manpower which historically has been contributing significantly in form of foreign remittances. Pakistan ranks 7<sup>th</sup> in terms of largest recipient of officially recorded remittances in the world where remittances cover more than 30 percent of exports. However, the success of these initiatives would depend however on the effectiveness and timeliness of implementation of the framework in order to achieve the desired goals.

## 5. CONCLUSION

Pakistan adopted ISI strategy for industrialization and enforced various kind of trade barriers to provide protection to the domestic industry. The protectionist policies remained in place for a very long period until it was realized that openness to trade was necessary to achieve the desirable goals of economic development and prosperity. The protectionist policies were observed but they did not contribute much in terms of economic growth and instead resulted in anti-export biases that negatively affected the export sector. The liberalization reforms started in 1980s and subsequently in late 1990s with efforts from donor agencies, such as World Bank, IMF and WTO stirred growth in many sectors, especially during the period from 1997-98 till 2002-03. These efforts led to rationalization of tariff structure and implementation of policies related export promotion; however, Pakistan is still far from full liberalization. Despite these efforts the existing tariff structure remains complicated and requires serious considerations to streamline the trade policy, especially, the existing maximum tariff should be reduced and protectionist policies in automobile sector should be revised to enhance competition and growth of the sector. Furthermore, the trade policy also needs to be reassessed in terms of high tariff

rates on consumer goods compared to intermediate industrial inputs so that undue burden of high consumer prices could be reduced.

## REFERENCES

- Abe, K. (1992). "Tariff Reform in a Small Open Economy with Public Production" *International Economic Review* 33, 209–222.
- Alan D. Woodland. (1982.) "International Trade and Resource Allocation" North-Holland, Amsterdam and New York.
- Government of Pakistan. *CBR Year Book* (various issues). Islamabad: Central Board of Revenue.
- Government of Pakistan. *Economic Survey* (various issues). Islamabad: Finance Division.
- Government of Pakistan. "Effective Protection of Manufacturing Industries In Pakistan" Islamabad: The Ministry of Commerce.
- Government of Pakistan. *Pakistan Statistical Survey 2013*. Islamabad: Federal Bureau of Statistics.
- Government of Pakistan. Trade Policy speeches (various issues). The Trade Development Authority of Pakistan.
- Hatzipanayotou, Panos, Michael S. Michael and Stephen M. Miller, "Win-Win Indirect Tax Reform: A Modest Proposal," *Economics Letters* 44 (1994):147-51.
- Hussain, F. (2010), Pakistan's Exports Demand: A Disaggregated Analysis. SBP Research Bulletin, Vol. 6, No. 2.
- Kemal, A. R. (1978) An Analysis of Industrial Efficiency in Pakistan: 1959-60 to 1969-70. Unpublished Ph.D. Thesis, University of Manchester.
- Keen, M. and J. E. Ligthart. (2002). "Coordinating Tariff Reduction and Domestic Tax Reform," *Journal of International Economics* 56, 489–507.
- Lahiri, S., A. Nasim and J. Ghani. (2000). "Optimal Second-Best Tariffs on an Intermediate Input with Particular Reference to Pakistan," *Journal of Development Economics* 61, 393–416.

- Lahiri, S., & Nasim, A. (2005). Commercial policy reform in Pakistan: Opening up the economy under revenue constraints. *International Tax and Public Finance*, 12, 723–739.
- Lahiri, S., & Nasim, A. (2005). Export-promotion under revenue constraints The case of tariff-rebate on intermediate inputs in Pakistan. *Journal of Asian Economics* 17 (2006) 285–293.
- Mahmood, Z., and M. Azhar (2001) On Overinvoicing of Exports in Pakistan. *The Pakistan Development Review* 40:3, 173–85.
- Museleh et al. (2007). Recent Experience and Future Prospects of Pakistan's Trade with China. *Lahore Journal of Economics*.
- Nadeem Ul Haque & M. Ali Kemal, 2007. "Impact of Export Subsidies on Pakistan's Exports," PIDE-Working Papers 2007:26, Pakistan Institute of Development Economics.
- Pitt, Mark M., 1981. "Smuggling and price disparity," *Journal of International Economics*, Elsevier, vol. 11(4), pages 447-458, November.
- Pritchett, Lant & Sethi, Geeta, 1993. "Tariff rates, tariff revenue, and tariff reform : some new facts," Policy Research Working Paper Series 1143, The World Bank.
- Pursell, Garry, Ashraf Khan, and Saad Gulzar (2011). "Pakistan's trade policies: future directions." International Growth Center Working Paper.
- Siddiqui, Rizwana, and Zafar Iqbal (1999). "Tariff Reduction and Functional Income Distribution in Pakistan: A CGE Model. Paper presented at the workshop on Micro Impact of Macroeconomic Adjustment Policies," November 9, 1999, Islamabad, Pakistan.

VITA

Graduate School  
Southern Illinois University

Shahid Karim

shahidkarim@gmail.com

Shaheed Zulfiqar Ali Bhutto Institute of Science and Technology

Bachelor of Business Administration, May 2007

Shaheed Zulfiqar Ali Bhutto Institute of Science and Technology

Master of Business Administration, May 2010

Special Honors and Awards:

Fulbright Scholarship, 2012-2014

Research Paper Title: Trade Policy Reforms in Pakistan

Major Professor: Dr. Sajal Lahiri