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Analysis

Pakistan's Trade Liberalization Experience

Ishrat Husain*

Pakistan has been one of the fastest growing economies in Asia for last five years. Economic growth rates have risen from 1.8 per cent in 2000/01 to average 6-7 per cent a year. For Pakistan these rates are not spectacular but a reversion to the average longer term growth rate.

The average annual growth rate of GDP over 60 year period of Pakistan has been 5.2 per cent. In the five years ending 2006-07, manufacturing sector output grew by over 15 per cent, exports doubled in US dollar terms and an open trade regime has allowed imports to triple. Tax revenues have risen by 14 per cent a year reducing the fiscal deficit, which used to average 7 per cent a year in the 1990s to average 4 per cent now. The external debt burden has been halved from 52 per cent to 26 per cent of GDP and is projected to decline further. The country's capacity to service its debt has considerably improved as the debt servicing ratio, which used to pre-empt almost 60 per cent of public revenues, is now down to 28 per cent. The incidence of poverty has fallen from 34 per cent to 24 per cent according to official estimates and 29 per cent according to the World Bank. Unemployment is down to 6.5 per cent from 8.4 per cent

One of the factors contributing to Pakistan's growth performance is Pakistan's track

record on trade liberalization reforms. According to a World Bank study 'Pakistan's recent reforms have been substantial. Its trade regime is now one of the more open in South Asia. It has the lowest applied average tariff rates of the three large South Asian economies India, Pakistan and Bangladesh. Pakistan reached this position by reducing the number of tariff band to 25 per cent. Unlike Sri Lanka and Bangladesh, and indeed most countries around the world, Pakistan has not shied away from opening its agriculture sector. In addition, the government eliminated quantitative restrictions, regulatory duties and other para tariffs and several other measures that restricted trade in the past. Finally, it reduced the number of statutory regulatory orders (SROs) and the exemptions granted under these orders. Ordinary custom duties are now the principal instrument of trade policy. Improvement in Pakistan's incentive structure and export environment surely contributed to its strong export performance in recent years.'

The speed with which trade liberalization has taken place during the last decade is impressive. The maximum tariff was reduced from 80 per cent in 1995, and the simple average applied rate is 15 per cent compared to 51 per cent in 1995. The average import weighted tariff rate in 2006-07 was around 8 per cent. The number of regulatory duties has declined significantly. Virtually all tariffs (99.3 per cent) are ad-valorem and resolve around only six slabs including zero. Local content requirements have been eliminated in all sectors and policies have been brought in compliance with TRIMS agreements.

Paper of the Month

The paper of the month for June 2008 was **Measuring Tariff Equivalents in Cross-Border Trade in Services** by Soon-Chan Park.

Latest News

The first conference in a major new EABER project with Dhurakij Pundit University will take place 15-16 July in Bangkok. The topic will be Financing Higher Education and Economic Development in East Asia.

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State trading has been restricted to a few selected items only and not on a regular basis or under monopoly conditions. All public sector corporations engaged in trading activities have been disbanded except one, that is, the Trading Corporation of Pakistan (TCP). TCP intervenes selectively to cope with domestic demands of essential conditions as and when explicitly decided by the Cabinet.

The number of concessionary notifications in tariffs (SROs) has been reduced substantially. Customs clearance system and international trade related procedures have been streamlined to bring them at par with international best practices and make them compliant with international standards and conventions.

Export facilitation and promotion have been the main focus of Export policies and export subsidies, rebates and refunds have been gradually phased out or curtailed in scope and coverage.

The impact of these measures is reflected in the huge growth in trade. It would be reasonable to surmise that as a result of trade policy reforms, anti export bias in manufacturing, agricultures and for services has declined substantially. But relative to the countries in East Asia, Pakistan still has a long way to go.

A study carried out by an independent research institute – the Social Policy Development Centre (SPDC) - using both partial equilibrium and the general equilibrium impact of trade liberalization and the simulations for the future concludes that, contrary to popular beliefs and perceptions, the process of trade liberalization in Pakistan does not appear to have had a significant adverse impact on poverty and income inequality. These results indicate that trade liberalization has,

if anything, reduced poverty and inequality although only modestly so on balance. The main channels of transmission leading to this outcome are growth, productivity, investment and price stability. Foreign direct investment that has come into Pakistan does appear to increase income inequality as it is focused on sectors that use highly skill labour and capital intensive technologies and does not use much of the abundant factor of production, labour. This finding is also consistent with a recent IMF study on the impact of FDI flows to developing countries. Some industries do seem to have suffered from trade liberalization but the necessary adjustments are being made to maximise the net gains. One particular adjustment cost relates to fiscal adjustments. The lower government revenue from a reduction in import tariffs has been fully neutralized by other modes of direct and indirect taxation and development expenditures, without which the impact on poverty and income inequality would have been larger. Thus, trade liberalization policies need to be pursued in conjunction with government revenue-neutral policies.

Despite pressure and protests from rent seeking businesses, the risks of reversal of these reforms are low as the main political parties are not only committed to trade liberalization but have actually been behind the implementation of these reforms in the decade of 1990s. institution's legitimacy will be called into question.

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