Tariffs & export expansion

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NO country has achieved prosperity by relying solely on its domestic markets. The spectacular success of China, despite having a large market of 1.4 billion people, is primarily attributed to its integration into the world economy. In merely three decades, China has become the top exporting nation.

Notably, our neighbours India and Bangladesh have also progressed since 1990 by actively participating in the global economy. Vietnam, once a war-shattered country with a lower export level than Pakistan until 1996, exported $371bn of goods, equal to 106 per cent of GDP, in 2022, while Pakistan hardly reached $30bn, or 8pc.

Had Pakistan retained its share in the 1990s' global exports of 0.15pc, it could have generated $50bn by 2024-25. Unfortunately, our global share has slid to an average of 0.08pc in the 2020s. Export earnings of $50bn would have prevented recurring crises and reliance on external borrowing, preserving economic sovereignty.

All major political parties seem to agree that Pakistan must recapture its lost market share and reduce its dependence on external borrowing. This implies surpassing other countries in pricing, quality, reliability, and the timely delivery of goods and services. Regaining its market share would enable accelerated economic growth and jobs for the youth as well as act as a buffer against external shocks. The recent debate in parliament focused on how tariff rationalisation can achieve the export expansion target. One cannot expect a single instrument such as tariff rationalisation alone to deliver the desired results; the matter must be seen in the larger context of enhanced competitiveness. It should be conceded that there will be losers and winners and that some industries won't survive while new ones would emerge.

The challenge of improving competitiveness is intricate, as states do not directly compete. Rather, it is the myriad firms, enterprises, and companies within them that compete under a national policy and institutional framework. Hence, a comprehensive analysis of competitiveness means a two-layered approach — at the national and firm level.

A conducive national environment entails well-functioning governance institutions, streamlined investment climate, emphasis on human capital, especially female labour participation, rationalised tariffs and taxes, flexible exchange rate policy and policies for the promotion of exports. At the firm level, investments in upskilling the workforce, professionalised management structures, collaboration with international experts, engagement in joint ventures with foreign companies, participation in global value chains, service exports, innovation, and digitalisation are imperative.

We can't expect a single instrument such as tariff rationalisation alone to deliver the results.

With tariff reform planned over the next five years, some complementary changes are needed. First, overregulation and high entry barriers disadvantage firms in the formal sector, with only 5pc of businesses accounting for 76pc of exports. Regulatory reforms have been underway for the last five years and should be brought to a culmination point. By eliminating outdated rules, streamlining processes in land acquisition and SEZs, and providing access to finance, a conducive environment is created for new entrants. Persisting difficulties in navigating bureaucracy and securing approvals hinder business growth and innovation. Facilitating ease of entry and exit is crucial to break rent-seeking practices, promote efficiency and encourage new ventures.

Second, dedicated commercial courts and alternative dispute resolution mechanisms should be set up to enforce contracts speedily and avoid protracted litigation which acts as a barrier, keeping resources trapped in low-productivity firms.

Third, energy prices should be determined in a competitive market consisting of multiple buyers and sellers without intervention by the regulator or government.

Fourth, the Export Facilitation Scheme and Export Development Fund should be aligned with international best practices and the excessive tax burden on the export sector eliminated.

Fifth, proliferating new technologies have spurred advanced production and processing methods, elevating the need for knowledge-based skilled workers. Platform economies, encompassing online sales, technology frameworks, and transaction platforms are gaining traction. Public-private partnership in resolving skill shortages must be incentivised.

Finally, tariff rationalisation. Our highly protected economy relies heavily on high output tariffs, a significant source of rents for shielded firms. Profitability for sectors with strong trade protection is more than double that of other industries, leading to pressure from political and business lobbies to maintain high tariffs. While economists agree on time-bound, performance-related protection for infant industries, Pakistan continuously extends concessions and high tariff rates, resulting in low entry and exit rates for exporting firms, reduced product diversification, unchanged sectoral composition since the 1990s, and heightened geographical concentration.

Though the latest estimates of effective rates of protection are unavailable, a previous PIDE study suggested a decline in the early 2000s. However, introduction of additional customs and regulatory duties in the last five years has increased ERPs, with the average rate rising from 12pc in FY15 to almost 20pc in FY20 — double that of our competitors' and China's 5pc. In a world dominated by global value chains, tariffs on imports of components, ancillary supplies and intermediate inputs act as a tax on exports. Reducing import duties helps minimise input costs, enabling downstream industries — automobiles, construction, consumer electronics, engineering goods — to become competitive in third-country markets. Despite protection, auto-grade steel isn't domestically produced, hindering the fabrication of certain auto parts. Similarly, pharma faces challenges as active ingredients are imported. High tariff rates impede industries in sunrise sectors from scaling up, reducing unit costs and becoming competitive globally. In fast-moving market dynamics, static input-output coefficients lose relevance.

Meanwhile, the private sector needs a radical mindset shift. While blaming the government is often justifiable, owners must reconsider their own attitude towards workers and recognise them as key partners, invest in R&D, and explore new markets. Professionalising the management cadre, utilising management consultancy and adopting international benchmarks and best practices are additional enablers.

As these targets and action plans evolve, maintaining consistency, continuity, coherence, coordination and predictability is paramount. To that extent, open debate and discussion in parliament signals that these reforms, once agreed upon, will not be abdicated if a new political party comes to power in 2029.

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