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Trade Liberalization in Pakistan: An Alternative Perspective

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Abstract: *This study narrates the history of trade liberalization in Pakistan from 1972 to 2021. It outlines the history of trade reforms, which is divided into three distinct periods: the partial trade liberalization period from 1972 to 1987, the trade liberalization period from 1988 to 2004, and the post-liberalization period from 2005 to 2021. Existing studies of trade liberalization often overlook the underlying explanations, which frequently fall within the realm of history and interests. This paper addresses that gap and discusses the significance of domestic and international political economy factors leading up to trade liberalization. In Pakistan, trade liberalization did not coincide with compensatory real devaluation of the currency, as the exchange rate policy prioritized price stabilization. Consequently, domestic policy rates remained high, resulting in an overvaluation of the currency, which significantly reduced the rate of capital accumulation. The consumption-driven trade liberalization contributed to the phenomenon of premature deindustrialization. As a result, the country experienced low economic growth.*

Keywords: Deindustrialization, Protectionism, Tariff, Liberalization, Globalization.

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1. Introduction

Pakistan's economy has become consumer-driven at a low level of per capita income.[1] The rise in real income, following the emergence and expansion of the middle class, has boosted consumption levels within the economy. The pressure and expectation from the majority of the population to maintain higher consumption levels arise from both domestic and international demonstration effects. This consumerism has strengthened the relative power of various interest groups, which in turn has fueled trade liberalization in Pakistan. Consequently, the reduction in tariffs has encouraged consumerism aimed at imported goods and services, resulting in consumption-driven import liberalization in Pakistan.

Trade liberalization relies on 'efficientist' measures, combining import liberalization with exchange rate reform. Morrissey (1995) stated that import liberalization entails reducing tariffs to align with world prices, dismantling quantitative restrictions, and easing access to the foreign exchange market, while exchange rate reform seeks to align the currency closer to its equilibrium level. He further emphasized that the economic objective of trade liberalization is to stimulate economic growth through exports. Additionally, Morrissey (1995) suggested that trade liberalization could advance more rapidly with increased political commitment and enhanced institutional capacity.

The policy of trade liberalization gradually gained prominence as neo-classical trade theory questioned the role of protectionism in promoting economic growth. This theory has guided the development agenda of International Financial Institutions (IFIs), such as the World Bank and the International Monetary Fund (IMF), since the 1980s. Furthermore, multilateral regulatory institutions overlooked the heterogeneity and diversity of countries, applying uniform rules (Alonso, Cornia et al. 2014). Time and again, these multilateral institutions insisted that successive Pakistani governments enhance trade liberalization reforms. Pakistan's bureaucracy has absorbed neo-classical trade theory from either Western academia or executive training programs offered by

[1] Pakistan's GDP per capita (constant $ 2010) was $ 1357 in 2015.

IFIs, as these institutions aligned with the liberal factions within the bureaucracy.

Many Pakistani academic scholars and practitioners, including Abdul Qayum, Ashfaq Hasan Khan, A. R. Kamal, Riaz Riazuddin, and Rizwana Siddiqui, supported 'efficientist' measures. They contended that the economic policy paradigm remained anti-export because of the exemptions and concessions afforded to import substitution industries. In this context, Riazuddin (1994) proposed a phased reduction of tariffs to redirect resources toward more efficient industries. He conveyed optimism that the long-term benefits of tariff reductions would surpass the short-term costs of displacement. Khan (1998) asserted that trade liberalization is crucial for economic growth in Pakistan.

Furthermore, Khan and Qayyum (2007) conducted an econometric study on trade liberalization, finding that it enhanced economic growth in the long run and further suggested the acceleration of trade liberalization reforms. Similarly, Siddiqui et al. (2008) contended that Pakistan's trade regime remained restricted due to import bans and various forms of trade restrictions in the 1980s. However, these studies adhered to economic rationalism and overlooked the long-term effects of trade liberalization on industrial performance, which in turn led to decelerating growth and a decline in social consumption. McCartney (2015) posed a pertinent question: Under what conditions is trade liberalization beneficial for economic growth in Pakistan? The aforementioned studies neglected the underlying explanations, which often lie within the realms of history and interests. This paper addresses that gap by narrating the history of trade liberalization and discussing the domestic and international political economy factors that contribute to trade liberalization in Pakistan.

The next section discusses the significance of protectionism in promoting industrialization. Section 3 details the history of trade liberalization, divided into three distinct periods: partial trade liberalization from 1972 to 1987, trade liberalization from 1988 to 2004, and the post-liberalization period from 2005 to 2021. During the partial trade liberalization, the government employed import-weighted average tariffs to protect domestic industries. In the trade liberalization period, the government reduced tariffs but could not implement a compensatory real devaluation of the currency. The post-liberalization period witnessed a continuous stream of trade reforms that exposed domestic industries to international competition. Section 4 examines the domestic and international political economy of trade liberalization in Pakistan. Sections

5 and 6 describe the effects of trade liberalization on social expenditure and industrial performance, respectively. Section 7 concludes the paper by discussing the potential for extension.

2. Literature on Protectionism

The narrative of economic development shows that protecting infant industries played a significant role in promoting the necessary structural changes and, consequently, industrialization within an economy. Frederick List (1885), a prominent advocate of infant industry protection, traced the history of English industry and argued convincingly that industrial development could not occur without state intervention. Tariffs, especially during the early stages of economic development, can help domestic industries thrive and increase the likelihood of more profitable future exchanges for a country. Therefore, O'Rourke (2000) demonstrated that tariffs were positively associated with economic growth in the late nineteenth century. The relationship between tariffs and economic growth continues to intrigue economic historians, development economists, and practitioners. The ambiguity surrounding tariffs and growth extends beyond the theoretical level. For instance, the existing empirical literature presents mixed evidence on the issue (see Harrison and Rodríguez-Clare for a literature survey).

In the 1950s and 1960s, the development paradigm was dominated by structuralists, [2] who advocated for protecting infant industries in developing countries. This led to recommendations for import substitution industrialization to maintain market size. Pakistan was no exception; it adopted import substitution industrialization to accelerate economic development, targeting the highest possible growth rate of per capita income. The government implemented policies such as higher average tariffs, import licensing, and quota restrictions.

Unlike mainstream economics, much of the peripheral literature in the discipline assigns a favorable role to tariffs, considering them as one of the key institutions[3] that significantly contributed to the structural transformation of developing countries. On this basis, Ha-Joon Chang (2002) argued, through the analogy of the ladder, that developed countries climbed it to achieve industrial supremacy and then kicked it away. Chang

[2] Structuralist is a current of economic thought which recognizes the heterogeneity of conditions in different countries and between sectors within countries. The notable structuralists were Raul Prebisch, Celso Furtado, Osvaldo Sunkel and Lance Taylor.

[3] Ha Joon Chang (2002) called tariff as an institution, while raising and lowing tariff as a policy.

(2003) further pointed out that free trade policies in developing countries resulted in economic stagnation during the 1980s and 1990s. He refined his argument by examining the role of dynamic comparative advantage while engaging in a debate with Justin Lin in 2012, which focuses on endogenously nurturing the manufacturing base to attain comparative advantage over time (Lin and Chang 2012).

Another group of scholars also took a favorable view of protection through tariffs and its positive association with economic growth. Bruton (1998) believed that the primary sources of development were learning and knowledge accumulation, which should be protected. Moreover, Stiglitz and Charlton (2005) conducted a detailed study of 52 developing countries, upholding the importance of protectionism through tariffs for industries where developing countries lacked a comparative advantage. They argued that tariffs nurture infant industries, while the removal of tariffs exposes them to external shocks. These shocks can dismantle infant industries and create joblessness, which, in turn, increases the cost of adjustment for poorer countries. Similarly, Nayyar (2007) mentioned that trade liberalization led to the exit of domestic firms, which would weaken the economy's capacity to respond to changes in relative prices. Lastly, Stiglitz and Charlton (2005) differentiated between free and fair trade, emphasizing that fair trade policies could be promoted among developing countries, allowing them to implement tariff barriers to nurture and promote their infant industries. The literature demonstrates the importance of the right form of protectionism in promoting economic development, which has been overlooked by scholars in Pakistan. The next section details the history of trade liberalization and its connection to the overvalued exchange rate.

3. History of Trade Liberalization in Pakistan

The following sections discuss the history of trade liberalization from 1972 to 2021, divided into three distinct periods based on trade reforms: the partial trade liberalization period from 1972 to 1987, the trade liberalization period from 1988 to 2004, and the post-liberalization period from 2005 to 2021. During the partial trade liberalization period from 1972 to 1987, the state primarily protected the domestic industry through high import-weighted average tariffs,[4] quantitative restrictions, and an import licensing system.

[4] Import weighted average tariff is a way to measure the average tariff rate. It is calculated as custom collection/nominal merchandize imports.

The trade liberalization period coincided with the rise of neoliberal policies when the government of Pakistan implemented the IMF's Structural Adjustment Programs. This era was characterized by low import-weighted average tariffs and the dismantling of the import licensing system. Subsequently, the post-trade liberalization period continued the dominance of international policies, resulting in a noticeable decline in import-weighted average tariffs and the abolition of quotas. Multilateral institutions neither acknowledged the initial conditions nor recognized the diversity among countries, which reduced domestic policy space (Alonso, Cornia et al. 2014).

3.1 Partial Trade Liberalization from 1972 to 1987

The period of partial trade liberalization was marked by high import-weighted average tariffs, the elimination of some import licensing, and a gradual relaxation of quantitative restrictions on imports. During the 1970s, the maximum tariff rates reached approximately 225 percent, as illustrated in Table 1. The tariff structure was designed to be the lowest for industrial raw materials, slightly higher for intermediate goods, and the highest for luxuries and finished consumer goods, a system known as cascading[5]. The import-weighted average tariff rate rose from 18.1 percent in 1972 to 22.2 percent in 1977, indicating that protectionism remained strong during this period to support the domestic market's size. Consequently, James and Seiji (1990) argued that higher average tariffs, restricted quota licenses on imports, and indirect taxes on imports favored import substitution industries throughout the 1970s. However, the devaluation of the Pakistani rupee from Rs. 4.76 per dollar to Rs. 11 per dollar in May 1972 marked the first step toward liberalizing trade.

Table 1: Maximum Tariff Rate and Import Weighted Average Tariff from 1972 to 2021

Year	Maximum Tariff Rate %	Import Weighted Average Tariff %
1972	225	18.11
1973	225	21.92
1974	225	18.93
1975	225	21.58
1976	225	21.02
1977	225	22.24
1978	225	20.79
1979	225	22.73

[5] Cascading means that raw materials are imported without duties while restricting the imports of value-added products in order to promote local production.The cascading resulted into 17 tariff slabs.

Year	Maximum Tariff Rate %	Import Weighted Average Tariff %
1980	225	23.98
1981	225	25.61
1982	225	23.28
1983	225	26.48
1984	225	26.19
1985	225	24.91
1986	225	32.80
1987	225	32.94
1988	125	32.03
1989	125	28.87
1990	125	31.49
1991	95	25.04
1992	90	26.16
1993	90	23.57
1994	80	23.53
1995	70	21.31
1996	70	20.22
1997	65	17.98
1998	45	17.73
1999	35	12.92
2000	35	10.58
2001	30	10.31
2002	30	7.13
2003	25	9.24
2004	25	8.28
2005	25	7.55
2006	25	7.57
2007	25	6.77
2008	25	5.05
2009	25	5.60
2010	35	5.12
2011	35	4.88
2012	25	5.30
2013	25	5.29
2014	25	5.03
2015	25	6.73
2016	25	8.27
2017	25	8.15
2018	25	8.31
2019	25	9.07
2020	25	8.44
2021	25	6.48

Note: Import Weighted Average Tariff= Custom Collection/Merchandize Imports
Source: Author's Calculation from World Development Indicators (WDI) Dataset.

The military regime of Zia-ul-Haq[6] came to power in 1977. The domestic industry remained partially protected through tariffs from 1978 to 1987. In this context, the maximum tariff rate was maintained at 225 percent, as shown in Table 1. The import-weighted average tariff rate fluctuated from 20.8 percent in 1978 to a peak of 32.94 percent in 1987. Therefore, Sayeed (1995) noted that the nominal tariff for manufacturing was among the highest in 1986. The state was gradually moving toward import liberalization; consequently, many non-tariff barriers, particularly quantitative restrictions, were replaced with tariffs in 1983. However, tariff slabs were reduced from 17 to 10 in 1987, and the average tariff for capital goods decreased from 61 percent to 51 percent. The state continued to implement protectionist policies and even imposed a 5 percent import surcharge during this period (Zaidi 2015). Pakistan adopted a managed float exchange rate regime in 1982 to balance flexibility and discipline in exchange rate management.

The influence of the neoliberal paradigm was strongly felt in the early 1980s. Pakistan began to adhere to this paradigm and took a Structural Adjustment Loan (SAL) in 1980; the IMF advised liberalizing the trade regime. Similarly, the World Bank emphasized import liberalization and repeatedly insisted to Pakistan that its trade regime remained restrictive. This is referred to as a new orthodoxy by Bruton (1998).

Table 2: Period Averages of Industry, Manufacturing and GDP Growth Rate from 1972-1987

Average Share of Industry in GDP (Percentage)	Average Share of Manufacturing in GDP (Percentage)	Average GDP Growth Rate (Percentage)
23.0	15.8	5.8

Source: Author's Calculation from Pakistan's Bureau of Statistics Data.

3.2 Trade Liberalization Period from 1988 to 2004

After discussing the partial trade liberalization period, we now incorporate the discourse surrounding the trade liberalization period into our narrative. This period, from 1988 to 2004, marked the triumph of the neoliberal era, characterized by small governments. More than half of this

[6] General Zia-ul-Haq ousted Zulfiqar Ali Bhutto and charged him murder but also started reforms in the name of a purge campaign.

time was defined by a democratic dispensation[7] from 1988 to 1999, followed by a military regime from 1999 to 2004. Regardless of the political context, a continuity of trade liberalization measures was observed. This era was characterized by gradual tariff reforms, the abolition of the import licensing system, and the ongoing removal of non-tariff barriers and exemptions.

Under this emerging international context, Pakistan entered into a Structural Adjustment Program (SAP) with the IMF in 1988. At that time, the fiscal deficit was 8.5 % of GDP, which prompted macroeconomic stabilization. Although Pakistan had previously taken loans from the IMF in the 1970s without conditions, this entry was markedly different as numerous conditions were attached to align the trade regime with world markets. To promote a specific trend, the World Bank (1988) corroborated that the trade regime in Pakistan was biased in favor of import substitution, where domestic markets remained insulated from foreign competition due to high tariffs and non-tariff barriers. The SAP led to comprehensive tariff reform in 1988 when the maximum tariff rate[8] was drastically reduced for the first time from 225 percent to 125 percent, as shown in Table 1. Consequently, the import-weighted average tariff rate declined from 32 percent in 1988 to 25 percent in 1991.

Pakistan implemented a series of Structural Adjustment Programs (SAPs) under the close guidance of the IMF and the World Bank, accepting 'conditionality' to alter the policy regime in exchange for loans[9] (Zaidi 2015). These reforms abolished the import licensing system in 1991, allowing the import of nearly all items except for a few restricted on the grounds of religious, health, and security considerations. The number of tariff slabs was reduced to six in 1993, and tariffs on capital goods were further cut[10], which also lowered the weighted import tariff to 20.2 percent. Based on this reduction, Riazuddin (1994) noted that imports would surge and the Balance of Payments (BOP) would worsen in the short term. In another reform, non-tariff barriers were replaced with tariffs[11] and the existing five percent import surcharge was merged into the tariff rate

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[7] From 1988 to 1999, there were four democratic governments of two political parties one after the other.

[8] The tariff rate was decreased for 670 items out of 3200.

[9] Zaidi (2015) differentiated between Structural Adjustment Loans and Structural Adjustment Programs on the basis of strings to be attached to the latter.

[10] The engineering and chemicals were the only exception which remained protected. Specifically, the maximum tariff rate was further reduced from 125 percent in 1990 to 70 percent in 1996

[11] The World Bank and the IMF as champions recommended replacement of non-tariff barriers with tariffs as latter was deemed to be less efficient.

(WTO 1995). Pakistan's trade policy regime remained under close scrutiny from multilateral institutions during the 1990s. The maximum tariff rate was further lowered to 35 percent in 1999, and the weighted average import tariff rate was nearly halved from 25 percent to 13 percent between 1990 and 1999, as shown in Table 1. Additionally, Pakistan adopted a unified exchange rate regime in May 1999 to promote trade liberalization.

The military regime[12] of Pervaiz Musharraf came to power in 1999, and Pakistan continued its trade liberalization reforms during his tenure. Under the direction of the IMF, Pakistan opted for one program in 2000 and another in 2001. The maximum tariff rate was reduced from 35 percent in 2000 to 25 percent in 2004, while the import-weighted average tariff decreased from 13 percent in 1999 to 8.3 percent in 2004. In addition to tariff reductions, exemptions through SROs[13] were further minimized, which ultimately accelerated the pace of liberalization.

Table 3: Period Averages of Industry and Manufacturing Shares in GDP, GDP Growth Rate from 1988-2004

Average Share of Industry in GDP (Percentage)	Average Share of Manufacturing in GDP (Percentage)	Average GDP Growth Rate (Percentage)
24.3	16.3	4.7

Source: Author's Calculation from Pakistan's Bureau of Statistics Data.

3.3 Post Liberalization Period from 2005 to 2021

After outlining the trade liberalization period, this section discusses the post-liberalization era from 2005 to 2021. The post-liberalization period included a military regime[14] from 2005 to 2008, followed by democratic administrations from 2008 to 2021. Despite noticeable differences in the political regimes, the process of trade liberalization reforms continued unabated in Pakistan. Although the maximum tariff rate remained at 25 percent, the import-weighted average tariff rate fell from 7.6 percent in 2005 to 5.1 percent in 2008. Additionally, the applied weighted mean tariff in Pakistan decreased from 23.1% in FY2000 to 8.9% in FY2014.

[12] General Pervaiz Musharraf ousted the democratically elected Prime Minister in 1999 and charged him with treason.
[13] There were 250 SROs in 2002 which quickly went down to 60 in 2004.
[14] General Pervaiz Musharraf stepped down from the Presidency in 2008.

The Global Financial Crisis (GFC) of 2007-08 prompted a reassessment among multilateral institutions, sparking a debate on industrial policy aimed at facilitating structural changes in the economy. Discussions emerged around protectionism, positing that infant industries should be nurtured in developing countries and that tariffs could serve as a policy tool in this context (Lin and Chang 2012). The financial crisis temporarily enabled the Pakistani government to raise the maximum tariff rate to 35 percent in 2009 and 2010, as shown in Table 1, without any significant policy reversal. However, this maximum tariff rate was subsequently reduced from 35 percent to 25 percent in 2011. Nevertheless, the import-weighted average tariff rate remained stagnant at approximately 5 percent from 2008 to 2013, as illustrated in Table 1.

The democratic government[15] came to power in 2008 after the military regime continued existing practices. This period was characterized by ongoing tariff reforms, increased uncertainty stemming from the global financial crisis (GFC), and domestic political instability[16]. The combination of increased imports, as previously noted, due to trade liberalization, political instability, and the GFC led to a balance of payments (BOP) crisis, forcing the government to turn to the IMF[17].

The democratic regime completed its term in 2013, and a new democratically elected government took office[18]. The new government negotiated an agreement with the IMF[19] to avert a balance of payments crisis and continued the tariff reforms. In this regard, the number of tariff slabs was further reduced to four in 2013, and the SRO regime was eliminated in 2014 to provide a level playing field for all importers. However, the maximum tariff remained at 25 percent, while the import-weighted average tariff slightly increased to 6.48 percent in 2021. Consequently, the customs collection to total revenue ratio increased to approximately 14.5 percent in 2021.

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[15] The democratic government has been called the era of electoral politics by Zaidi (2015). The coalition government of Pakistan People's Party came to power after the resignation of General Pervaiz Musharraf in 2008.

[16] The transition to democratic regime, war on terror and judicial activism of the Supreme Court of Pakistan contributed to political instability in the country.

[17] The Government of Pakistan opted for Standby Program of the IMF in 2008 which carried on until 2011.

[18] The Pakistan Muslim League Nawaz won the election with a sizeable majority and came to power. Then Pakistan Tehreek-e-Insaaf (PTI) remained in the government from 2018 to 2022.

[19] The government negotiated the Extended Fund Facility (EFF) with the IMF from 2013 to 2016.

Table 4: Period Averages of Industry and Manufacturing Shares in GDP, GDP Growth Rate from 2005-2021

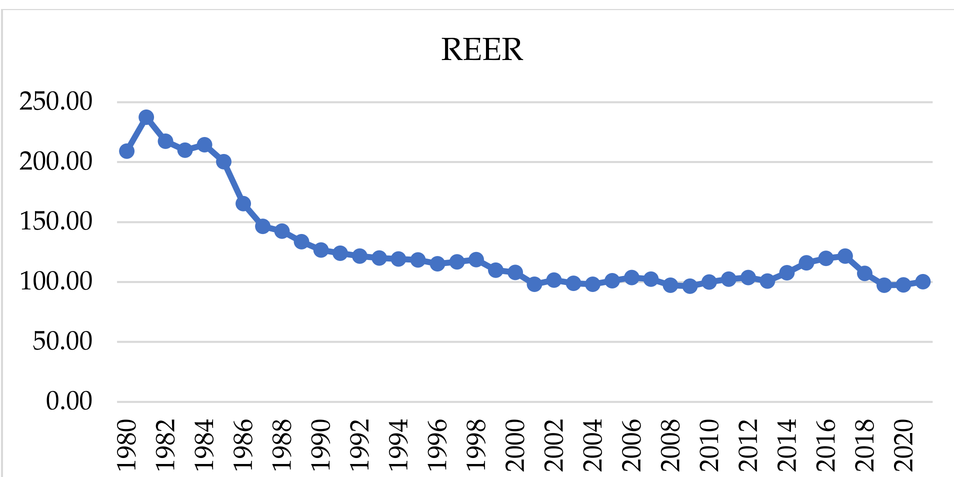
Average Share of Industry in GDP (Percentage)	Average Share of Manufacturing in GDP (Percentage)	Average GDP Growth Rate (Percentage)
19.12	11.93	3.94

Source: Author's Calculation from Pakistan's Bureau of Statistics Data.

3.4 Trade Liberalization and Overvalued Exchange Rate

Exchange rate reform began when the fixed exchange rate regime was replaced by a managed exchange rate system in 1982. The goal of this reform was to better align the exchange rate with the equilibrium level and integrate domestic prices with global prices. During the partial trade liberalization period, the Real Effective Exchange Rate (REER) peaked at 237.53 in 1981, indicating a substantial overvaluation of the Rupee. Although the REER experienced a significant decline to 146.37 in 1987, it still remained overvalued. Following considerable tariff reductions that began in 1988, the REER was recorded at 107.9 in 2000, still reflecting an overvalued situation. In the post-liberalization period, the REER stood at 103.79 in 2006, which then rose to 121.65 in 2017 before falling to 100.26 in 2021. Thus, the Pakistani Rupee fluctuated within a narrow range during the post-liberalization era but remained overvalued from 2014 to 2018. Figure 1 illustrates the trend of the REER during this period.

Figure 1: Real Effective Exchange Rate (REER) from 1980 to 2021



Source: Author's calculations.

In Pakistan, trade liberalization did not accompany compensatory real devaluation of the currency, as the exchange rate policy focused on price stabilization. Therefore, domestic policy rates remained high, which resulted in the overvaluation of the currency. In addition, the country adopted Capital Account Liberalization (CAL) in the early 1990s, which also contributed to currency overvaluation. This overvaluation dampened the tradeable sector as the rate of capital accumulation considerably reduced. This set in motion the process of de-industrialization.

The case of Chile is instructive. The Chilean government implemented significant trade liberalization from 1974 to 1982, reducing the average nominal tariff from 94 % in 1974 to 11 % in 1979. However, the government continued to pursue a policy of inflation control, resulting in the overvaluation of the currency[20]. This combination of policies led to the disappearance of the industrial sector and initiated a process of de-industrialization that could not be reversed. Agosin and Ffrench-Davis (1995) have explained the case of Chile.

The following section examines the domestic and international political economy factors associated with trade liberalization.

4. Domestic and International Political Economy

4.1 Domestic Political Economy

This subsection illustrates how various interest groups have evolved, developed, and contributed to trade liberalization. Pakistan's economy is characterized as consumer-driven, relying heavily on the purchasing power of the middle class, which has been evolving since the 1970s, with its expansion continuing into the 1980s. However, the ongoing growth of the middle class ushered in significant transformations during the 2000s. The domestic factors that contributed to trade liberalization are as follows.

First, the increase in real income and the heightened level of consumption in the economy reflected both domestic and international demonstration effects. In the 1970s, this rise in real income resulted from the growth of small-scale manufacturing and remittances channeled from

[20] Chile completed its trade policy reforms in 1979 and also adopted Capital Account Liberalization (CAL) to tap the international liquidity. It attracted high capital inflows in 1979 and faced BOP crises in 1982. The case has been documented by Agosin and Ffrench-Davis (1995).

the Gulf region, which, in turn, contributed to the emergence of the middle class. Zaidi (2015) referred to this class as the urban petit bourgeoisie.

Second, transnational corporations (TNCs) expanded their presence in Pakistan during the 1980s. Bruton (1998) argued that the presence of TNCs alone is insufficient for developing countries. They should also enhance the indigenous learning of national firms by fostering a supportive social environment. However, TNCs focused their production on the upper-income strata of the population, influencing consumer psychology through brand consciousness. For instance, Coca-Cola and Pepsi emerged as the main sponsors of cricket matches in Pakistan, promoting a culture of beverages. The middle class became attracted to imported fast-moving consumer goods (FMCGs), further facilitating trade liberalization. Additionally, the ongoing growth of small-scale manufacturing, along with the revitalized expansion of larger units, created an enabling environment for domestic traders and transporters to generate income. The influx of traders and transporters contributed to the growth of the middle class.[21]. The traders, who are integral to the middle class, began to assert their power and form an interest group, being the primary beneficiaries of trade liberalization. [22]

Third, trade liberalization redirected resources to non-tradeable sectors, as Morrissey (1995) noted, suggesting that a reduction in tariffs may not guarantee a shift of resources toward exportable goods. The country experienced four real estate booms: from 1993 to 1996, 2001 to 2005, 2011 to 2016, and 2020 to 2022. During these periods, property prices increased significantly, though they stagnated in the intervening years. The first boom introduced the concept of an iconic lifestyle in housing for the middle class. The second boom fostered a culture of shopping malls. Meanwhile, the third and fourth booms perpetuated a luxurious lifestyle in housing and continued the shopping mall culture. These booms encouraged consumerism in society and advanced trade liberalization in the economy. They also resulted in the emergence of a real estate developers' interest group.

Fourth, print and electronic media have significantly nurtured and promoted consumerism. Initially, the media showcased how the elite

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[21] The middle class is a loosely defined term in the context of Pakistan since different factions loosely constitute a middle class. Zaidi (2015) includes transporters, traders, large shopkeepers, small scale industrialists as part of the middle class.

[22] The traders, time and again, assert their power by resisting frequent attempts to document the economy.

attempts to emulate foreign consumer patterns through advertising campaigns. The advertising industry also expanded alongside the middle-class revolution and now reflects their preferences and aspirations. Specifically, the rapid growth of electronic media has fostered brand loyalty, which in turn promotes excessive consumerism since the early 2000s. For instance, advertisements for luxury housing depict a hassle-free environment, private security arrangements, dancing fountains, green parks, grandiose mosques, and the promise of an active and vibrant community. Thus, the media has become another interest group.

Consumerism strengthened the power of traders, while trade liberalization benefited local merchants, who evolved into a political constituency for the ruling party. Additionally, transport groups gained influence due to the increasing transportation demands in the economy. In this context, Zaidi (2015) noted the excessive consumerism observed in Pakistan's metropolitan cities, semi-urban towns, and smaller rural areas, which resulted in a surge of merchandise imports. This rise in consumerism significantly widened the trade deficit, prompting successive governments to seek assistance from the IMF to address balance of payments crises. The next section discusses how factors in the international political economy contributed to trade liberalization in Pakistan.

4.2. Trade Liberalization and International Political Economy

This sub-section illustrates the role of multilateral institutions, specifically the World Bank and the IMF, in promoting trade liberalization in Pakistan. These institutions advocate for the concept of free trade and support the 'efficientist' argument. Bruton (1998) notes that powerful institutions strongly recommend outward orientation to developing countries.[23]. They emphasized that free trade leads to economic efficiency based on studies that reinterpreted the economic successes of Western Europe and the USA during the late twentieth century, highlighting that trade liberalization was a key source of income convergence between rich and poor countries (Sachs, Warner et al. 1995; Harrison 1996). In this context, the World Bank (1988) reevaluated the industrial transformation of developed nations and asserted that countries pursuing free trade policies to integrate their industrial sectors with the international economy surpassed those that isolated their domestic sectors from foreign competition. [24].

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[23] Bruton (1998) highlighted that the IMF, the World Bank, the USAID, the Economist Magazine and think tanks strongly supported the outward orientation

[24] Outward Orientation was touted in the World Bank's East Asian Miracle (1993).

To support existing free trade theories, a detailed cross-country study was conducted by Sachs et al. (1995). They applied cross-country indicators of trade openness to examine the timing of trade liberalization and found that it promotes economic integration. Their criteria categorized Pakistan as a closed trade regime, characterized by higher average tariff rates on imports of intermediate and capital goods. [25] The next paragraph further illustrates the trend of trade liberalization and the use of policy instruments supported by multilateral institutions in Pakistan.

The beginning of the twenty-first century brought a significant shift in the thinking of multilateral donor agencies, leading to the replacement of SAP with Poverty Reduction Strategy Papers (PRSP) as these institutions aimed to achieve the Millennium Development Goals (MDGs). As Pakistan engaged with a PRSP facility, its trade policy regime remained largely a continuation of the 1990s. The efforts made by the Pakistani state were even acknowledged by the WTO, as Pakistan liberalized its trade policy regime in pursuit of productivity gains, along with the goal of enhancing competition in the domestic economy (WTO 2002). The next paragraph discusses unguided globalization.

This era of globalization was characterized by the establishment of the World Trade Organization (WTO) regulatory framework, the initiation of Free Trade Agreements (FTAs), and the persistent dominance of transnational corporations (TNCs). The enforcement of uniform WTO rules resulted in the abolition of quotas and a reduction in average tariff rates in Pakistan since 2005. The following paragraph illustrates the continuity of trade liberalization in Pakistan, along with recognition of efforts by multilateral institutions.

An unbroken continuity in trade liberalization reforms remained as the flow of trade and information spurred this development. Therefore, the WTO not only acknowledged the efforts of the Pakistani government but also suggested improvements in one of its reports in 2015:

> Despite cautious liberalization, overall tariff levels remain high, which weakens productivity growth and constitutes

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[25] The criteria was based on five characteristics and the authors judged the existing trade regime of countries and listed those factors: Nontariff barriers covering 40 percent or more of trade; average tariff rates of 40 percent or more; a black market exchange rate that is depreciated by 20 percent or more relative to the official exchange rate, on average, during the 1970s or 1980s; socialist economic system; a state monopoly on major exports. If any of the above factors holds, the trade regime would be considered closed.

> an impediment to efficient resource allocation and the integration of Pakistan into global value chains. In addition, the use of ad hoc trade policy instruments under SROs remains common and severely undermines the predictability of the trade regime; it also supports a culture of rent-seeking.

Shifting from the topic of international political economy, we will now discuss the connection between trade liberalization and cuts in social expenditure.

5. Effects of Trade Liberalization on Social Expenditure

The protection provided by tariffs generally persisted during the period of partial trade liberalization, which enhanced the fiscal flexibility of the state, enabling it to finance development and social expenditures. To highlight the significance of trade taxes, Stiglitz and Charlton (2005) contended that these taxes were the primary source of revenue and that trade liberalization restricted the tax collection options in developing countries.

The Pakistani state relied heavily on international trade taxes to manage its affairs, as evidenced by a customs duties to tax revenue ratio of 31 percent in 1976. This dependence grew significantly, with the ratio increasing from 36.7 percent in 1978 to 50.8 percent in 1987 during this period. Consequently, the development budget remained between 8 and 10 percent of GDP. This indicates that the state not only met its revenue needs through trade taxes but also supported social expenditure, with the period's average social expenditure to GDP ratio at around 3.1 percent. [26] During the trade liberalization period, the customs collection/tax revenue ratio steadily declined from its peak of 50.8 percent in 1987 to approximately 15 percent in 2004, due to tariff reductions. Without trade taxes, the state had to depend on alternative forms of taxation to make up for the revenue decline, but the business community resisted these measures. [27] This left the state with using the General Sales Tax (GST) to address revenue losses. [28] The government had to increase GST to 12.5 % to counteract these losses. Initially, the scope of GST was limited. Unable

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[26] Here, expenditures on education and health care are considered as the social expenditure.

[27] The state intended to document the economy to mobilize resources in 2000, which was severely opposed and resisted by the business community and the state caved to that pressure.

[28] GST was introduced in 1990 to compensate for the international trade taxes. This shows that trade taxes were replaced with a regressive tax.

to generate revenue from alternative sources, the state struggled to allocate sufficient funds for education and healthcare, as reflected in the expenditure to GDP ratio falling to 2.7 percent during this period. This decline in social spending contributed to a lack of social consensus within society. Consequently, Zaidi (2015) noted that the state embraced a neoliberal orthodoxy regarding trade policy in the 1980s and 1990s, guided by multilateral institutions that began to provide macroeconomic guidelines, which in turn influenced social decisions.

In the post-trade liberalization period, the trend of reducing the fiscal flexibility of the state that began during the liberalization period was further reinforced. Even McCartney (2015) pointed out that trade liberalization in a developing country would lead to a loss of government revenue and force fiscal adjustments elsewhere. In 1993, the ratio of import taxes to GDP was 54 percent but fell to 45 percent in 2016. The customs collection-to-tax revenue ratio continuously declined from 18.2 percent in 2005 to approximately 14.5 percent in 2021. As a result, development expenditure remained stagnant at 4 percent of GDP during this period. The decrease in social expenditure to 2.5 percent of GDP reduced the accessibility of government services for the poor. In the next section, we will detail trade liberalization and its effects on industrial performance.

6. Effects of Trade Liberalization on Industrial Performance

An industrial base was developed in Pakistan during the ISI period through a deliberate design of protectionist trade policies. Krueger (1974) presented the forms of rent-seeking and their associated costs. The theory of rent-seeking became the basis for criticizing the ISI[29].

Despite all odds, the industrial bourgeoisie experimented, tested, and learned about the production phase of consumer goods in Pakistan. During the period of partial trade liberalization, the industrial sector was the engine of growth from 1972 to 1987, with its average share remaining at 23 percent, as shown in Table 2. Similarly, the share of manufacturing remained at 15.8 percent, which was also significant. The industrial sector made a substantial contribution to a high GDP growth rate of 5.8 percent. During the 1980s, the regime of Zia-ul-Haq made efforts to restore the confidence of the private sector by incentivizing industrial capitalists through lower interest rates. As a consequence, a rebound was seen in the large-scale manufacturing sub-

[29] Bela Balassa made it clear that import substitution created distortions and resulted into misuse of resources.

sector, which grew at an average rate of 8 percent from 1978 to 1987. The small-scale manufacturing sub-sector, on average, continued to expand at an impressive rate of 8.4 percent during the same period. Based on this, Sayeed (1995) argued that industrial policy was formulated and executed for the first time in Pakistan during the Zia regime.

During the trade liberalization period, the share of the industrial sector remained stagnant at 24 percent, and the size of the market could not increase to the desired level. Of this, the share of manufacturing accounted for 16.3 percent throughout the period, as shown in Table 3. The stagnation in the industrial sector contributed to a slightly lower GDP growth rate of 4.7 percent. The impact of trade liberalization on industrial performance led to low economic growth, a point even argued by Kaldor (1967). Furthermore, Mazhar and Rehman (2019) argue that manufacturing acts as a growth escalator in low-- and middle income countries from 1990 to 2013, based on a panel study involving 52 countries. In addition, the industrial bourgeoisie could not experiment with or learn capital goods production, nor could they create the capacity for capital goods. Consequently, a state of inertia was observed in the industrial and manufacturing base of Pakistan. Therefore, trade liberalization did not yield capital development in Pakistan to the extent that was sorely needed.

We now assess the performance of the industrial sector in particular and economic growth in general during the post-liberalization period. The post-liberalization period did not expand the market size, even though the focus shifted from the domestic market to the international one. Moreover, industrial bourgeoisies either became financial capitalists or speculators[30]. The industrial sector declined as its share fell to 19.12 percent for the entire period, alongside the manufacturing sub-sector, which held a share of 11.93 percent, as shown in Table 4. This decline in the industrial sector coincided with a lower GDP growth rate of 3.94 percent during this period. It also implies that domestic manufacturers became more vulnerable to foreign competition. The ongoing decline in the industrial sector, coupled with the erosion of the manufacturing base at an early stage of development, suggests that the post-liberalization period can be viewed as a prelude to premature deindustrialization in the economy. This aligns with the argument put forth by Rodrik (2016) that developing countries experienced this trend at much lower income levels compared to early industrializers, resulting in slower economic growth. Such

[30] Notable industrials launched modern housing schemes and shopping malls in the post-liberalization period.

deindustrialization has hindered capital accumulation and, consequently, economic growth in Pakistan.

The actors in the international political economy propelled the wave of globalization that led to the formation of FTAs.[31] The Pakistani government concluded FTAs with Sri Lanka, Malaysia, and China without considering the repercussions on the industry in particular and the economy in general. The FTAs with relatively advanced economies led to the erosion of Pakistan's manufacturing base. Even the excerpt below shows how the dominance of cheap Chinese products has rendered the Pakistani manufacturing sector increasingly vulnerable, and the State Bank of Pakistan (2015) pointed out the shortcomings of the Chinese FTA on manufacturing:

> The influx of low-cost Chinese products (under the umbrella of FTA) weighed heavily on electronics and especially engineering products, which showed a steep decline for the last few years. The state of the art technology, skilled labor, inexpensive energy, smooth raw material availability, transportation facilities, and economies of scale available to Chinese producers, are making it difficult for these segments to compete in Pakistan.

The abolished quota intensified global competition for Pakistan's textile industry, forcing it to compete with India, China, Bangladesh, Vietnam, and Turkey.[32] The textile industry struggled to compete in a challenging international environment and began to decline because it failed to achieve dynamic economies of scale.[33] The evidence shows that Pakistan's share of textile exports in the world has remained stagnant since 2005. Hasan and Raza (2015) note that the silk industry became uncompetitive and relocated to Bangladesh due to a cheap influx of products from China and India. They further explain that retailers and wholesale dealers involved in this trade became the beneficiaries. Additionally, they mention that the uncompetitive silk production forced the new owners to move their production to low-income residential areas to avoid taxes and high energy costs, which in turn fostered informality.

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[31] The Government of Pakistan signed FTA with Sri Lanka in 2005, with Malaysia in 2007 and with China in 2007.

[32] Multi Fiber Agreement (MFA) expired on Ist January 2005 which used to provide textile export quota to Pakistan.

[33] The share of textiles in the total merchandize exports of Pakistan was 64 % in 2005, which has declined to 55 % in 2015.

The possible underlying mechanism explaining this observed pattern is that the reduction in tariffs encouraged consumerism directed towards imported goods and services, which led to 'import-led deindustrialization' that eroded the manufacturing base of consumer goods. Therefore, McCartney (2015) notes that despite extensive trade liberalization, the outcome remained disappointing in terms of economic growth and global integration. This also implies that trade liberalization has increased imports without significantly boosting exports [34] (Linder 1961). Nayyar (2006) argued that globalization did not lead to rapid economic growth or convergence worldwide. Therefore, trade liberalization is a conditional means to promote development (Alonso, Cornia et al. 2014).

7. Conclusion

This paper presents an alternative perspective on trade liberalization, contrasting with the viewpoint of Pakistani scholars and practitioners who advocate for accelerated trade liberalization reforms. It integrates history, politics, and economics to narrate the story of trade liberalization. It demonstrates that multilateral institutions uniformly applied rules implemented by the liberal factions within Pakistan's bureaucracy. As a result, the instruments of import-weighted average tariffs, import quotas, and licensing saw a considerable decline. Trade liberalization did not occur alongside compensatory real devaluation of the currency since exchange rate policy prioritized price stabilization. Consequently, domestic policy rates remained high, leading to an overvaluation of the currency. This combination of policies diminished the rate of capital accumulation, which, in turn, hindered the country's economic growth.

Unfettered globalization dominated the post-liberalization period. The influence of international policies and a multilateral regulatory framework further reduced the government's policy space. The process of quantity adjustment eroded the manufacturing base in the country. The import-weighted average tariff decreased, precipitating a decline in the industrial sector that, in turn, led to premature deindustrialization. When we compare the economic growth rate of this period with the preceding ones, we observe a noticeable slowdown.

[34] Staffan Linder (1961) argued that a country cannot export new products until it has produced them for the home market as firms need learning to produce them.

The international demonstration effect fostered consumerism in the country as the middle class began to emulate the consumption patterns of advanced nations, which, in turn, led to the emergence of multiple interest groups. These interest groups loosely formed the core of the middle class. The dominant interest group comprised the powerful traders who emerged and gained prominence due to rampant consumerism in society. Transporters also gained influence due to the ever-increasing transportation needs within the economy, and these interest groups further expanded their impact through electronic and print media. This development prompts us to ask the fundamental question: what benefits a consumer society may not benefit economic development?

All these trends illustrate the far-reaching effects of trade liberalization on the government, significantly reducing its size. As the government relied on trade taxes to fulfill its functions, the substantial decrease in those taxes gradually diminished its fiscal flexibility. Consequently, the government found itself unable to allocate enough of its budget for social consumption. This, in turn, highlighted the challenge of social cohesion within society.

The interplay of social, political, and international factors establishes that trade liberalization is not an end in itself. The country could not develop the capacity of the capital goods sector, as industrial capitalists were unable to experiment, test, and learn. This underscores the significance of the right form of protectionism in promoting technological capabilities. These capabilities are developed through experimentation at the domestic level, where the government can play a pivotal role in fostering indigenous learning. Additionally, the government can scale up successful experiments to generate positive externalities. This is how a learning culture can be nurtured and flourished in the country. However, this is not an exhaustive study of factors and is mainly based on secondary sources. Nevertheless, this study opens up possibilities for future research based on primary data.

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