IPRI Islamabad Policy Research Institute
Research | Innovation | Dialogue | Policy

Policy Brief

Implications of a Premature Trade Liberalisation in Pakistan

Dr Aneel Salman
Muneeb Shah

July 2025

OGDCL-IPRI Chair Economic Security

Executive Summary

This Policy Brief explores the implications of a premature trade liberalisation in Pakistan. It highlights that Pakistan's economy faces recurring balance of payments crises, foreign exchange shortages, limited export diversification, and weak domestic demand. Collectively, these structural vulnerabilities pose a significant risk to the country's long-term economic security.

To address these challenges, the Government of Pakistan revised most of its customs duties as part of a broader trade liberalisation agenda. However, this shift occurs at a time when the industrial sector's share in the economy is declining. High energy tariffs, weak domestic demand, and increasing trade and production costs continue to hamper the competitiveness of Pakistan's industrial sector, particularly that of the Large-Scale Manufacturing (LSM) sector. During the first eight months of FY2024-25, the LSM contracted by 2%.

Based on the ITC data, this Brief suggests that without a sufficient exportable surplus, a competitive industrial base, and lower trade and energy costs, abolishing customs duties may further erode Pakistan's economic security by increasing import dependency as well as making the economy more vulnerable to external shocks.

Policy Recommendations

Pakistan may:

- Follow a phased liberalisation by prioritising sectors (such as sports goods) where Pakistan has a comparative advantage, strong export potential, high productivity, and alignment with the country's human capital strengths.
- Conduct a comprehensive sectoral assessment using comparative advantage analysis, ROI evaluation, and value chain mapping to identify other high-impact sectors for a phased liberalisation.

- **Overview**

Pakistan's economy faces significant challenges, as the current growth models are ineffective in rectifying its structural issues[1]. The tendency to focus on short-term solutions over long-term structural reforms has brought the economy to its current state. A narrow industrial base, recurring balance of payments (BOP) crises, foreign exchange (FX) shortages, lack of export diversification, and rising import dependence continue to decline Pakistan's trade competitiveness[2]. To overcome these challenges, the Government of Pakistan is revising most of its customs duties as part of a broader push towards trade liberalisation[3].

The Empirical literature on international trade states that liberalisation can lead to revenue losses, impact industrial competitiveness, and increase import dependency and external vulnerability if not implemented carefully[4]. Trade liberalisation is effective when a country has a strong industrial base, competitive exports, improved infrastructure, and fiscal sustainability. However, in Pakistan, there is a lack of research and empirical evidence on the impact of abolishing customs duties on Pakistan's economy.

Hitherto, the manufacturing sector of Pakistan, particularly the Large-Scale Manufacturing, is experiencing a downward trajectory. During the first eight months of FY 2024-25, it was contracted by 2%. Key industries such as textiles, food, chemicals, and iron & steel have significantly declined. This is due to high energy costs, a double-digit interest rate, and a weak domestic demand[5]. In this context, pursuing trade liberalisation without first strengthening the industrial capacity may be premature.

This Policy Brief aims to explore the effect of a reduction in major customs duties on Pakistan's economy. It suggests that Pakistan currently lacks a sufficient exportable surplus, faces high electricity tariffs and trade costs, and has a minimal manufacturing base (relative to its GDP size). A hasty trade liberalisation in the form of abolishing

---

[1] Salman (2024). Address at Margalla Dialogue 2024. Special Forum Economy. https://www.youtube.com/watch?v=c2jXBykM4q8

[2] PIDE (2022) https://pide.org.pk/research/pakistans-structural-economic-woes/

[3] Hussain (2025). https://www.dawn.com/news/1912556 The Government first abolished most of its customs duties. Later, some of the duties were reimposed.

[4] IMf (2010). https://www.elibrary.imf.org/view/journals/024/2010/002/article-A006-en.xml

[5] The News (2025). https://www.thenews.com.pk/print/1301715-large-scale-manufacturing-declines-3-5pc-in-february?utm_source=chatgpt.com

customs duties without fundamental reforms in its economic structure may undermine the country's economic security.

- **Analysis**

Traditional trade theories [e.g., Ricardo (1817) and Heckscher-Ohlin (1919)] argue that economies experience greater benefits from trade liberalisation. Nonetheless, empirical evidence within the literature provides mixed results regarding these benefits. Developed countries appear to have gained more advantages from trade liberalisation compared to their developing counterparts. For instance, Viner (1950) states that trade improves efficiency, investment, and integration within economies. Conversely, Slaughter (1997), in the dependency theory, presents findings that contradict this view.

The dependency theory states that developed countries tend to benefit more from trade liberalisation due to their ability to diversify their economies and achieve economies of scale. In contrast, free trade can exacerbate structural inequalities in developing countries, which often rely heavily on low-value exports. As a result, these nations may experience limited advantages from international trade.

Moreover, Slaughter (1997) and Ita (2024) highlight that trade can deepen dependency, particularly for countries that import high-value goods and export primary commodities. Likewise, Pooja (2018)[6] supports the idea of giving protection to less competitive domestic industries. This idea is based on the infant industry argument. It states that premature exposure to global competition can harm multiple sectors of an economy.

In Pakistan's case, Salman & Shah (2025) argue that increasing reliance on Chinese imports impacted Pakistan Economy negatively due to its narrow export base[7]. Global examples also suggest that nations with robust industrial policies and export-oriented growth strategies, such as Vietnam, benefit more significantly from trade liberalisation (World Bank, 2022)[8].

---

[6] Pooja (2018).Infant-Industry-Argument: Case Study on the Brazilian Computer Industry.
[7] [7] Ita (2024). https://www.ssbfnet.com/ojs/index.php/ijfbs/article/view/3645 . Salman & Shah (2025) https://ipripak.org/free-trade-agreements-a-bridge-or-a-burden-for-pakistan-economy/
[8] World Bank (2024). https://www.worldbank.org/en/country/vietnam/publication/viet-nam-2045-trading-up-in-a-changing-world

In summary, Pakistan's trade policy has historically emphasised duty reductions without attaching them to sectoral performance. However, this approach is not supported by rigorous research or empirical evidence, particularly in the context of Pakistan.

- **Methodology Followed**

International trade theories suggest that trade has a multiplier effect by enhancing consumer welfare within an economy. Nevertheless, in multiple economies, dismantling tariffs has not produced meaningful results (Ebrill et al, 1999)[9].

This Brief applies a comprehensive analytical approach. Building on Salman and Ahmad (2025)[10], the study presents a forward-looking tariff rationalisation policy path. Salman & Shah (2025)[11] provide a functional analysis regarding the impact of liberalisation on Pakistan's economy. However, the study does not sufficiently explore the fiscal consequences of removing trade duties. To address this gap, the current research integrates their model with the revenue loss estimation methodology from Ebrill et al. (1999). This combined approach facilitates a more reliable analysis of the potential fiscal impacts of duty abolition. For the potential fiscal impacts of trade liberalisation, this Brief uses the following equation:

$$\mathbf{TTr} = \mathbf{t} \times \mathbf{VM}\ (\mathbf{1})$$

TTr = total trade tax revenue

t= average duties

VM = Value of imports

It is important to note that, in Pakistan's case, a specific duty coefficient cannot be applied, as customs authorities in Pakistan impose multiple duties with varying slabs. To address this issue, this Brief uses data from multiple years and various duties, thereby estimating an average revenue loss based on average customs duties (10%, 15%, and 20%).

Moreover, it assumes that Pakistan's trade performance may not undergo drastic changes[12]. Given Pakistan's current economic structure and trade experience, it is

---

[9] Ebrill (1999). Revenue Implications of Trade Liberalization-Washington.

[10] Salman and Ahmad (2025). https://ipripak.org/tariff-rationalisation-in-pakistan/

[11] Salman and Shah (2025). https://ipripak.org/free-trade-agreements-a-bridge-or-a-burden-for-pakistan-economy/

[12] If trade performance rapidly changes, like shifts in volume or the types of goods traded, or reallocation occurs, the duty structure and revenue patterns would also change. That would make the estimates based on past data less reliable.

reasonable to presume a static trade performance based on Pakistan's current economic indicators.

- **Data**

Results related to Pakistan's international trade are based on the International Trade Centre's (ITC) data. Details about the countries with which Pakistan has Free Trade Agreements (FTA) are provided by Pakistan's Ministry of Commerce. The baseline duties data is provided by Hussain (2025).

- **Discussion and Findings**

Based on Equation 1, the potential revenue losses are provided hereunder:

Table 1: Pakistan's Average Revenue Losses (in USD Thousand) (2015 - 2024)

Years	Import Value	Average effective duty		
		10%	15%	20%
2015	43,989,645	4398965	6598447	8797929
2016	46,998,269	4699827	7049740	9399654
2017	57,518,651	5751865	8627798	11503730
2018	60,391,133	6039113	9058670	12078227
2019	50,134,812	5013481	7520222	10026962
2020	45,841,651	4584165	6876248	9168330
2021	73,106,624	7310662	10965994	14621325
2022	71,104,684	7110468	10665703	14220937
2023	50,362,541	5036254	7554381	10072508
2024	56,522,668	5652267	8478400	11304534
Average revenue losses		**5559707**	**8339560**	**11119414**

Source: Own estimates based on ITC data[13]

In Table 1, the estimates suggest a potential average revenue loss of USD 8.34 billion (assuming an average 15% customs duty reduction). This figure highlights the magnitude of fiscal risk posed by the current liberalisation.

- **Country-wise trade performance and revenue statistics**

In 2007, Pakistan and China entered into an FTA. This FTA is often depicted as a success story. However, from 2005 to 2023, Pakistan's exports to China have increased by 14%.

[13] ITC (2025). https://www.trademap.org/Country_SelProductCountry_TS.aspx?nvpm=1%7c586%7c%7c%7c%7cTOTAL%7c%7c%7c2%7c1%7c1%7c1%7c2%7c1%7c2%7c1%7c%7c1

Meanwhile, imports from China have grown by 17%. Moreover, the overall trade deficit continued to increase, reaching USD 17.66 billion in 2021. This shows an increase in trade volume. However, the challenges of the trade deficit still persist. Table 2 also states that the estimated average trade revenue losses per year would be USD 142,915,233.

Table 2: Pakistan's trade with China and potential Revenue losses*							
Pakistan's Exports to China				**Pakistan's Imports from China**			
Years	**Value in USD thousand**	**Growth**		**Years**	**Value USD thousand**	**Growth**	**Custom Revenue**
2005	435682	0.52		2005	2349395	1.06	352409.25
2006	506642	0.16		2006	2914926	0.24	437238.9
2007	613759	0.21		2007	4164230	0.43	624634.5
2008	726711	0.18		2008	4738055	0.14	710708.25
2009	997854	0.37		2009	3779769	-0.2	566965.35
2010	1435944	0.44		2010	5247713	0.39	787156.95
2011	1678959	0.17		2011	6470653	0.23	970597.95
2012	2619944	0.56		2012	6687566	0.03	1003134.9
2013	2652223	0.01		2013	6626323	-0.01	993948.45
2014	2252900	-0.15		2014	9588418	0.45	1438262.7
2015	1934926	-0.14		2015	11019005	0.15	1652850.75
2016	1590858	-0.18		2016	13680153	0.24	2052022.95
2017	1510410	-0.05		2017	15404325	0.13	2310648.75
2018	1829435	0.21		2018	14599749	-0.05	2189962.35
2019	2042893	0.12		2019	12423997	-0.15	1863599.55
2020	1867755	-0.09		2020	12504581	0.01	1875687.15
2021	3042838	0.63		2021	20705497	0.66	3105824.55
2022	2561413	-0.16		2022	16343912	-0.21	2451586.8
2023	2762635	0.08		2023	11777695	-0.28	1766654.25
Average Growth:		15%		**Average Growth**		17%	**Average Revenue:** 142915233
Source: ITC (2025)							
***Assuming an average 15% custom duties reduction in Pak-China trade**							

Pakistan has experienced multiple trade regimes. However, they have a limited impact on export and import volumes. This is due to Pakistan's relatively low trade elasticity, resulting from its narrow export base. Hence, the substitution effect has always been meagre. A closer look at the disaggregated Pak-China trade indicators suggests that trade liberalisation resulted in a rise in imports of intermediate and finished goods. This has adversely impacted Pakistan's domestic industries by creating dependency on imported Chinese goods. However, Pakistan has lost a significant amount of duty. A further decrease in the duties or a reduction in the domestic industry protection may negatively impact Pakistan's economy. This suggests that for a developing country like Pakistan, which has an underdeveloped manufacturing sector, there may be relatively fewer benefits from hasty trade liberalisation.

- **Recommendations**[14]

Pakistan may:

- Improve its human capital by investing in quality education, vocational training, and technology adoption to increase productivity, aligning them with the skill set of regional competitors such as Vietnam, India, and Bangladesh.
- Prioritise energy sector reforms to lower production costs and increase local manufacturing through targeted subsidies and infrastructure development.
- Introduce a comprehensive Industrial Policy that prioritises export competitiveness, industrial development, export diversification, domestic capacity-building, value-added & high-value production, and upgrade industrial infrastructure to reduce production costs and improve industrial competitiveness.
- Reduce duty slabs and eliminate protective tariffs for infant industries once the industrial sector reaches scale and efficiency. After cutting the slabs
- Also implement safety nets and retraining programs for displaced workers and design fiscal buffers to offset temporary revenue losses during adjustment periods.
- Conduct a comprehensive sectoral assessment using comparative advantage analysis, ROI evaluation, and value chain mapping to identify high-impact sectors for phased liberalisation.
- Follow a phased liberalisation by prioritising sectors (such as sports goods) where Pakistan has a comparative advantage or excess capacity, strong export potential, high productivity, and alignment with the country's human capital strengths.

---

[14] The recommendations are based on discussions with Mr. Adil Ramay, CEO of Ramay Textile Mills, and Mr. Adnan Lodhi, Policy Advisor, International Trade Centre

- **Conclusion**

Removing customs duties in a premature industry may not yield the expected results. Without generating exportable surplus, streamlining domestic production, and building a resilient fiscal structure, it may lead to further economic instability. The estimates in this Brief show a potential average revenue loss of USD 8.34 billion resulting from the removal of import duties.

The Pak-China free trade experience, often portrayed as a success story, has already resulted in significant trade deficits, as well as a 17% increase in imports from 2005 to 2024. Domestic industry protection indeed results in the loss of consumer welfare. The long-term objective may be a liberal trade agenda. Policymakers may follow a sequential liberalisation model that strengthens the economy's foundations, reduces both tariff and non-tariff trade costs, as well as eliminates infrastructure barriers.

The international trade literature, moreover, suggests that international trade can raise a country's overall income. However, it often disrupts employment patterns. Workers cannot always shift easily between industries or sectors. That is, the reallocation among different factors of production is difficult. Because trade creates concentrated losses and diffuse gains, those who are hurt often lobby harder than those who benefit. This explains why even countries that champion free markets, such as the U.S. and Japan, maintain protectionist policies in their textile and agricultural sectors.

Liberalisation without protections can erode fragile industries, especially in economies where industrialisation is still in its early stages of development. Policymakers may recognise that open markets are not a cure-all. Without attention to timing, transition costs, and capacity-building, liberalisation risks stalling development rather than driving it.[15]

[15] These insights are based on *Krugman (2018). Increasing returns and the theory of international trade*.

About the authors

Dr. Aneel Salman holds the distinguished OGDCL-IPRI Chair of Economic Security at the Islamabad Policy Research Institute (IPRI) in Pakistan. As a leading international economist, Dr Salman specialises in Monetary Resilience, Macroeconomics, Behavioural Economics, Transnational Trade Dynamics, Strategy-driven Policy Formulation, and the multifaceted challenges of Climate Change. His high-impact research has been widely recognised and adopted, influencing strategic planning and policymaking across various sectors and organisations in Pakistan. Beyond his academic prowess, Dr Salman is a Master Trainer, having imparted his expertise to bureaucrats, Law Enforcement Agencies (LEAs), military personnel, diplomats, and other key stakeholders, furthering the cause of informed economic decision-making and resilience.

Mr. Muneeb Shah is a Research Associate at the OGDCL–IPRI Chair Economic Security at the Islamabad Policy Research Institute (IPRI). His areas of expertise include the blue economy, international trade, monetary economics, the Balochistan economy, the informal economy, and national & regional accounts compilation. Mr. Shah also has strong expertise in quantitative and data-driven policy analysis, with his work involving the application of advanced econometric techniques to support evidence-based decision-making.