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THE POLITICAL ECONOMY OF TRADE LIBERALISATION: A Framework and Application to Pakistan

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Trade policy reform, in the form of liberalisation or removal of restrictions on trade, has been a predominant feature of World Bank Structural Adjustment Programmes (SAPs) undertaken, to various degrees, by some 60 developing countries since 1980. The early literature of SAPs concentrated on the types of economic reforms required, and more recent literature addresses the political and institutional dimensions of economic policy reform. This paper addresses the latter issues and presents a framework for analysing the role of institutional change, encompassing the building of both political consensus and administrative capacity, in implementing trade policy reform, and how this relates to domestic political considerations. Pakistan's current trade liberalisation proposals are discussed to illustrate how the framework can be applied. A number of general conclusions are drawn regarding the design of trade liberalisation programmes so as to accommodate political considerations and enhance institutional capacity.

I. Introduction

Many developing countries have been inclined to adopt an inward-oriented trade policy: tariffs and quantitative restrictions protected the import-competing sectors, while protectionism and exchange rate policy tended to reduce the return to exports (relative to domestic production of importables). There is growing evidence that outward-oriented trade policies, in which exports are encouraged or at least not discriminated against, promote more rapid (export-led) economic growth. Trade liberalisation, the removal of restrictions on imports and reduction of discrimination

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against export, has become an increasingly common policy reform. Whether independently or as part of a World Bank Structural Adjustment Programme (SAP), virtually all developing countries have attempted some degree of trade liberalisation since 1980, and there are numerous episodes of trade liberalisation attempts in previous decades. But the success of the many liberalisation episodes, on their own or as part of a SAP, has been very mixed, whether evaluated according to the amount of trade liberalisation actually undertaken or the ultimate effect on economic growth [see, Corbo et al., (1992); Dean, et al., (1994); Greenaway and Morrissey, (1993), (1994); Papageorgiou, et al., (1991)].

The experiences of the more than fifty counties that have undertaken SAPs in the 1980s has been varied: their initial conditions differed; the scope of conditions (the number of policy areas to which conditions applied), the intensity of reforms (the degree of change embodied in conditions), and the degree of compliance (the extent to which conditions were implemented) differed; and hence the effects of reforms were varied. Early evaluations of SAPs concentrated on the types of reforms proposed, the extent of implementation and the economic outcomes [eg., Corbo, et al., (1992); Greenaway and Morrissey, (1993). Apparent 'failure' of SAPs has been attributed to, inter alia, exogenous shocks, failure to implement or sustain intended reforms and inappropriate sequencing of reforms. Implementation problems were often attributable to political constraints, thus recent emphasis has shifted to the politics of economic policy reform: why is it that some governments are better able to reform than others, and what factors determine the political capacity to implement effective reforms [Frey and Eichberger, (1994); Haggard and Webb, (1993)]. An emerging literature addresses the role of institutions and administrative capacity, and links this to political commitment to assess the evolution of the policy reform process [Levy, (1993); Morrissey, (1994)]. This paper addresses the implications of political economy considerations for promoting trade liberalisation, noting that political reforms and changes in the policy-making process are themselves elements of institutional change.

Trade reforms generate winners and losers, and political capacity relates to the ability of the government to mobilise support for reform (a coalition of winners) and to manage the opposition and compensate losers. Import liberalisation generates losers among those previously earning rents from protection, usually a politically influential lobby. Export promotion, in contrast, mobilises support by building a lobby of winners. The combination of the two in a programme of trade reform can have important implications for success and sustainability. Turkey, for example, provided extensive export promotion early in the reform process but was very slow in liberalising imports. The effect was to complement support for reforms and an early surge in exports which fuelled economic growth and reinforced the perception that the adjustment programme was successful [Morrissey, (1993)]. Tanzania, in contrast, liberalised imports but did little to directly promote exports; losers may have outnumbered winners, which contributes to explaining the slow pace and limited success of the reforms [Morrissey, (1994)]. Many other examples can be found to support the point that political economy (by which we mean political and institutional) factors should be incorporated into the design of effective trade liberalisation programmes.

Section II presents a brief review of the literature on trade liberalisation in LDCs, focusing on the period since 1980. Our intention is to clarify what is meant by trade liberalisation, in particular to identify the types of trade policy reforms involved. Having clarified our subject matter, we then turn to the political and institutional aspects of trade liberalisation in Section III, which elaborates on the twin concepts of political commitment and institutional capacity on which our framework for analysing the political economy of reform programmes in based. Section IV illustrates how the framework could be applied to Pakistan. Section V concludes.

II. Trade Liberalisation: Meaning and Evidence

There is no concise and generally agreed definition of trade liberalisation in the literature [Greenaway and Morrissey, (1994), discuss the alternatives]. It will be helpful for our purposes to adopt a broad definition of trade liberalisation as any reform that brings the relative incentives for production of exportables and importables in an economy more closely into line with relative world prices. This allows us to identify two principal types of liberalisation, noting that in all cases we are moving from a situation of anti-export bias (arising principally but not exclusively from protection which favours the import-competing sector). Import liberalisation encompasses those reforms which reduce protection, making it possible to import at world prices. This includes the removal of quantitative restrictions (QRs) and the reduction of tariffs.

Export promotion reforms increase the return to exports and encourage domestic resources to be redirected to the exportables sector. Such reforms frequently take the form of export subsidies, and it may seem strange to argue that the introduction of distortions can amount to liberalisation. The rationale is that removing protection will reduce the return to importables but this alone may not guarantee that resources are redirected to exportables. Hence, temporary export promotion may ensure that resources do not go to non-tradables.

It is common to include reforms of the exchange rate regime as an element in a trade liberalisation programme. This can be justified most clearly for devaluation, which increases returns to exports and is intended to bring the exchange rate closer to its equilibrium level. Easing access to foreign exchange makes it easier to import, and thus could be considered an element of import liberalisation. More generally, the 'correct' real exchange rate is required to keep relative domestic incentives in line with relative world prices for importables and exportables.

Tables 1 and 2 summarise elements of trade liberalisation in a large number of

TABLE 1

Summary of Pre-1980 Trade Liberalisations

Country	Policy reforms present or not[a]				Post-reform growth[b]	
	QRs	Tariffs	Exports	ER	Exports	GDP
Argentina (2)		√	√	√	+	?
Brazil		√	√	√	+	+
Chile (2)	√	√			+	+
Colombia (2)	√	√	√		-ve	+
Indonesia (2)	√	√	√	√	+	+
Isreal (3)	√	√		√	?	+
Korea (2)	√	√	√	√	+/-ve	+/-ve
New Zealand (3)	√	√		√	+	?
Pakistan (2)			-ve	√	+	+
Peru	√	√			-ve	-ve
Philippines (2)	?	?		√	+	+
Spain (3)		√	√	√	+	?
Sri Lanka (2)	√	-ve	-ve	√	-ve/+	?/+
Turkey (2)	√	√	√	√	+	?
Uruguay	√	√		√	+	+
Yugoslavia	√	√	-ve	√	-ve	-ve
Total (16)	11	13 (1)	7 (3)	13	11+	9+

Notes: These are broad indications of diverse reform packages from a variety of countries and time periods (numbers in parenthesis refer to number of liberalisation episodes), and are no more than indicative.

[a] Policy areas : QRs - reduction in the number/extent of quantitative restrictions on imports; tariffs - reduction in average level or range of tariffs; exports – direct measures to promote exports; ER – rationalisation and/or devaluation of the exchange rate. A √ indicates the reforms were present; ? indicates that the reforms were ambiguous or very limited; -ve implies opposite reforms (e.g., export disincentives or increases in tariffs).

[b] Comparison of annual average growth rates for three years prior to reforms and the three years after reforms: + implies growth increased after reform; -ve implies growth slowed; ? implies minimal difference; two keys imply significant differences between reform episodes (e.g., Sri Lanka).

Source: Adapted from Greenaway and Morrissey (1994), Tables 14.1, 14.4 and 14.5

TABLE 2

Components of Some Recent Trade Liberalisations

	Policy reforms present or not			
Country	QRs	Tariffs	Exports	ER
Bangladesh	√	√		√
Cameroon	√	√		
China		√		
Costa Rica	√	√	√	√
Cote d'Ivoire	√	-ve		
Ecuador	√	√		
Gambia	√	√		√
Ghana √	√		?	
India √	-ve			
Kenya √	√		√	
Korea √	√	√		
Malawi	√	√		
Malaysia	√	√	√	
Mauritius	√	√	√	
Mexico	√	√		
Morocco	√	√		
Nepal √	√			
Nigeria	√	√		√
Senegal	√	√		
Tanzania	√	√		√
Thailand	√	-ve		
Trinidad & Tobago	√	√		
Tunisia	√	√		
Uruguay		√		
Venezuala	√	√		
Zambia	√	√		
Total (26)	24	22 (3)	5	7

Notes: As for Table 1, note a.
Source : Author, from a wide range of case studies and reviews.

countries, classified according to the components outlined above. As can be seen, reductions in nominal tariffs figure prominently as does the tariffication of quotas. Both would be regarded as acts of import liberalisation. Exchange rate reforms also feature regularly and, less commonly, export promotion;both reduce anti-export bias. Most of the pre-1980 liberalisation programmes listed in Table 1 were unilateral and voluntary. The data in Table 2 refer to the outcome of World Bank SAPs; some were tied into World Bank/IMF cross conditionality. Trade policy reform, in the form of import liberalisation and some export promotion, has figured prominently in SAPs [Greenaway and Morrisey, (1993)]. We can also note that the Bank supported studies of the impact of trade reform in some 70 per cent of SAPs agreed in the 1980s [Thomas and Nash, (1991)]; this is an important form of technical support which can promote reform and institutional change in adjusting countries.

Table 1 summarises the experience of 16 countries with a combined total of 31 liberalisation episodes in the period 1960-84 (all but the second Turkish episode of 1980-84 commenced before 1980). In 80 per cent of the countries tariffs were reduced, QRs were reduced in almost 70 per cent, while direct export promotion was evident in almost half; there was exchange rate adjustment in 80 per cent of the countries. Seventy per cent of the countries experienced improved export performance following liberalisation (but no single class of policy reform appears to have been a necessary and sufficient condition for this), and in just over half of the countries this promoted improved economic growth. This lends evidence to the claim that trade liberalisation has a beneficial impact on economic performance.

Nearly all of the 26 countries included in Table 2 were undertaking trade liberalisation as part of a World Bank sponsored economic adjustment programme. In contrast to Table 2, these countries placed greater evidence on reducing QRs (92 per cent) and tariffs (85 per cent), but much less emphasis on direct export promotion (19 per cent) and exchange rate adjustments (27 per cent); the latter figure may be because exchange rate adjustments occur early in an adjustment programme and are not included as part of the trade liberalisation phase. It is clear, however, that the emphasis is predominantly on import liberalisation in these cases.

One could reasonably enquire why there have been so many liberalisation attempts since 1980. [Greenaway and Morrissey (1994)]; offer a partial answer in suggesting why the Bank embraced liberalisation so enthusiastically. By the late 1970s the dominant economic ideology, at least in the US, Britain and among Bank technical staff, advocated free markets and minimal government. This view was perhaps strongest in respect of trade policy, where economic theory stated that trade interventions were never the optimal welfare-increasing policy (even when distortions were present). In addition, a persuasive body of empirical evidence demonstrated a significant positive correlation between outward orientation and economic growth. Furthermore, economic techniques for evaluating and monitoring trade policy are relatively well-developed and the evidence seemed to point to pervasive and significant distortions in developing countries [Greenaway and Milner, (1993)]. Thus, by 1980, the Bank was persuaded of the need for economic liberalisation and the arguments for trade liberalisation, in particular reducing protection, were especially persuasive.

We can offer an explanation as to why the Bank adopted economic liberalisation and why trade reforms figured so prominently in SALs, and this helps to explain why so many countries implemented trade liberalisation in the 1980s, if only because this was an intrinsic component of a Bank-sponsored adjustment programme. The burgeoning literature on economic policy reform in the LDCs, based on the experiences of numerous countries, demonstrates how varied the extent of actual liberalisation and the effects on economic performance have been in practice. Trade liberalisation is not a neatly defined policy package, nor is it a panacea. We have argued for a fairly wide view of the components of trade liberalisation: particular countries will incorporate some of these components, will implement them to a grater or lesser degree, and will enact other economic policies and reforms at the same time (which may or may not be complementary). It is clear that LDCs will commit themselves to reforms in order to receive the external financing associated with SAPs. This in itself, however, does not mean that the countries will implement effective reforms.

The principal economic objective behind trade liberalisation is that it will provide a solid grounding for, if not actually generate, more rapid economic growth, fueled by export growth. Papageorgiou et al., (1991), in a cross country assessment of the process and outcomes of 26 liberalisation episodes in 19 countries (on which Table 1 is based), provide further evidence to that provided in Table 1. Their key conclusions are:

i) Liberalisation which is initiated at a time of crisis (as defined by the authors) tends to be radical and sustained. Liberalisation launched as a bold step tends to be more sustainable than that which is staged.
ii) Radical removal of quotas is conducive to sustainability.
iii) Exchange rate devaluation is crucial to sustainability, but expansionary demand management is associated with abortive liberalisation.
iv) Liberalisation appears to impact favourably on balance of payments.
v) The impact of liberalisation on unemployment is minimal.
vi) Liberalisation tends not to lower production, nor inhibit economic growth.
vii) Liberalisation leads to rapid and sustained export growth.

The objective of liberalisation is to get (relative) prices right in the tradeable sector, with a view to improving efficiency in the allocation and utilisation of resources, increasing exports and increasing growth. Judged in these terms, the evidence suggests that liberalisation has been effective [Greenaway and Morrissey, (1994): 222]. It seems that average growth three years after liberalisation was 35 per cent higher than the average for the three years prior to liberalisation (6 per cent as opposed to 4.45 per cent). In some cases, such as Korea and Spain, the increases are quite spectacular. The results for real export growth are even more impressive, with average real growth rates being 150 per cent higher for the three year period following liberalisation than they were for the three years prior to liberalisation, (11 per cent rather than 4.4 per cent). The performance of some countries stands out, Korea and Turkey for example.

These results appear to be very favourable to the case for liberalisation, not only because of the absolute magnitude of the changes, but also because they appear to reflect the experience of a large number of countries with different initial conditions, different programmes and so on. There are, however, problems with the evidence and some fairly fundamental problems with the way in which liberalisation episodes in the Papageorgiou et al., (1991) study are identified and measured [Greenaway, (1993)]. In particular, it is not always clear that 'liberalisation' in any of the various senses discussed above has occurred. In some instances it is only stabilisation combined with devaluation which has been implemented. This is important because these may be key causal ingredients in stimulating export and output growth (where devaluation increases the incentives it exporters). Furthermore, the increasing evidence on SAPs in general would lead one to question many of the key conclusions of Papageorgiou et al., (1991) listed above: reforms in rapid response to crises are frequently not sustained once the crisis has passed; gradual liberalisation frequently proves sustainable; many adjusting economies experience serious detrimental impacts on employment; and the positive effect on economic growth often fails to materialise. This is not, however, the place to review the experience with SAPs [see Corbo et al., (1992); Greenaway and Morrissey, (1993)].

Trade liberalisation is an important issue, and it is important to understand the factors undermining the success of reforms in those countries where liberalisation attempts have not resulted in the anticipated economic benefits. A failed reform can undermine the political commitment to engage in further reforms. There is broad agreement that trade liberalisation, if effectively implemented, will be beneficial. The reasons for poor and/or unsustained implementation are most often to be found in political constraints (a government unwilling, or unable in the face of powerful opposition, to effect reforms) or a lack of administrative capacity. Reform programmes influence and are influenced by the political and institutional circumstances of the policy environment. Reform programmes should recognise these circumstances, and trade liberalisation can be sequenced and designed to suit the policy environment and to promote the institutional changes required for effective implementation. These issues are addressed in the next section.

III. Politics and Institutional Change

Political commitment and institutional capacity are central to the success of economic reform. While it is not obvious that the type of political regime, whether authoritarian or democratic for example, is central to the success of reforms, it is clear that political commitment is necessary, although not sufficient [Haggard and Webb, (1993)]. Furthermore, it is apparent that many reforms fail for lack of institutional capacity, or specifically the ability of the administration to implement fully the reforms required [Levy, (1993)]. Following the discussion of Section II, we can assume broad agreement on the economic reforms to be implemented and confine attention largely to political commitment and administrative capacity.

Institutions can be defined as the rules and conventions delimiting and guiding human behavior and social interactions, including economies, politics and other social sciences, and of special importance to the development process [Lin and Nugent, (1994)]. Institutional capacity thus encompasses the efficiency of political and economic systems, while institution-building encompasses changing political and economic relationships as part of the development process. Institutional change, therefore, includes not only expanding adminsitrative capacity but also developing the efficiency of the political system and of economic markets. The framework proposed here adopts this broad interpretation, although the specific application to trade reforms is confined largely to administrative capacity.

Levy (1993) classifies the design of reform programmes on dimensions of political flexibility and organisational capability. Were both are low, prospects for reform are limited; where both are high, many reforms are possible. The approach offered here is only broadly similar: the concepts employed are slightly different, and the objective is to offer a means of classifying the policy environment in such a way that appropriate reforms (i.e., reforms which can be implemented feasibly in the existing environment) are identified, and are attempted in the appropriate sequence (i.e., not only are reforms implemented when feasible, but they are implemented so as to facilitate further reforms). Attention is directed at two concepts. Institutional capacity is relatively objective: in reference to administrative capacity, one can make judgements on the level of resources and training available, on the capacity to implement particular types of reforms, and on the improvements in capacity (institution-building) necessary if more ambitious reforms are to be attempted. Political commitment is a more elusive concept. It is not easy for an outside observer to identify the commitment to a particular reform. Sometimes a government will announce its intention to implement certain reforms. This would seem to indicate commitment, and suggests ownership – the government ties itself to the success of the reform in question. However, one can imagine circumstances where a government supports a particular reform but, perhaps due to strong opposition or because it is unsure of the success of the reforms, is reluctant to declare its commitment. In such cases the government may not announce its intentions openly, and may be willing to allow external ownership of the reform (for example, declaring that the reform is imposed by the World Bank). The government can benefit from success, but can minimise the losses from failure.

Political commitment is difficult to define as ideally one needs to know the true intentions of the government and its capability to carry them through. The true measure of commitment is intent, not open declaration of such intent. A range of possibilities are depicted in Figure 1: political capability refers to the ability of the government to carry out its policies, which must be related to the strength of opposition. For example, a powerful government exhibits high capability. If opposition to a reform is likely to be low, such a government would feel confident enough to declare its ownership of the reform. Its (high) commitment would be announced. On the other hand, if opposition is expected to be strong, the government is less likely to declare ownership. It may do so, if it feels confident, but will not do so if it fears being a hostage to fortune even though it is committed (hence, there is an element of doubt regarding the outcomes in cell IV). Public pronouncements are neither necessary nor sufficient for commitment, but do confer ownership of the programme. If capability is limited and opposition relatively strong, governments may not wish to declare their intent – they may be committed, but will not wish to risk failure by declaring ownership (external influence and support, hence ownership, will be important if the commitment is to be realised). Thus, ownership is the public declaration of intent; its presence is a sign of strong commitment, but its absence does not imply no commitment. Where both capability and opposition are low, for specific reforms, commitment is likely to be high and announcement of intent can build support and capability if the reforms are successful.

High commitment is likely if opposition is low, or is weak relative to capability, while low capability plus high opposition imply weak commitment (weak in the sense that although the intent may be strong, ability to realise the commitment is limited). The government can alter its position (in terms of Figure 1) by building

		POLITICAL CAPABILITY	
		Low	High
OPPOSITION	Low	I Announcement (to build support) High commitment	II Announcement Ownership High commitment
	High	III No announcement External ownership Low commitment	IV Announcement Ownership (?) Commitment (?)

FIGURE 1

Identifying Ownership and Political Commitment consensus in favour of reform or by reducing political conflict, both of which can involve changes in political institutions. The dominance of the public sector relative to the private sector strengthens opposition to liberalisation, hence undermines commitment. Public sector employees, especially those in parastatals, and those gaining rents from government regulations are the first to lose from liberalisation (eliminating import licences reduces economic rents to holders; reducing tariffs reduces rents to protected producers). To enhance its ability to implement reforms, the government needs to build a consensus in favour of reform (and such attempts are a sign of commitment). Export promotion, for example, creates gainers and builds a coalition in favour of liberalisation. Our definition of high commitment requires both that reforms are attempted and the government has taken steps to build a political consensus (or, alternatively, to subdue or compensate the opposition).

The framework we propose is summarised in Figure 2; the four cells classify the 'policy environment' according to political commitment and institutional capacity. If a country has neither the desire nor the capacity to commence reform (cell I) then any attempts will probably result in failure. The implication is that sustainable reform is not feasible and the policy environment must be changed before meaningful reform can be attempted. If commitment is high but capacity low (II), then feasible reforms are likely to be of the 'dismantling' type (removal or simplification of regulations; reduction in taxes) and may be innovative (it is possible to implement gradually reforms of limited scope). Institutional capacity is the constraint that

		POLITICAL COMMITMENT	
		Low	High
INSTITUTIONAL CAPACITY	Low	I Minimal	II Dismantling Innovative
	High	III Incremental non-innovative	IV Extensive Liberalisation

FIGURE 2

Reforms under Alternative Policy Environments should be relaxed. If capacity is high but commitment low (III), there is potential for gradual incremental reforms, but the political system may not support innovative reforms (nor is it likely to support rapid dismantling because this is likely to create opposition from immediate losers). Cell IV is the objective, where innovative and effective reforms can be implemented successfully. Specific reforms can be classified as either requiring greater or lesser capacity, and then one must study the country to identify the political commitment for that reform. A reform can then be located in one of the cells of Figure 1 which identifies the policy environment. The issue then is what to do if it is not in cell IV (and in virtually all cases it will not be).

Moving from left to right (cells I to II or III to IV) requires measures that will increase political commitment. This may arise through the normal policy-making process: if the government, or a group of influential policy-makers, accepts that reform is essential they may attempt to alter opinion and form coalitions in favour of reform. Generally, some prompting will be required to encourage consensus; this is most often provided through external pressure, such as from the IMF and World Bank (and is implicit in SAPs). Regimes not committed to reforms are likely to be susceptible to external pressure. Once commitment exists, institution-building is required to facilitate moves downward in the figure, especially from II to IV. Institution-building itself requires political commitment but can be greatly furthered with technical assistance. If commitment is high then institutional capacity is the major constraint.

To evaluate institutional capacity we need information on the scope of reforms and the resources of the administrative units responsible for implementation. Scope has two aspects; complexity represents the administrative difficulty of the reform, and is often associated with innovative reforms which require new skills; range refers to the number of policy areas affected by the reform. Both are positively correlated with resource requirements, especially human capital. Wide-ranging complex reforms obviously require high capacity, and should not be attempted unless that capacity is in place. Narrow and simple reforms are feasible if capacity is low. An appropriate objective of sequencing can be to keep the range of reforms narrow and increase complexity as capacity is expanded. Furthermore, the experience of implementing even simple narrow reforms can enhance the capacity for attempting more complex reforms, and helps to build commitment.

The essence of this approach is to identify the policy environment before recommending a reform programme. The types of reforms attempted first should be those compatible with the prevailing environment; more extensive reforms necessitate interventions to change the environment. Figur 3 applies the framework to trade liberalisation. Specific types of reform may not always fit neatly into a cell, but one can indicate the policy environment most conducive to effective implementation of a reform. Cell I is only suited to fairly limited reforms, such as reducing the number of exceptions applied to import restrictions or tariffs (which are easy to administer and will not create many losers), or to simple types of export incentives

		POLITICAL COMMITMENT	
		Low (conflict, weak intent)	High (consensus, intent)
INSTITUTIONAL CAPACITY	Low (narrow, simple)	I Limit exceptions Export incentives	II Remove exemptions Reduce tariffs
	High (wide, complex)	III Export incentives Remove QRs	IV Rationalisation Full liberalisation

FIGURE 3

Locating Trade Policy Reforms

which create gainers from reforms (eg., export retention schemes or rebates to exporters on taxes paid on imported inputs).

If capacity is fairly high but commitment weak (cell III), certain reforms are appealing. Removing quantitative restrictions (QRs) on imports, for example by easing access to import licences or foreign exchange, will elicit opposition from losers (those previously gaining rents from having licences or access to foreign exchange) but the numbers, and their loss, need not be great. If QRs are converted to equivalent tariffs, the reform will be revenue-enhancing and may help build political commitment. Export incentives, which can be more effectively introduced if capacity is high, need not require high commitment as there are no immediate losers but there will be gainers, thus contributing to building a consensus in favour of reform. If the incentives are effective in promoting exports, the favourable impact on growth and the balance of payments will support the reform process. Thus, the types of reforms recommended for cell III are both feasible and facilitate movement to cell IV.

If the policy environment is one of high commitment but low capacity (II), a different strategy is required. Tariff reductions (a specific form of 'dismantling') are easily implemented but generate considerable opposition from previously protected sectors; if a coalition in favour of reform has not been built, implementation may prove politically difficult. High commitment, even if capacity is low, does allow some significant tariff reforms, such as expanding the base by reducing the number of rates and exemptions and allowances. Finally, it is worth noting that a country can be in cells II and III at the same time: there may be high commitment but low capacity for some difficult reforms, such as tariff rationalisation, yet low commitment but adequate capacity for other reforms, such as export promotion. The implication of our framework is that both sets of reform should be integrated so that both move 'towards' cell IV.

IV. An Application to Pakistan

The aim of this section is to illustrate how the framework outlined above could be applied to Pakistan; a full application would need to be part of a detailed study of the politics and economics of Pakistan's trade (and economic) policy reforms [an application to Tanzanian adjustment policy is provided in Morrissey,(1994)]. There are two approaches to applying the framework. The first could be termed retrospective: one studies the reforms that have been attempted and identifies the policy environment applicable at the time, i.e., were the reforms attempted placed in the correct cell of Figure 3 given the policy environment? In this way one can shed light on why some reforms were not successfully implemented, because commitment and/or capacity were lacking. The second approach in prospective: one identifies the current policy environment and asks whether proposed reforms are likely to be implemented successfully or, alternatively, what changes in the policy environment are required to support implementation. Here we illustrate the second approach.

Considering Figure 1, the position of Pakistan in 1994 could be depicted as one of relatively low political capability but relatively high opposition. This suggests that political commitment will be relatively low (both because the government's capability to push through reforms is limited and because powerful opposition can be readily mobilised). We would also expect that the government will be inclined to allow external ownership, which is consistent with the observation that considerable public emphasis is given to the pressure from the IMF and World Bank on Pakistan to implement reforms. Turning to Figure 2, and assuming that institutional capacity is relatively high, the low commitment suggests that only incremental or non-innovative reforms are feasible; to achieve innovative or dismantling reforms requires building political commitment. Turning to Figure 3, our approach to the political economy of trade reforms would predict that Pakistan could implement policies involving the promotion of exports and the removal of QRs, but that attempts to remove exemptions and reduce tariffs significantly are likely to be thwarted in the current environment. Armed with these predictions we can turn to the proposed trade policy reforms.

The Government of Pakistan announced an extensive tariff reform programme to be implemented over 1994-95 [Riazuddin, (1994), p. 117]. One of the proposals had an element of export promotion: the intention to subject imported inputs used predominantly for the production of exports to a zero tariff (this would increase the returns to exporting). Furthermore, Pakistan had already made considerable progress in reducing the prevalence of QRs. The other proposals were of a dismantling form as they related to the reduction of tariffs, but there is ample evidence in the proposals of the weakness of political commitment. The reduction of tariffs and exemptions, which would be a significant import liberalisation if implemented, are to be phased in gradually over about three years. Furthermore, protection will be maintained through higher tariffs on imports competing with locally produced goods. These reforms will reduce effective protection but, given the high initial levels and very wide distribution of effective protection rates [Riazuddin, (1994)], many distortions will remain in place.

The proposals do not amount to a significant import liberalisation: tariffs will only be removed moderately and slowly, with a likelihood that relative distortions (the dispersion of effective protection) could increase, often in a non-transparent manner. One of the explanations for the slow pace of tariff reductions must be, fear of the revenue impact. Import taxes accounted for almost 54 per cent of tax revenue, equivalent to seven per cent of GDP in 1992-93, despite the fact that some 45 per cent of imports were, either because of exemptions or zero-rating, free of import duties [Riazuddin, (1994), p. 118-119]. As in the case of many developing countries, the Pakistani tax system is heavily reliant on import taxes and the major taxes, imports, and income, have narrow bases. Thus 'significant scope exists for generating higher revenues by broad-basing the tax system, removing exemptions and modernising the administration' [Pasha and Iqbal, (1994), p. 49]. While many tax reforms have been attempted recently, there has been no discernable increase in tax revenue [Pasha and Iqbal, (1994), p.72] and fears regarding loss of revenue can act as a constraint on tariff reductions. Devaluation, insofar as it increases the domestic currency value of the tariff base, and conversion of QRs to tariffs can combine with tariff rate reductions to produce a revenue neutral trade liberalisation. Unfortunately, the scope for such a package of reforms in Pakistan appears limited.

Pakistan has achieved some import liberalisation since 1987 [Dean et al., (1994), p. 24-26]. The coverage of QRs has been amost halved (the share of domestic industrial value added protected by QRs fell from 63 per cent in 1980 to 33 per cent in 1987); the range and dispersion of tariffs has also been reduced significantly, with the average tariff reduced from 77 per cent in 1981 to about 60 per cent in 1991; devaluation has been gradual but steady, and some export promotion measures were introduced. However, tariffs and protection remain relatively high and there are many export taxes, especially on agricultural goods. In effect, considerable anti-export bias still exists and little appears to have been done to build a consensus in favour of liberalisation. If effective trade policy reform is to be attempted, political commitment will be required. Real export incentives would be an advisable place to begin, and study of the fiscal implications of trade tax reductions, so as to design a reform programme that is broadly revenue neutral, would seem to be a prerequisite for eliciting political support (alternatively, other tax reforms will be required to compensate for any shortfall in revenue).

Export promotion measures can take many forms (and we note that countries with a nominal per capita GDP of US$ 1000 or less are permitted to use export subsidies under the Uruguay Round GATT Agreement). Direct export subsidies are not recommended as they are costly and distortionary and, once introduced, difficult to get rid of. A more viable proposition is to utilise indirect subsidies: exempting exporters from tariff on imported inputs has been proposed (and reduce the likelihood of export industries facing negative effective protection); providing easy access to credit is another common form of indirect subsidy, as providing export insurance. However, often the most important incentives are non-financial: ensuring the availability of skilled labour and a functioning infrastructure, especially for transport and communications; providing information on marketing opportunities, and general advice and support in penetrating overseas markets. Effective export promotion does require identifying which industries to support, which in turn presupposes an industrial policy. Further research to identify relatively efficient industries with export potential should be encouraged (for example, a new study of effective protection).

The political economy approach suggests that the current policy environment in Pakistan is not conducive to further pronounced import liberalisation; now is not the time to attempt significant tariff reductions. However, tariff cuts should remain a reform objective to be attained in the near future. In the present, reforms that pave the way for further import liberalisation are required. We propose, in this context, two areas for analysis, research and reform. First, the implementation of export promotion measures for selected sectors in accordance with a carefully chosen industrial policy. Second, the implementation of tax reforms, especially improved administration and collection efficiency, so as to avert any detrimental revenue impact from tariff cuts. Measures that help build political commitment and institutional capacity are to be recommended; successful reform, even if gradual (as in incremental rather than slow or delayed), and economic growth are frequently the most effective such measures.

V. Conclusions

The expanding literature on the political economy of reform and the design of reform programmes has emphasised the importance of political commitment and institutional capacity. This paper has offered a framework for incorporating these factors into the design of trade liberalisation. Effective trade policy reform requires a suitably designed liberalisation programme, one that is appropriate to the policy environment of the countries in question, and attention to the institutional changes required to support a more liberal economy. This has implications for Pakistan.

One conclusion is the need to identify the policy environment first, then assess which reforms are appropriate to that environment and also which can help to improve the environment. This approach to the design and sequencing of reforms can be applied to any adjusting economy, and we have offered a particular order for trade liberalisation (essentially summarised in Figure 3). Countries with greater capacity and/or commitment can move faster. It has been common to propose economic liberalisation reforms without supporting institution-building. However, market institutions do not evolve overnight, and failure to support new institutions, and administrative capacity, has undermined many reform programmes. Thus, we suggest not only that Pakistan should provide export incentives but also that some of these should be institutional in nature (that is, marketing and industrial research organisations that can provide information and support to exporters).

There are a few general conclusions that can assist in the design of trade reform programmes. First, political commitment is essential and is strengthened by good economic performance and building a consensus in favour of reform. This goes against the 'big bang' approach but favours the gradual implementation of reforms, especially those that create more winners than losers. Early export promotion, particularly with devaluation, and gradual dismantling of protection are consistent with this approach. Major and complex reforms should wait until a momentum has been created. Second, external influence and support are important for initiating and encouraging commitment, although less so where a government is sufficiently strong and committed to declare ownership of the reform (in which case institutional capacity is the binding constraint). Third, measures to build commitment can also increase institutional capacity: administrators learn by doing, hence gradual reforms can build capacity, and benefit from external support (technical and training), which is essential when new market institutions are required.

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