

INSTITUTIONAL CAPACITY, GOVERNANCE QUALITY, AND EXPORT DIVERSIFICATION IN PAKISTAN

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Abstract

Export diversification and sustained export growth are widely regarded as essential for long-term economic development in developing countries. However, export performance depends not only on market access and price competitiveness but also on the institutional and administrative capacity of the state. This study examines the relationship between institutional capacity, governance quality, and export performance in Pakistan over the period 1995–2022. Drawing on institutional economics and developmental state theory, the study conceptualizes institutional capacity through governance indicators including regulatory quality, government effectiveness, and control of corruption. Using time-series econometric analysis, the findings reveal that weak institutional capacity has significantly constrained Pakistan's export growth and diversification. The results highlight that improvements in regulatory quality and corruption control are particularly important for enhancing export competitiveness. The study concludes that strengthening institutional capacity is a prerequisite for achieving sustainable export-led growth and structural transformation in Pakistan.

Keywords: Institutional Capacity, Governance Quality, Export Diversification, Developmental State, Pakistan

1. Introduction

Export performance plays a central role in economic development by generating foreign exchange, promoting industrial upgrading, and facilitating technological learning. Export-led growth strategies have been successfully employed by several East Asian economies, where sustained export expansion was closely linked to strong state institutions and effective governance. However, many developing countries have struggled to replicate this success despite adopting export promotion policies and trade liberalization measures.

Pakistan represents a notable case of persistent export underperformance. Although the country has implemented multiple export promotion initiatives since the 1990s, exports remain narrowly concentrated in low-value-added and labor-intensive products, particularly textiles and agricultural commodities. Export growth has been volatile, and Pakistan's share in global exports has declined over time. This pattern suggests that structural and institutional constraints, rather than market access alone, may be responsible for weak export outcomes.

Institutional capacity influences export performance through multiple channels, including regulatory enforcement, customs efficiency, infrastructure provision, policy coordination, and innovation support. Weak governance increases transaction costs, discourages investment, and limits firms' ability to compete in international markets. In Pakistan, governance challenges such as regulatory inconsistency, bureaucratic inefficiency, and corruption continue to undermine export competitiveness.

This study aims to analyze the impact of institutional capacity and governance quality on Pakistan's export performance. By integrating governance indicators into an export performance framework, the study contributes to the literature on trade and development and provides policy-relevant insights for export-led growth strategies.

2. Literature Review

2.1 Institutional Economics and Export Performance

Institutional economics emphasizes that institutions shape economic incentives and market outcomes by reducing uncertainty and transaction costs (North, 1990). Strong institutions protect property rights, enforce contracts, and ensure regulatory predictability, all of which are

essential for export activities. Weak institutions increase compliance costs and discourage firms from engaging in international trade.

2.2 Governance Quality and Export Diversification

Empirical studies show that governance quality significantly affects export diversification and competitiveness. Countries with higher regulatory quality and lower corruption are more likely to diversify exports and integrate into global value chains (Dollar & Kraay, 2003; Hausmann & Rodrik, 2003). Regulatory stability enables firms to make long-term investment decisions necessary for export upgrading.

2.3 Developmental State Perspective

The developmental state literature highlights the role of capable and coordinated state institutions in promoting export-led growth (Johnson, 1982; Evans, 1995). Successful export-oriented economies combined bureaucratic autonomy with close coordination between government and industry. These states actively supported exporters through industrial policy, infrastructure development, and institutional capacity building.

2.4 Export Performance in Pakistan

Existing studies on Pakistan's export performance primarily focus on exchange rates, trade openness, and global demand conditions. However, governance and institutional factors receive limited attention. Studies that do address institutional constraints point to policy inconsistency, weak industrial coordination, and corruption as major barriers to export growth. This study builds on this literature by providing a systematic empirical analysis of institutional capacity and export performance.

3. Methodology

3.1 Data Sources and Period

The study uses annual data for Pakistan covering the period 1995–2022. Export performance is measured as exports as a percentage of GDP, obtained from the World Development Indicators. Governance indicators are sourced from the Worldwide Governance Indicators database.

3.2 Variables

- **Dependent Variable:**
Export performance (exports as a percentage of GDP)
- **Independent Variables (Institutional Capacity):**
 - Regulatory Quality
 - Government Effectiveness
 - Control of Corruption
- **Control Variables:**
- GDP growth rate and inflation rate, which capture macroeconomic conditions affecting export competitiveness.

3.3 Model Specification

The econometric model is specified as follows:

$$\text{Exports}_t = \alpha + \beta_1 \text{RegQual}_t + \beta_2 \text{GovEff}_t + \beta_3 \text{Corruption}_t + \beta_4 \text{GDPGrowth}_t + \beta_5 \text{Inflation}_t + \epsilon_t$$

3.4 Estimation Technique

Time-series analysis is conducted after testing for stationarity using Augmented Dickey–Fuller tests. Ordinary Least Squares (OLS) regression is employed, followed by diagnostic tests to ensure robustness and reliability of the estimates.

4. Results and Discussion

4.1 Overview of Empirical Results

The empirical results indicate that institutional capacity has a statistically significant impact on Pakistan's export performance. Governance indicators explain a substantial proportion of variation in export outcomes, even after controlling for macroeconomic factors. This confirms the central role of institutions in shaping export competitiveness.

4.2 Effects of Governance Indicators

Regulatory Quality emerges as the most influential determinant of export performance. Improved regulatory frameworks reduce uncertainty, lower compliance costs, and enhance firms' ability to engage in international markets. This finding underscores the importance of predictable and transparent export-related regulations.

Control of Corruption also shows a strong positive effect on exports. High corruption increases informal costs, delays export procedures, and discourages small and medium-sized enterprises from exporting. Reducing corruption improves efficiency and market access for exporters.

Government Effectiveness positively affects export performance, reflecting the importance of efficient public administration, export promotion agencies, customs services, and trade facilitation infrastructure.

Among the control variables, GDP growth positively influences exports by expanding productive capacity, while inflation negatively affects export competitiveness by increasing production costs.

4.3 Institutional Constraints and Export Structure

Despite policy efforts, Pakistan's export structure remains highly concentrated and lacks technological sophistication. Weak institutional capacity limits export diversification by discouraging investment in innovation and higher-value production. Poor coordination between trade, industry, and finance ministries further constrains export upgrading.

These institutional weaknesses explain why Pakistan has struggled to move beyond traditional export sectors despite favorable trade access in some markets.

4.4 Theoretical and Comparative Interpretation

The findings support institutional economics and developmental state theories, which emphasize that export success requires capable and coordinated state institutions. Pakistan's experience contrasts with that of successful export-oriented economies, where strong bureaucratic capacity and governance facilitated export diversification and industrial upgrading.

5. Conclusion

This study examined the impact of institutional capacity and governance quality on export performance in Pakistan over the period 1995–2022. The empirical results demonstrate that weak institutional capacity—particularly poor regulatory quality and high corruption—has significantly constrained export growth and diversification.

The study contributes to the literature by highlighting the institutional foundations of export performance in a developing-country context. It shows that Pakistan's export stagnation reflects deeper governance failures rather than purely market or macroeconomic factors.

From a policy perspective, the findings suggest that sustainable export-led growth in Pakistan requires comprehensive institutional reform. Strengthening regulatory quality, improving government effectiveness, and reducing corruption are essential for enhancing export competitiveness and diversification. Without such reforms, export promotion policies are unlikely to deliver long-term results.

Future research may extend this analysis by using firm-level export data, sector-specific studies, or comparative analysis with other developing economies.

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