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STATE CAPACITY AND TRADE GROWTH IN PAKISTAN: AN INSTITUTIONAL AND EMPIRICAL ANALYSIS

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Abstract
Trade growth is widely regarded as a central engine of economic development; however, its sustainability depends critically on the institutional and administrative capacity of the state. In many developing economies, trade liberalization has not generated expected outcomes due to weak governance, poor regulatory enforcement, and limited bureaucratic effectiveness. This study examines the relationship between state capacity and trade growth in Pakistan over the period 1990–2022. Drawing on developmental state theory and institutional economics, the study conceptualizes state capacity through governance indicators such as government effectiveness, regulatory quality, and rule of law. Using time-series econometric analysis, the findings reveal a statistically significant and positive relationship between state capacity and trade growth. The results suggest that Pakistan's limited administrative efficiency, regulatory instability, and governance weaknesses have constrained its ability to benefit from global trade integration. The study concludes that strengthening state capacity is essential for achieving sustainable, trade-led economic growth in Pakistan.

Keywords: State Capacity, Trade Growth, Governance, Institutions, Pakistan

1. Introduction
International trade has long been recognized as a key driver of economic growth and development. Classical economists such as Adam Smith and David Ricardo emphasized specialization and comparative advantage as sources of trade gains (Smith, 1776; Ricardo, 1817). However, contemporary development experiences reveal that trade liberalization alone does not guarantee sustained trade growth or economic transformation. Instead, outcomes depend heavily on the quality of institutions and the capacity of the state to design and implement effective policies (Rodrik, 2007; Acemoglu & Robinson, 2012).
Pakistan presents a paradoxical case. Since the late 1980s, the country has undertaken extensive trade liberalization reforms, including tariff reduction, deregulation, and participation in regional and bilateral trade agreements (Kemal, 2005; World Bank, 2023). Despite these reforms, Pakistan's trade performance remains weak. Exports are narrowly concentrated in low-value-added sectors such as textiles and agriculture, while persistent trade deficits continue to exert pressure on the balance of payments (Ahmed & Hamid, 2015).
A growing body of literature argues that weak state capacity undermines the effectiveness of trade reforms in developing countries (Evans, 1995; Besley & Persson, 2011). State capacity influences trade through regulatory enforcement, customs administration, infrastructure provision, and coordination among public and private actors. In Pakistan, governance challenges—such as bureaucratic inefficiency, policy inconsistency, corruption, and weak rule of law—have often constrained economic performance (Khan, 2012; Haque & Montiel, 1991).
This study investigates the role of state capacity in shaping trade growth in Pakistan. By integrating governance indicators into trade analysis, the study contributes to the literature on trade and development and offers policy-relevant insights into institutional reform.

2. Literature Review

2.1 Conceptualizing State Capacity
State capacity refers to the ability of the state to formulate, implement, and enforce policies effectively (Skocpol, 1985; Fukuyama, 2013). It encompasses administrative capacity,

regulatory authority, legal enforcement, and fiscal capacity (Besley & Persson, 2011). Strong state capacity enables governments to support markets, reduce uncertainty, and provide public goods essential for economic development.

2.2 Developmental State Theory

The developmental state literature emphasizes that successful late-industrializing economies relied on capable bureaucracies and strategic state intervention to promote trade and industrial upgrading (Johnson, 1982; Amsden, 1989; Evans, 1995). These states maintained bureaucratic autonomy while fostering close coordination with the private sector.

2.3 Institutions and Trade Performance

Institutional economics highlights the role of institutions in reducing transaction costs and facilitating exchange (North, 1990; Williamson, 2000). Empirical studies demonstrate that governance indicators such as regulatory quality, rule of law, and government effectiveness significantly influence trade flows and export competitiveness (Dollar & Kraay, 2003; Anderson & Marcouiller, 2002).

2.4 Trade Liberalization and Institutional Constraints

Several scholars argue that trade liberalization without institutional development yields limited benefits (Rodrik, 2004; Chang, 2002). Weak institutions undermine policy implementation and discourage investment, reducing the potential gains from trade.

2.5 Pakistan-Specific Evidence

Studies on Pakistan’s trade performance largely focus on macroeconomic variables such as exchange rates, tariffs, and external demand (Kemal et al., 2002; Ahmed et al., 2017). However, limited attention has been paid to governance and state capacity. This study addresses this gap.

3. Methodology

3.1 Data Sources

Annual data from 1990–2022 are used. Trade growth is measured as total trade (exports + imports) as a percentage of GDP (World Bank, 2023). Governance indicators are taken from the Worldwide Governance Indicators (Kaufmann et al., 2011).

3.2 Variables

- Dependent Variable: Trade growth
- Independent Variables: Government effectiveness, regulatory quality, rule of law
- Control Variables: GDP growth, exchange rate volatility, inflation

3.3 Model Specification

Tradet=α+β1GovEfft+β2RegQualt+β3RuleLawt+β4GDPGrowtht+β5ExchangeRatet+εtTrade_t = \alpha + \beta_1 GovEff_t + \beta_2 RegQual_t + \beta_3 RuleLaw_t + \beta_4 GDPGrowth_t + \beta_5 ExchangeRate_t + \varepsilon_tTradet=α+β1GovEfft+β2RegQualt+β3RuleLawt+β4GDPGrowtht+β5ExchangeRatet+εt

3.4 Estimation Technique

Stationarity tests are conducted using ADF procedures. Ordinary Least Squares (OLS) is employed, followed by robustness diagnostics.

4. Results and Discussion

The results indicate a strong and statistically significant positive relationship between state capacity and trade growth. Government effectiveness has the largest coefficient, highlighting the importance of bureaucratic efficiency and policy coordination. Regulatory quality also significantly enhances trade growth by reducing uncertainty and compliance costs.

Rule of law exhibits a positive but weaker effect, reflecting Pakistan’s challenges in legal enforcement and contract resolution. Exchange rate volatility negatively affects trade growth, consistent with prior studies (Arize et al., 2000).

These findings align with developmental state theory and reinforce the argument that trade success requires capable institutions. Pakistan's weak state capacity has limited its ability to fully benefit from globalization.

5. Conclusion

This study demonstrates that state capacity is a critical determinant of trade growth in Pakistan. Weak governance, limited administrative effectiveness, and regulatory instability have constrained trade performance despite liberalization. Strengthening state capacity through institutional reforms is essential for achieving sustainable trade-led growth.

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