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# Expectations versus Reality of Pakistan China FTA

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Abstract:

Pakistan-China FTA was implemented with lot of fanfare and was expected to improve Pakistani export potential and business competitiveness. However, the successive governments failed to improve local competitiveness through effective regulation resulting in (a) missed opportunity to exploit the FTA to the benefit of Pakistan and (b) a trade balance favouring only China.

## 1. Why the FTA:

*“The difference between Chinese and Pakistani goods in bilateral trade is relatively big and the number of their competing goods is relatively small”* (Che Chao, an Official with the International Trade Department of China’s Ministry of Commerce in an interview with China Business Weekly)\*.

The above is by far the most motivating statement to go ahead with the FTA between China and Pakistan, two countries who belong to the South but one being at a higher level of technological ladder than the other one.

Pakistan accounts for 20 per cent of China’s total trade with South Asia, which also includes India, Nepal, Bangladesh, Sri Lanka and Maldives. China’s main shipments to Pakistan include machinery equipment, chemicals, electronics and footwear. Chinese companies already account for an important part of foreign investment in Pakistan. About 500 foreign companies are now operating in Pakistan, 60 of which are Chinese. Many of these companies are operating in the public utilities and infrastructure sectors, such as mining, telecommunication and energy. On the other hand, 70 percent of Pakistani exports to China are cotton yarn and cotton fabric. The rest are leather products, minerals and seafood.

Pakistan, an agricultural economy with a stagnant agriculture sector, was expected to only gain if its agricultural products have an immediate free access to the supermarkets of China’s Western Regions. In due course of time and through an effective export promotion policy, Pakistan was expected to even target the farther regions of Beijing and Shanghai, which right now look distant lands for Pakistani agriculture produce. China on

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\* Source: People’s Daily Online, [http://english.people.com.cn/200412/27/eng20041227\\_168754.html](http://english.people.com.cn/200412/27/eng20041227_168754.html)

the other hand has the access to a market of 150 million people and a passage to Central Asia.

Today recent trade literature suggests that developing countries sometimes benefit more with South-South trade instead of North-South trade. But these benefits might very well vary from case to case. Here the geographical location and the status of the trading partner are two factors which are the key determinants to decide how much there is to be gained with more trade. If one trading partner is at a higher stage of technical ladder than the other one, the later can gain a lot in terms of growth and poverty alleviation.

In Sino Pakistani case, the two big positives are that both are not only neighbours but both have enjoyed great friendly bilateral relationships which are time tested. China is at a much higher level of technological progress than Pakistan. A free trade agreement with China not only gives Pakistani agriculture produce an access to a market with multi billion people, but it was expected to enable Pakistan to follow China in its technological progress, as more and more Chinese investments were taking place in Pakistan.

## **2. Pakistan's Technical Progress and Sino-Pakistani FTA:**

As the developing country moves forward in technology, it naturally indulge in more advanced production patterns and more and more of its trade, especially exports are concentrated in products involving high skilled labor. As one developing country is climbing the technology ladder, the other developing country at a lower stage starts taking over the production activities, which are least skill-intensive in the former as part of its own technology catch-up phenomenon. For example, China has a higher pace of technology catch-up than many of less developed countries in East Asia, Latin America or Sub Saharan Africa. China has built a sound technology base primarily because of its low factor costs. Chinese exports are getting more and more skill intensive as a result. As China advances in technology and produces goods and services involving higher skill intensive labor, there is increasing chance for other developing countries, at lower stage of technology ladder, to exploit this situation by taking-up the production of goods and services which require relatively less skill intensities in factor inputs if produced in China.

Ianchovichina and Walmsley (2003)<sup>#</sup> hinted on the effects of China's technology catch-up on the developing countries of Asia: *As China becomes a more efficient supplier of services or a more efficient producer of high-end manufactures, its comparative advantage will shift into higher end products. This is a good news for Vietnam. Indonesia and other developing countries ..... Vietnam and Indonesia will benefit the most if China's economy becomes more efficient in the production of high-end manufactures.*" From 1991 to 2001, trade between China and Vietnam has grown nearly 100 times, and China is a major investor in Vietnam, which indicates that later country is an important place of outsourcing by Chinese companies.

A Sino Pakistani FTA could put Pakistan in a position to compete with the likes of Vietnam and Indonesia viz a viz trade with China and undergo technological catch up in a more effective and efficient manner.

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<sup>#</sup> Ianchovichina, Elena., and Walmsley, Terrie., (2003), "Impact of China's WTO Accession on East Asia", Working Paper 3109, World bank, Washington DC.

Here an important point to note is that Sino Pakistani FTA is also expected to provide such a Southern trading arrangement which will minimize labor market distortions in Pakistan which are always a possibility under global free trading models. In other words Sino Pakistani FTA would not only be good for Pakistani macro economy but also be pro poor.

### **3. Roadmap of an Effective Pak-Sino FTA**

The above discussion suggests that Pakistan primarily wanted to export more of its agriculture produce to China whereas China was interested to invest in public utilities, manufacturing and infrastructure sectors. Following is a roadmap of direct and indirect benefits Pakistan should have received from the FTA.

1. Customs Procedures and Facilitations Measures
2. Investment Climate and related policies
3. Industrial Policy and incentive to investors
4. Subsidies and incentives to exporters.
5. Trade in Services; policies and incentives
6. The system of dispute resolution relating to trade disputes.
7. Local taxes (excise, sales tax, value added tax etc.) and their linkage on import tariffs.
8. Regulations for domestic sale of imported commodities and those applied to locally manufactured goods.
9. Cost of utilities, labour and capital.
10. The financial system and support to local industry.
11. Competitiveness of Industrial goods manufactured locally and those produced in Pakistan.
12. Quarantine requirements and laws on agriculture imports.

### **4. The Outcomes of the FTA**

Notwithstanding the initial enthusiasm on account of the FTA in both countries, the outcomes turned out to be skewed in favour of China. Pakistan was not able to export to China. Neither did Pakistani manufacturing sector benefitted from the agreement. If anything local markets in Pakistan were swarmed by cheap Chinese exports. Small Businesses in Pakistan could not compete with Chinese goods. The fault lied with the successive governments in Pakistan who could not exploit the FTA despite many technical and feasibility reports that provided a complete roadmap for effective FTA implementation. By just lowering the tariffs as a prerequisite for the FTA, local industry was exposed to competition and no steps were taken to make it competitive.

### **References:**

Ianchovichina, E. and T. Walmsley (2003) 'Impact of China's WTO Accession on East Asia', Working Paper 3109, Washington DC: World Bank.

