



SWOT ANALYSIS OF PAKISTAN-CHINA FREE TRADE AGREEMENT: PROS AND CONS



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ABSTRACT

Pakistan and China share a long lasting cordial relationship. To extend this relationship a free trade agreement (FTA) was signed in 2006 which came into effect in 2007. This study examined the impact of this FTA on patterns of goods traded by both nations. Before-After analysis reveals that the trade patterns have improved generally (Pakistan exports as well as imports from China have increased) but the trade deficit of Pakistan has also increased; the Revealed Comparative Advantage (RCA) and SWOT analysis shows that there is a difference in goods traded by both countries in world markets and bilaterally except the top ranked products. Conversely, Pakistan's GDP does not have much influence on its exports to China. Therefore, in present conditions, Pakistan benefits more from the bilateral trade because its' exports to China are positively correlated with China's GDP, which is growing faster than Pakistan's GDP.

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Keywords: Pakistan trade, SWOT, RCA, Free trade agreement, China, Bilateral trade.

Contribution/ Originality

This Study examined the impact of Pakistan-China Free Trade Agreement by Revealed Comparative Advantage (RCA) and SWOT analysis, being one of the few studies which investigate the Pros and Cons of Pakistan- China Free Trade Agreements.

1. INTRODUCTION

All the way through human history, people acquired knowledge from their environment and get influenced by immediate nations. People are accustomed to trade, voyage migrate or through invasion, leaving ethnical influence. Nation learned and developed their lives by acquisition of skills and mode of life that suits them. Even at present this process has not congested. Different nations that have dissimilar demographics and history, adopts and gain knowledge from each other. The cultural diversity between countries has its consequence on trade in a complex way. Furthermore, trade among nations has its special effects on culture. Correspondingly, there is high possibility that nations with common cultural attributes might trade more. Although trade is built on comparative advantage, subsequently with diverse culture, higher trading may be possible (Cyrus, 2011). The benefits from trade could differ from country to country based on its national welfare, economic, political, regional and strategic state of affairs.

Countries tend to agree upon mutual free trade agreement when multilateral liberalization is unattainable. More free trade could help increase national welfare (Krugman and Obstfeld, 2009).

Pakistan and China are both members of World Trade Organization (WTO) and in accordance with Article XXIV of General Agreement on Tariffs and Trade (GATT), WTO members are allowed to enter into bilateral or regional agreements provided they cover a large amount bilateral trade flows and they do not have net trade diversion effect. Both the nations have dissimilar economic structures and constricted accordingly. It is hard to say that if their specialization in goods is based on the theory of comparative advantage where countries tend to specialize in those individual segments of production where they have comparative advantage. China's exports to Pakistan are more diversified and bigger in volume. Pakistan's export of product mix is very limited; around 70% of its exports consist of cotton yarn (Shabir and Kazmi, 2007).

Like other nations, Pakistan is also altering its direction of policies towards growing efforts to grasp gains from trade through plurilateral and bilateral agreements. Bilateral relations seek mutually advantageous arrangements with the goal of reducing tariffs and eliminating non-tariff barriers (NTBs). The Islamic Republic of Pakistan and the People's Republic of China have adored long-lasting and friendly ties—regardless of their ideological differences, evident in their very names (Muhammad *et al.*, 2015). Table 1 demonstrates the recent trade agreements of Pakistan and China with other trading nations in the world especially immediate neighbors.

Table-1. China and Pakistan's FTA commencements in 2015¹.

Country	Framework Agreement signed	Negotiations launched	Signed but not yet In Effect	Signed and In Effect	TOTAL
China	0	6	2	14	22
Pakistan	0	5	2	10	17

Source: Asian Regional Integration Center, Asian Development Bank

Economic hypothesis and empirical evidence have obviously established the relations between trade, productivity and economic development. Countries that have bulky internal markets have also gained from desegregation into the global economy and opening up their economies. Total exports of world in 2014 amounted to US\$18.7 trillion and total world imports accounted US\$ 18.73 trillion in the same year. The size of Pakistan's domestic market is only US\$ 271 billion in 2015. Even a 0.5 percent share in the world export market connotes that Pakistan's exports could climb to \$60 billion instead of US\$ 30 billion in last year. Imagine the jobs that will be shaped directly or indirectly as an outcome of expansion in the invention and production of exportable items. Alternatively, imports brings into the country the transfer of technology entrenched in imported goods and services and hoist the country's production opportunity frontier. Hence, it follows that augmented trade is in the superior economic interest of the country.

2. METHODOLOGY

The purpose of our study is to examine observations from 2003-2015, which has been carried out using before-After FTA analysis. We are only observing this period due to available data limitations. For Revealed Comparative Advantage (RCA) and SWOT analysis, we acquired observations from the last five years. All exports and imports statistics were taken from International Trade Center (ITC), World Bank, World trade organization and all the additional data was taken from respective Ministry of commerce websites that are considered as a main source of

¹ (1. Framework Agreement signed: The parties initially negotiate the contents of a framework agreement (FA), which serves as a framework for future negotiations. 2. Negotiations launched: The parties, through the relevant ministries, declare the official launch of negotiations or set the date for such, or start the first round of negotiations. 3. Signed but not yet in effect: Parties sign the agreement after negotiations have been completed. However, the agreement has yet to be implemented. 4. Signed and in effect: Provisions of FTA come into force, after legislative or executive ratification. As of August 2015).

information due to the reliability, consistency and transparency of its data and records. The results and discussion part contains the SWOT analysis in detail for Pakistan China Free Trade Agreement (PCFTA).

3. THE BUMPY ROAD TOWARDS LIBERALIZATION (PCFTA)

The road of free trade between Pakistan and China was filled with tariff obstacles thrown up by both countries. First of all, the Pakistan economy is much more dependent on international trade than the China economy because of local market demands are higher than the local supply of goods in the country. The Pak-China and China-ASEAN FTAs are typically treated as footnotes in most discussions of Pakistan Trade policy, owing to the handsome amount of trade they cover. The importance of these agreements to Pakistan trade policy goes far beyond their trade coverage, however. The agreements set several precedents for Pakistan trade policy and also provide some lessons for the border debate over the imbalance trade of the bilateral FTAs. First and foremost, the Pak-China and China-ASEAN are clear examples of the use of trade policy- specifically bilateral free trade agreements- as a means of pursuing foreign policy objectives.

The worldwide export patterns are shifting fast as a result of lessening in trade barriers and technological innovations that have led to gains in productivity and revolutionary in comparative advantage patterns in global economies. Asian economies for example China and ASEAN nations are enjoying an outstanding growth in changing situations across the globe. Pakistan also has immense potential for elevated growth however the political intimidation, socio economic atmosphere and lack of modernized technologies are obstacles in the way of advancement (Naseem, 2009). In response to increasingly altering global trends of trade, China on multi-tracking its regional and multilateral trade negotiations in 1990 and emphasized the economic factors more willingly than political to develop its trade liberalization. Trade is one of the most important channel through which China has altered from a closed autarkic economy to an open globalized one. It is also becoming pretty obvious that the equilibrium of economic power is moving away from developed countries to developing countries. Economy of China has overtaken several developed nations to become the largest exporting nation and has surpassed Japan to become the second largest economy in the world.

Pakistan and China share extensive cordial relationship. To widen this bond, a free trade agreement (FTA) was signed in 2006, which came into effect in 2007. This Agreement was separated into two phases: Phase I, which concluded in December 2012, China eradicate/lessen tariffs on 6418 product lines, and Pakistan made the similar on 6711 product lines over a period of five years. For phase II negotiations/discussions on the move since July 2013, to attain the FTA's preliminary objective to remove tariffs on at least 90 percent of entire products (together in terms of tariff lines and trade volume), it is very important that the Government of Pakistan utilizes this opportunity to develop Pakistan's access to the Chinese markets. The target for bilateral trade of \$15 billion (by the end of Phase II) was agreed as part of the original FTA along with the objective of improving economic relations between the two countries through trade. As of the end of 2013, bilateral trade equaled over \$9,278 million, as compared to \$3,421.96 million in 2006 prior to the FTA being implemented. The agreement targeted bilateral trade of 20 billion dollars between Pakistan and China at the end of Phase II. Total trade of Pakistan and China under FTA rapidly increased from US\$ 3.5 billion in 2006 to US\$ 16 billion in 2014. China was a top importing partner of Pakistan with a share of 20.2% of Pakistan's total imports in 2014 (Muhammad and Qi, 2015). Figure 1 demonstrates the trade between Pakistan and China before and after agreement. Trade between two countries growing since 2007 and trade balance also moves up which is not favorable for Pakistan.



Figure-1. China Pakistan trade under FTA (Before and after) by China. (US\$ Billions)
 Source: Author's own calculations based on ITC & UN COMTRADE statistics

China has obtained substantial advantage after signing the free trade agreements (Qi et al., 2014). China has established win-win relationships in its targeted market by providing common benefits to its counterparts. Figure 1 shows a graph with healthy profitable trade for China due to rapidly increase in exports to Pakistan but a negative balance for Pakistan. This is the alarming situation for Pakistani stake holders and Government to discuss with Chinese officials for reducing the tariff at maximum level. Furthermore, China managed to exports along 57 percent of his product lines in which it had preference under FTA, conversely utilization was a mere 5 percent beside lines in which Pakistan had managed to negotiate concessions. The FTA between China and South Korea will officially come into force starting 20 December 2015. Under the deal, both countries will eliminate tariff on more than 90 percent of highly traded goods within 20 years after the implementation (Hua Xia, 2015). That is what Pakistan seeks from China, an elimination of tariff should be on highly traded goods not at the limited goods.

4. REVEALED COMPARATIVE ADVATAGE (RCA)

The Balassa (1965) of RCA is defined as a country's share in global exports of a commodity/product divided by its share of total worldwide exports. The study may also facilitate us in understanding the composition of goods traded between Pakistan and China. The outcomes will also help us realize if Pakistan has RCA in the same goods in its bilateral trade with China as in the trade with the whole world. We have short listed the commodity categories at the HS-2 digit level. We have analyzed top 10 sectors of Pakistan since 2010 to 2014. This index is calculated as follows;

$$RCA_{ij} = (X_{ij} / X_{wj}) / (X_i / X_w)$$

Where

X_{ij} = ith country's export of commodity j

X_{wj} = world exports of commodity j

X_i = total exports of country i

X_w = total world exports

Table 2 demonstrates those sectors which have a comparative advantage (RCA>1) while it approaches to Pakistan's exports to China. The Textiles sector has the uppermost comparative advantage, with the Hides/Skins, Food Products and animal also showing a clear comparative advantage.

Table-2. Pakistan's sectors with comparative advantage with China

HS Code	Sectors	RCA>1 / RCA<1				
		2010	2011	2012	2013	2014
50-63	<i>Textiles and Clothing</i>	30.36	30.14	29.71	33.74	35.21
41-43	<i>Hides and Skins</i>	10.00	9.37	7.88	8.28	9.42
16-24	<i>Food Products</i>	3.88	2.10	1.88	2.08	3.69
01-05	<i>Animal</i>	3.26	2.74	1.71	1.13	1.71
25-26	<i>Minerals</i>	1.59	1.39	0.92	1.01	1.03
72-83	<i>Metals</i>	1.10	1.21	1.09	1.06	1.11
06-15	<i>Vegetable</i>	0.42	0.52	3.02	2.10	2.31
39-40	<i>Plastic or Rubber</i>	0.26	0.28	0.23	0.28	0.29
64-67	<i>Footwear</i>	0.08	0.17	0.05	0.10	0.10
28-38	<i>Chemicals</i>	0.05	0.23	0.04	0.01	0.01

Source: Author's own calculations based on ITC & UN COMTRADE statistics and WITS²

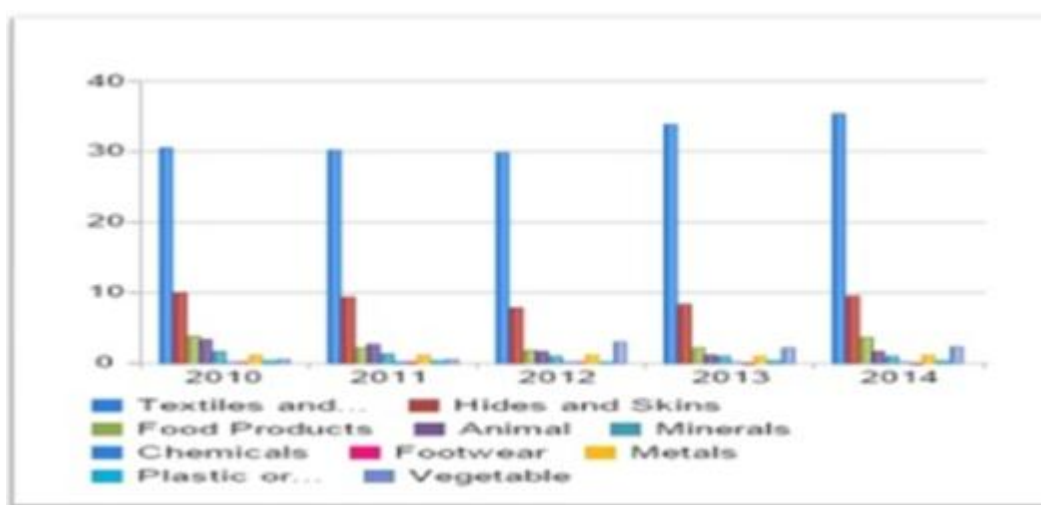


Figure-2. Demonstrates the clear picture of Pakistan's sectors with RCA

Source: Author's own calculations based on World Integrated Trade Solution (WITS)

Generally, if the importing nation lowers import barriers, it is predictable that home country's exports boost to the importing nation. Since FTA lessens China's import barriers, Pakistan's exports to China are projected to enhance. Particularly, the exports of the products with $RCA > 1$ are probable to increase quicker than exports of other products after FTA, since Pakistan has comparative advantage in those sectors. If the exports of these sectors with $RCA > 1$ indeed increase more rapidly than those of other sectors after FTA, then it illustrates that the Pakistan-China trade model goes as expected by the belief of comparative advantage. Otherwise, we imagine that there are some impediments preventing the bilateral trade to follow the principle of comparative advantage (Muhammad and Qi, 2015). Another possibility is that cultural differences allow nations to exploit comparative advantage, thereby raising trade (Cyprus, 2012).

5. RESULTS AND DISCUSSIONS

5.1. SWOT Analysis of PCFTA

SWOT means strengths, weaknesses, opportunities and threats. We utilize SWOT analysis to explain the trade agreement between Pakistan and China. Figure 3 shows all aspects of SWOT and also demonstrates the internal or domestic market effects and external effects of PCFTA.

² WITS (World Integrated Trade Solution), Country Profile 2010-2014.

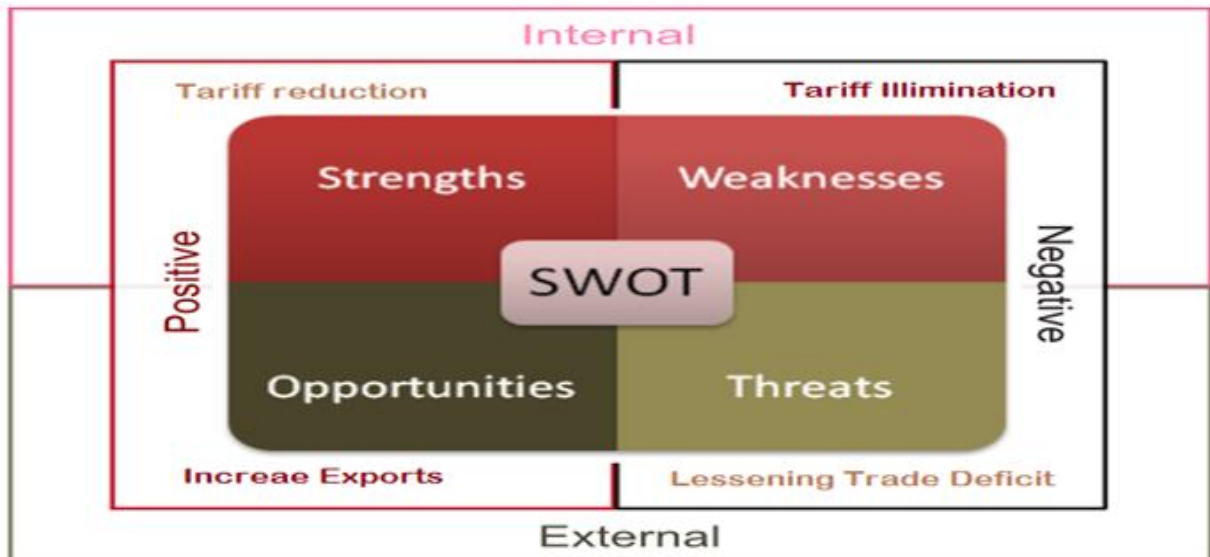


Figure-3. SWOT (strengths, weaknesses, opportunities and threats)

5.1.1. Strengths

The strength of the FTA from Pakistan's perspective lies in the growth of the overall exports to China that have shown considerable progress since the enforcement year, a fact that cannot be discounted. Performance of exports along each concession category has been consistent, even though one can contest that the value of exports are not significant as compared to imports from China or even Pakistan's exports to the world.

Alongside, China's incoming products into Pakistan have gained unparalleled momentum climbing by US\$ 13 billion dollars from 2006 to 2014. This sudden rise in imports from China can be associated to lower prices of Chinese products, trade diversion because of low transportation costs as well as the lower tariffs that are imposed by Pakistan on Chinese products. This has consequently made China, Pakistan's top import partner. On the positive side, lower tariff from Pakistan for China's value-added products has meant that local producers could import machinery at reasonable prices and managed to retain and even increase production in some cases. The strength of the FTA relies upon the opportunities it deems to provide in the future for Pakistan and the doors it has opened for trade which Pakistan could potentially avail given that it diversifies its production composition and increases its capacity while China provides it competitive tariff concessions via further trade negotiations.

5.1.2. Weaknesses

Given the difference in sizes of the two economies, their growth in world trade, the enormous gap in the level of industrial development, and the relatively disproportionate contribution of trade made by each country, the rationale behind an FTA was to strengthen relations by providing deeper access into each other's markets. Such however could not be achieved. The FTA had merely 35.5% (2,681 of 7,550) tariff elimination product lines (where as many as 1400 products did not record any exports at all in 2012), 15% in no concession and 15% with marginal concessions. In addition to the narrow coverage of this FTA, other FTAs signed by China with over eight countries and regions give hefty concessions, making Pakistan's products inconsequential by design, in the Chinese markets. The ASEAN countries enjoy tariff elimination coverage of over 90% traded goods. Many of these products coincide with what Pakistan specializes in and exports as shown in the RCA analysis of this study.

We have seen that while exports to China grew overall, significant growth was witnessed in exports of products that lay outside the framework of the FTA. This appears to defeat the purpose of a free trade agreement where many products were deceptively added into tariff concession lists but had no potential in trade to utilize these concessions. In fact, many top exports to China overall belonged to the no concession protected list of China or were outside the

FTA zone altogether. In light of preferential tariffs offered to ASEAN countries, Pakistani products could not compete in China's extremely aggressive market even in products that Pakistan trades in worldwide.

Additionally, multiple reasons such as high tariff concessions and therefore flexible per unit pricing, product availability, ease of access and greater customs relief have made local producers lose to Chinese products in their own market.

5.1.3. Opportunities

China recently has made commitments to invest US\$46 billion in Pakistan. The China Pakistan Economic Corridor (CPEC) contains many development deals, which are equivalent to approximately 20 per cent of Pakistan's annual GDP (Andrew, 2015). This will be China's prevalent foreign direct investment deal to invest in Pakistan. Altogether, the economic corridor project endeavors to contribute some 17,000 megawatts of electricity production at a cost of approximately \$34 billion. The rest of the wealth will be spent on transport, infrastructure, together with upgrading the railway line linking the port megacity of Karachi and the northwest city of Peshawar (Saeed, 2015). China took over the operational control of a strategic deep water seaport of Pakistan that will prove to be a crucial economic hub for Beijing and a key military outpost. The port located in a former fishing village of Gwadar in the province of Baluchistan was funded by China with about US\$ 2 billion but was a commercial failure since it opened in 2007. Now signed over to China, it will be run by a Chinese company for 40 years. This evidently provides a trade corridor between the two countries to further boost Pakistan and China relations. In fact, this provides Pakistan a strategic timing to renegotiate the FTA on mutually beneficial terms. Additionally, with both countries embarking on new government terms, a deeper emphasis would be placed upon trade and improving global economic ties, especially for Pakistan.

Speaking from Pakistan's exports perspective, renegotiations should be made along the FTA whereby the agreement should bring in products that have been highlighted in this study which were given no concession or not included in the agreement at all but showed immense potential of trade. Additionally, preferential treatments, not just concessions in tariffs are needed for these products. The potential exports for Pakistan are estimated to be more than US\$ 10 billion in current the year. Several of the products that compose of Pakistan's top exports to the world are largely imported by China from the world but many of these do not get access into China's markets. Such products are also included as they need to be brought into the framework of the FTA while removing redundant products that have no hope in trade. Additionally, RCA analysis provides a list of products along which Pakistan has comparative advantage over China especially in textile sector.

According to the Pakistan Economic Survey 2012, products such as urea (fertilizers HS 31) have local production facilities but remained underutilized in absence of fuel due to large volumes were imported. Similarly, production have decreased for iron and steel (HS 71, 72, 73) and rubber products both of which were imported from China. Products that have sufficient production capacity include those in textile, wood, paper and board were also imported. Surgical and medical instruments which are export products have underutilized capacity in addition to many textile products like knitwear, readymade garments and towels. Installing efficient machinery and equipment and providing a source of uninterrupted power are two major steps that must be taken immediately. Funds should be injected in focused areas to induce expansion in the mid and long term. Increased capacity will automatically serve as a driving force to a more favorable trade terms and tariff concessions.

5.1.4. Threats

China trades in a variety of products ranging from raw to semi to finished products providing high tech machinery and electrical products, while also specializing in raw materials such as yarn, iron and steel, organic chemicals, fertilizers, plastics and rubber. While creating market for itself in Pakistan, China does not provide any significant preferential treatment to Pakistan even in products that it is importing from the world in large volumes

(leather raw material, textile products, cotton, chemicals and copper articles etc). The tariff concessions granted to Pakistan are in fact inconsequential. The export performance and its ratio with China's imports from the world are warning signs to Pakistan and its future trade relations with China. Though China and Pakistan claim friendly social, political and economic ties, it is evident that without competitive tariffs, Pakistan will further lose market into China in the future despite allegiances to the contrary. Moreover, if Pakistan does not diversify its exports, its performance with China will eventually become stagnant. This coupled with further revenue losses due to soaring tariff concessions of high potential import products from both nations would have little to inject back into the economy or increase production capacity, this being one of the few sources of revenue for the country.

Trade imbalance is already a cause for concern with China because of the growing imports that may even be adversely affecting the local producer. In the past few years, as many as 10 cases of anti dumping have been filed by local producers against Chinese products to the National Tariff Commission and subsequently anti-dumping duties as high as 71% have been levied upon them. Lax protection of underdeveloped industries from rampant Chinese exports is one of the threats of high tariff concessions and increasing injury to local industries.

6. RECOMMENDATION AND CONCLUSION

In today's age, approximately all advance nations are focusing on trade in manufacturing goods and have specified its strategic importance. Governments have been censoriously analyzing and performing investigations for designing valuable policies for each sector. Unlike developed nations, developing nations have been in shape of ignorance and have not specified due value. Pakistan is no different from other developing countries. Scanty attention and assistance is given to the fabricators of manufacturing goods. This demonstrates government's lack of support in terms of regulations, legislation, institutional prop up and accession to loans or funding, etc. underneath these circumstances, policy and strategy framework and also guidelines be able to help in assisting and supporting the manufacturing merchandise commodities trade industries for their growth and developments. Ironically, Pakistan's trade and industrial policies are conspicuously silent regarding manufacturing goods producing industries and their exports (Saba and Zafar, 2014).

Before-After analysis reveals that the trade patterns have improved generally (Pakistan exports as well as imports from China have increased) but the trade deficit of Pakistan has also increased; the RCA analysis shows that there is a difference in goods traded by both countries in world markets and bilaterally except the top ranked products. The positive and statistically significant China's GDP could have positive influence on Pakistan's exports to China because the bigger China's GDP, the greater China's imports from Pakistan and the bigger its capacity to absorb imports. On the other hand, Pakistan's GDP does not have much influence on its exports to China. Therefore in present conditions it is Pakistan which benefits more from the bilateral trade because Pakistan's exports to China are positively correlated with China's GDP, which is growing faster than Pakistan's GDP.

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