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Pakistan's Experience with the Pak-China Free Trade Agreement: Lessons for CPEC

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Introduction:

As Pakistan enters the CPEC era, there is a sense of both optimism and concern due to uncertainty regarding the economic impact of this major collaboration between China and Pakistan. While much of the evidence about gains for Pakistan have been centered on infrastructural development and energy incentives, the gains for the industrial sector in Pakistan are still somewhat unclear. While this has many obvious benefits for consumers, domestic producers are worried about the impact of further opening the Pakistani market to Chinese producers. As Pakistan and China enter Phase II of the negotiation, it's important to identify the opportunities and lessons from the Phase I, so Pakistan can benefit out of this collaboration.

Research conducted at the Lahore School of Economics (by Dr. Azam Chaudhry, Dr. Theresa Chaudhry and Nida Jamil) tests the impact of the last major economic agreement between the two countries, which was the 2006 Pakistan-China Free Trade Agreement (FTA) on the industrial performance for Pakistan. The study uses both firm- and sector-level data[1] from before and after the FTA was signed to see the impact of the FTA on various indicators, such as productivity, value added, trade flows, employment, and number of firms. In particular sectors competing with Chinese imports along with the sectors that are exporting to China were considered for the analysis. Basic chemicals, fertilizers, leather, iron and steel, rubber, aluminum, general purpose machines, special purpose machines, animal feed, cutlery, pharmaceuticals and wood and related products were amongst the sectors focused by the study.

Main Results:

Results of the study showed that <u>for the import competing sectors</u>:

- Total imports have increased significantly more than in the other sectors.
- Moreover, the number of firms in the vulnerable sectors has fallen relative to the number of firms in the other sectors after the FTA.
- Total employment, productivity and value added in the vulnerable sectors has fallen relative to the other sectors.

Overall, Pakistan's share of imports from China has doubled between 2007-2015. So the end result is that Chinese imports may be potentially pushing Pakistani producers out of the market in certain vulnerable sectors and the remaining firms are smaller and less productive.

[1] Firm level analysis is based on Punjab CMI 1995-96, 2000-01, 2005-06 and 2010-11. Sector level analysis is based on UN Comtrade and the Punjab Directory of Industries 2006, 2010, 2014.

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On the other hand, for the exporting sectors that got better access to China's markets due to the FTA, the research showed:

- An increase in the amount exports and in terms of the relative number of firms as compared to other sectors.
- The relative employment in the benefited sectors has increased significantly relative to the other sectors.
- However, productivity and value added in those sectors that should have benefited from greater access to China has decreased relative to other sectors.

Policy Recommendations:

- Firstly, it's worthwhile to note while China has lowered its tariffs on Pakistani products, it has still given a better deal to ASEAN members – zero tariffs in many cases – while Pakistani firms are still being assessed positive tariffs (Pakistan Business Council, 2013). It is critical for Pakistan to lobby for same level of tariff concessions from China as received by the ASEAN countries.

- Secondly, policies need to be designed that ensure that CPEC related activities keep the interest of the local stakeholders in mind. Joint ventures and some minimum requirement of local partner involvement for business set up in Pakistan should be considered.

- Thirdly, the government's main focus of industrial policy at this time should be to design specific policies which precisely target the sectors for which Pakistan has a revealed comparative advantage in. This includes High Value-Added Textiles, Agro-Processing (including dairy), Automobiles, Motorcycles and Auto parts (including tractors), Electrical and Mechanical Goods (Including fans, motors, air-conditioners, refrigerators, etc.), Pharmaceuticals, Leather Goods, Sports Goods, and Tools (including Surgical Goods and Cutlery), Solar Panels, Construction related Materials and Machinery etc.

- Fourthly, CPEC related industrial projects should be designed in a manner which can help Pakistani firms move up the technology ladder. This can be done by creating firm level incentives for investment in advanced machinery. Minimum local content requirements for all goods created in CPEC industrial zones, technology transfers from China by making it mandatory for a minimum level of technology transfer to take place over the life of all CPEC initiatives are some possible channels in which this could be achieved.

- Lastly, CPEC related labor policy should be designed that enables a shift from low-skilled to high-skilled labor. Policies required to achieve this include: Stipulating a minimum level of domestic labor for all joint industrial initiatives, creating requirements that improves working conditions and thereby workers' productivity, ensuring that all industrial zones and joint projects automatically include training facilities, with a minimum proportion of these devoted to training women and making it mandatory for all industrial zones along with joint projects to provide their workers with both health and life insurance.

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