

Improving Regional Trade to Support Pakistan's Economic Growth

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Abstract

Regional trade has been an important factor in the economic success of many countries. Within most trading blocs, intra-regional trade comprises 40 percent or more of each member country's individual trade. However, for the regional arrangements of which Pakistan is a member, intra-regional trade accounts for less than 5 percent. Pakistan's strategic location is its greatest asset, but it has not leveraged this to its advantage. Although it was a relatively forward-looking country until the mid-1960s its policies have not been favorable to promoting trade and economic development since then. While other successful developing countries have espoused liberal trade regimes since the 1980s—resorting to protectionism only on a selective basis—Pakistan continues to rely on import substitution policies. Clearly, the country needs to revisit its regional and global trade policies.

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1. Regional Trade in Pakistan's Context

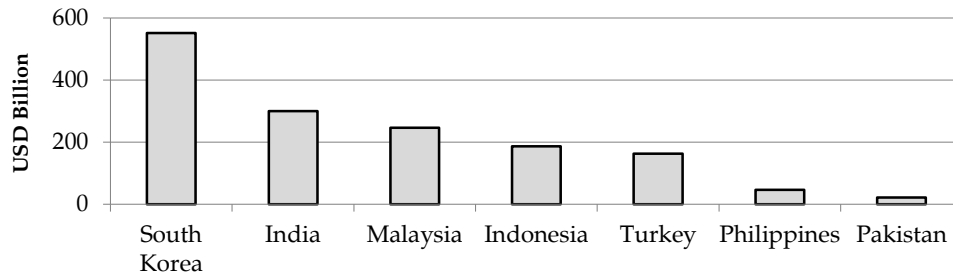
Until the 1960s, Pakistan was a relatively forward-looking country and its economic activity more integrated with the rest of the world. Its volume of manufactured exports exceeded those of the Philippines, Thailand, Malaysia, and Indonesia combined. Today, however, Pakistan's total exports are only a fraction of the exports of any of these individual countries. Figure 1 depicts Pakistan's export performance in contrast to its once comparable trading economies.

Since the mid-1960s, Pakistan's policies have not been favorable to promoting trade and economic development. In 1965, it ceased trading with its neighbor India. In the early 1970s, Pakistan nationalized all major industrial and services enterprises, which eventually enabled them to

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demand higher protection. As a result, exports stagnated. At present, 40 percent of the country's tax revenues are derived from imports, whereas for other competing countries this figure is less than 15 percent.

Figure 1: Pakistan's comparative export performance



Despite its strategic geographical location, Pakistan has yet to leverage this to its trade advantage. The country straddles a key trade route between the energy-rich countries of western and Central Asia and those in South Asia with a high demand for energy. Its three seaports—Karachi, Port Qasim, and Gwadar—provide the shortest routes linking Afghanistan, China, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan to the rest of the world. At present, however, hardly any transit trade passes through these Pakistani ports despite the fact that all these countries would benefit greatly from lower trade and transportation costs.

Figure 2: Pakistan's strategic location



In particular, transit trade through the new Gwadar port could bring huge dividends. The port is located on the coast of the Arabian Sea, approximately 75 km east of Iran's border with Pakistan and 400 km from the Strait of Hormuz, which is the only sea passage to the Persian Gulf

through open sea. For China, trade and energy transiting through Pakistan from the Persian Gulf and East African states would reduce a distance of about 15,000 km to just 2,500 km. Once a high-speed rail and road network across Pakistan is completed, oil tankers from eastern China would reach Gwadar within 48 hours. Gwadar port could, potentially, become even more significant than Dubai because it would be able to handle larger cargo S-class ships and oil tankers.

Pakistan is signatory to two regional trade agreements: the South Asia Free Trade Agreement (SAFTA) and the Economic Cooperation Organization Trade Agreement (ECOTA). However, both are of little service to Pakistan as any normal trading arrangements with the members of these blocs have yet to be established. SAFTA was formed in 2006 and, until recently, Pakistan allowed only a limited number of trade items under its Positive List. In March 2012, the country liberalized its trade policies to some extent although many restrictive policies are still in place. As yet, SAFTA has not been fully implemented in Pakistan although other SAFTA members have integrated their economies and benefitted greatly from this collaboration.

ECOTA was signed in 2003, but after ten years it has yet to become operational. Progress toward its implementation is unlikely as some of its member countries have not been very forthcoming. While other countries in the region have allowed the movement of goods by acceding to the TIR Convention (which works under an international guarantee system and facilitates the movement of trucks and containers), Pakistan has yet to follow suit.

A similar setback to Pakistan's integration with regional trade blocs has been its failure to put into effect the various regional transit agreements to which it is a signatory. The only operational agreement is the Afghanistan Pakistan Transit and Trade Agreement, but since its implementation in 2011, most of Afghanistan's transit trade (which was previously routed through Pakistan) has been diverted to Iranian ports because of the complex provisions and procedures outlined in the agreement. This is unfortunate, given that Pakistan's ports could provide Central Asia the shortest overland route to sea, and there is tremendous export potential among the Central Asian markets.

In addition to these regional trade and transit agreements, Pakistan has signed several bilateral preferential or free trade agreements (FTAs). Many of these—such as with Indonesia, Mauritius, and Iran—are

nominal, covering less than 5 percent of tariff lines. Pakistan's FTAs with China, Sri Lanka, and Malaysia are more significant, but the country would have gained more had it carried out essential domestic reforms prior to signing these FTAs, especially the bilateral FTA with an economic powerhouse such as China.

In contrast, Turkey lowered its external tariffs to the same level as those of the European Union (EU) before joining the latter's customs union. Pakistan, on the other hand, raised its tariffs against other countries (after having signed the FTA with China) in clear violation of World Trade Organization (WTO) rules. This created a trade diversion among Pakistan's importers toward Chinese goods, making it more trade-dependant on its eastern neighbor. According to a recent study conducted by the Pakistan Business Council, Pakistan uses a mere 5 percent of the tariff concessions negotiated with China whereas the latter is able to exploit 57 percent of the concessions negotiated with Pakistan. Thus, instead of benefitting from its FTA with China and Malaysia, Pakistan has hampered its trade prospects by not further liberalizing its trade with other countries.

2. Regional Trade in the Global Context

Over the last two decades, the intensification of regional trade has played a powerful role in economic and political integration. The EU's original free trade area, for example, evolved into a customs union, which later became an economic and monetary union. It is now en route to becoming a political union. Almost two thirds of the EU's trade is conducted between members. Similarly, the North American Free Trade Agreement (NAFTA), which was created 20 years ago to expand trade between the US, Canada, and Mexico, has been a great success. Trade between NAFTA members has grown by over 500 percent: from US\$ 297 billion in 1993 to US\$ 1.6 trillion. The GDP of the three countries has almost tripled. Similarly, since the formation of the ASEAN Free Trade Area in 1992 in Singapore, many ASEAN economies have registered miraculous growth rates. The area's intra-regional trade is now over 25 percent.

Having consolidated the benefits of intra-regional trade, trade blocs across the world are now moving forward to amplify the benefits of global trade through inter-regional trading blocs. NAFTA and ASEAN members, for instance, are now negotiating the Trans-Pacific Partnership Agreement, while the EU and the US are negotiating the Transatlantic Trade and Investment Partnership Agreement.

3. The Way Forward

Fortunately, the Government of Pakistan has recognized these problems and the value of regional linkages. It has taken some steps in the right direction but a more holistic approach is needed. Bilateral trade with India is being normalized gradually. In 2010, Pakistan also joined the Central Asia Regional Economic Cooperation Program, a partnership of ten countries and six multilateral institutions; 2012 was declared the Year of Regional Trade and Economic Connectivity. In its Vision 2025 document, the present government has emphasized the importance of promoting Pakistan's economic development. Notably, it continues to pursue the normalization of trade with India and build an economic corridor with China, but these policies need to be supplemented with several regulatory changes and other domestic reforms.

While the budget for 2014/15 was a good opportunity to take some concrete steps in this direction, many of the measures proposed have done the opposite. Instead of lowering import tariff levels to those of its regional partners, Pakistan has raised them further. While other competing countries continue to espouse liberal trade regimes, resorting to protectionist trade policies only on a selective basis, Pakistan has turned further inward and enhanced import duties on already over-taxed imports. These measures have widened the existing gap and made it difficult for Pakistan to integrate with other regional countries.

Pakistan needs to benchmark its tariffs or trade policies with those of its competitors and rely less on taxes derived from international trade. This is a major deterrent to promoting local industry since the heavy taxation causes loss of competitive grounds for local industries vis-à-vis their foreign competitors. Table 1 compares the industrial tariffs applied to various categories of products and clearly shows that Pakistan's tariff rates are the highest among other developing countries. Pakistan must carry out serious tariff and trade policy reforms, benchmark its trade openness with that of its competitors, and try to achieve the same level of tariff control.

Table 1: Comparison of average industrial tariffs

| Commodity group | China | | India | | Indonesia | | Malaysia | | Sri Lanka | | Pakistan | |
|--------------------|-------|------|-------|------|-----------|------|----------|------|-----------|------|----------|------|
| Chemicals | H | 6.5 | H | 8.5 | M | 4.8 | L | 1.9 | L | 2.8 | H | 8.6 |
| Plastics/rubber | L | 9.4 | L | 9.5 | L | 8.4 | M | 13.2 | M | 12.6 | H | 17.0 |
| Paper/paperboard | L | 5.3 | M | 9.1 | L | 4.4 | M | 10.3 | H | 12.8 | H | 15.8 |
| Textiles | M | 11.5 | L | 9.8 | M | 10.8 | L | 7.7 | L | 6.7 | H | 18.7 |
| Glassware/ceramics | L | 13.4 | L | 9.5 | L | 7.9 | M | 17.9 | M | 17.8 | H | 24.7 |
| Machinery | M | 8.3 | L | 7.2 | L | 5.2 | L | 5.4 | L | 4.9 | H | 12.2 |
| Vehicles | L | 13.2 | H | 30.2 | L | 16.9 | L | 17.7 | L | 15.5 | H | 35.8 |
| Misc manufactures | L | 11.6 | L | 9.8 | L | 9.5 | L | 8.9 | H | 19.8 | H | 21.3 |

H = high, L = low, M = median.

Source: World Trade Organization.

Additionally, the country should turn its attention to improving regional trade by developing its current supply chains and production networks. The surge in bilateral trade between China and ASEAN, for instance, is primarily in intermediate goods, accounting for over 80 percent of China's exports to and over 95 percent of its imports from ASEAN.

Unlike most other developing countries, Pakistan has not eliminated its import substitution policies despite the implementation of the WTO agreement on trade-related investment measures (TRIMs) in 2000. For example, in the case of the automobile industry, India, China, Brazil, Indonesia, and many other developing countries eliminated their import substitution policies within five years of the WTO rules. Pakistan, which retained its outdated import substitution policies, is the only country where the production of cars has plunged in relation to that of other countries (Table 2).

Table 2: Number of cars produced

| Country | 2005 | 2011 |
|-----------|-----------|------------|
| China | 5,708,421 | 18,418,876 |
| India | 1,638,674 | 3,936,448 |
| Brazil | 2,530,840 | 3,406,150 |
| Mexico | 1,624,238 | 2,680,037 |
| Thailand | 1,122,712 | 1,457,798 |
| Turkey | 879,452 | 1,189,131 |
| Indonesia | 500,710 | 837,948 |
| Pakistan | 153,393 | 162,194 |

Source: World Trade Organization.

Pakistan needs to learn from the trade policies adopted by the more successful developing countries if it wants to achieve similar levels of economic growth. In the 1980s, both Pakistan and Turkey had a similar volume of exports (approximately USD 3 billion). While Pakistan resorted to a protectionist arrangement, raising its external tariffs and encouraging a series of import substitution policies, Turkey made efforts to integrate with the EU and began eliminating its import substitution policies. By 1996, it had lowered its external tariffs to a level comparable to those of the EU. Subsequently, it joined the EU customs union. Today, Turkey's exports are over USD 170 billion while Pakistan's exports have yet to surpass the USD 25 billion mark. Turkey's per capita GDP is about USD 9,000, while Pakistan's per capita GDP stands at less than USD 1,000.

Another interesting example is that of Chile. Until the late 1970s, Chile was one of the world's most protectionist countries. In the mid-1970s, it carried out deep structural economic reforms, among which the most impressive effort was to move from import substitution to export-led economic growth. Chile decided to dispense with protectionism and in the 1980s reduced its tariffs across the board to 10 percent ad valorem; its total exports in 1980 stood at a mere USD 5 billion. Despite temporary hardship and several uncompetitive industries going bankrupt, Chile's exports started to grow by 25 percent per year. In the longer term, it became one of the fastest growing economies in the world with current exports valued at USD 80 billion.

It will not be easy for Pakistan to become part of a global supply chain unless it opens up its economy further. The perception that Pakistan is a considerably open economy is incorrect: its import tariff

profile is comparable only to that of sub-Saharan Africa. Moreover, Pakistan's economy has consistently been rated "mostly un-free" by the Heritage Foundation's global ranking.

4. Conclusion

Pakistan needs to revisit its regional and global trade policies. It must fully embrace trade with India and Central Asia by opening up more routes and acceding to the TIR Convention. Pakistan's ports could provide Central Asia with the shortest land route to sea and there is tremendous export potential among the Central Asian markets. With regard to global trade, Pakistan must restructure its taxation policies and look for ways to integrate its comparative advantages within global supply chains. It must also reassess its current protectionist policies, which are stifling the economy and undermining the country's ability to compete in the global market. Instead, Pakistan must allow domestic industries and infrastructure to operate in an environment that maximizes its potential.

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