

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

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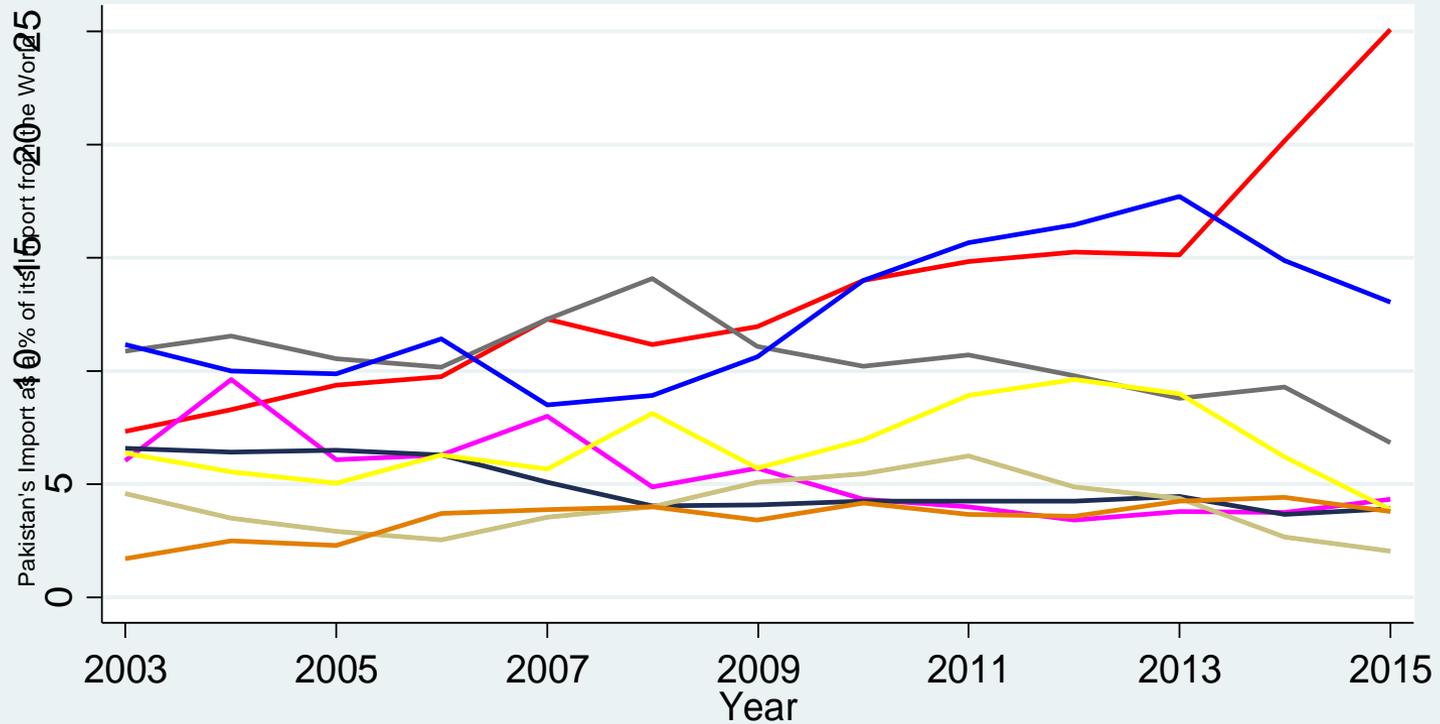
CPEC: CHALLENGES AND OPPORTUNITIES

- CPEC, now underway, centered around infrastructure development and energy initiatives
- At the same time, Pakistan and China are negotiating Phase II of the Pakistan China Free Trade Agreement
- Phase I FTA operational since 2007
- Critical to look at impact of Phase I to understand Pakistan's vulnerabilities and opportunities for Phase II
- The direct route from Western China is Pakistan's gem and it must not give it away too cheaply!

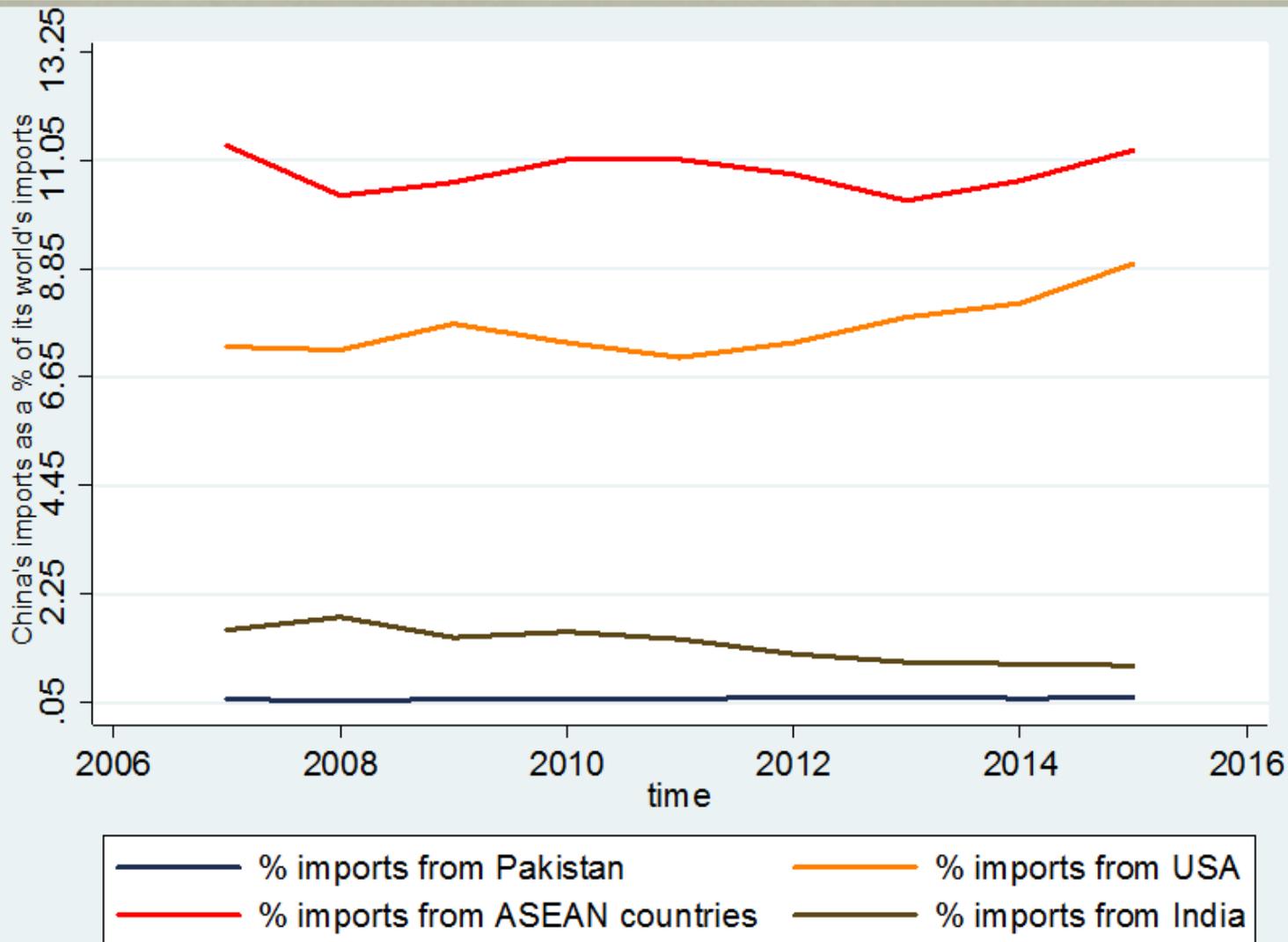
2006 PAK-CHINA FTA

- A significant number of Pakistani tariffs on Chinese goods were reduced
- As were a significant number of Chinese tariffs on Pakistani goods.
- Most of the “analyses” of the impact of this FTA have looked at anecdotal evidence
 - the flood of Chinese goods in Pakistani markets, or
 - macroeconomic data trends showing a significant surge in Chinese imports to Pakistan.
- Indeed, Pakistan’s imports from China have increased in dollar terms, as well as in share.
 - Pakistan’s imports from China increased from less than 10% of imports in 2006 to more than 25% in 2015.

PAKISTAN'S IMPORTS FROM CHINA AND THE OTHER KEY TRADING PARTNERS



CHINESE IMPORTS FROM PAKISTAN AND THE REST OF THE WORLD



THE PROBLEM WITH SIMPLE TRENDS

- The problem with this approach is obvious:
- What if the Pakistani firms that produce the goods competing with Chinese exports are less productive to begin with or in decline?
 - Then goods coming from China have simply hastened the demise of these sectors.
- Similarly, if the Pakistani firms that produce goods that have been granted increased access to Chinese markets are non-competitive, then exports to China won't register any meaningful increase.
- Then blaming the FTA for hurting Pakistan is just masking a general malaise in manufacturing

OUR APPROACH: (DIFF-IN-DIFF)

- We would like to see the impact of the FTA on:
 1. Sectors that faced greater competition from Chinese imports (due to lower Pakistani tariffs)
 2. Sectors granted greater access to the Chinese market (due to lower Chinese tariffs)
- We will compare the targeted sectors to non-targeted ones, before and after the FTA;
- If the FTA has had no impact then the all sectors should follow the same trend over time
- But if the targeted sectors have been impacted differently, our approach should capture a divergent trend.

OUR APPROACH: (DIFF-IN-DIFF)

- We take data from before and after the FTA, for affected and non-affected sectors on:
 - productivity,
 - value added,
 - trade flows,
 - employment, and
 - number of firms.
- One of the contributions of our paper is that we have put together a list of the average tariffs rates on a wide range of sectors before and after the FTA.

FIRST STEP

- After going through all FTA agreement in depth, we began by identifying Pakistani sectors that would be potentially more vulnerable because of lower Pakistani tariffs and increased Chinese imports.
- We then identified sectors that would potentially gain because of lower Chinese tariffs and increased access to the Chinese markets.
- In the paper, we have presented quite a bit of in depth information on particular sectors and the changes in both Pakistani and Chinese tariffs in these sectors after the FTA.
- We begin by looking at the impact of lower Pakistani tariffs on Chinese imports.

TABLE 4: FIRM LEVEL DIFFERENCE-IN-DIFFERENCE ANALYSIS OF IMPACT OF LOWER PAKISTANI TARIFFS ON CHINESE GOODS

	PRODUCTIVITY	VALUE ADDED	VALUE ADDED PER WORKER
TREATMENT*TIME	-0.468*** (0.127)	-0.358*** (0.168)	0.032 (0.112)
TREATMENT	0.951*** (0.095)	0.884*** (0.129)	0.066 (0.086)
TIME	0.386*** (0.094)	0.078 (0.123)	-0.177*** (-0.082)
N	2541	2556	2555

- Productivity in the vulnerable sectors has decreased relative to other sectors after the Pakistan-China FTA.
- Value added in the vulnerable sectors has decreased relative to other sectors after the Pakistan-China FTA.
- Value added per worker has decreased across all sectors over time and the value added per worker the vulnerable sectors has not changed relative to the other sectors.

TABLE 5: SECTORAL ANALYSIS OF IMPACT OF LOWER PAKISTANI TARIFFS ON CHINESE GOODS

	LOG IMPORTS FROM CHINA	LOG NO. OF FIRMS	LOG EMPLOYMENT
TIME*TREATMENT	1.139* (0.636)	-0.182 (-0.258)	-0.218 (-0.213)
TREATMENT	-0.604 (-0.501)	0.755 (0.541)	0.972 (0.709)
TIME	1.557*** (0.486)	0.069 (0.14)	0.364*** (0.156)
N	335	90	90

- Total imports in the vulnerable sectors has increased significantly more than in the other sectors.
- The number of firms in the vulnerable sectors has fallen relative to the number of firms in the other sectors after the FTA, though this fall is not statistically significant.
- Total employment in the vulnerable sectors has fallen relative to the other sectors, though this difference is not statistically significant.

HOW HAS THIS HAPPENED?

- The conclusions one can reach from this analysis is that the Pakistan-China FTA has had a significant impact on the amount of imports from China especially in the sectors that have been left vulnerable because of significant decreases in Pakistani tariffs.
- At the same time, the productivity and value added of firms in these vulnerable sectors has fallen (and may have the number of firms and employment).
- 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.

NEXT STEP

- We continue by looking at the Pakistani sectors that could have potentially gained as a result of lower Chinese tariffs on Pakistani exports.
- Again, we compared the Pakistani sectors that could have potentially benefited with those sectors that didn't benefit from lower Chinese tariffs on Pakistani exports.

TABLE 7: FIRM LEVEL DIFFERENCE-IN-DIFFERENCE ANALYSIS OF IMPACT OF LOWER CHINESE TARIFFS ON PAK GOODS

	PRODUCTIVITY	VALUE ADDED	VALUE ADDED PER WORKER
TREATMENT*TIME	-0.644*** (0.13)	-0.312* (0.17)	0.153 (0.11)
TREATMENT	0.908*** (0.10)	0.685*** (0.13)	-0.073 (0.09)
TIME	0.453*** (0.09)	0.037 (0.12)	-0.230*** (0.08)
N	2541	2556	2555

- Productivity in those sectors that should have potentially benefited has decreased relative to other sectors after the Pakistan-China FTA.
- Value added in the potentially benefited sectors has decreased relative to other sectors after the Pakistan-China FTA.
- Value added per worker has in the potentially benefited sectors has not changed relative to the other sectors.

TABLE 8: SECTORAL ANALYSIS OF IMPACT OF LOWER CHINESE TARIFFS ON PAK GOODS

	LOG EXPORTS TO CHINA	LOG NO. OF FIRMS	LOG EMPLOYMENT
TIME*TREATMENT	2.341** (1.06)	0.281 (0.20)	0.484*** (0.21)
TREATMENT	0.964 (0.90)	-0.055 (0.63)	-0.813 (0.56)
TIME	0.186 (0.73)	-0.198 (0.16)	-0.063 (0.16)
N	344	90	90

- Total Pakistani exports to China in the potentially benefited sectors has increased significantly after the Pakistani-China FTA.
- Number of firms in the potentially benefited sectors has increased relative to the number of firms in the other sectors after the FTA, though this increase is not statistically significant.
- The relative employment in the potentially sectors has increased significantly relative to the other sectors.

HOW HAS THIS HAPPENED?

- Our analysis implies that while Pakistan's focus on low value added exports to China may have led to higher exports, this may have been driven by an increase in smaller, less productive firms as opposed to larger, more productive firms.
- Several of the sectors that gained access to China through the FTA were the same sectors in which Pakistan reduced tariffs on Chinese goods
- ASEAN countries face lower (mostly zero) tariffs on many of these goods, while Pakistan still faces significant tariffs on beverages (27.5%), transport equipment (22.5%), refined oil (17.5%), ceramics (12.5%), apparel (9.9%), dairy (9.85%), footwear (8.5%), knitwear (7.4%), textile made-ups (6.4%), paper (6.25%) and others.

LESSONS FOR CPEC

- CPEC is not simply a series of projects but rather an entire strategy for long-term economic cooperation
- Existing economic relationships between Pakistan and China can and should be reevaluated and where necessary upgraded
- It is critical that Pakistan gain the same level of tariff concessions from China as received by the ASEAN countries
- Aim to move out of the cycle of low productivity firms producing/exporting low value added goods to China, into higher productivity firms producing/exporting higher value added goods to China

LESSONS FOR CPEC

- Ensure that CPEC-related industrial activities have well-defined local stakeholders
 - Joint ventures
 - Minimum requirements for local partner involvement
- Focus on sectors that Pakistan has a revealed comparative advantage, and other critical sectors
 - 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.

LESSONS FOR CPEC

- CPEC related industrial projects should help Pakistani firms move up the technology ladder, 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.

LESSONS FOR CPEC

- CPEC related labour policy that enables a shift from low-skilled to high-skilled labour. Policies required to achieve this include:
 - Stipulating a minimum level of domestic labour 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.
 - Making it mandatory for all industrial zones and joint projects to provide their workers with both health and life insurance.