

## Pakistan-China Free Trade Agreement (PCFTA) Treaty Model: Capability, Prospects and Disputes

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### ABSTRACT

*Despite the tremendous economic growth of Pakistan-China economic relations, but the outcomes from Pakistan-China Free Trade Agreement (PCFTA) remains near to the ground. This Paper analyzes the capability of PCFTA in goods between Pakistan and China. An analysis based on revealed comparative advantage (RCA) and trade intensity (TI) measures in used to categorize product groups, in which Pakistan and China situate to amplify the most from decrease in tariff levels. Analysis is performed to approximate the change in bilateral trade stream under two dissimilar tariff regimes. The paper accomplished that, from a Pakistan perception, FTA covering only goods trade will not be valuable to Pakistan. The practicability of a FTA will hinges upon the non-goods components such as investments, services, teamwork in research and development.*

**Keywords:** RCA, TI, PCFTA, FTA, Pakistan China Trade

### INTRODUCTION

Pakistan became a limb of WTO in 1 January 1995 and China has joined the WTO in 11 December 2001. Pakistan and China share a muscular and rapidly expanding trade and economic relationship. The relationships of both countries are not only bound in economic and trade but also in the field of diplomacy and strategic partnership. Two countries have frequently exchanged high-level visits resulting in a variety of agreements and investments in both nations at government level as well as private bodies. The People's Republic of China has rendered economic, military and technical assistance to Pakistan and each considers the other a close strategic ally Jiang, (2001)<sup>[1]</sup>. The China-Pak FTA is important on many levels. First and foremost, it strengthens the long time trade relations between the Pakistan and China. Both nations have been leading trade partners of one another from last decades. For example, the China is the leading exporter of electronic products, appliances and machinery to Pakistan. Conversely, Pakistan has been a major exporter of cotton yarn, textile articles and consumer goods such as electronics mobiles, semiconductors and automobiles. Pakistan and China have come to play an increasingly dominant role in world economic affairs. Both nations have posted aggressive growth rates and friendly relationship, amongst other things. China in particular, has gained huge footprints in international trade and investment. At present China is the world's largest exporting country, while Pakistan's exports have grown doubled over the period of 2000-2014.

In the recent past both Pakistan and China have been pursuing FTAs with other nations particularly in Asia. However, no progress has been made to get maximum profit from PCFTA. Pakistan's domestic industry has sounded remarks of concern on several occasions over Pakistan's free trade agreement with China. In the framework it is significant to analyze, and if possible measure, the possible effects of PCFTA and to recognize the exact areas

wherein, a reduction of trade barriers might consequence in mutual advantage and maximization of profit from PCFTA.

### INTERNATIONAL TRADE OF PAKISTAN AND CHINA

China’s international trade has witnessed brisk growth in recent years. China's emergence as a major player in world trade is a significant development in the global trade system. China revised its trade development policy at the end of the 1970s when China ranked 32nd among international trade nations, due to China's "Import Substitution" strategy Long.G, (2010)<sup>[2]</sup>. Three decades afterward, China became the world's top exporter. China has become the world's biggest trading nation in goods, ending the United States’ post-war international trade dominance, according to official figures Qi and Muhammad (2014)<sup>[3]</sup>. There is no comparison between Pakistan and China’s International Trade. According to Muhammad and Qi (2014)<sup>[4]</sup> China should gradually phase out these backward industries that compete with ASEAN, such as high-polluting industries and resource-based industries, and should improve the cooperation with the different countries and regions according to their resource characteristics, economic structure and technological level. Optimizing the industrial structure will be conducive to China-ASEAN trade.

**Table 1. Trade flows of Pakistan and China in 2013. (US\$ Billions)**

	<i>Pakistan to World</i>	<i>China to World</i>	<i>Pakistan to China</i>
Imports	43.76	1950	6.63
Exports	25.12	2209	2.65
Total	68.88	4159	9.28
Trade Balance	-18.64	259	-3.98

Source: Author’s own calculations based on ITC & UN COMTRADE statistics

However, Table 1 shows how China trades as much as multiple times more than what Pakistan does. In addition, China has emerged as an exports-driven nation with its growth rate of exports surpassing that of its imports. Pakistan’s export growth rate is still lagging at the back its import growth rates. According to Kowalski (2008)<sup>[5]</sup>, more than 50% of China’s exports come from final processing and assembly of intermediate goods imported from Asian neighbors. Conversely, Pakistan’s exports are primarily raw material and labor oriented with items such as cotton, other made textile articles, sets, worn clothing etc. and cereals. Table 2 demonstrates Pakistan and China’s total and yearly exports to world and table 3 shows Pakistan’s and China trade under free trade agreement.

**Table 2 (Part-I). Pakistan and China’s Exports to World, top Five Chapters (US\$ Billions)**

<i>Chapter</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>
52’	3.20	4.01	5.09	5.23	5.33
63’	2.92	3.28	3.57	3.29	3.69
10’	1.82	2.28	2.81	2.06	2.18
61’	1.68	1.98	2.24	2	2.11
62’	1.21	1.46	1.77	1.69	1.85
Pakistan’s Total Export	17.55	21.41	25.34	24.61	25.12

**Table 2(Part-II). Pakistan and China’s Exports to World, top Five Chapters (US\$ Billions)**

Chapter	2009	2010	2011	2012	2013
85’	301.10	388.76	445.76	487.32	561.29
84’	236	309.81	353.76	375.10	383.15
94’	38.94	50.58	59.34	77.89	86.41
61’	53.76	66.71	80.16	87.05	96.80
62’	46.72	54.36	63.07	61.22	68.25
China’s Total Export	1201.65	1577.76	1898.39	2048.78	2209

Source: Author’s own calculations based on ITC & UN COMTRADE statistics

**BILATERAL TRADE OF PAKISTAN AND CHINA**

Pakistan-China trade has a marked imbalance with Pakistan importing three times as much as it exports to China. Growth in bilateral trade has been fast since 2007 FTA commence between Pakistan and China (Figure 1). China’s exports to Pakistan have been growing at a greater rate than overall Chinese exports as well as overall Pakistan imports. In other words, China is making inroads in to the Pakistan market at a much quicker pace than in any of its other export destinations.

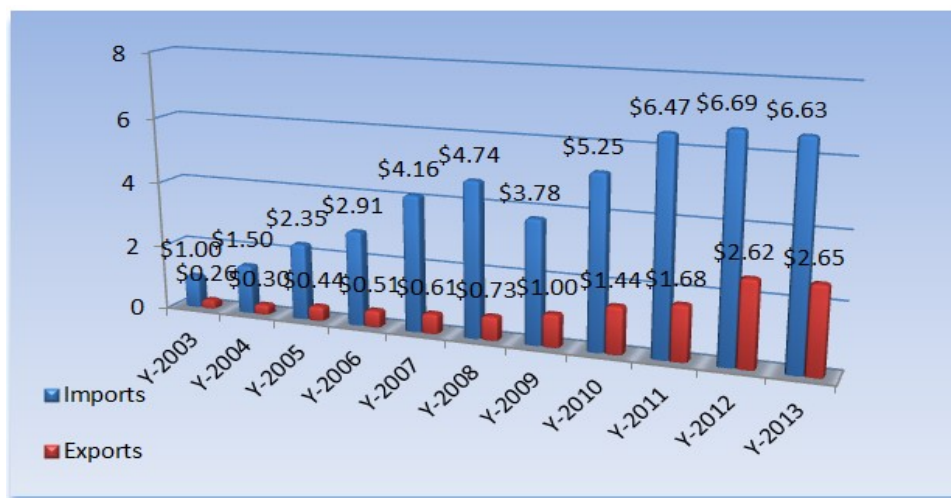


Figure 1. Pakistan-China Bilateral Trade Flows before and after PCFTA.

Source: Author’s own calculations based on ITC & UN COMTRADE statistics

Pakistan and China signed a bilateral Free Trade Agreement (FTA) in 2006 which came into effect in 2007. The agreement was separated in two parts with Phase I ending in December of 2012 and negotiations for Phase II beginning in July of 2013. 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\$ 14.3 billion in 2013. China was second largest importing partner of Pakistan with share of 16.17% of Pakistan’s total imports in 2013 Qi and Muhammad (2014).

**Table 3. Exports of Pakistan and China under FTA, top five chapters (US\$ Billions)**

<i>Chapter</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>
52'	0.70	0.91	1.13	1.83	1.94
10'	0.00043	0.0015	0.011	0.26	0.14
26'	0.075	0.15	0.11	0.12	0.13
25'	0.011	0.021	0.038	0.044	0.064
41'	0.034	0.047	0.048	0.062	0.057
Pakistan's Total Exports to China	1	1.44	1.68	2.62	2.65
<i>Chapter</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>
85'	0.86	1.15	1.42	1.79	2.08
84'	0.88	1.03	1.05	1.30	1.39
54'	0.58	0.69	0.75	0.78	0.96
72'	0.10	0.30	0.32	0.41	0.47
55'	0.15	0.25	0.37	0.40	0.63
China's Total Exports to Pakistan	5.52	6.94	8.44	9.28	11.02

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

## ANALYSIS AND DISCUSSION

### Revealed Comparative Advantage

The Balassa Index (1965)<sup>[6]</sup> of RCA is defined as a country's share in world exports of a commodity divided by its share of total world exports. The analysis may also help us in understanding the composition of goods traded between Pakistan and China, Pakistan and world, and China and world. The results will also help us understand if Pakistan has revealed comparative advantage in the same goods in its bilateral trade with China as in the trade with the rest of the world. In this study this index will help to examine the commodities/industry in which Pakistan and China have revealed comparative advantage. We short listed the commodity categories at the HS 2-digit level. We analyzed top 5 chapters form both countries since 2009 to 2013. This index is calculated as follows;

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

Where

$X_{ij}$  = i<sup>th</sup> 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

Therefore, we can say that if  $RCA_{ij} > 1$  then a comparative advantage is revealed. Batra and Khan (2005)<sup>[7]</sup> mentions the advantage of using RCA approach that ‘it considers the intrinsic advantages of a particular export commodity and is consistent with changes in an economy’s relative factor endowment and productivity’ on the other hand its disadvantage is ‘it cannot distinguish improvements in factor endowments and pursuit of appropriate trade policies by the country’. However, RCA advantages and disadvantages are beyond the focus of current analysis.

**Table 4. Pakistan’s revealed Comparative Advantage (Top 5 Chapter)**

Chapter	2009	2010	2011	2012	2013
52'	52.50442	48.2618	51.13886	57.27432	56.04458
63'	48.26024	47.67975	45.38314	42.90103	42.58623
10'	16.47008	19.00186	17.07928	12.6529	12.83534
61'	7.403845	7.787788	7.643613	6.885029	6.759151
62'	5.421089	6.094044	6.699467	6.415636	6.550304

Source: Author’s own calculations based on ITC & UN COMTRADE statistics

**Table 5. China’s revealed Comparative Advantage (Top 5 Chapter)**

Chapter	2009	2010	2011	2012	2013
85'	1.924356	1.891813	1.990421	1.998928	2.208383
84'	1.603066	1.647468	1.634883	1.608936	1.556141
94'	2.736773	2.889246	2.958582	3.264971	3.090046
61'	3.460242	3.560737	3.651151	3.599655	3.526218
62'	3.057054	3.078987	3.02575	2.791661	2.747999

Source: Author’s own calculations based on ITC & UN COMTRADE statistics

There may be many other factors which affect both countries’ relative share in world market but that is out of the scope of this analysis. To analyze RCA for both Pakistan and China at HS-2 digit product level to have overall picture of both countries relative performance. In general, if the importing country lowers import barriers, it is expected that home country’s exports increase to the importing country. Since FTA lowers China’s import barriers, Pakistan’s exports to China are expected to increase. Especially, the exports of the items with  $RCA > 1$  are expected to increase faster than exports of other items after FTA, since Pakistan has comparative advantage in those items. If the exports of the items with  $RCA > 1$  indeed increase faster than those of other items after FTA, then it shows that the Pakistan-China trade pattern goes as expected by the principle of comparative advantage. Otherwise, we suspect that there are some obstacles preventing the bilateral trade follow the principle of comparative advantage. Analyzing product to product for these five years it is revealed that the items have been almost same during 2009, 2013 with  $RCA > 1$ .

### Trade Intensity

Trade Intensity (TI) is a measure of a country's export competitiveness in a specific partner's market. Like RCA, it uses a country's current trade flows to measure its competitiveness. We calculated top 5 chapters wise trade intensity for Pakistan-China trade flows. Trade Intensity of  $i^{th}$  country with respect to the  $j^{th}$  country under  $k^{th}$  commodity category,  $T_{ijk}$  is given by

$$T_{ijk} = (X_{ijk} / X_{jwk}) / (X_{wjk} / X_{wk})$$

$X_{ijk}$  = Country  $i$ 's exports to country  $j$  in category  $k$

$X_{iwk}$  = Country  $i$ 's exports to the world in category  $k$

$X_{wjk}$  = World's exports to country  $j$  in category  $k$

$X_{wk}$  = Total world exports in category  $k$

We calculated Pakistan's trade intensity in the Chinese market for top five commodities and China's trade intensity in the Pakistan market for top five commodities. Trade intensity value of greater than 1 is construed as high competitiveness.

**Table 6. Pakistan's Trade Intensity with respect to China (top five Chapter HS-2 digits)**

Chapter	2009	2010	2011	2012	2013
52'	1.513198	1.24813	1.068874	1.251264	1.437532
10'	0.022515	0.03942	0.241619	3.327999	1.682769
26'	0.010776	0.001371	0.00073	0.000892	0.000874
25'	0.288412	0.439977	0.65308	0.549841	0.796688
41'	0.007623	0.007912	0.006988	0.008708	0.007098

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

According to table 6, Pakistan's trade intensity with respect to China remains low. Merely two construed as high competitiveness in Chinese market, chapter 52' *cotton* greater than 1 and chapter 10' *cereals* went up from year 2012. Others chapter 26' *ores, slag and ash*, chapter 25' *salt, sulphur, earth, stone, plaster, lime and cement*, the last one in top five is chapter 41' *raw hides and skins and leather*.

**Table 7. China's Trade Intensity with respect to Pakistan (top five chapters HS-2 digits)**

Chapter	2009	2010	2011	2012	2013
85'	0.018782	0.01845	0.019334	0.020625	0.017441
84'	0.045454	0.034645	0.030648	0.038936	0.042611
54'	0.824784	0.74281	0.6527	0.667388	0.768037
72'	0.074625	0.158233	0.120586	0.202302	0.22399
55'	0.268234	0.352133	0.384268	0.432922	0.650857

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

As table 7 China was not competitive in the Pakistan's market. China's exports to Pakistan still not much mature as other Asian countries. All results we found are less than zero means less competitive.

## **CONCLUSION**

Pakistan and China share long lasting cordial relationship. To broaden this relationship a free trade agreement (FTA) was signed between the countries in 2007. In case of Pakistan-China Free Trade Agreement, it seems China is better-off then that of Pakistan. Our analysis shows that slight goods based FTA will be greatly in favor of China and is improbable to be acknowledged by Pakistan industry. Every bilateral agreement linking the two countries desires to be comprehensive and overarching, surrounding not just goods but also services, collaboration in research and growth, investment, and must be backed by frameworks on issues such as standards, antidumping and dispute resolution. Only then can Pakistan stand to gain from a bilateral accord with China. The results of RCA and TI form basis to capture the effects of FTA at HS-2 digit product level and it also helps in understanding the diversification in Pakistan's trade goods as well as China's. China's trade goods seem more diversified whereas Pakistan as compared to China is less diversified. China has advantage in producing capital intensive goods which is also evident from results of RCA and TI whereas, Pakistan has advantage in producing textile products and other products includes semi manufactured goods. Like Chinese industry Pakistan's industry has also gone transition and bilateral trade flows show that the products traded in 2009 and 2011 are different from those in 2013 especially in case of Pakistan. Consequently, our work suggests a need for a comprehensive study to assess how Pakistan and China can engage each other in other areas, specifically in cross border investments, services trade and research and development efforts. Finally, one must not ignore the role of trade and commerce in moderating bilateral relationships.

## **SIGNIFICANCE OF STUDY**

There are two conditions that must meet in order for countries to successfully participate in a free trade agreement. First, an incentive constraint mutually satisfied, and must make countries better-off. Second, the worthwhile long-run gains to the countries that keeps them to commit to the agreement, as opposed to maintaining tariffs. In the context of Pakistan's trade environment and domestic industry the results are disturbing. Serious consideration is required to see if this FTA is resulting in degradation of Pakistan's domestic industry including large, medium and small industry or improved it. The policy makers need to make sure that favorable environment (incentives) for growth of the industry is provided so that the industry can compete in international market. This is a necessary step which is required to be taken as Pakistan and China share a long lasting friendship and this FTA has political as well as economic impact on the societies of both the countries.

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