



## LEVERAGING CPFTA FOR NATIONAL ECONOMIC GROWTH AMIDST GLOBAL CRISES

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### **Abstract:**

*The global challenges related to pandemics and political disputes are one of the hardest front confronted by international development cooperation and becomes the challenge for regional integration initiatives. During the phase of pandemic it is the matter of great concern for all the governments not only to identify possible outcomes to minimize long term losses to their economies but to facilitate the residents for their recovery to challenge the issues of maintaining their livelihood, poverty, employment and through provision of global public goods. The impact of Trade agreements is long-term on a country's economic outlook. China-Pakistan FTA-I entered into force w.e.f Oct.10th, 2009 and bring zero rates on 35.5% of tariff lines and the CPFTA-II entered into force w.e.f. Jan-2020 and in terms of tariff lines, China liberalized 1026 new tariff lines. Under CPFTA, China's tariff on 313-priority tariff lines were eliminated that which cap over \$8.7 billion worth of our International exports and over \$64 billion worth of imports from China. As a result, though trade with China has increased manifold, still it could not achieve desired results. Additionally, domestic and global economies are passing through an extraordinary time when the world is confronted by pandemic uncertainties and economic threats convoluted by the Ukraine war crunch, where national preferences shaping against globalization. In this background, we need to fast find solutions to these issues and explore how*



*bilateral agreements can be leveraged for enhancing trade ties for sustainable economic growth. This study examines the trade response using export and import data, which indicates the intensity of trade reciprocity by analyzing pre, and post-CPFTA conditions. This study, therefore, aims to comprehend the role of the China-Pakistan Free Trade Agreement (CPFTA) in Pakistan's trade regime and its contribution to the economy.*

*The study has compared the imports and Pakistani exports to China during and after the CPFTA-I based on Pakistan's annual GDP growth rate while for due short period of time from 2019 onwards CPFTA-II data is not utilized for analysis. The resulting analysis will be used to recommend measures to increase trade with China and other regional countries, address non-tariff impediments to maximize utilization of the FTA, and address bottlenecks for the implementation of the Free trade agreement and the results foreshadow forthcoming mutual trade in fields of technology, investment, Agriculture, Blue growth and CPEC between both nations.*

**Keywords:** *China-Pakistan Free Trade Agreement (CPFTA), Trade Policy, Import, Export, Pakistan, China Pakistan economic corridor( CPEC ), Blue Growth.*

### **Significance of the study:**

Through this study, officials, academicians, and researchers will learn about the importance of trade agreements with regional countries and identify bottlenecks to accrue desired results from the FTAs. Also, the practitioners and policymakers may ensure that how there will be smooth trade between Pakistan and China. The findings of the study will be used by a variety of stakeholders interested to work in the domain of Pakistan's trade with China. This study compares the trade data of Pakistan to China during and after the CPFTA 1<sup>st</sup> phase based on the annual GDP growth rate of Pakistan. The data on imports and exports were taken from World Integrated Trade Solution (WITS, 2022) database while the data on GDP annual growth has been taken from World Development Indicators (WDI, 2022) database. Overall, solutions to achieve desired outcomes through the CPFTA will be explored for sustainable long-term economic growth and bilateral trade and facilitate the trade that can address challenges to livelihoods, poverty alleviation, provision of global public goods employment creation, and the global order. This study also works on Blue growth, Agri Sector opportunities under CPEC and Pakistan's trade by adding literature on these domains.

### **Introduction:**

Free trade agreements (FTAs) have been widely discussed in trade-related research in recent years. Though a latecomer in the negotiations through FTAs, Asia has been catching up rapidly over the past decade. The number of preferential trade agreements (PTAs) notified to the WTO significantly increased between 1990 and 2015 (Hofmann et al., 2018). As of Jan 2022, there were 47 FTAs in Asia and similarly, China has signed 17 FTA with regional and extra-regional



countries. These FTAs gain significance in studying the economic potential between the two partner countries, especially in the backdrop of the China Pak Economic Corridor (CPEC). Since its beginning, the analysis of the CPFTA showed significant fortuity to bolster and variegate exports to China covering a wide range of goods, services, and possible investment potential. Phase-I of the China-Pakistan Free Trade Agreement (CPFTA) became operational in 2007 and was critiqued for unsuccessful provision of preferential access for exporters of Pakistan into the giant Chinese markets. Accordingly, Phase II of the CPFTA, covers a period of 2019 till 2024 was finalized in early 2019 and becomes functional from January 1, 2020. The deep analysis highlighted that the structure of tariff offered to Pakistan under CPFTA-II was improved with changes on the tariff lines and their impact. It was expected that CPFTA-II would improve Pakistani exporters' access Chinese import market and thus help to address the challenge of deficit in trade (Nazish Afraz & Nadia Mukhtar, 2019). However, the true potential remains to be realized largely due to capacity and understanding issues of the Pakistani businesses, which negatively impact the ability to fulfill and deliver orders from China as it requires scale enhancement within the designated period of time. Today, Pakistan's trade deficit with China has reached to a knocking situation, which demands to create a well-balanced position of trade among both nations for which it is mandatory that upcoming CPFTA should provide equal outcomes to both Pakistan and China. Thus to analyze and evaluate the performance of CPFTA, it is equally imperative to connect it with Pakistan's global export which has generally reduced.

Historically, the China-Pakistan relationship has been political and strategic; however, the changing dynamics of international politics, as well as the growing need for economic cooperation, mandated the two countries to collaborate on economic matters (Firdous et al., 2021). In 2003, the two partner countries inked a preferential trade deal in which Pakistan was awarded tariff concessions on 767 goods while China's duties on 386 product lines were cut by 5% (S. H. Shah et al., 2020). In November 2006, Pakistan secured concessions on 6,418 products, while China earned concessions on 5,686. Pakistan used about 5% of the concessions between 2006 and 2016, while China used concessions on 59% of the product categories. (Sher et al., 2019). This helped alter the mix of those exports and their dynamic comparative advantage. Pakistan's exports of food and live animals, crude materials, inedible items (excluding fuels), and manufactured goods categorized largely by material to China increased between 2006 and 2016. (Haq et al., 2021), whereas Pakistan's chemical, machinery, and transport equipment exports to China decreased. This demonstrates that the CPFTA shifted the trade balance between China and Pakistan in China's favor (S. H. Shah et al., 2020).

Free trade, according to liberal trade theories enhances exports by increasing the efficient allocation of limited resources. Pakistan implemented various policy measures to raise exports and improve global economic integration, although exports (as a percentage of GDP) remained relatively unchanged (McCartney, 2020). As a result, Pakistan negotiated bilateral FTA with a number of trading partners, notably China, to alleviate the burden of underdevelopment and encourage exports. Yet, each FTA is unique and is beneficial to commerce, Pakistan had high expectations from China (Uzair & Nawaz, 2020). Following 9/11, China-Pakistan economic and trade relations strengthened and have lasted throughout the South Asian region's economic



ups and downs. The structure of the two countries' agreement on trade is constantly a source of new commercial possibilities, such as lowering tariffs, revising quotas on import and export, and eradicating obstacles. Such agreements entice investors to help a country's economy (Hussain & Rao, 2020). This slackness in trade and investment ties was accelerated (S. H. Shah et al., 2020). After FTA was signed and increased even more after Pakistan was offered the China-Pakistan Economic Corridor (CPEC) in 2013 (Siddique & Shafqat, 2021). Another cause for improving commercial relations is China's support of the Gwadar port development (Asif, 2018). The future trajectory of bilateral ties is projected to trend upward in light of these changes. Owing to the agreements stated, Pakistan and China have strengthened their trade and investment. Pakistan has surpassed India as China's second-largest commercial partner in the South Asian area (Jamil et al., 2019).

As a result, Pakistan thought that commerce with China at preferential tariff rates would aid the country's economic recovery. CPFTA, on the other hand, did not deliver the expected effects (Uzair & Nawaz, 2020). Rather, after signing the CPFTA in 2006, Pakistan's imports from China increased, but exports to China stayed flat (S. H. Shah et al., 2020). As a result of adopting CPFTA, in just ten years, Pakistan's trade deficit with China has grown from \$1.4 billion to \$12.1 billion. As a result, the value of CPFTA for Pakistan's economy has been doubted (Mukhtar, 2018).

Pakistan's reliance on China for commerce has grown in recent years, on both sides, China's reliance on Pakistan is low. Exports to China made up 7.7% of overall exports in 2016, while imports from China made up 29% of total imports. (S. H. Shah et al., 2020). In 2006, Pakistan met 0.13 percent of China's import demand, rising to 0.17 percent in 2012 before decreasing to 0.12 percent in 2016. This shows that Pakistan did not effectively position itself to profit from China's rapid economic growth. (Haq et al., 2021). In addition to a static market share, Pakistan's exports are weak in variety. Only three products accounted for 80% of Pakistan's exports to China: cotton, textile products, and rice. (S. H. Shah et al., 2020). Additionally, misreporting of trade data also remains a challenge for an appropriate analysis of the data.

FTAs, on the other side, are a potent weapon that can drastically alter a country's bilateral trade and economic standing. In the argument over the efficacy of FTAs, the conflicting forces of trade creation and trade diversion create a contradiction. FTAs are said to improve trade and encourage governments to pursue free multilateral trade agreements. (Kim, 2022), while some say that they distort trade and raise trade imbalances. According to the relationship between FTAs and trade, there has yet to be a consensus on the impact of FTA on economic growth and trade deficits. Some study stated hopeful evidence in the limited literature on the impact of FTA on economic growth, while others believe they have a detrimental impact. (S. H. Shah et al., 2020). If we analyze the 1<sup>st</sup> phase of CPFTA we saw growth in exports to China including drivers of blue growth i-e Sea foods, mechanical goods and organic chemicals but on the whole leading competitiveness of China was quite prominent during the whole phase where misreporting of trade data leave footprints on mutual trade.

#### **FTA's as Socio Economic Drivers:**

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Since their inception under the WTO, Free trade agreements have been the leading instrument attracting surge in trade liberalization. In usual practices, gains from trade have been most apparent in FTAs in which nations have largely differentiated economic structures like (Pak China FTA) where Comparative advantage in different regions of production enable partner nations to gain from trade. Here, detailed analysis highlighted that how trade increases the prices of low cost goods in each of the trading partners while lowering the prices of the scarcer (imported) goods to more than offset this(William Krist,Ch-3) . These macro effects translate into reductions of poverty, and helps the lower economy to develop industries that specialize in parts of a production process supporting the partner country leading to trade generation and diversion. The existing literature and the emerging body of knowledge help to identify the fact that regional bilateral trade agreements helps in creation of multilateral trade liberalization and act as a driver of growth which shifts trade outward focusing many developing nations (Asian Development Bank Institute report, 2017).

The connectivity and bonding of trade agreements and socio economic wellbeing is not new. Policy makers focused on the openness to global flow of goods and services that bring high jumps in national income, which in turn enables moving forward on resource intensive development issues for a Win–Win outcome using various tariff and non-tariff measures. Imported raw materials under FTAs increases competitiveness of producers and encourage the formation of regional value chains. These deep agreements are meant to generate positive economic impact, although some sectors and segments of the population could be adversely impacted. (UN report African continent free trade, 2017). Overall, it is aimed at enhancing:

- a. The relative importance of both countries as a trading partner.
- b. Reducing the size and extent of existing trade barriers and provide diversification.
- c. The liberalization helps industries to expand especially for the smaller economy.
- d. The larger economy can take the jump to next level through a cost-effective collaboration.

### **Research Objective:**

The literature on distributional aspects of free trade agreements is still limited. This study is aimed at identifying bottlenecks to achieve objects and make recommendations that would allow policy makers to better evaluate the costs and benefits of the FTA. Secondly, it can help prepare measures to address the negative impact of the agreements and focus on the parts of the agreement yielding the highest returns. Lastly, the objective of the study is to learn more about how the China-Pakistan (CPFTA) affects Pakistan's trade system and how CPFTA can be leveraged for economic growth amidst global economic crises.

### **Structure of the paper & Literature Review:**

The current study is divided into five sections that cover the complete research procedure. The introduction section of the paper covers the background of the study, including a comprehensive knowledge of the role of the CPFTA in Pakistan's trade regime, the problem statement and research gaps, the research objective, and the study's significance. The second



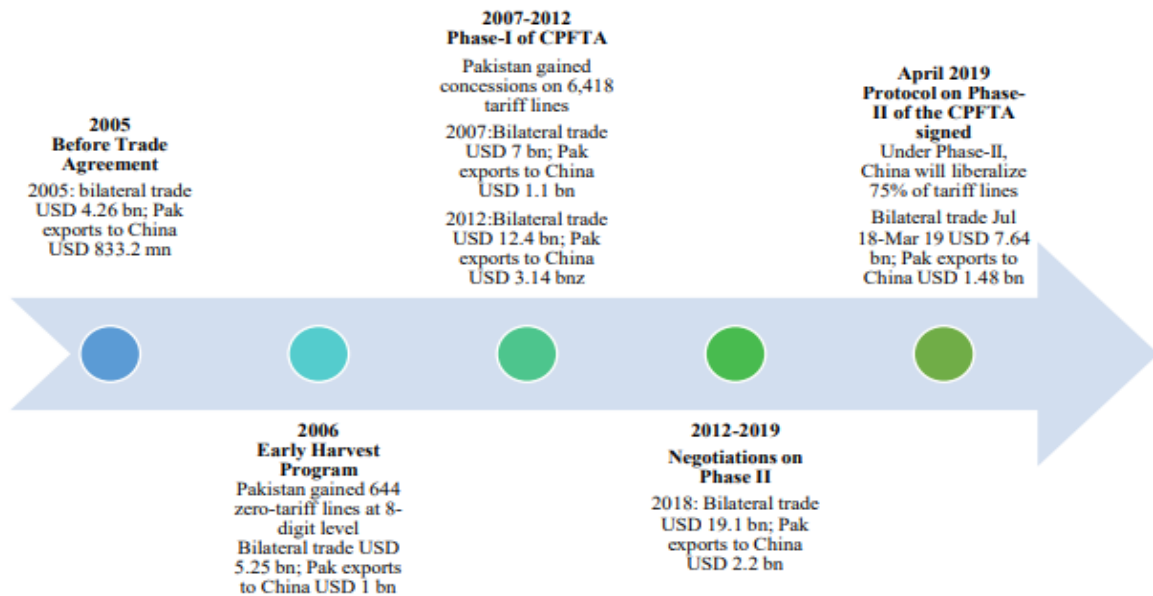
section known as literature review will include the relevant discussion about different aspects of CPFTA for Pakistan's trade regime. The third section, titled research methodology, would go over research methodologies and procedures. The fourth section is data analysis, which includes the results of the investigation. The conclusion of the study as well as policy recommendations will be included in the fifth section, Conclusion and Recommendations.

### **China-Pakistan Free Trade Agreement (CPFTA):**

The FTA encourages member nations to increase production, trade, and investment, resulting in increased growth in the economy. Trade flows between nations that are based on trade agreements may be classified into two main heads: inter-industry trade (IT) and intra-industry trade (IIT). IT is the inter-economy trading of completely diverse goods. Countries frequently invest in IT to improve their competitiveness (Zahid et al., 2021). Pakistan and China entered into a Free Trade Agreement (FTA) in July 2007. The objectives of the FTA signed between Pakistan and China were to support the mutual friendship and promote expansion of trade through ease the cross-border movement of goods between the parties. Pakistan and China have a good working relationship. These two nations are adjacent, and the shared border serves as a workhorse for promoting commercial links. (Mukhtar, 2018). CPFTA was created to improve their cooperation, remove trade obstacles, and boost trade and investment contracts in order to spur economic progress. Within five years, the CPFTA was expected to triple the volume of current bilateral trade between Pakistan and China. The CPFTA addressed expropriation, investment, and its treatment, promotion and protection, dispute settlement, and restitution for damages or losses. (S. H. Shah et al., 2020).

Presidents Pervez Musharraf of Pakistan and Hu Jintao of China were present at that time when the CPFTA was signed by Pakistan's and China's commerce ministers (Humayun Akhtar Khan and Bo Xilai respectively). These two nations also negotiated an Early Harvest Program (EHP) agreement to provide the groundwork for the CPFTA. According to the CPFTA, Pakistan and China will begin removing or reducing tariffs on all goods in two phases (Abdul Kamal et al., 2021).

The first phase of tariff reductions began in 2006, and the phase 2 began two years later. Blended fruits and synthetic fabrics, marble tiles, textiles, sporting goods, chemicals raw materials, surgical products, pharmaceuticals, and industrial machinery were on the lists at the time. These lists would be expanded to cover more items in the future. It was also decided that during Phase I of the CPFTA, both countries will lower tariffs by 85% within five years of implementation. (Qayyum & Nigar, 2020). Furthermore, it was planned that tariffs on 36% of items would be reduced within three years of the CPFTA's implementation. China reduced duties on vegetables, cattle, textiles, aquatic items, and mineral products in the first phase, while Pakistan reduced tariffs on chemicals, beef and mutton, and equipment (Lateef et al., 2018).



Source: Preliminary-Analysis-of-Pak-China-FTA-Phase-II., 2019.pdf

Following the conclusion of the first five years of the agreement, Phase II of the CPFTA was launched, with both nations agreeing to further reduce tariffs on commodities based on an evaluation of the agreement's implementation. The goal was to reduce tariffs on commodities and tariff lines worth up to 90% of trade volume and tariff lines within an acceptable time frame, subject to mutual agreement and debate. (Mukhtar, 2018).

Traditional trade setups suggest that trade is always evaluated through comparative advantage of both partners and is a mean to maximize the impact while leveraging integration between nations is a move towards free trade. The resulting economic linkages are considered viable policy options (Jose L. Tongzon, 2005). The CPFTA thus provides an interesting case study of the effects of integration of economies of two neighboring countries, trade, and even extending it to the supply chains, which is the part of Blue growth (Tongzon, J., 2008). Pakistan is a relatively complex political economy with a large population and low per capita income. China, on the other hand, is a huge country with an enormous population with a high per capita income. China being the 2<sup>nd</sup> largest economy and the factory of the world (Hamid Mukhtar, 2018) is on the higher stage of the economic ladder. But due to large population sea food and Agriculture looks to be the attractive venues of trade promotions where Pakistan may generate huge economic profits through utilization of its traditional and blue economies without disturbing food availability in Pakistan that require proper planning. Sea food which is usually not utilized in Pakistan may be exported to China and other parts of the World.

For sea food and citrus food exporters the main issues arises on the demand-side due to lack of knowledge about consumers and technical barriers to trade (TBT) which is quite different as compared to other export markets where our exporters are not familiar of standardized policies of recognition required at China that which make the process of trade more complicated and



time consuming. This can easily be addressed via quick implementation of the Strategic agreement on Agriculture and livestock under the frame work of CPEC Framework and setting up FMD Free zones in Punjab, KP and in Sindh. It is mandatory for Pakistani government to work with China in order to set testing facilities at the border with China in order to minimize the load on exporters to get tested for all quality and technical safety standards at the border we share with Chin. Being agricultural nation Pakistan is also in a state to capture the Chinese food market without exposing their nationals to the danger of starvation but it requires huge reforms.

Now, the global economies are not only playing on land to boost their economies but they are struggling hard to develop their blue economies to support the traditional economy where sea food may act as a driver of blue growth of Pakistan which requires strengthening of Marine fisheries in Pakistan. This strengthening will enhance the capacity of department to liaise with concerned departments in China (CNCA) because access to market is not enough for generating gains it requires technical and product strength accompanied by lobbying Pakistan for trade creation like India. Gwadar Port, CPEC, and connection with Central Asia are all critical to the country's economic destiny where, FTA's economic and political interests should be aligned with the CPEC's goals and priorities which require general consensus on route of projects so that all provinces are in a position to take advantage out of CPEC.

### **Negotiation for CPFTA**

Interaction with the experts and the literature suggests that the negotiation of FTA with China did in any way was not influence by the existing strategic relationship between the two countries, Neither was influenced by any regional activity (ADB report of FTA in Asia, 2008). Similarly, at the time there was no discussion on regional trading blocs as is emerging today in case of the Ukraine crisis and the US-China trade war. Though the trade with China increased since CPFTA, growing over three-fold to USD 16.4 billion in 2018, yet Pakistan's exports could not secure similar gains in China, Thus focus was on getting Pakistan preferred access to the markets of China and was the subject of considerable debate, particularly as to whether its impact on local industry. The challenge during negotiation also came with different rules negotiated under different agreements, enforcement of these rules and compliance with them by local businesses, failure to understand business culture including the different dispute settlement mechanisms as well as different standards regimes and other harmonization arrangements. It was expected that the resultant trade integration will play a pivotal role in propelling the development trade relations between the two countries. Overall, better connectivity and the integration of SMEs was anticipated to further boost trade and increase growth. The other benefits that were aimed are:

- a. Increases access to higher quality, lower-priced goods.
- b. Ease inflationary pressure
- c. Reduction in the businesses' production costs and promotion of economic growth.
- d. Promote efficiency and innovation.





However, this has not achieved targets nor has produced optimal outcomes in the long term including numbers of jobs created are considered small given that the Chinese economy creates numerous job opportunities.

### **The Benefits and Issues:**

The increase in imports from China is primarily due to:

- a. The surge in machinery and equipment in the context of Pakistan's development activities
- b. Import diversion from other trading partners to China
- c. The increase in demand for imported raw materials due to the emergence of local assembly businesses.
- d. The robust demand for low-cost goods; and
- e. Trade diversion from informal to formal channels following the signing of the CPFTA (S. H. Shah et al., 2020). Imports of low-cost machinery assist Pakistan in upgrading its domestic industries. The majority of Pakistan's imports from China were capital goods, which might help the country's economy in two ways:
  - a. Chinese machinery, particularly in the textile and cement sectors, may assist local industry in upgrading its technology (Jahangir et al., 2020).
  - b. Imported machinery may be used in public sector projects in the electricity and infrastructure sectors (including those related to CPEC efforts). These imports can assist alleviate energy supply limitations while also supporting ongoing infrastructure development efforts in the country (McCartney, 2020).

Fiscal incentives, a low-interest rate environment, improved law and order, and a brighter macroeconomic outlook give ample support to investors and the business community in this process (Firdous et al., 2021). Imported raw materials and equipment are less expensive, which helps the local manufacturing process. Pakistan also imports low-cost raw materials from China, which may aid local industry in a variety of ways, including the textile industry and other heavy transport equipment for the construction industry (McCartney, 2020).

In addition, the import of low-cost consumer items has increased throughout this time, which may assist local retailers. According to anecdotal evidence, several markets/shopping centers have emerged around the country offering Chinese imported items as a main commodity, particularly electronic, autos, toys, electrical goods, and accessories (Firdous et al., 2021). Furthermore, Chinese goods are not only concentrated in wholesale marketplaces and retail malls, but they are also poured into tiny businesses in vital commercial areas/local markets. Consumer products, on the other hand, are important from the consumer's standpoint. Low-cost consumer products, such as computers, medical equipment, consumer durables, mobile phones, vehicle replacement parts, and so on, benefit a large portion of society (Kanwal et al., 2020).

Furthermore, while any FTA is advantageous to trade, Pakistan had great hopes for China. The CPFTA was created since China is a prominent global economy and Pakistan's next-door neighbor. (S. H. Shah et al., 2020). As a result, Pakistan thought that commerce with China at



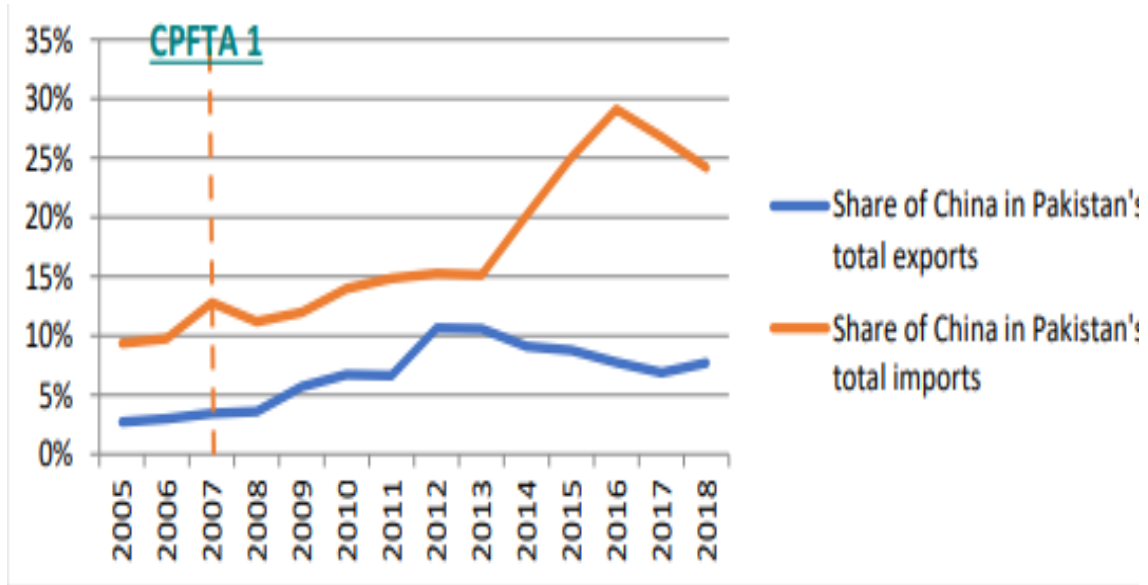
preferential tariff rates would aid the country's economic recovery (Javed, 2020). Trade agreements can act as a valuable tool in international policy, supporting member nations in avoiding disputes and conflict burdens, and trade agreements bind members' states, eliminating the issue of unilateral trade liberalization time inconsistency, according to the literature. Trade agreements reduce policy uncertainty and macroeconomic volatility by allowing weak institutions to improve and reap the benefits of long-term growth. (Thomas, 2020). Tariff reduction and FTA are viewed differently by scholars of "new trade theory." Lower tariffs, they claim, expand small businesses' market reach and, as a result, their economies of scale, increasing efficiency on the one hand and strengthening their competitive edge on the other. (S. H. Shah et al., 2020). Pakistani imports do not complement exports; rather, they compete with and reduce Pakistani exports. The negative impact of Pakistan imports on Pakistan exports is a major source of concern for Pakistan in an era when manufacturing activities are globalized and imports are used to enhance exports. Although Pakistan's imports have recently expanded significantly, the majority of its imports are final goods and consumables, which contribute very little to exports. (Khan et al., 2021). The dummies for CPFTA, infrastructure, and global GDP all favorably and significantly contribute to Pakistani exports. Despite their limitations, bilateral trade agreements are critical for increasing exports in Pakistan, as evidenced by the CPFTA dummy's significant yet minor positive influence on Pakistan exports. (S. H. Shah et al., 2020).

In terms of tax concessions for Pakistani exports and local industry protection, the updated (CPFTA-II) is considerably better negotiated. These initiatives would help Pakistan increase its exports to China and strengthen bilateral commercial ties (Aslam, 2020). Pakistan must enhance its production capacity, improve market competitiveness, trade facilitation, and broadcast information in order to fully realize the promise of CPFTA-II. It also has to increase the fiscal value of its exports by selling higher-value-added goods. CPFTA-II should be considered in conjunction with CPEC rather than as a stand-alone deal (Shakila-Tul-Kubra, 2020). The CPEC framework has improved the nations' interconnection. CPFTA-II might be implemented with the support of Special Economic Zones (SEZs) under CPEC to bring investment in various industries and products, which is expected to raise demand for Pakistani commodities (Rauf, 2019). The business sector must also participate by identifying new consumers to create large markets, spending cash on research and development (R&D), and pursuing collaborative partnerships with Chinese counterparts, and overcoming language difficulties. For steps to boost commerce with China, the government should seek to entrepreneurs (Khan & Liu, 2019). Pakistan's trade, industrial, and investment policies should all be geared around one goal: increasing product exports to China (Rauf, 2019).

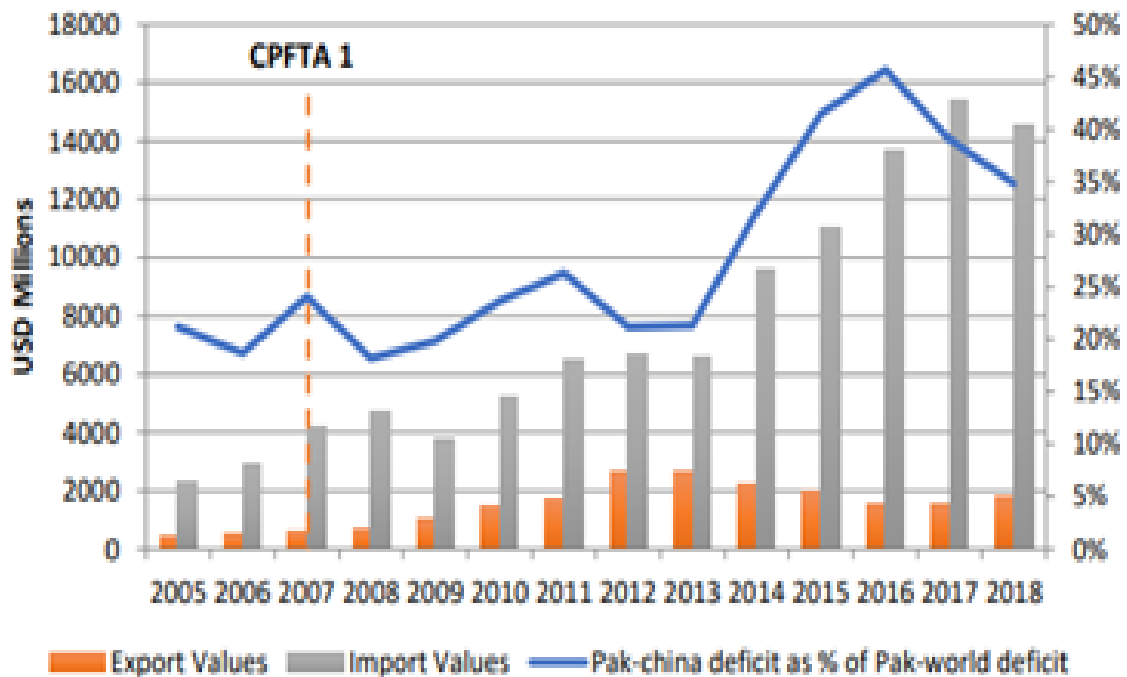
Furthermore, with the start of the second phase of the CPFTA at the beginning of 2020, China-Pakistan economic relations have taken a new direction. (Uzair & Nawaz, 2020). The deal instantly eliminated tariffs on 313 items for Pakistan, with a total of 75% of tariff lines liberalized over the next decade. This would greatly increase Pakistani exporters' access to the Chinese market. Textiles, clothes, fish and other sea food, meat, Agricultural goods, leather, chemicals, plastics, and footwear are among the items protected by these concessionary tariffs



(Aslam, 2020). Share of China in Pakistan’s global exports and imports and Pak-China trade flows and deficit is given below,



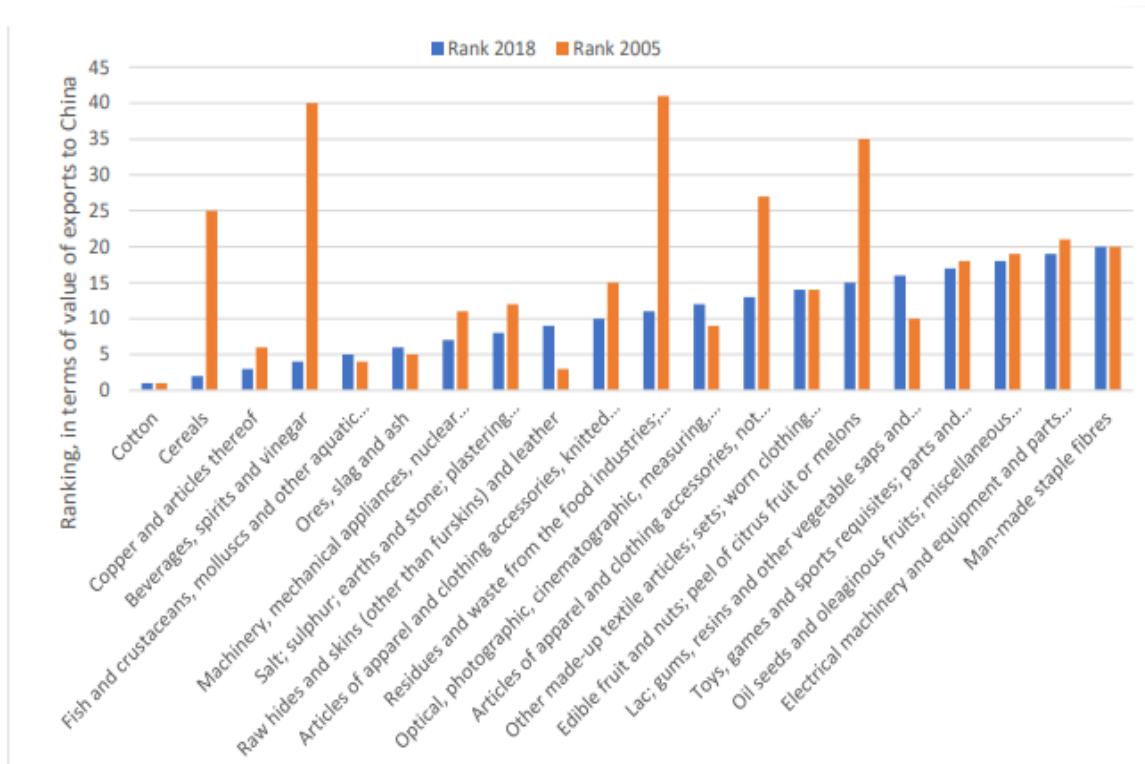
Source: UN Comtrade



Source: UN Comtrade



Ranking of products exported by Pakistan to China in 2018 and 2005 is,



Source: ITC Trade Map

### Drawbacks of CPFTA for Pakistan:

Despite the fact that the two nations signed an FTA in 2006, Pakistan remains a little contributor to China's overall commerce (S. H. Shah et al., 2020). Pakistan and China have yet to engage in considerable bilateral trade. In spite of the fact that China's global imports crossed \$1 trillion, Pakistan is unable to gain a prominent position (Haq et al., 2021). Pakistan's volume of trade is only US\$1.82 billion in the 2018 fiscal year (UN, 2018), while Chinese exports to Pakistan enhanced from \$3.5 billion to \$18.25 billion between 2006 and 2017. (Jenkins, 2018). Where, distribution of trade balance of Pakistan and China is highly skewed (Haq et al., 2021).

The CPFTA intended to be implemented in two stages. By the end of the second phase, the two sides had agreed to liberalize 90% of tariff lines. The CPFTA's Phase I was finalized in December 2012, and Phase II talks began in July 2013. (Signé & Van der Ven, 2019). Nine rounds of CPFTA phase II negotiations have already taken place, however the parties have yet to reach an agreement due to Pakistan's desire to renegotiate the FTA on new terms and conditions. Pakistan has asked for full commercial access to China's market. (Ullah et al., 2021). China, on the other hand, has been denying it, claiming that no such provision existed in the original CPFTA. Local Pakistani business and producers have been exerting pressure on



the government, arguing that an oversupply of Chinese goods in the Pakistani market has harmed the local economy. (Rauf, 2019). Pakistan's industry is still in its development, and local producers are unable to compete on pricing with Chinese producers. Furthermore, due to enormous dumping of Chinese goods into the Pakistani market, Pakistan's indigenous industries are under peril. (S. H. Shah et al., 2020).

Furthermore, due to their low cost, Chinese items have become extremely popular in Pakistan (Akhtar, 2019). Pakistani goods, on the other hand, are not sold at a premium when they are exported to China. Because of its high production costs, Pakistan is unable to take advantage of China's CPFTA incentives. (Khan et al., 2021). Excessive Chinese product imports into Pakistan raised the trade gap between Pakistan and China from USD 2859 million in 2008 to USD 12,090 million in 2016, making it Pakistan's worst trade deficit with any trading partner. (Mukhtar, 2018).

Similarly, Pakistan has only used about 5% of the available CPFTA concessions, but China has used more than 55% of the available CPFTA concessions. (Mukhtar, 2018). Despite the fact that China offered Pakistan 7,550 items (at eight-digit HS codes), Pakistani exports were only documented in 350 product lines, accounting for 4.64 percent of all concessional products. (Mukhtar, 2018). Chinese exports to Pakistan, on the other hand, were reported in 3800 goods out of 6803 products on Pakistan's offer list to China. As a result, China was able to use 55.87 percent of the total items (S. H. Shah et al., 2020).

In the first case, the tariff discounts granted to Pakistan by China under the CPFTA appear to be considerable. China, on the other hand, has offered the ASEAN countries similar or even higher concessions for products in which Pakistan has a competitive edge. (Abdul Kamal et al., 2021). In 2011, For Pakistan, China reduced tariff reductions under the category of 100 percent concession to ten percent. These products account for 35% of the total products for which China has given CPFTA concessions. (Khan et al., 2019). China, on the other hand, has reduced ASEAN tariff rates to zero percent on equivalent commodities. As a result, Pakistan argues that China's FTAs with other countries, particularly ASEAN members, have reduced Pakistan's freedom of choice. (Khan et al., 2019; S. H. Shah et al., 2020).

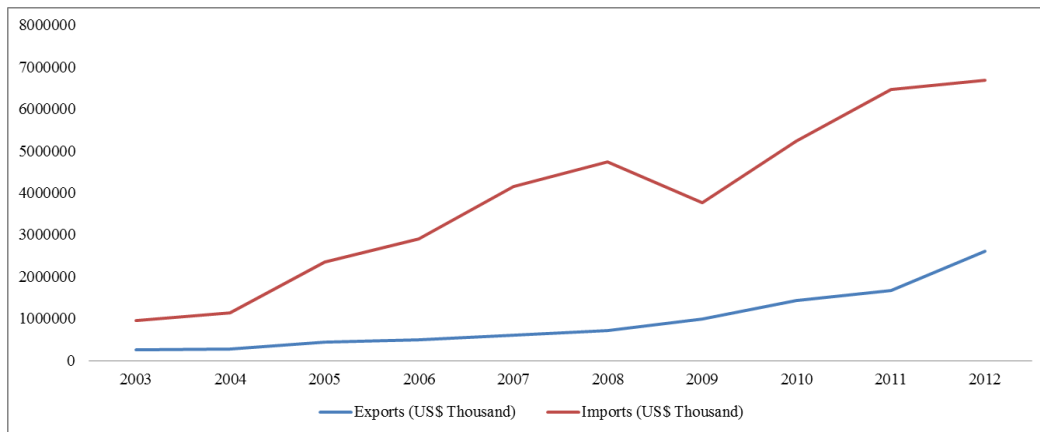
Importantly, the increase in Pakistani exports has also been seen in exports of items that are not eligible for CPFTA concessions. Despite the fact that China's demand for certain items is enormous, Pakistan contributes less than 1% of China's overall supply of such products. (S. H. Shah et al., 2020). It reveals that the CPFTA does not include the items in which Pakistan has a competitive advantage. On the other hand, concessions offered by Pakistan to China under the CPFTA appear to be more beneficial to China in terms of product diversification. (Khan et al., 2019; S. H. Shah et al., 2020). Resultantly, CPFTA was criticized from both sides including highlighting imports that replaced some goods previously produced domestically though inefficiently. It was also highlighted that that the removal of trade barriers to some partners bars imports from a country that is outside the FTA (UKAID report, 2015).

### **CPFTA and Pakistan's Trade:**

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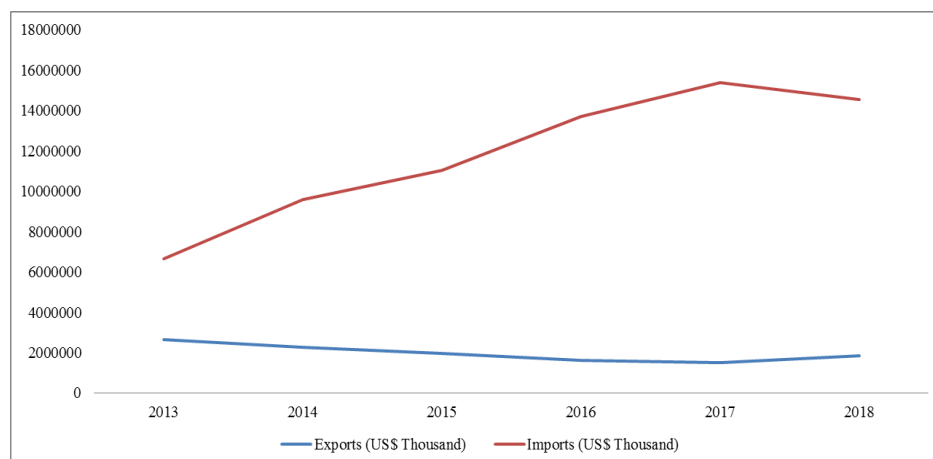
During the 1<sup>st</sup> phase of CPFTA, as shown in the above figure 1, Pakistan's exports to China have been increased slightly in the last years while Pakistan's imports from China have little fluctuation but were in large volumes.



*Figure 1: Import and Export in US\$ Thousands (CPFTA Tenure)*

**Source:** Authors' Estimation

There was a gradual increase in imports from 2004 to 2008, and a sharp drop from 2008 to 2009 (Shahbaz & Rahman, 2012). But then in 2009 the imports were seen to be increasing at a constant speed and stayed this way up until 2011. From 2011 to 2012 the imports of Pakistan were around 6,000,000 US\$ Thousands and showed very little improvement. In addition, the exports of Pakistan from 2003 to 2008 improved very slowly, with almost negligible increase in terms of US\$ Thousands. From 2008 to 2009 there was a gradual increase. Similarly, from 2008 to 2012, there was a significant increase in exports, almost reaching 3,000,000 US\$ Thousands in 2012 (Anjum & Sgro, 2017).

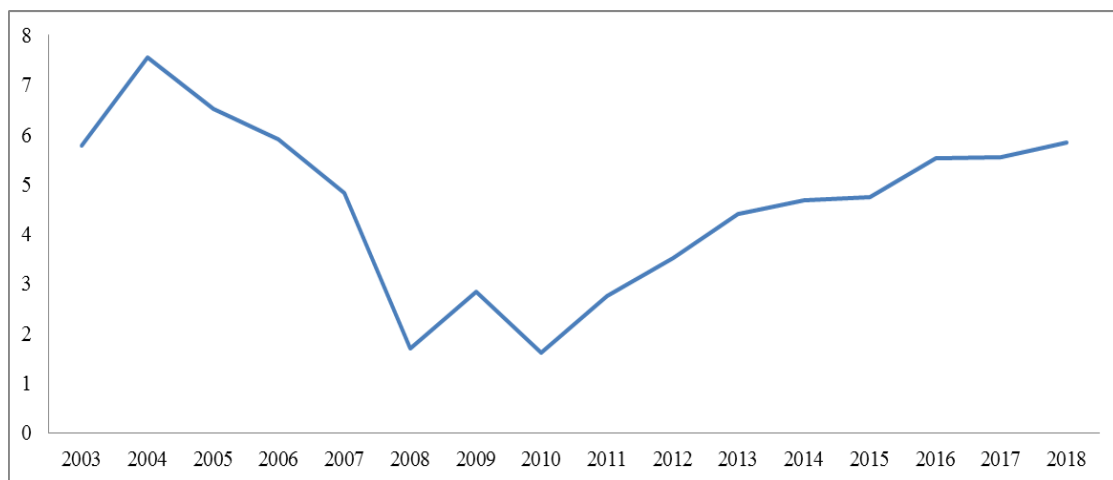


*Figure 2: Import and Export in US\$ Thousands (Non-CPFTA Tenure)*

**Source:** Authors' Estimation



Above figure 2 showed that in the non-CPFTA tenure, Pakistan's import from China has been increased drastically while the exports were stable at the lowest benchmarks. During 2013 to 2017, there was a gradual but steady increment in imports from china (I. H. Shah et al., 2020). They came to a halt and showed a slight decline in 2017 to 2018. Conversely, the exports of Pakistan has constantly decreased from 2013 up until 2017. From 2017 to 2018 there was a slight increment in exports of Pakistan in terms of US\$ Thousands (Kakar et al., 2020).



*Figure 3: Economic Growth (Annual %)*

**Source:** Authors' Estimation

As shown in the above figure 3, Pakistan's economy has continuously faced decline during the 1<sup>st</sup> phase of CPFTA; however, just in the last year of the 1<sup>st</sup> phase of CPFTA, Pakistan's economic growth has again revitalizing its annual economic growth of more than 5%. The CPFTA's first phase finished in December 2012. The above graph shows that there is a constant increase in annual economic growth of Pakistan, from 2010 to 2013. Although there is a slight stability in percentage of annual growth from 2013 to 2015, but the good news is that it didn't decline. From 2015 to 2016, there is a significant increase. The fiscal year of 2016 – 2017 showed stable growth that neither declined nor increased and 2017 to 2018 showed some gradual increment in annual economic growth of Pakistan.

### **Challenges to Exports to China:**

The Analysis of data and literature of 1<sup>st</sup> phase of CPFTA highlighted the fact that Pakistan has competitive advantage on diverse range of goods within the three preference domains where Pakistan's Exports to China falls on 1<sup>st</sup> preference, on 2<sup>nd</sup> preference exports to entire world falls excluding China and Imports of China falls on 3<sup>rd</sup> preference but due to many reasons Pakistan is not in a position to export to all three priorities.

It is observed that Pakistan's trade deficit with China gradually forms upward trajectory where we allow 6711 Chinese goods to enter in our market on concessional rates under first phase of CPFTA where goods are categorized in 6 categories:



USD Billion	2013	2014	2015	2016	2017
Imports from China	6.63	9.59	11.02	13.68	15.40
Exports to China	2.65	2.25	1.93	1.59	1.51
Pakistan's Trade Deficit with China	3.97	7.34	9.08	12.09	13.89

Source: Pakistan's trade with China (USD Billions) (2013-17)

Similarly, China allowed 7550 goods from Pakistan to enter in their market under the categories of,

- Category 1: Elimination of tariff for three years
- Category 2: Tariff reduced to 0-5% for five years
- Category 3: 50% reduction in tariff rates for five years
- Category 4: 20% reduction in tariff rates for five years
- Category 5: No concession

	Pakistan's Exports to China(2017) Value(USD Mn)	Pakistan's Exports to China(2016) Value(USD Mn)	Pakistan's Exports to China(2015) Value(USD Mn)
Category1-Zero Tariff (2,681 tariff lines-35.5%)	438-----29%	346-----22%	510-----26%
Category 2-0.5% (2,604 tariff lines-34.5%)	825-----55%	869-----55%	1,087-----56%
Category3-50% Reduction (604 tariff lines-8%)	17-----1%	16-----1%	13-----1%
Category4-20% Reduction (529 tariff lines-7%)	24-----2%	23-----1%	18-----1%
Category5-No Concession (1,132tariff lines-15%)	199-----13%	326-----20%	277-----14%
<b>Total Exports to China</b>	<b>1,508</b>	<b>1,591</b>	<b>1,935</b>

Source: Break-up of Pakistan's exports to China by categories defined under the CPFTA (USD Millions) (2015-17)

### **China-Pakistan Economic Corridor (CPEC) and CPFTA:**

Beside border connectivity and increase investment under CPEC, several other factors give Pakistan a comparative edge over several of China's trade partners. Through CPEC's multi-modal investments, it is believe that China will also re-locate several industries to Pakistan by





2030. This factor was the bedrock during negotiations where fresh principles were agreed by both sides to address the concerns raised in results of CPFTA-I (Hamid Mukhtar, 2019). The key characteristics of phase two of CPFTA include enhanced market access into each other's economy for both nations, a list of protected product lines, revised safeguard systems, an electronic data interchange system, and a balance of payment clause. CPFTA improves both nations' market access. China has dropped tariffs on 44 percent more product categories in the second phase than it did in the first (Zahid et al., 2021). China promptly removed duties on 313 product categories from Pakistan, notably frozen meat, textiles and other animal products, ready-to-eat meals, plastics, footwear, chemicals, items, leather, seafood, oilseeds, engineering items and auto components are all examples. Pakistan has given China quick access to its market for machinery, intermediate goods, and raw resources. (Aslam, 2020). If a charitable organizations or threatens to cause harm to their local sector, Pakistan and China can impose duties on it or temporarily ban its importation under the CPFTA. The CPFTA's first phase featured safeguard mechanisms, but the second phase revised them to make them more accessible so that local firms in both nations could be protected. (Abdul Kamal et al., 2021). It has gained broad support from business organizations and domestic industry in Pakistan, as it includes safeguard procedures to protect local industry in both China and Pakistan. Phase two has also been praised by Pakistani business associations as a substantial improvement in Pakistan's commercial access to China. (Zahid et al., 2021). Moreover, Pakistan has gained a competitive advantage over its primary export competitor, China, because it will be subject to reduced tariffs. Pakistan has a competitive advantage in 80 percent of product categories, such as machinery, mechanical appliances, plastics, steel, and iron. (S. H. Shah et al., 2020).

### **Methodology:**

The study has compared the imports and exports of Pakistan to China during and after the CPFTA 1<sup>st</sup> phase based on the annual GDP growth rate of Pakistan. The data of imports and exports were taken from World Integrated Trade Solution (WITS, 2022) database while the data of GDP annual growth has been taken from World Development Indicators (WDI, 2022) database. The study has taken two time periods separately for analyses (1) 2003 to 2012; CPFTA tenure/period and (2) 2013 to 2018 non-CPFTA tenure/period. For the graphical representation, and statistical analysis purposes, Microsoft Excel 2013 and E-Views 9 have been used respectively.

### **Results and Discussions:**

Based on the statistical inferential results of regression analysis, the following results have been estimated.



Table 1:  
*Regression Analysis (Economic Growth; Annual %)*

Variable	CPFTA (2003 - 2012)			Non-CPFTA (2013 - 2018)		
	Beta	S. E.	Prob.	Beta	S. E.	Prob.
Constant	7.863	15.819	0.640	102.090	18.012	0.111
Log (Exports to China)	-1.557	3.181	0.645	-13.297	1.804	0.086
Log (Imports to China)	-5.543	5.595	0.367	-0.454	0.824	0.680
Consumer Price Index	0.011	0.208	0.959	0.005	0.021	0.837
Exchange Rate	0.414	0.292	0.216	-0.091	0.011	0.075
R-Square	0.848			0.999		
Adjusted R-Square	0.726			0.993		
F-Statistics (Prob.)	6.960 (0.028)			168.906 (0.058)		

Above table clearly showed that Pakistan's exports and imports to China did not affect Pakistan's economic growth during the CPFTA 1<sup>st</sup> phase tenure (between 2003 and 2012); however, Pakistan's exports to China has negatively affected the Pakistan's economic growth in the non-CPFTA tenure. In a nutshell, it has been manifested from the data that CPFTA have not been proven effective for trade-growth relationship of Pakistan. Furthermore, Pakistan's imports from China have also not supported Pakistan's economy in anyway.

### **Lessons for Pakistan from CPFTA Phase-I for Magnifying the Positive Outcomes of CPFTA-II:**

Most of Pakistani exporters experience supply side issues in Pakistan and information gaps in all domains at China where this issue becomes serious concern when the companies are unable to target markets in China as they are quite familiar with European and USA markets but totally unaware at Chinese competitive market due to language barriers which require specific efforts at state level and through commercial councilors.

Although the first phase is gone but the lessons we learn from first phase require to be targeted in the second to make Pakistan beneficiary of CPFTA where diversified exports should be the point of attention for Pakistan. According to research of Pakistan Business Council China utilize 55.87% of total goods offered for concession in CPFTA-I out of which almost 50% goods are 0 rated while Pakistan only utilize 5% of 0 rated goods showing loop holes in our negotiations which must be considered in future before signing any FTA. Inappropriate tariff reductions is also the critical point of CPFTA where China offer equal or higher tariff reductions in products of high competitive advantage (for Pakistan) to ASEAN, reducing Pakistan's volume of trade (M Mujib , Glob. J. Polit. Law Res, 2017).



In addition, permitting huge variety of imports from China (even at the low cost) at the stake of domestic industries is the real challenge for local investors. Many complaints are at the record of National Tariff Commission regarding the dumping activities of Chinese goods where they impose anti-dumping restrictions for regulation but the policies seems ineffective and results alarming situation in case of trade imbalances where pace of increase in Chinese exports is very high as compared to Pakistan. But these Chinese exports (imports for Pakistan) is necessary for Pakistan as due to low cost after concessions Pakistan's Industries are gaining profits but necessary actions are necessary to boost local industries where value addition and diversification is mandatory but positive outcome require collective efforts of state, Business community and private sector.

### **Conclusion and Recommendations::**

The FTA with China has had wide-ranging impact and have demonstrated surge effect on the trade relations with further reforms required for a deeper, broader, rapid and a bigger effect that can also encourage investment, technology transfer and increase in number of enterprises. However, results suggest that CPFTA alone will not address issues of trade. Literature will only provide limited practical models to leverage FTAs. Assessment on the impact normally takes place over a period of between 10 to 20 years, thus FTA-I was taken for analysis of the results. Additionally, firms are not in a position to take the burden of additional administrative costs because the benefit they receive in return in the form of tariff gains are very less. The FTA trade agreements with China and other partners are crafted with a short, medium and long-term objectives and had major impact on trade due to tariff barriers that it cuts.

The set targets of economic integration by Governments focused policies that add in volume of trade which is not possible without betterment of quality, improvement in efficiency, development of trade infrastructure to support trade, removal of NTBs, harmonization of regulatory system and promotion of integration of both nations for adding in global supply chains. The results suggest that of the FTA has the potential ingredients that can yield the largest macro-economic gains for Pakistan in terms of income, output and exports. We examined the strength of trade relations between the two strategic partners. On general trade relations of Pakistan with China becomes stronger after the signing of FTA but the trade reciprocity of both nations, indicate positive effects from the integration. However, the trade reciprocity also highlighted the fact that mutual trade is not yet balanced which needs improvement where, Intra-industry trade has developed in selected industries, with huge opportunity of investment under CPEC especially in the fields of agriculture, food products, sea food and construction material.

Although the relation between economic integration and trade remains positive after FTAs along with the expansion of tradable categories which results rapid increase of intra-industry trade where new sectors saw surge in trade, which in turn grow inter-industry trade but the main concern in the complete scenario of FTAs was the role of each partner where authorities are concerned about the dominant role of larger partner but our analysis suggests that has not been the case.

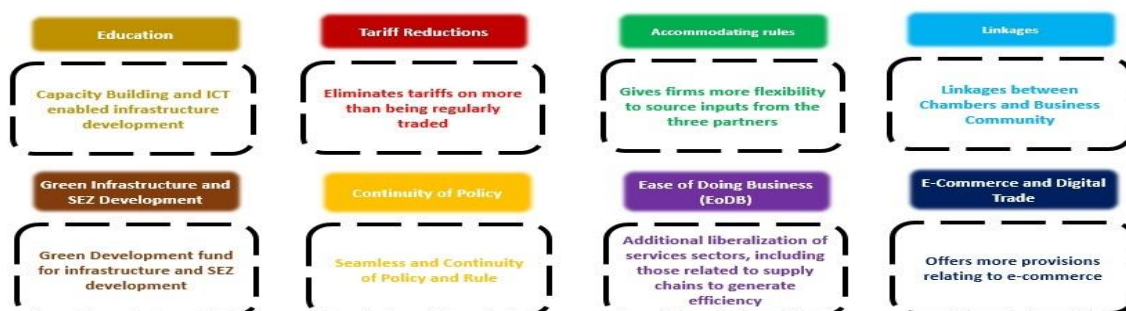


The results of the study highlights that the objectives and plan for implementation of FTAs along with the road map was well designed for accruing benefits from a neighbor which has the market that can benefit Pakistan. Furthermore, the two countries' increasing trading relationship is encouraging, and Pakistan may be able to benefit from these close ties. The trade imbalance has expanded in favor of China as a result of low-cost goods as compared to slow delivery of our goods as compared to fast and quick Chinese imports to Pakistan. In the past three decades, low-cost Chinese goods have had a negative impact on Pakistan's local industries which require revival of our domestic industries. In fact, Pakistan and China are working hard to diminish the growing trade disparity. There should be no more FTA talks to deal with the situation. Import-export policies should include Pakistani businesspersons in the formulation and decision-making processes. CPEC and Gwadar, on the other hand, provide new trading opportunities. With Pakistan, China, Central Asia, Russia, and other nations, more regional integration appears to be taking place as a result of the BRI and CPEC.

Another reason for undesired outcome was the lack of guidance for the business community of Pakistan. (Soomro Shabbir Ahmed, 2021). It recommended that the government should may endeavor to have a national opening-up mindset for export, and to pave the way for the revamping of less competitive enterprises. Future FTAs should be approached strategically and a bottom-up approach should be taken to achieve national interests as negotiations that are undertaken without collecting public opinion are most likely to attract criticism due to the lack of internal understanding. Furthermore, a scarcity of trained labor impedes trade balance; nevertheless, this problem may be addressed by establishing technical training institutes. It is also suggested that further studies may be carried out on issues of SEZs development, employment and environmental standards for broader attention to 'policy space'. In addition, the CPEC project requires Pakistan to secure the transfer of manufacturing technology. Similarly, to cope with competing goods, Value-added and modernized Pakistani exports are necessary. Additionally, stronger bonding between the people and businesses (P2P & B2B) is plays an important role in enhancing our overall bilateral relationships with China and hence trade. Following model is recommended to leverage the CPFTA for a wider economic impact:

## Pakistan-China Comprehensive Partnership

### Key Development Features





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