



Case for More Trade Liberalization with China

by

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INTRODUCTION –

One cannot doubt the emotional attachment of the majority of Pakistanis with China. Generations of Pakistanis are bred on the belief of all-weather friendship with China. And China did prove its worth over the decades of supporting Pakistan and standing by it in hours of trial. On the economic front, Pakistan is the second country, with whom China has entered into a Free Trade Agreement (FTA). Post-FTA, China has become the largest trading partner of Pakistan, with a caveat of persistent high trade deficit suffered by Pakistan. Even without statistical evidence, one can observe presence of Chinese products ranging from high-end electronics to toiletries in large swathes of Pakistan.

We may ask a question here. Is trade with China a bane or boon for Pakistan? Reply depends on the shoe one is wearing. On a lighter note our shoe industry is among those, who are complaining of being swamped under cheap Chinese imports. As in case of any economic change, there are gainers and losers in trade with China. Our beneficiaries list includes consumers and industries using cheaper Chinese raw materials, intermediate goods and machinery. Sufferers are those industries that cannot compete for finished goods market with China pricing and quality. An influential segment in the industry is continuously raising voice for protectionism against cheaper imports. Government intervention is sought in the shape of subsidies and exemptions to protect local employment & obviously local industrialists from competition.

As a consumer, I am happy to enjoy greater range of goods with less pressure on my pocket. However, in the role of an industrialist, my heart pounds fast when I see more of my buyers shifting their preference to Chinese options. Is there any need to resolve this dilemma? Market forces are creating their own momentum, where consumer demand is determining the enhanced flow of Chinese goods. However, we, the consumers, have not lobbied for this opening up of trade with China. Indeed, we have emerged as its biggest beneficiaries. Just try a survey on the origin of home appliances in an average Pakistani household. It is the China price that has enabled a Pakistani housewife to bring more automation to her house chores.

However, our industrialists also have genuine concerns in competing with Chinese goods. There are structural issues that have raised the cost of manufacturing in Pakistan. Key issues include energy crisis, inadequate infrastructure and grim security situation. Now the question is that whether we should delay the opening up of the economy till these structural issues are resolved. Or should we allow the liberalization of economy simultaneously with the efforts of resolving structural issues? And we should remain aware of one fact that our entrepreneurs, like anywhere in the world, are smart and adaptable to market conditions. They will try their level best to resist opening up of competition, as it will hit their profit margins. In case, they cannot stop creeping competition especially from foreign companies, then they will ask for government subsidies and exemptions for protection.

Similar things have happened in Pakistan as elsewhere with consequences for us, the consumers and citizens. As we are diffused and scattered, whereas vested interests are concentrated and resourceful; hence rationally speaking we have to pay more cost. Opening up of market do provide us some comfort, but vested interests will always strive to reduce these

gains for their own profit. And now we need to ask some questions from policy makers, businesses and from ourselves to evaluate the outcome from trade with China in a dispassionate manner. In this regard, our questions are:

- (1) Will protectionism of industry by government serve our interest?
- (2) Is FTA an appropriate tool for expanding our choices?
- (3) Will further trade liberalization with China enhance our quality of lives?

Our search is on for premise that creates greater value on net basis. Indeed there is no free lunch. A price needs to be paid for every gain. Point to ponder remains that whether the price is extracted out forcefully or paid voluntarily. Let us begin our exploration.

EXPLORATION –

Heritage Foundation, a US-based think tank, publishes an index of economic freedom annually. Since the inception of the index 13 years ago, Hong Kong has continuously retained the distinction of being the freest economy of the world. In 2012, Pakistan ranked at 121st out of 185 countries included in the index, scoring 55.1 out of total 100 marks. For the same year, Hong Kong, the number one country on the index, scored 89.3 marks. This index takes into account 10 different factors for evaluating the economic freedom in any country. Related to our topic is the factor of trade freedom. Index defines trade freedom as a composite measure of the absence of tariff and non-tariff barriers that affect imports and exports of goods and services.

Where does Pakistan ranks on the trade freedom? It is ranked 145th with a score of 66. In comparison, Hong Kong, Mauritius, Turkey, Malaysia and China score 90, 88, 85, 77 and 72 respectively, much higher than Pakistan. Our purpose is not to simplify the equation of economic development of any country. We recognize the fact that there are plethoras of other factors that influence economic progress. However, vitality of opening up an economy to trade for development cannot be underestimated. Enhanced trade flow remains among the main pillars contributing to the prosperity of Eastern Asian countries.

Now, if Pakistan is ranked lower on trade freedom, then it means that it is providing more protection to its local industry. We need to see that who is paying the price for this enhanced protectionism? Usually protection is provided through higher tariff on imports, resulting in high prices for us, the consumers. And who gains, the government, who has more taxes to spend at will and manufacturers, who remain cozy with some guaranteed profit margins.

Should government be rescuing local industry from competition? Or should the local industry be entering in a field, where it doesn't enjoy a competitive edge? Or should the consumer be paying higher prices to sustain local industry? Now, all these measures have opportunity cost attached to them. It means that if tax payers are penalized through high taxes, then they have to forego consumption in other areas, where they can generate economic activities. And if local industry is given government crutches to sustain, then they will develop a nexus with government officials for persistent provision of subsidies and exemptions. Majority of the industrialists will lose innovation edge for sustaining themselves in competitive markets.

Case in point is the local automobile industry in Pakistan. A sort of monopoly is provided to three Japanese manufacturers, who are always on the back of government to stifle competition from imports. Now, what's the point if automobile manufacturers have not become competitive even after three decades of protection? And why should Pakistan get engaged in manufacturing of expensive automobiles? After all, majority of the countries in the world don't manufacture automobiles. And few countries dominate exports of automobiles. And on innovation level, Pakistani automobile manufacturers are more of assemblers. They have never met the deletion levels as promised with government. And their clout with government dilutes any accountability efforts.

Now, all these economic resources, which went into supporting inefficient industries that never induces much innovation or generated high employment, could have been utilized in more productive industries. After all, Pakistan could have taken advantage of its agrarian base, of inducing more value addition and broader employment, as done by Netherlands and New Zealand, which are accounted among most free economies. We need to comprehend that amount of resources and government money is limited; they should not be spent on the nexus of crony capitalists and government officials. Instead, businesses should be subject to market discipline and market chaos allocates resources more efficiently than government. On the whole, it could be safely presumed that protectionism will not serve our interest well; instead we the consumers and citizens will be worse off with protectionism.

Now, let us explore the appropriateness of FTA in expanding our choices. Pakistan China FTA is now in its sixth year of implementation. Both countries have included around 6,500 tariff lines for tariff reduction. We may not consider this agreement as free trade implement, as free trade means that there are no barriers or duties on trade flows. Both the countries have included a list of goods, on which there is no reduction in tariff. Even, other included tariff lines are segregated into categories with different range of tariff reduction. This sort of trade agreement may be called as a Preferential Trade Agreement (PTA). Now, whether we call it FTA or PTA, this agreement has resulted in enormous growth of trade flows between Pakistan and China. Mutual trade between the two countries have almost doubled in 5 years from USD 5.3 billion in 2006 to USD 10.2 billion in 2011. Pakistani exports to China are mainly concentrated in textile group of cotton yarn and cloth with food items gradually raising their share in the exports. Chinese imports in Pakistan are more diversified, with electronic and telecom equipment, machinery and chemicals emerging as the import categories. In value terms, Pakistani firms are mostly importing intermediate and capital goods from China for processing purpose. This may be called an angle of resource utilization for more value addition.

China is now the largest trading partner of Pakistan. It remains the number one origin for imports in Pakistan, whereas for exports it is the third major destination for Pakistan. FTA may not be considered an alternate to free trade, as it provides preferred access to one origin over other, which may not be the cheaper source in absence of tariff concessions. We can take the example of NAFTA, which resulted in shifting of outsourcing of American companies from China to Mexico. However, in less than perfect world, FTA could be the more near instrument of reducing trade barriers, which is politically acceptable. And ample evidence is available of its contribution in expanding the range of products for consumers in Pakistan.

Our last question pertains to enhancement of quality of lives through further trade liberalization. Pakistan and China has reached the end of phase-I of their FTA in December 2012, whereby the decided tariff reduction have reached their floor.

Now the officials and business representatives of the two countries are engaged in negotiation for phase-II of the FTA. They are working on further tariff reduction in existing lines and for including 2,000 more tariff lines in the FTA. Ideally speaking, the two countries should bring tariffs on all trade to zero and there should be no barriers on trade. In actual, it may not be possible. However, competitive edge of cheaper Chinese products will keep the inflation low in Pakistan, as it has done in USA. As compared to Pakistan, whose total exports stand at USD 25 billion, China is the largest exporter of the world with around USD 1700 billion exports. Its imports are also touching the mark of USD 1500 billion. Trade liberalization opens more vistas for Chinese companies to invest in Pakistan from commercial viability perspective. Pakistani exporters can be facilitated in establishing presence in more prosperous Eastern China region.

From economic angle, trade liberalization will result in lower inflation and broader trade flows, consequently increasing our purchasing power and enhancing life style.

POSITION –

Based upon of our findings and libertarian principles, we hereby adopt a stance that Pakistan and China should be working towards complete freeing of trade between the two countries. FTA may not be an ideal instrument for free trade; however it is supported as a less than perfect tool for reducing trade barriers. We don't accept the protectionist stance of some of our industry segments against Chinese imports. Its net impact will neither favor our industry or the consumers in the long run. Even one-sided trade concessions will work in Pakistan's favor, as it will reduce cost of business for some of our domestic industries that will make them competitive in other export markets.

ACTION –

Presently, ministries of Commerce from the two countries are engaged in negotiations for the phase-II of the FTA. Input is also sought from trade bodies and related government agencies. Besides Pakistan, China has also entered into FTA with 10 other countries / regions. It is also currently negotiating 3 more such FTAs with GCC, Australia and Norway. For the future, China is considering 3 FTAs with India, Korea and Japan. It appears that Pakistan is going to face much more competition for entering in the Chinese market in the coming future.

Negotiators from Pakistan need to bargain hard with their Chinese counterparts in extracting maximum gains in line with existing China-ASEAN FTA. From textile focused FTA, Pakistan may explore its comparative advantage in agro-based segment for food-deficit China. Case in point is of rice exports from Pakistan, which has been included in no concession category by China. Pakistani rice attracts 65% import tariff in China.

Issue of across the board tariff reduction may be elaborated in presentations to Ministry of Commerce, Pakistan. Other entities such as Pak China Business Council and Trade Development Authority of Pakistan may also be approached for soliciting free trade between Pakistan and China. Selective reduction in tariff will not optimizes the trade potential between the two countries. Deeper economic integration will bring added advantages to Pakistan, such as enhanced Chinese and other Foreign Direct Investment (FDI). Increase trade will remain the key of further economic collaboration between the two countries.