



## **INFONALYSIS**

# ***TRADE AGREEMENTS & THEIR IMPLICATIONS ON PAKISTAN'S TRADE***

**MAY 2013**

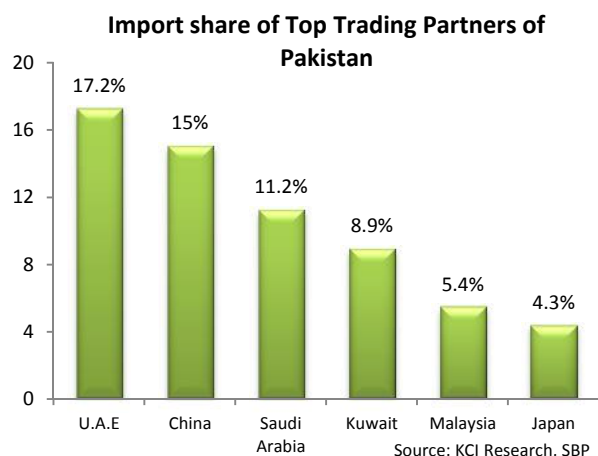


**Karachi Chamber of Commerce & Industry**

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The world is becoming increasingly a global village which necessitates enhanced and closed bonded trade relations among the countries on international level. For the purpose of trade enhancement, countries are more and more opting for the trade agreements which may be Free or Preferential in nature.

**Preferential Trade Agreement** provides contracting parties to avail reduced tariff rate for certain trading commodities. On the other hand, **Free Trade Agreement** incorporates elimination of quotas, tariffs, and other barriers to international trade, allowing



contracting parties to specialize in the products that can be produced cost effectively and on mass scale. As both kind of trade agreements are aimed at facilitating trade, there is only a slight difference between the two. The Preferential Trade Agreements are starting point in the process of trade liberalization while Free Trade Agreements works for removal of tariffs altogether.

Such trade agreements predominantly improve the trade balance of the countries having specialization in products of interest to each other.

**How Trade Agreements incentivize trade?**

The trade agreements provide opportunity to contracting countries to avail concessions on the tariff lines thereby giving way to the enhanced trade volume and increased trade revenues. The Free Trade Agreements decline trade barriers and encourages economies of scale of production along with the intra and inter-industry specialization within the countries. The level of welfare & gains of trade agreements mainly depends on the productivity of contracting countries and the conditions applied on these countries

to qualify for the trade preferences like rules of origin. The low levels of tariff that is applied in such agreements enhance competition which leads to greater and improved output. They may also cover the protection of intellectual property rights, dispute settlement and government procurement.

**Role of GATT/WTO in promoting trade**

Several rules and regulations have been introduced on international level for the promotion of trade liberalization process. In this regard, General Agreement on Tariffs and Trade (GATT) was introduced to facilitate trade by reducing quotas, tariffs and providing subsidies. While, later on in 1995, the World Trade Organization (WTO) was formed for setting out the rules of global trade with objective of having same tariffs and duties in international trade between countries.

**Pakistan reaping limited benefits of trade agreements**

Pakistan has signed various FTAs and PTAs with its neighboring countries and trade partners. In South Asian region, Pakistan has its Free Trade Agreement with Sri Lanka, China and Malaysia. SAFTA is another important trade agreement concluded in 2006 among various South Asian countries including Pakistan.



Similarly, Pakistan also has its Preferential Trade Agreement with Iran and Mauritius which provide trade preferences to the countries while exchanging commodities through trade with each other. The South Asian countries possess comparative advantage in different fields that provide them edge to sign trade agreements with each other.

On Pakistan's part; there is a need to get engaged in further trade agreements with the countries more

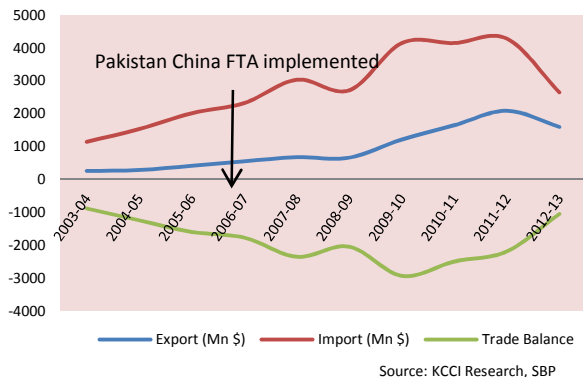
interested in the export oriented sectors like textile and apparel products.

The analyses of trade agreements show that FTAs and PTAs are usually contracted among the neighboring countries due to low cost of transportation. Afghanistan, India, Iran and China are the neighboring countries of Pakistan with which it already has its PTA, FTA or trade transit agreement. The major trading partners are also the strong candidates with which trade agreements can be signed. In case of Pakistan, the export partners are USA, U.A.E, Afghanistan, China, UK and Germany. Pakistan should also sign trade agreements with rest of its export partners.

**FTA between Pakistan & China**

Pakistan and China signed a Free Trade Agreement (FTA) in 2006 under GATT. In the first phase of the tariff reduction program (from 2007-12), tariffs on Pakistani exports to China were eliminated on 70% of the product lines, while tariff reduction of 20-50% was implemented on 15% of lines. From imports point of view, Pakistan eliminated tariffs on 55.5% of the lines and reduced tariff in the range of 20-50% on 28% of lines. After the implementation of Pak China FTA, trade witnessed obvious surge where imports increased by 30.5% while exports could not match the desired pace and jumped only by 23.1% during FY08. Thus Pak China FTA further widened trade deficit of Pakistan with China. It seems that Pakistan has not been very successful in exploring the full potential of FTA.

**Pakistan's Trade with China**



In the second phase, which is currently under consideration, both parties shall endeavor to completely eliminate the tariffs on at least 90% of products within a reasonable period of time. Pakistan has agreed to reduce tariffs mainly on machinery, organic, and inorganic chemicals, fruits and vegetables,

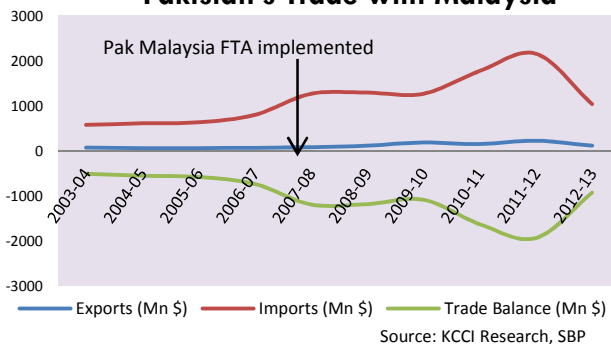
medicaments and other raw materials for various industries including that of the engineering sector, intermediary goods for engineering sectors, etc.

Pakistan's exports to China are comparatively low as compared to its imports from China. Given the current export structure, it becomes imperative to analyze the prospective impact of this FTA on Pakistan's economy and it should be ensured that Pakistan manages to enjoy benefits of this trade agreement at least on equal grounds.

**FTA between Pakistan & Malaysia**

The FTA between Pakistan and Malaysia was approved on November 6<sup>th</sup>, 2007 under which Pakistan agreed to eliminate tariff on 43.2% of its current imports from Malaysia by 2012. On the other hand, Malaysia eliminated tariff on 78% of imports from Pakistan. Two tracks for Margin of Preference (MoP) have been set under FTA on the basis of product categories. The five palm based products (margarine, glycerol, non-ionic soap, medium density fibreboard and other related commodities) are included under first track. In this track, the import tariff will be reduced by 5% MoP on January 2008 followed by an additional 5% MoP every year till 2011.

**Pakistan's Trade with Malaysia**



The Track two includes Crude Palm Oil, Palm stearin, RBD palm oil, Palm olein, Crude Palm Kernel oil and other related commodities. Under this track, import duty will be reduced by 10% in 2008 followed by an additional 5% starting from 2010. Pakistan's export to Malaysia has remained at extremely low levels that have hurt the economy due to huge trade deficit. The actual gains of FTA can be enjoyed by Pakistan only when desired levels of exports to Malaysia are achieved.

**Trade Profile of Pakistan with Key Trading Countries**

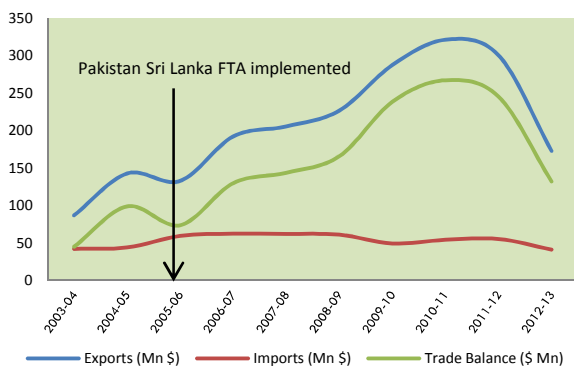
Nature of Trade Agreement	Country	Exports (Mn \$)			Imports (Mn \$)		
		2010-11	2011-12	2012-13 (Jul-Jan)	2010-11	2011-12	2012-13 (Jul-Jan)
FTA Partners	China	4144.93	4159.84	2633.27	4848.76	4892.56	2874.26
	Malaysia	154.63	229.23	118.92	1773.71	2156.3	1040.02
	Sri Lanka	321.452	300.807	172.98	54.1	55.258	41.017
PTA Partners	Mauritius	43.67	37.26	18.71	6.72	8.38	1.11
	Iran	302.08	123.67	19.84	128.94	131.49	75.7
	Indonesia	126.4	194.83	136.95	418.97	673.89	417.16
Trade Agreements Under Negotiation	Russia	206.58	206.98	117.24	25.22	87.84	50.97
	Turkey	751.01	608.62	228.64	147.76	154.81	118.09
	Bangladesh	907.98	662.45	394.6	74.64	63.4	34.2
	Saudi Arabia	426.33	455.86	279.99	4450.84	4795.68	2444.27
	South Korea	415.47	500.91	240.1	554.94	647.88	333.71
	Singapore	237.45	139.92	94.14	2515.15	2803.17	1567.28
	U.A.E	1855.36	1947.14	1059.27	5811.69	6426.25	3706.55
Potential Trade Agreements	U.S.A	4101.96	3948.92	2287.83	1119.55	789.43	498.76
	Thailand	83.84	117.99	57.41	509.91	579.79	295.16

Source: KCCI Research, SBP

**FTA between Pakistan & Sri Lanka**

The FTA between Pakistan and Sri Lanka was implemented in June 2005 under which Sri Lanka received duty-free access to Pakistan for a total of 10,000 metric tons (MT) of tea and 1,200MT of betel leaves with reduced rates of 35% on applied MFN rate. The kitchen ware and ceramic articles are entitled to enter Pakistan with 20% reduced rates when manufactured in Sri Lanka. 35% preferential duty margin is also given to 21 product categories of Sri Lankan apparel under FTA.

**Pakistan's Trade with Sri Lanka**



Source: KCCI Research, SBP

However Margin of Preference (MOP) and Tariff Rate Quota (TRQ) granted to Pakistan under FTA includes 100% duty free access of 6000 MT of Pakistan basmati rice and 1000 MT of potatoes per year (2/3 to be exported during June/July and 1/3 during October /

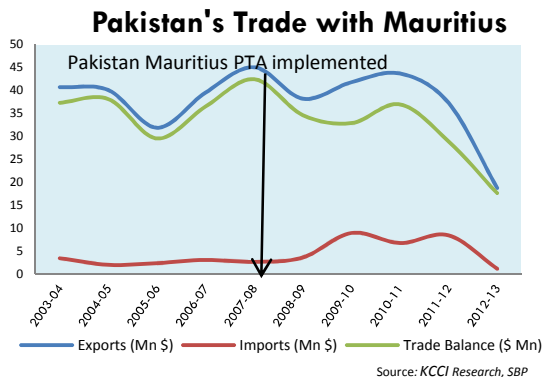
November each year). Products wholly produced, obtained or at least 35% value added in Pakistan such as agricultural, fishery and mineral products will be allowed duty free access in Sri Lanka. The FTA between Sri Lanka and Pakistan has worked well as the trade volume has significantly increased which is also in the favor of Pakistan.

**PTA between Pakistan and Mauritius**

The Preferential Trade Agreement between Pakistan and Mauritius was signed on July 30<sup>th</sup>, 2007, ratified on October 30<sup>th</sup>, 2007 and became operational on November 30<sup>th</sup>, 2007. Under the Agreement, Pakistan offered concessions to Mauritius on 130 items which makes 1.9% of its then national tariff lines, whereas Mauritius has given concession on 102 items that is 1.64% of its total existing national tariff lines.

Right after the implantation of PTA in 2008, Pakistan's export to Mauritius faced decline mainly due to the ongoing recession however the imports remained unaffected sustained the previous level.



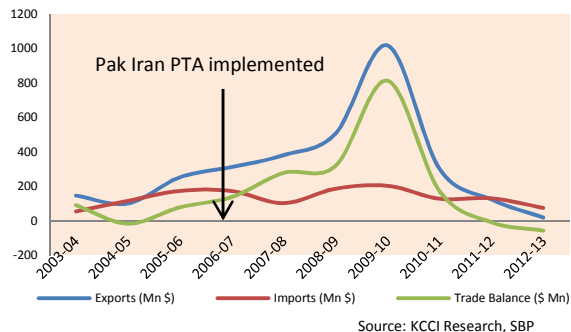


The trade figures do not reflect significant improvement in the trade volume which might also be due to low tariff concessions under PTA. Thus implementation of FTA might be considered to explore the true trade potential between the two countries.

**PTA between Pakistan and Iran**

Pakistan signed a Preferential Trade Agreement (PTA) with Iran on March 4, 2004 and the agreement became operational from September 1, 2006. Under the agreement, Pakistan offered concessions to Iran on 338 tariff lines, whereas Iran gave concessions on 309 tariff lines. Preferences granted by both countries to each other cover around 18% of MFN (Most Favored Nation) tariff of both countries. The items imported by Pakistan from Iran include petroleum, metals, chemicals, plastics etc. Pakistan exports various items to Iran like rice, yarn, textiles, surgical instruments etc. Rice is a major export item of Pakistan to Iran.

**Pakistan's Trade with Iran**



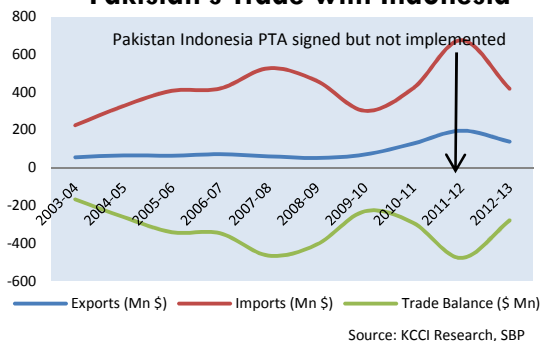
The trade volume flourished between the two countries after the implementation of PTA. However after 2010, Pakistan's exports to Iran nosedived due to the strict U.S sanctions on Iran. Accordingly, barter trade has become a better option to continue trade

with Iran and therefore can be further promoted. On the other hand, trade may also be redirected to Iran through other countries like Dubai.

**PTA between Pakistan and Indonesia- still pending**

Pakistan and Indonesia signed a Preferential Trade Agreement (PTA) on February 3, 2012 in Jakarta. Indonesia agreed to offer market access to Pakistan on 216 tariff lines on preferential rate while Pakistan offered 287 tariff lines. The Indonesian offer list included export products like fresh fruits, textiles, fans, sports goods, leather goods and other industrial products. However implementation of this PTA is still pending and needs attention of concerned authorities to fulfill the pre requisites of the implementation of trade agreement to reduce huge trade deficit.

**Pakistan's Trade with Indonesia**



Pakistan imports bulk of crude palm oil from Indonesia while it exports fruits, value added textiles, leather, fabrics to Indonesia on small scale which is relatively low priced and is an aggravating factor in high trade deficit. Exports to Indonesia are significantly low because exported products do not cater major import needs of Indonesia which is machinery, equipment, fuels and chemicals. However there is surge in Pakistan's export of cotton yarn and cereals to Indonesia in the recent years.

Through this PTA, Pakistani importers would be able to import palm oil and other similar items on preferential tariffs while exports would also be boosted. Pakistan also agreed to provide the similar treatment to palm oil products from Indonesia as provided to Malaysia under Pak-Malaysia FTA. It means Pakistan would import palm oil from Indonesia at 15% Margin of Preference (MoP).

### **Who Pakistan should sign Trade Agreements with?**

Pakistan already has its FTA with several neighboring countries however, for further free market access and trade enhancement on reduced tariff lines, agreement with the export partners would be a recommended step on Pakistan's side. There is a great potential for Pakistan to have its trade agreement with U.A.E, U.S.A and Thailand. U.S.A and U.A.E are not only major trade partners but they also possess commodities of interest to Pakistan mainly POL, machinery, vehicles, chemicals.

### **Pakistan - Thailand FTA in Pipeline**

Pakistan and Thailand have long term bilateral trade relations in the fields of economics and commerce. The bilateral trade between Pakistan and Thailand crossed \$ 1Bn in 2012 and the meeting of Joint Trade Commission will be leading to the Free Trade Agreement between the two countries. Both Thailand and Pakistan can help each other in enhancing their trade relations by reducing their tariffs on trading commodities. Pakistan exports cotton, sea food and other edible items to Thailand while Pakistan imports vehicles, organic chemicals, machinery and other such items from Thailand. Both countries have comparative advantage in different fields which encourages way to the reduced tariff lines on traded commodities by signing Free Trading Agreement.

### **Potential Target Countries for Trade Agreements**

It is recommended that U.S.A and U.A.E should also be brought under Preferential or Free trade agreement with Pakistan mainly due to quantum of trade with these countries.

U.A.E being an important trading partner enjoys friendly relations with Pakistan. The two countries have significant trade volume that can be further enhanced to greater levels. There is a great scope of Free Trade Agreement between U.A.E and Pakistan as both the countries are engaged in extensive trade. At present, Pakistan's export to U.A.E has increased to \$ 8.4Bn. Although Pakistan runs trade deficit with U.A.E due to huge import of oil, having FTA with U.A.E may include concessions on oil import. Being a re-export market and the fact that U.A.E has been used as a trade route for Pakistani commodities to Iran and India, FTA will also result in reduced levels of tariffs on exporting commodities. Thus, Pakistan will not only be able to import oil from U.A.E on concessionary prices but will

also be able to export its commodities on reduced tariff lines which would reduce its trade deficit with U.A.E.

Similarly, Pakistan and the United States are old allies since the Cold War of 1950s. Several agreements have been signed between the two countries to protect South East Asian region from the effects of terrorism. However there is no official agreement between Pakistan and US in trade sector.

U.S.A has been engaged in various bilateral trade agreements with countries of the world. Talks about U.S.A - U.A.E FTA are on final stages which show that these countries are looking forward to cooperate on improved and enhanced trade operations by providing reduced tariff on traded commodities. Looking into this perspective, Pakistan should also take such steps and enhance its bilateral trade with U.A.E and U.S.A to enjoy reduced tariff rates on trading commodities as well.

The total exports volume of Pakistan to U.S amounted to \$ 572Mn during 2011-12 while Pakistan's imports to the U.S. are around \$ 3,532Mn in 2011-12. The United States is also the biggest export market for textile and cotton apparel of Pakistan which covers almost 16% of its total exports.

The woven fabrics, cotton yarn, leather, rice, textiles, sports and surgical goods are all the export items of Pakistan to the U.S while wheat, boiler machinery, electrical and telecom appliances and petroleum products makes up the import list of Pakistan from the United States. The United States being the biggest export market for Pakistani textiles and is destined to American traders and retailers; it still has to pay heavy disproportionate tariff rates in comparison to other diversified economies. In case of Free Trade Agreement between the United States and Pakistan, withdrawal of these heavy tariffs will result in upswing in Pakistani exports that may go up by approximately \$ 3Bn along with the lifting of other trade restrictions.

### **What should be done?**

The trade agreements FTA and PTA are the means of enhancing economic prosperity and improving trade gap among the contracting countries. Pakistan, being an agrarian economy, has comparative advantage in textile and food products. The cotton yarn is among the top most exporting commodity of Pakistan

however diversification is needed to enhance exports commodities of Pakistan. The present FTAs and PTAs of Pakistan are contributing to its trade volume however they are not very responsive in reducing its trade deficit. The trade agreement of Pakistan with China and India is the example of such situation which is mainly due to the weak trade policy, lack of prior analysis on trade agreements and low diversification of its export items.

The exports of textile products have helped in reducing trade deficit, Pakistan's textile products are heavily taxed in the U.S. Furthermore, Pakistan should also strengthen its engineering sector, auto sub-sector and consumer durables mainly domestic appliances by giving import protection to them so that developments could be made and exports could be diversified in the future would boost. Thus, Pakistan should consider getting into agreement with the countries with which it has its trade surplus or at least have low trade deficit to promote its domestic industry. The trade agreements of Pakistan with its international counterparts that specialize in latest technology transfers, if imported, would provide comparative advantage to the country.

# INFONALYSIS - TRADE AGREEMENTS & ITS IMPLICATION ON PAKISTAN'S TRADE

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