Pakistan-China trade and investment relations*

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As we celebrate 2011 as the year of Pakistan-China friendship, it gives us an important occasion to look back and cherish the evolution of Pak-China relations, which have stood the test of time in the real sense of the word. The world has been continuously transforming in many ways since we established our diplomatic relationship 60 years ago. However, in our relations, nothing has changed in terms of mutual understanding, cordiality and friendship. The only change this special relationship has experienced is that it has moved from strength to strength over all these years. And today, especially after the recent visit of Chinese Prime Minister Wen Jiabao, we can proudly claim that Pakistan-China relations are at their highest level yet.

Assessment of trade and investment relations

During the past sixty years, our political and defence relations have developed substantively. However, expansion in our economic relations is a development of the recent past and the last decade (2000-2010) can distinctively be termed as a decade of institutionalizing Pak-China economic relations.

With the end of bi-polarity, the process of globalization gained momentum and geo-strategic priorities were reformulated in a way to give more space to geo-economic considerations. Regionalism within the processes of globalization assumed immense importance for creating regional cooperation frameworks that focus on economic integration and common development. The world has thus increasingly become interdependent in bilateral, regional and intra-regional contexts.

Pakistan and China also felt the need, towards the end of 1990s, to enhance economic cooperation in order to provide sustenance to their evolving comprehensive relations in a fast changing regional and global environment, while also continuing to upgrade the level of cooperation in other areas. Since then, the leadership of both countries has shown determination to catch up and take economic relations to a higher level that is comparable to political and defence relations.

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* Paper presented at the seminar on "Pakistan-China Relations – 2011: Year of Friendship", organised by the Institute of Strategic Studies, Islamabad, January 11-12, 2011.

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Since early 2000, we see a persistent pattern of growth in bilateral economic relations and a number of initiatives have been taken by the public and private sectors of the two countries. China has contributed immensely in the development of infrastructure in Pakistan with projects such as the Gwadar deep-sea port, coastal highway, up-gradation of the Karakoram Highway (KKH) and several other energy related projects. Together, the two countries are working hard to chalk out a roadmap for future that includes putting in place certain measures for short-term cooperation, while also formulating policies for the long-term, by creating complementarities in trade and enhancing investment opportunities.

In the last ten years, there has been a regular exchange of high-level visits between the leadership of both countries. Each of these visits has reflected in clear terms the desire for consolidation of economic relations.

I will focus briefly on the three recent important visits by Chinese Prime Ministers - in 2001, 2005 and 2010 respectively. Each of these visits clearly spelled out and reassured Pakistan of Chinese support for the expansion in overall economic relations, especially in the area of trade and investments. I intend to refrain from juggling with statistics because they are often misleading and in this case may not portray the correct picture. Therefore, I would rather deal with issues in trade and investments in a broader conceptual framework to analyze achievements, challenges and prospects. In the last ten years, the volume of bilateral trade has risen from $1 billion to about $7 billion. However, the percentage in growth of Pakistani exports on yearly basis has been declining. Figures for the last five years show an expansion of bilateral trade, but with the balance of trade constantly increasing in favour of China.

TABLE-1

In US $ (millions)			
Year	**Imports**	**Exports**	**Total**
2005	**3,427**	**833**	**4,260**
growth %	39.03	40.24	39.26
2006	**4,239**	**1,007**	**5,246**
growth %	23.69	20.89	23.15
2007	**5,780**	**1,105**	**6,885**
growth %	36.35	9.73	31.24
2008	**5,974**	**1,006**	**6,980**
growth %	3.2	-8.9	1.3
2009	**3,779**	**1,258**	**5,037**

In May 2001, the then Prime Minister Zhu Rongji, during his visit to Pakistan, identified broad parameters and areas of cooperation, urging the two sides to "boost cooperation in agriculture, infrastructure, information technology and other fields under the principle of reciprocity and mutual benefit for achieving common prosperity." During his visit, six major agreements and one MoU were signed. These included agreements on economic and technical cooperation, tourism cooperation, lease of Saindak copper-gold project, supply of locomotives, supply of passenger coaches to railways, white oil pipeline, and a MoU between ZTE and PTCL. China pledged around $1billion to support these agreements and reiterated its commitment to assisting in the construction of Gwadar Port and the Coastal Highway. Prime Minister Zhu Rongji said, "These projects are very important for the development of Pakistan. We will fully support these projects and provide help in this regard." And support they did eventually, especially in the case of Gwadar and the Coastal Highway.

In the following five years till the 2005 visit of Premier Wen Jiabao, there were a number of visits by Pakistan's leadership to China, and each visit concluded with several agreements and MoUs specifically focusing on economic cooperation and expansion of trade and investments. Noteworthy among these visits were by President Musharraf in November 2003, and Prime Minister Shaukat Aziz in December 2004. During the former, the two sides signed a very important document known as the "Joint Declaration on Direction of Bilateral Relations", which was in fact a blueprint for future cooperation with special emphasis on developing economic relations. Similarly, during the Prime Minister's visit, seven agreements aimed at enhancing trade, communication, further movement on Preferential Trade Agreement and Chinese investments in Pakistan were made and Pakistan also announced the "Free Market Economy" status for China.

By the year 2005, Pakistan-China trade had been showing continuous increase and it had reached from around $1 billion in 2000 to $4.5 billion in 2005, which again was in favour of China. At this stage, Pakistan felt that simultaneous investments in the industrial sector could help reduce the growing trade imbalance and attempted to persuade the Chinese side, from both public and private spheres, to bring in investments along with their goods to make the trade partnership sustainable and create a win-win situation. Unfortunately though, Pakistan did not succeed in this endeavor to attract meaningful investment as China was not forthcoming in terms of investing in the country. From 2000 to 2005, while the FDI in Pakistan increased about 600 percent, China's share remained very low.

In April 2005, Premier Wen Jiabao, who was on first official visit to Pakistan, attended the China-Pakistan Business Cooperation Conference, and delivered a speech on economic and trade cooperation between the two countries.

He gave three suggestions on how to further expand the scope of bilateral trade and investments:

1. To adhere to the principle of equality and mutual benefits, and share complementary advantages. Pakistan enjoys abundant resources. China possesses the applicable technologies and development experiences. China will try to optimize China-Pakistan trade structure and improve the trade imbalance with Pakistan. China will actively encourage the competitive enterprises to invest in Pakistan so as to achieve win-win results and create more employment opportunities in local areas.

2. To strengthen communications and exchanges and expand opportunities for business cooperation. The governments of both countries should build a platform and create opportunities to promote the establishment of cooperation and communications mechanism. The exchange and cooperation between enterprises are important pillars of China-Pakistan economic and trade relations. China encourages the enterprises of both countries to strengthen mutually beneficial cooperation and learn from each other for common development in a manner that better complies with the rules of market economy.

3. To expand the cooperation fields and seek for varied means of cooperation. The established cooperation basis should be solidified. The cooperation in such fields as agriculture, finance, science and technology should be expanded and the cooperation in new fields continuously sought, such cooperation means as joint venture, sole foreign ownership, lease, training and contracting explored actively so as to inject new vitality to China-Pakistan economic and trade relations.

Subsequently, five years later when Prime Minister Wen Jiabao visited Pakistan in December 2010, our trade has surged from $1 billion in 2001 to around US$7 billion, though still heavily in favour of China. And there has been no substantive progress on the investment side.

The common perception in the Pakistani business community is that the Chinese private and public sectors are not interested in investing in areas that could enable Pakistan to create an export surplus for Chinese markets as well as other destinations. Rather, they contend, Chinese entrepreneurs simply want to sell products and make quick profits while based in China and do not seem to be interested in generating profits from Pakistan through joint ventures of private foreign ownerships.

The question to be asked is why we have not been able to achieve the desired results in trade and investments. First, let us review the trade structure between Pakistan and China. They had signed a trade agreement as far back as 1963, according to which both countries granted Most Favoured Nation (MFN) status to each other. However, substantive trade relations could not develop due to various reasons and in 2003 a 'Preferential Trade Agreement' was signed and it became operational in 2004. The two countries also instituted a joint study group to negotiate a 'Free Trade Agreement' (FTA) that was signed in 2006 and became operational in January 2007.

There are many questions raised in Pakistan regarding the rationale behind signing the FTA with China. It is commonly asked, for instance, whether this was a market-forces driven decision or a political decision to demonstrate the strength of the economic relationship since the size of Pakistan's economy is very small when compared to the Chinese economy. There is a huge gap in the level of industrial development between the two countries. Their economies of scale are unmatchable given the structure of industrial production of the two countries. Complementarities between the two countries are not primarily based on manufactured goods but Pakistan exports mainly raw materials, especially cotton, copper, chrome etc. against the import of value added manufactured goods. While China's exports to Pakistan constitute more than 20% of its imports, Pakistan's exports to China constitute only 0.13% of Chinese imports. What was the expected advantage for Pakistan of signing the FTA? With these factors on the ground, how did the two sides envisage a win-win situation?

A study by the Trade Development Authority of Pakistan highlights that one of the causes of the FTA's ineffectiveness is that it has "too low Tariff Lines Coverage and elimination of Tariff under FTA Elimination."

	No. of Tariff Lines	**% of Tariff lines at 8 digit**
Elemation of Tarrif - Three years	2681	35.5%
0-5% tarrif reduction five years	2604	34.5%
tarrif reduction on MOP - of 50% five years	604	8%
tarrif reduction on MOP - of 20% five years	529	7%
No Concession	1132	15%
Total	**7550**	

It is clear that Tariff Elimination is on 35.5% of tariff lines only, whereas on 34.5% of tariff lines there would be a tariff of 0-5%. In the remaining 30% tariff lines, there would be no concession at all to 15% and marginal concession to the remaining 15%. The statistics for 2009 show that Chinese businesses could import only 19.2% duty free tariff lines. The only difference the FTA has made is that the average tariff of import has dropped to 6.9% in 2009 from the overall MFN average of 9.5%.

Therefore, it is clear that maximum concession is only provided to 35.5% of a total of 7550 tariff lines covered under the FTA. According to the findings in the aforementioned study, this is too narrow a coverage of bilateral trade and too low tariff lines if we look at China's FTA programs with other countries.

China has signed a FTA with eight countries and regions, including ASEAN, which became operational from January 1, 2010 and ASEAN countries at present are enjoying a trade surplus with China. Under this FTA, China has given enormous concessions and tariff elimination covers 90% of goods traded between China and the ASEAN countries. Under the agreement, average tariff rate of China for goods from ASEAN would be 0.1% instead of 9.5%.

On comparing China's FTA with Pakistan and ASEAN, one would find that the items covered under China-ASEAN FTA at zero percent duty put ASEAN at an advantage since there are duties on export of the same items from Pakistan, thus rendering Pakistan's products less attractive for Chinese buyers.

Chapter	**Description of item**	**MFN Rate**	**Tariff for Pakistan (FTA)**	**Tarrif for ASEAN (FTA)**
Chapter-1	Live animals	10%	6.7%	0% all
Chapter-2	Meat	12-15%	8%	0%
Chapter-3	Fist etc.	10-16%	5-14.8 Some zero	0%
Chapter-4	Dairy Produce	10-15%	6.7-13%	0%
Chapter-7	Edible vegetable and certain roots and tubers	7-13%	0-8.7%	0%
Chapter-8	Fruits	10-30%	6.7-16.5% Zero on mangoes, oranges and dates	0%
Chapter-11	Cereals	5-18%	6.7-15.7%	0%
Chapter-12	Oil Seeds	6-15%	5.3-8%	0%
Chapter-16	Meat/Fish preparation	5-15%	5.3-8%	0%
Chapter-27	Mineral fuels	3-11%	0-5.7%	0%
Chapter-29	Organic chemicals	2-5.6%	5.5%	0%
Chapter-32	Dyes , paints/varnishes	6.5-10%	5.5-6.7%	0%
Chapter-33	Perfumery, costmetic or toilet preparation	10-15%	6.7-13%	0%
Chapter-39	Plastic	6.5-10%	5.5-6.7%	0%
Chapter-41	Raw hides/skins & leather	5-14%	5-12.2% few zero	0%
Chapter-42	Article of Leather	10-20%	6.7-14%	0%
Chapter-51	Wool	5-10%	5.3-6.7%	0%
Chapter-52	Cotton	5-10%	0-4.5%	0%
Chapter-57	Carpets	10-14%	6.7-12.2%	0% all
Chapter-61	Articles of apparel knitted or crocheted	14-17.5%	9.4-13.9%	0%
Chapter-62	Articles of apparel not knitted/crocheted	14-16%	9.4-15.2% some zero	0%
Chapter-63	Textile made up articles	14-16%	9.4-13.9%	0%
Chapter-68	Articles of stone	8-24%	0-13%	0%
Chapter-69	Ceramic products	8-15%	6-13%	0%
Chapter-70	Glass and glassware	8-17.5%	6-15.2%	0%
Chapter-72	Iron and Steels	2-10%	0-5.7%	0%
Chapter-73	Articles of iron/steel		upto 8%	0%
Chapter-82	Tools/Cutlery, Spoon/forks of base metal	8-18%	6-16.2%	0%
Chapter-84	Machinery & Equipments	4-15%	0-18.2%	0%
Chapter-94	Furniture	10-12%	6.7-25.2%	0%

Source: *Country brief-China, data compiled by TDAP.*

Similarly, China has given a concession of zero tariff to the 33 least developed countries of the world. These include 26 from Africa and three from South Asia, namely Maldives, Nepal and Bangladesh. Imports in this category include textile, agricultural products, aquatic products, minerals etc. The study concludes that Pakistan is clearly at a disadvantage with reference to its competitors.

Moreover, there are some non-tariff barriers and while they are not Pakistan-specific, they have an impact on Pakistan's exports to China. To quote just one example, due to the protocols of the port of entry, Pakistan's mangoes cannot enter through Chengdu, the fourth largest city of China, which has two incoming flights of China Southern Airlines from Karachi every week.

Factors inhibiting the trade relations

Many factors are involved in hindering growth of Pakistan's economic relationship with China. These include the following:

1. Infrastructure deficit, particularly in energy
2. Poor innovation and technological infrastructure
3. Low labour productivity
4. Low levels of manufacturing value addition
5. Little Foreign Direct Investment (FDI) in manufacturing and exportable sectors
6. Anti-export bias in taxation
7. Increasing costs of exports as compared to imports
8. Lack of product and geographical diversification in exports
9. Absence of economies of scale in the production processes, especially in the Small and Medium Enterprise (SME) sector, which accounts for a vast majority of the enterprises in the country

The primary reason for low-level trade could be attributed to non-complementarities of items in both countries and the fact that China has been competing in almost all major sectors of Pakistan's exportable commodities.

Another factor that continues to persist even today is the Pakistani business community's narrow vision, which has remained locked onto established export destinations such as the U.S. and Western Europe. Pakistani exporters hardly made serious efforts either to diversify the base of exportable commodities or to explore other markets, especially in East Asia, for enhancing the volume of their exports. This mental fixation with the western markets, which fetches relatively high profit margins, thus becomes a non-innovative export approach that has constantly been undermining Pakistan's export potential for Chinese markets.

The security environment in Pakistan, especially in the two of its western provinces, is also deterrence for Chinese private sector investment. The five unfortunate incidents in which Chinese workers lost their lives have negatively affected potential Chinese investors and ensuring the security of Chinese workers is a serious challenge if more effective trade policies are to be made.

China is fast integrating into the global economic system and its trade, investment and economic co-operation is now increasingly being directed by market forces as opposed to state planning that used to be the norm. Corporations and industries are making their decisions simply on commercial viability and profitability of a particular project rather than directions or instructions from the government. Thus even more than before now, engaging the Chinese private sector on a long-term basis is important for sustainable economic and trade relations.

Also, making the Pakistani private sector more innovative and pro-active is essential to produce any tangible results as without this, the country may even lose its current level of trade to more competitive and aggressive market forces. We don't see this happening in a big way although the government in Pakistan is patronizing the private sector and the role of the public sector is being curtailed in order to create an enabling environment for private sector endeavours.

The quality and quantity of goods also needs to be highlighted. Pakistan's exports to China are centred mainly on cotton yarn and cotton fabric although there is an increasing trend in the export of seafood and leather. This potential can only be realized by revamping the processing technologies and producing internationally acceptable quality.

While most of Pakistan's imports from China are value added, over 85% of its exports to China are raw materials such as cotton yarn and fabric, chrome and copper ores. For example, copper and gold from Saindak Copper-Gold Project is exported to China in semi-finished form and re-exported to Pakistan after adding value. Chrome ore is exported to China in a raw form and China has the technology and smeltering plants that can then add value to Pakistani chrome exports. Pakistan must add value to its exportable raw materials and other commodities within the country and this can be in the shape of joint ventures with Chinese companies that have the technology and wherewithal to do so.

Pakistan has a narrow base for exportable commodities and more than 75% of its exports originate from four items, namely cotton, rice, leather and sports goods. Diversifying commodities to make them suitable and more attractive for the Chinese domestic market is the sort of proactive export policy that could enhance the volume of exports and rectify to an extent the trade imbalance. It will not be possible for Pakistan to increase its exports to China without this step and it should seek Chinese investment for projects aimed at export diversification.

Also, Pakistan should seek Chinese investment in the complete chain of manufacturing and not only in assembly-line activities. The Chinese companies involved in electronics, home appliances, automobile, motorcycles etc. are only the screwdriver assembly lines. Most of the parts are being imported from China and the companies enjoy tax breaks. Such activities neither create job-opportunities in the local market nor broaden the manufacturing base in the country. Thus it is more beneficial for Chinese companies rather than for the Pakistani economy.

Another challenge to sustain this progressive economic relationship is to establish best trade practices. It has been reported that the machinery being imported from China is usually under-invoiced in order to evade taxes and such practices can be curtailed through joint efforts by both countries. Another area where they have to work together is unregistered trade. There are huge quantities of a wide variety of items that are being smuggled into Pakistan where markets seemed to be flooded with such commodities. To counter this, Pakistan and China need to establish best business practices. Here one case in point is the supply of locomotives to Pakistan Railways by Chinese firm Dongfang Electric Corporation, and passenger coaches by China Machinery Import and Export Corporation (CMC) under an agreement signed in 2001. The engines were found faulty and sub-standard and the coaches were supplied at a higher price than offered by the same company recently. The ZTE agreement in 2001 clearly included manufacturing telephone switch-boards in Pakistan, but that never materialized. And with the media highlighting such dealings, it could create a negative impact on bilateral relations well.

Slow implementation on the agreements signed between the two governments does not reflect positively on growing trade relations. Timely implementation of the decisions already taken is a major challenge for, first building, and than sustaining the momentum of economic progress. All the challenges to Pakistan-China economic relations can be effectively met with the collaborative joint efforts. Both countries have agreed to conduct a joint study to remove obstacles in the growth of trade and this will work out a comprehensive plan for the next five years in order to increase the volume of trade.

I would like to suggest that once again a window of opportunity has opened on Pakistan with the recent visit of Prime Minister Wen Jiabao during which 22 trade-related agreements worth \$15 billion, and 20 other agreements and MoUs worth \$20 billion, covering a period of the next five years, have been signed. Pakistan must take full advantage of Chinese commitments and offers to reverse its economic down-turn. In the end, I would like to quote from Prime Minister Wen Jiabao's statement, "Let's stand together with a new confidence and begin a new era of progress and prosperity by jointly confronting all challenges."