

TRADE CONNECTIVITY.



Economic Advisory Group

Policy Research Institute of Market Economy (PRIME) was established in January 2013 in Islamabad as an independent economic research and advocacy organization by economist Ali Salman. It is the leading voice for open trade and economic freedom in Pakistan. PRIME has played a lead role in national debates on public debt, open trade, and tax reforms. It is included in Asia-Pacific top 100 think tanks by the University of Pennsylvania's Think Tank Index.

The Economic Advisory Group is an independent platform of individuals drawn from economics, policy and the private sector. The EAG deliberates on Pakistan's economic policies regularly and shares its views with the public and government. It was formed in January 2021, under the auspices of PRIME Institute, an independent think tank, which serves as its secretariat.

The study titled “Trade Connectivity” by Economic Advisory Group analyses the contemporary trade dynamics of Pakistan, existential flaws in our policies, and the way forward for better prospects. This study contemplates that the growth of a country is linked to its ability to promote trade liberalization and reduce barriers to trade. It is imperative to expand connectivity and trade ties with regional blocs. It lays out a plan to overcome structural and policy weaknesses, and promote the integration of Pakistan into global value chains.

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Table of Contents

Executive Summary	02
1-Regional and Global Connectivity - CPEC, Central Asia, Asean and the World.....	04
2-Boosting the Full Potential Trade With China, Central Asia, and Globally.....	11
2.1-Missing Exports Based on the Estimation of a Gravity Model of Trade.....	11
2.2-Unleashing the Full Potential of China–Pakistan Free Trade Agreement (CPFTA) and China–Pakistan Economic Corridor (CPEC).....	13
2.3-Exploring the Potential of RCEP.....	15
2.4-PTA with Uzbekistan Starts Process of Linkages with Central Asia.....	21
3-Pakistan as a Regional Trade Hub	24
3.1-Benefits of Being a Hub.....	25
3.2-TAPI – From Pipedream to Pipeline for Prosperity	26
3.3-Looking Beyond the Energy Prism.....	27
3.4-People to People Connectivity.....	29
3.5-Challenges Pakistan Must Overcome to Harness the Opportunities Afford as a Hub.....	30
3.6-Afghanistan - Unlocking the Key- Renewal of Afghanistan-Pakistan Trade and Transit Agreement (APTTA)	31
3.7-Recognize that it is Key for Pakistan to Become a Regional Trade and Energy Hub	32
3.8-Everyone as a Winner	34
3.9-India - Seeing Through the Geopolitical Lens and Beyond Towards Economic Growth	36

4-Leveraging the Advantages of Being Part of GVCs.....	39
4.1-Defining Global Value Chains.....	41
5-Select Current Sectoral Policies and How they can be Improved with Greater Connectivity	65
5.1-Mobile Sector Policy:	65
5.2-Auto Sector Needs to move from Protection and Indigenization to Liberalization and Integration.....	81
6-Appendix.....	85
7-References.....	107

List of Figures

Figure 1: Global Value Chain Participation by Exporters (in Value)	42
Figure 2: Global Value Chain Participation by Exporters (Percentage of Gross Exports)	43
Figure 3: Global Value Chain Participation by Exporters Distributed by Region (in Value)	44
Figure 4: Global Value Chain Participation by Exporters Distributed by Region (Percentage of Gross Exports)	45
Figure 5: Global Value Chain Participation by Exporters Distributed by Sector (in Value)	46
Figure 6: Global Value Chain Participation by Exporters Distributed by Sector (Percentage of Gross Exports)	48
Figure 7: Global Value Participation as Classified by WITS Product References by Exporters (Contribution in Trade Flow)	49
Figure 8: Exports to Countries with FTA as a Percentage of Total Exports by Product Category	51
Figure 9: Imports from Countries with FTA as a Percentage of Total Imports by Product Category	52
Figure 10: Total Value in Global Value Chain Participation in Different Sectors by Exporters Distributed by FTAs with Export Destination	53
Figure 11: Average Weighted GDP per Capita of Importing Countries based on FTA Status with Export Destination Distributed by GVC Participation Channels	55
Figure 12: Average Weighted GDP per Capita of Importing Countries based on FTA Status with Export Destination Distributed by GVC Product Categories	56
Figure 13: Average Weighted GDP per Capita of Exporting Countries based on FTA Status with Import Sources Distributed by GVC Product Categories	57

Figure 14: Weighted Average Tariff Rates in 2019 Imposed by Importers Distributed by Intermediate Goods as Classified under GVC Product Categories.....	59
Figure 15: Weighted Average Tariff Rates in 2019 Imposed by Importers Distributed by Final Goods as Classified under GVC Product Categories	60
Figure 16: NTM Indices by Importers	61
Figure 17: NTM Indices Distributed by Final Goods of GVC Product Categories	62
Figure 18: NTM Indices Distributed by Intermediate Goods of GVC Product Categories.....	63
Figure 19: Scatterplot for the Import Price of a Mobile Phone after taxes and the Percentage Difference its Import and Local Prices	68
Figure 20: Bar plot for Percentage Difference between Import and Local Prices of Phone Models.....	69
Figure 21: Scatterplot for Import Price of Mobile Phone Model after Taxes and Percentage Difference between Local Price of Mobile Phone and Lowest Prices in Regional Countries of Mobile Phone Models Assembled in Pakistan	70
Figure 22: Bar plot for the Percentage Difference between Local Price and the Lowest Prices in Regional Countries of Mobile Phones Assembled in Pakistan.....	71
Figure 23: Scatterplot for Percentage Difference between Import and Local Prices and Percentage Difference between Local and Lowest Prices of Mobile Phones Assembled in Pakistan	73
Figure 24: Average Import Price of Mobile Phones by Brand	74
Figure 25: Average Percentage Difference between Import and Local Prices of Mobile Phones Assembled in Pakistan by Brand.....	75
Figure 26: Average Percentage Difference between Local Prices and Lowest Prices in the Region of Mobile Phones Assembled in Pakistan by Brand	76
Figure 27: Tax Rate on Phone Models by Brands	77
Figure 28: Tax Rates on Phone Models by Price Slabs for Tax Purposes	78

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EXECUTIVE SUMMARY

The economic growth of nation states is linked to their ability to exploit connectivity and interdependencies within strong regional blocs.

Contemporary trade theories, focusing on internal and external economies of scale, explain the emergence of global value chains, emphasizing the pivotal role played by intra-industry trade.

The limited purchasing power of the domestic market is inadequate for the scale advantage required to achieve a high level of productivity in the production of industrial goods.

Quite aside from being required by WTO rules, trade liberalization will serve to increase trade flows, bring down tariff and non-tariff barriers, and therefore potentially boost productivity and economic growth across the region. It will unambiguously benefit Pakistani consumers, since product prices fall and consumer choice increases with reduced trade barriers.

The Economic Advisory Group's key policy suggestions related to integration with regional and global markets are the following:

- a. Reduce custom and regulatory duties, and replace these with a uniform tariff across all sectors and product categories;
- b. Redesign existing schemes (such as the SBP's export finance scheme) to incentivize export of new products and/or to new markets;
- c. Focus on being competitive for parts of Global Value Chains (GVCs) for products, rather than for the entire product, and on moving up GVCs;

- d. Strengthen industrial and infrastructure capacity so as to attract efficiency-seeking FDI (which is more geared to boost exports) rather than market-seeking FDI;
- e. Actively engage with regional trading blocs with the aim to either join these or enter into an FTA with them. Potential candidates include RCEP (PRIME, 2021);
- f. Engage with regional countries and work towards signing bilateral FTAs;
- g. Work with national and sub-national trade bodies to help businesses conform to international standards;
- h. Improve infrastructure along the western border and facilitate Central Asian countries to utilize Gwadar port for trade.

Diplomatic initiatives are required to implement the above policy recommendations, backed by the ability to leverage numerous economic opportunities the country affords. We need to take advantage of Pakistan's unique geostrategic edge to maximize the benefits of globalization. While the country's location provides opportunities to facilitate trade with surrounding countries by acting as a trade hub, this potential will only be realized by undertaking significant internal reforms.

The liberalization of regional and international trade, starting from the present environment of measures implemented to protect allegedly strategic domestic industries and employment, must take place within the structure of various international trade laws and the WTO regime. The General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS) are supposed to provide the legal and regulatory framework to give all signatory nations equal market access for their goods and services.

1-REGIONAL AND GLOBAL CONNECTIVITY – CPEC, CENTRAL ASIA, ASEAN & THE WORLD

The economic growth of nation states is linked to their ability to exploit connectivity and interdependencies within strong regional blocs. Despite the reversal of Brexit, various forums such as the European Union (EU), Association of Southeast Asian Nations (ASEAN), United States-Mexico-Canada Agreement (USMCA), the Regional Comprehensive Economic Partnership (RCEP) and other regional treaties, demonstrate the importance of trade liberalization in boosting economic activity. Intense diplomatic efforts are required in the regional and international arena to participate in these trading blocs, and beyond.

While earlier trade theories focused on a country's intrinsic characteristics as the only driver of a comparative advantage, later theories have gone further and emphasized the role of both internal and external economies of scale. It is these later theories that help explain the emergence of global value chains, including the increased importance of intra-industry trade in global trade (Krugman, 1980).

Appreciation of the role that economies of scale play, however, goes further back. Irwin (2020)¹ notes that the Argentinian economist Raul Perbisch also worried “that economic efficiency would be sacrificed if developing countries, with their very small domestic markets, tried to pursue a policy of self-sufficiency.” Irwin shows that the small size of domestic markets became the key reason for why many development economists of the 1950s, who were earlier supportive of import substitution policies, became skeptical of import substitution policies. For example, Ragnar

¹ Douglas A. Irwin. (2020). The Rise and Fall of Import Substitution.

Nurkse's² early questioning of import substitution later turned to outright criticism. By the end of the 1950s, he argued that import substitution would draw resources away from the export sector and “may lead to costly and inefficient production in import substitutes.”

The limited size of Pakistan's domestic market can be gauged by appreciating that the median per capita annual income in Pakistan is almost the same as the price of latest iPhone 13 Pro. In other words, the limited purchasing power of the domestic market is inadequate for the scale advantage required to achieve a high level of productivity in the production of industrial goods.

A vast body of literature has discussed the dynamic gains from trade in detail. Meissner (2014)³ mentions how larger and more integrated markets allow, “entrepreneurs and investors to more easily cover the fixed costs related to the development of a new idea. Open international markets also promote the sharing of income enhancing ideas raising incomes and providing further stimulus for new ideas.” Jones and Romer (2009)⁴ talk about how an increase in integration increases the growth rate of ideas. Citing Romer (1996),⁵ Meissner note, “American economic development in the 19th century was founded on economies of scale, and that America's size also helped increase the rate of advance of total factor productivity.”

Due to the failure to integrate with the rest of the world, Pakistan has been unable to take advantage of the vast opportunities offered by the global marketplace (Ahmed et al., 2015).⁶ This has stymied

² Ragnar Nurkse. (1961).International trade theory and development policy.

³ C. M. Meissner (2014).Growth from globalization? A view from the very long run.

⁴ Charles I. Jones and Paul M. Romer (2009).The new Kaldor facts: ideas, institutions, population, and human capital.

⁵ Paul M. Romer (1996).Why, indeed, in America? Theory, history, and the origins of modern economic growth.

⁶ Vaqar Ahmed, Abid Q. Suleri and Asif Javed (2015). Strengthening South Asia Value Chain: Prospects and Challenges.

innovation and productivity gains among Pakistani manufacturers, making them uncompetitive for the global market, and therefore, unable to scale up and create jobs (Ahmed, 2018).⁷

Greater economic integration with the world markets, facilitated by internal reforms and aggressive diplomacy to facilitate market access, can enable the Pakistani industry to take advantage of the extensive opportunities offered by the global marketplace. Investment and trade are intertwined, and any growth strategy should be driven by investment in manufacturing for international markets, rather than to primarily satisfy domestic demand, as has been the case for Pakistan.

Data from the World Bank⁸ shows that those countries that have undertaken tariff rationalization and trade liberalization have achieved faster export growth than those that have been reluctant to open up their economies. It is ironic that policy makers have chosen to ignore the evidence of data for exports from 2001 onwards that clearly demonstrates that export growth is strongly correlated to tariff liberalization. Exports grew by 173% from US\$ 9.2 billion in 2001 to US\$ 25.1 billion in 2014, in a same period when the applied weighted mean tariff in Pakistan was reduced from 20.62% to 8.92%. However, from 2014 to 2017, when tariff liberalization was reversed by increasing the applied tariff to 10.09%, exports declined by 19% to US\$ 20.4 billion.

Varela et al. (2020)⁹ find that the effective rate of tariff protection which certain sectors enjoy is much higher: 245% for food products, 185% for wearing apparels, 167% for beverages and

⁷ Vaqar Ahmed (2018).Pakistan's Agenda for Economic Reforms.

⁸ Tariff rate, applied, weighted mean, all products (%) – Bangladesh and Vietnam, World Bank data

⁹ Varela, Gonzalo, Juan P. Gambetta, Federico Ganz, Andreas Eberhard, Sebastian Franco, and Stefania Lovo. (2020).Pakistan: Economic Policy for Competitiveness, World Bank Report

tobacco products, 165% for dairy products, 143% for motor vehicles and parts, 123% for sugar, and so on. Moreover, direct import tariffs constitute 13% of total tax revenues in Pakistan, which is very high when compared with export driven economies e.g. Malaysia (1.6%), Turkey (2.0%), Indonesia (2.5%), South Korea (3.9%), Thailand (4.3%) and China (4.6%). The total customs revenue collection in Pakistan at the import stage is over 40% of total tax revenues.

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- b. Redesign existing schemes (such as the SBP's export finance scheme) to incentivize export of new products and/or to new markets;
- c. Focus on being competitive for parts of Global Value Chains (GVCs) for products, rather than for the entire product, and on moving up GVCs;
- d. Strengthen industrial and infrastructure capacity so as to attract efficiency-seeking FDI (which is more geared to boost exports) rather than market-seeking FDI;
- e. Actively engage with regional trading blocs with the aim to either join these or enter into an FTA with them. Potential candidates include RCEP and AfCFTA (PRIME, 2021);
- f. Engage with regional countries and work towards signing bilateral FTAs;
- g. Work with national and sub-national trade bodies to help businesses conform to international standards;
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Diplomatic initiatives are required to implement the above policy recommendations, backed by the ability to leverage numerous

economic opportunities the country offers. We need to take advantage of Pakistan's unique geostrategic edge to maximize the benefits from regional and global integration.

While the country's location provides opportunities to facilitate trade with surrounding countries by acting as a trade hub, this potential will only be realized by undertaking significant internal reforms and shifting our focus away from import substitution policies toward exports promotion policies.

China's, Central Asia and Afghanistan's importance to Pakistan's international economic engagement matrix cannot be overemphasized. While the China Pakistan Economic Corridor (CPEC) has helped build an already strong strategic relationship between 'Iron Brothers', the enormous potential for economic development with the Central Asian region remains to be explored. An important component of the diplomatic interfacing is outreach to build on economic interdependencies with these countries.

Pakistani firms and companies, with their unique technological and entrepreneurial know-how, able to operate in low cost, low-technology environments, can partner with Central Asian countries. They can invest in new ventures in the Central Asian region, and help the region's countries develop new export markets. As trade flows and traffic grows on these transit routes, new jobs in the logistics sector in areas such as warehousing, trucking and packaging will also be created in the Afghan economy.

Access to energy resources and relatively cheap labor will result in the development of labor-intensive export-oriented manufacturing geared towards western and other markets. Such an export-oriented strategy is likely to succeed and create jobs. The strengthening of regional trade will also cushion the economies of regional countries from global financial or other external shocks.

Pakistan needs to accelerate steps being taken toward comprehensive trade reforms simultaneously, keeping in mind their interconnectedness, if it is to leverage its inherent strategic advantages. These advantages include potential access to over a \$2 trillion import market as a result of CPEC; proximity to Central Asia and the Middle East; readily available raw materials for manufacturing; and a large domestic market and human resource base.

When discussing regional connectivity, the study would be incomplete without considering the prospects of trade with India in the long-term. While it is imperative that the issue of Kashmir is resolved through dialogue, it is wrong to assume that countries with adverse political relationships cannot engage in cross-border trade, without giving up their principled stands on disputes. Singapore and Malaysia broke up as partners of a political union, but both countries have improved political relations through close economic ties. Confidence-building measures and the creation of stakeholders through trade foster a better understanding of each other's viewpoints, which eventually defuse tensions and make way for the peaceful resolution of disputes and disagreements.

The restoration of basic rights of Kashmiris is critical, but it should not be necessary for issues to be resolved before resuming economic relations. If engagement picks up steam, the new stakeholders, who benefit from such engagement, may challenge the hawks in each country. Pakistani investors, traders, transporters, bankers, and business groups who interact with Indian firms, and vice versa, will act as strong lobby groups to nurture, preserve, and promote peaceful bilateral political relations between the two countries.

This document does a helicopter level analysis of potential opportunities and threats for regional trade development, and policy reforms needed to enhance overall competitiveness and

sustainability of various sectors of the Pakistan economy. The study focuses on:

- a. Boosting the full potential trade with China, Central Asia, and globally;
- b. Market access opportunities with China, Afghanistan, and Central Asia, as well as India in the long-term, with a view to recommending policy reform for enhancing exports to these destinations;
- c. Integration of Pakistan in a larger international trade block such as RCEP, ASEAN and others;
- d. Becoming and leveraging the advantages of being part of GVCs; and
- e. Pakistan as a regional trade hub.

2-BOOSTING THE FULL POTENTIAL TRADE WITH CHINA, CENTRAL ASIA, AND GLOBALLY

Pakistan's export to GDP ratio is currently around 9 percent, ranking it amongst the bottom 10 of 193 United Nations member nations. Pakistan comprises approximately 2.6 percent of the global population, yet its share of global GDP and exports are less than 0.4 percent and 0.11 percent respectively. Failure to integrate with the world has meant not taking advantage of the vast opportunities offered by the global marketplace.

2.1-Missing exports based on the estimation of a gravity model of trade¹⁰

Analyzing the export potential of Pakistan, Alen Mulabdic and Gonzalo Varela¹¹ of the World Bank estimate that the merchandise export possible is equivalent to the level that is projected by the gravity model of trade. The gravity equation in international trade is one of the most robust empirical finding in economics: bilateral trade between two countries is proportional to their respective sizes, measured by their GDP, and inversely proportional to the geographic distance between them. The model was first introduced in 1954 by Walter Isard.¹² Although derived from physics research, it shows that there is overwhelming evidence that trade increases proportionally with the exporter's and importer's economic size and decreases with physical distance. Countries tend to trade more with large or nearby trading partners than with small or distant ones. Over time, several other determinants that impede or promote

¹⁰ J.M.C. Santos Silva and Silvana Tenreyo (2006).The log of gravity.

¹¹ Box 3.1 Pakistan development Update: Navigating in Uncertain Times, World Bank report 2021.

¹² Walter Isard (1954).Location theory and trade theory: short-run analysis.

trade among countries have been included, such as policy variables signaling the presence of trade agreements, or historical characteristics such as colonial history that determine bilateral trade friction.

Given Pakistan's observable characteristics in terms of economic size, the level of development, remoteness, and factor endowments, Mulabdic and Varela¹³ estimate that Pakistan's potential exports should be US\$88.1 billion. This is close to 3 times the level of exports in FY21. They note that, "the highest levels of missing exports lie with China (US\$13.3 billion), the United States (US\$5.8 billion) and Japan (US\$4.2 billion). These are destinations that have been widely penetrated by Pakistani exporters, and yet there is substantial potential for increasing trade. At the regional level, it is East Asia and the Pacific, and South Asia that present the largest untapped export potential for Pakistan." The level of missing exports with India is also as high as the missing exports with China.

These results support the EAG's observation that regional trade linkages offer the greatest potential for achieving economic transformation. In order to achieve this, we must identify the factors which prevent regional integration even where Pakistan has signed trade agreements with corresponding countries. The EAG Vision Document¹⁴ explains in detail why Pakistan continues to produce products where it cannot compete in the international markets. This prevents Pakistan from fully exploiting the benefits from signing the FTA with China.

¹³ Box 3.1 Pakistan development Update: Navigating in Uncertain Times, World Bank report 2021.

¹⁴ Economic Advisory Group (2021). New Vision for Economic Transformation.

2.2-Unleashing the full potential of China–Pakistan Free Trade Agreement (CPFTA) and China–Pakistan Economic Corridor (CPEC)

China is Pakistan’s largest trading partner, with trade between the two countries standing at \$27.82bn, according to data for total trade in 2021 released by the General Administration of Customs (GACC) of China. Pakistan exported \$3.58 billion to China, while importing \$24.23bn. The U.S. is Pakistan’s second-largest trading partner, with \$6.811 bn in 2020 trade. The U.S. runs a trade deficit with Pakistan of almost \$1 billion.

Pakistan has not been able to take advantage of its China-Pakistan Free Trade Agreement (CPFTA), or its proximity with China. Since signing of the CPFTA in 2006, Chinese exports to Pakistan have grown. China's exports to Pakistan increased from US\$1.4 billion in 2006 to US\$12.4 billion in 2020, while Pakistan’s exports to China have grown from US\$0.5 billion in 2006 to US\$1.4 billion in 2020. Although Pakistan’s gross imports from China are now substantially higher than its gross exports to the country, these are now growing much more quickly, as can be seen from the 2021 figures.

The first phase of the CPFTA was criticized by Pakistani business groups for Pakistan not being granted adequate market access for their main exports, such as rice, frozen fish, knitwear, cotton apparel and leather hides. They described how Pakistan was utilizing only 5% of tariff concessions available to them, whereas China was using 57% of their available tariff concessions. The second phase of the renegotiated CPFTA signed by Prime Minister Imran Khan in April 2019 takes a step in the right direction, by adding Chinese preferences in 313 Pakistani product lines, which matches to a great degree the preferences granted by China to ASEAN. Pakistan now has over 1,000 products that it can export to China with zero duties.

Despite China granting concessions to 72 percent of Pakistan's exports, only 30 percent of Chinese tariffs under the agreement have been fully liberalized. Pakistani product lines under the second phase are still not competitive due to high tariffs on cotton yarn, man-made fiber, garments, vegetables, oils, processed food and fruit. There is room for expansion in both sectoral scope and depth of the agreement.

The improved infrastructure as a result of the China–Pakistan Economic Corridor (CPEC) effectively reduces the distance between the two countries, or in other words trading time, but this will only materialize in boosting trade, especially in terms of exports from Pakistan to China, if it is accompanied by greater efforts in trade facilitation and tariff liberalization.

According to the United Nations Conference on Trade and Development (UNCTAD), ¹⁵as much of 80% of trade takes place in 'value chains' linked to Multi National Corporation (MNCs), which play a vital role in boosting exports in the developing world. This has been the model followed by China to boost its exports, and more recently the same model has been adopted by Vietnam, both countries acting as export-processing platforms for MNCs.

Based on detailed analysis and consultation with Pakistani stakeholders, the World Bank Group published "**Modernizing trade in Pakistan: A Policy Roadmap**", ¹⁶a report that makes specific recommendation for improving the Pakistani industrial sector's global competitiveness, increasing the country's global and regional linkages, and boosting investment and, therefore, exports. One of its key proposal is to "reduce tariffs and para-tariffs

¹⁵ UNCTAD, "80% of trade takes place in 'value chains' linked to transnational corporations, UNCTAD report says" <https://unctad.org/press-material/80-trade-takes-place-value-chains-linked-transnational-corporations-unctad-report>

¹⁶ Nadia Rocha (2020). Pakistan Trade Strategy Development, Modernizing Trade in Pakistan: A Policy Roadmap.

for intermediate and capital goods in agriculture, while lowering restrictions on services trade and foreign investment in enabling services”. Although there have been moves towards tariff reduction from 11 percent to 3 percent or zero on many raw materials and semi-finished products for the industrial sector, effective rates of protection for the food processing sector remain over 200 percent. Pakistan still maintains the third-highest average weighted tariff among the 68 countries with more than \$20 billion annual exports.

FDI from China to Pakistan has been concentrated in energy and infrastructure, and has been less than 1 percent of global FDI sourced from China annually. In order to move beyond signing agreements and building the infrastructure to fully unleash the full potential of almost \$13.3bn exports to China, Pakistan needs to comprehensively overhaul its tariff regime, competition policy, services, movement of capital, and intellectual property rights.

2.3-Exploring the potential of RCEP

The Regional Comprehensive Economic Partnership (RCEP) is a Free Trade Agreement (FTA) signed between 15 Asia-Pacific countries in November 2020. RCEP aims to establish a single, harmonized and predictable set of trade rules that facilitate businesses to locate their supply chains within the region. This mega-regional agreement is largely about liberalizing trade in goods, services, investment and intellectual property rights.

The agreement that came into force by the end of 2021, allows for new members to join within 18 months of its coming into effect. Incidentally, the PTI government claimed in its manifesto that it will “champion and incentivize creation of regional supply chain linkages; focus will be on increasing regional trade.” In this backdrop, RCEP may offer a good opportunity for Pakistan to develop and strengthen its regional and global supply chains, and enhance its trade potential. This report identifies some opportunities, and addresses certain apprehensions pertaining to

RCEP, and suggests a way forward for the country's possible accession to RCEP.

Given the sheer magnitude of RCEP and its trade significance for Pakistan, the country has the opportunity to join the mega-regional trading bloc that could expand its network of FTAs to support participation in global and regional supply chains. Some of these possibilities have been discussed below:

1. **ICT Services:** Pakistan is the second largest exporter of ICT services in South Asia, after India. This sector has a stable base, low cost of operations, a growing domestic market, and a reasonably strong network of overseas workers around the world. Although it is unclear what the post-Covid-19 business landscape will look like, ICT and ICT-enabled services will play a more prominent role than they did in the past. The recent recognition of the telecom sector as an industry, and the proposed tax cuts for the sector in the upcoming federal budget, are expected to enhance the productivity and competitiveness of the sector. According to Anabel Gonzalez,¹⁷ a World Bank Consultant on Trade and Investment, India is unlikely to join RCEP in the medium-term, which provides Pakistan's ICT industry, particularly financial technology, business process outsourcing, consultancy and software development, an opportunity to gain a modest share in the regional value chain.
2. **Mobile Manufacturing:** Another area where Pakistan can explore developing its regional supply chain via RCEP is the manufacture and export of mobile phones. With labor costs lower than most RCEP members, Pakistan should seriously look into the opportunity of developing its regional value chains in the manufacturing and exports of

¹⁷ Beenish Javed (2021). RCEP: An opportunity to increase Pakistan's trade and investment potential.

mobile phones. The government wishes to attract new entrants into the mobile market, using DIRBS (Device Identification, Registration and Blocking System) and tax incentives. However, care should be taken not to create a protected market for the limited manufacture of primitive unexportable phones, only sellable in the local market. Lessons must be learnt from the protectionist experience of the auto industry. Only truly globally competitive products, if evolved, can be leveraged to access the RCEP market. A full section on mobile phones industry follows later in the document.

3. **Health and Pharmaceutical Sector:** The Corona pandemic is most likely going to become endemic, and we have to learn to live with it. In this regard, Pakistan's health and pharmaceutical sector has the opportunity to benefit from the mega-regional bloc of RCEP. Pharmaceutical companies can ramp up production of medicines, surgical equipment, vaccines, etc. Even the textile sector can shift production towards manufacturing of Personal Protective Equipment, which can be exported to the RCEP market.
4. **Agricultural Commodities:** Since agriculture commodities such as fruits, vegetables and animal products remain major export items to RCEP, there is room for further strengthening this sector's integration into regional value chains. In this regard, Japan, Singapore and Myanmar, being major importers of food products, offer a potential market for Pakistan's agricultural products. In addition, being a net importer of agricultural goods and inputs, joining RCEP will allow Pakistan to enhance its export competitiveness through reduced trade costs and access to competitive agricultural inputs. However, in order to successfully assimilate into the regional supply chain, it is imperative that the quality of agro-products is improved and that they meet the sanitary and phytosanitary requirements of RCEP.

5. **Geographical Diversification of Exports:** Joining RCEP may inject new momentum to Pakistan's export strategy by geographically diversifying its existing exports. Most of Pakistan's exports are directed towards the United States and the European Union. If Pakistan joins RCEP, it has the opportunity to geographically diversify its exports to new RCEP markets, which may provide a buffer to Pakistani exporters, against the existing slowdown in western markets.
6. **Investment Diversification:** RCEP has the potential to help fuel investment in Pakistan. Some RCEP members such as China, Japan and South Korea are large investors in greenfield foreign direct investment projects in Pakistan, creating 28,000 jobs in communication, automotive and renewable energy sectors. This suggests that there may be significant potential to attract untapped investment from other RCEP members in sectors such as construction, agriculture, livestock, mining and tourism.
7. **Streamline Trade and Investment Policy:** Being part of RCEP would provide the much-needed push to Pakistan's trade and investment policy by bringing transparency, simplicity and predictability in the policy making. It will reduce red tape and ease the movement of goods, services and investment. Key to this are unified rules of origin, which implies that products manufactured to RCEP-originating criteria can move freely within the bloc with a single certificate of origin, slashing administrative time, complications and costs of sourcing inputs within the region, making the member countries more cost-effective and competitive. It is pertinent to note that Pakistan faces significant challenges due to smuggling of products as a result of high tariff rates. Streamlining of trade policy including tariff reduction is likely to reduce the illicit trade of goods.

8. **Road map to Other Trading Blocs:** In order to integrate into regional and global value chains, it is imperative for a country to be part of trading blocs, or have well-established FTAs with multiple countries. In this regard, RCEP offers Pakistan an opportunity to join other mega-regionals, and revitalize some of the stalled trade agreements that it has with other RCEP members, such as Philippines, Thailand, Singapore and South Korea. Of the 12 countries of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), seven are already members of the RCEP, with China favorably considering joining. Provided Pakistan joins RCEP, it may be easier for it to be a member of CPTPP, with due support from other members of RCEP.

Certain policy options are proposed that may facilitate the country's potential accession to RCEP:

- 1 **Arrange Stakeholder Consultations:** It is imperative that public stakeholders, such as the Commerce Division, approach RCEP members to express interest in accession, while simultaneously exchanging views with them, particularly with the less developed RCEP members on their experience in negotiating with RCEP. This will provide an insight into the negotiating process from the viewpoint of a developing country, and may assist in developing a roadmap for Pakistan's possible accession.
- 2 **Develop a Road map for Possible Accession:** Time is of the essence, as China has already ratified this trade deal, and it came into effect from January 2022. Therefore, the Ministry of Commerce should prepare a detailed study on the content and implications of RCEP, and establish a specialized unit to develop a strategy for potential accession to RCEP. In the process, it should also actively engage other stakeholders, such as the private sector and civil society, as their input is imperative for effective negotiation of this

mega-regional FTA.

- 3 **Enhance Public-Private Cooperation to Raise Awareness:** A renewed partnership between Pakistani businesses and the government will help prepare for market opening under the RCEP. In this regard, the government and the Chambers of Commerce and Industries can arrange workshops/ webinars to raise awareness among private stakeholders regarding RCEP, and the associated opportunities and risks. This way, the lobbying industries can be convinced that Pakistan's protectionist and isolationist policies will erode the competitiveness of domestic firms, and exporters will fail to reap gains from international trade.
- 4 **Leverage Sectors with Export Potential:** In order to compete and integrate into regional value chains, it is imperative that the government facilitates emerging sectors such as ICT, mobile manufacturing and light engineering through R&D, and streamlining of business procedures, so as to reduce their costs and increase their international competitiveness. These sectors can be leveraged to tap into the RCEP market. Pakistan should also leverage CPEC for attracting export-oriented FDI.
- 5 **Overhaul Trade Policy and Trade-related Investment Policy:** In order to reap the potential benefits of RCEP, Pakistan's Trade and Investment policies require an overhaul in letter and spirit. In the long run, the country holds the potential to target even the middle-to higher-end segments of the GVCs, given that all border-related procedures are streamlined (automated) and tariff structures are rationalized. Some industries such as automobile and steel, have continued to enjoy higher protection, which fueled an anti-export bias. Government should end the protection to redirect the flow of capital to more productive

sectors, so as to enable the country to improve its trade along intensive and extensive margins.

- 6 **Establish Digital Trade Portals:** Information to export a product to a given destination is very valuable for firms, particularly for new, small exporters that lack the scale to invest in information searching. Therefore, online trade portals should be established, which are easily accessible to everyone and can be a step in making non-tariff measures more transparent and compliance less costly for domestic exporters. This would also assist in improving the quality of the products, as exporters would be cognizant of the product standards in the destination markets.

2.4-PTA with Uzbekistan starts process of linkages with Central Asia

Pakistan and Uzbekistan have recently signed a preferential trade agreement (PTA) after having penned the transit trade agreement in 2021, which are aimed at boosting trade between the two countries. The PTA lower duties on 17 goods products in the range of 20% to 100% to significantly boost bilateral trade from only \$66 million in fiscal year 2021-22 that according to the State Bank of Pakistan. An uptick in trade has already been witnessed in the current fiscal year.

Pakistan has secured zero duty on export of cement, plates, sheets, film, foil and strip, of non-cellular polymers of ethylene, tubes and pipes of iron and steel, bottles, flasks, jars, pots, phials and other containers, of glass and maize starch to Uzbekistan. Uzbekistan has agreed to reduce custom duties by 20% on import of paints and varnishes, chemicals, mobile phones, confectionary and bakery items, tobacco, cutlery and mobile phones from Pakistan.

Uzbekistan has also agreed to cut 20% custom duty on import of banana and citrus from Pakistan but the duty rate cannot be less

than 20 cents per kilogram. In return, Pakistan has agreed to completely waive off custom duty on import of beans, dried apricots, and ground nuts from Uzbekistan. It has also agreed to 50% reduce the custom duty, 100% reduction in additional custom duty and 25% reduction in regulatory duty on import of sugar confectionery.

Pakistan has also agreed to waive off 50% custom duty and 100% additional custom duty on imports of chocolates. The custom duty and additional custom duty on import of copper wires will also be completely waived off by Pakistan.

Islamabad agreed to reduce 20% customs duty on the import of air conditioners and refrigerators. Duty on liquid dielectric transformers of 10kV is reduced by 25% and is completely waived off on import of inductors.

Also, where any country is in a serious balance of payments difficulty or under threat of a BOP crisis, it may adopt restrictive measures, which will be of limited duration and may not go beyond what is necessary to remedy the external sector situation.

Any dispute arising from the implementation of the agreement will first be settled amicably through bilateral consultations by the joint committee to be setup for the implementation of the preferential agreement. The PTA will remain in force for the period of five years and any country can give notice of termination of this agreement not less than one year before it is due to expire. The agreement is extendable further.

The concessions are based on principle of reciprocity and parity. Both the countries have also agreed to work together to minimize non-tariff barriers and measures by mutual recognition of standards and easing procedural requirements for goods. No new non-tariff barriers or measures having equivalent effect shall be introduced in trade of goods specified in the PTA.

With a return of stability in Afghanistan through the bilateral trade transits has already seen a considerable increase. The PTA agreement would further promote trade between the two countries and also increase regional trade as well as providing trade connectivity to Russia. The PTA may be the first steps towards establishing an economic bloc among Pakistan, Afghanistan and the five Central Asian countries, which would further enable trade in goods to reach Russia.

3-PAKISTAN AS A REGIONAL TRADE HUB

Since the Soviet Union collapsed and the Cold War ended, the countries of the world have shifted from isolationism towards economic interdependence. In other words, the world is becoming globalized. The economic relations between countries are becoming stronger than ever, and globalization has greatly promoted the economic development of all countries in the world through cooperation in trade, finance and talent exchange.

Pakistan is poised to take advantage of its unique geostrategic location to realize the maximum benefits from globalization. Its location allows it opportunities to facilitate trade between its surrounding countries by acting as a trade hub. It is particularly well suited to facilitate trade between Central Asia, which has a surplus of oil and gas, and South Asia, whose ever-increasing population requires a constantly increasing supply of energy.

Pakistan is suitably placed to launch its regional trade hub agenda, as it is a member of the following four regional co-operation initiatives¹⁸:

- Economic Cooperation Organization (ECO), currently comprising ten-member states: Afghanistan, Azerbaijan, Iran, Kazakhstan, Kyrgyzstan, Pakistan, Tajikistan, Turkmenistan, Turkey, and Uzbekistan
- South Asian Association of Regional Cooperation (SAARC) with eight-member states: Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka
- Central Asia Regional Economic Cooperation (CAREC) Program with ten-member states: Pakistan, Afghanistan, Azerbaijan, China, Kazakhstan,

¹⁸ A study of TIR Convention 1975 for Pakistan, USAID PDF

Kyrgyzstan, Mongolia, Tajikistan, Turkmenistan, and Uzbekistan.

- China-Pakistan Economic Corridor (CPEC) is infrastructure development program connecting Gwadar with the Western China.

Pakistan's location lends it advantages that other countries near it do not possess. To start with, it provides a direct connection between South Asia and Central Asia.

3.1-Benefits of being a Hub

A big challenge Pakistan faces today is to create enough jobs and economic opportunities for its large working age population. A dynamic economic environment would also go a long way in keeping Pakistan's youth from drifting into extremism. In order to achieve a vibrant economy, two urgent priorities for Pakistan are to modernize its ageing and inadequate infrastructure, and to have access to cheap and reliable energy resources. The Pakistani government has pursued natural gas resources all along its extended neighborhood – both in the Middle East and Iran, as well as in Central Asia, and has met with some limited success. However, Central Asia offers Pakistan the best option for accessing energy-related resources.

Pakistan, working in conjunction with Afghanistan, can offer the Central Asian region a comprehensive menu of export options and routes, leading to the development of an inter-connected market for oil and gas for Asia as a whole. A concerted, focused effort by Pakistan, India and the Central Asian states can lead to the optimal commercial development of Central Asian oil and gas resources, and at the same time address the energy security needs of 1.5 billion South Asian consumers. If Pakistan is to take advantages of the vast untapped oil and gas reserves of Central Asia and Siberian Russia, it would have to become an active stakeholder in the development

of pipeline infrastructure, as well as play a lead role in the commercialization mechanism of such resources.

3.2-TAPI – From Pipedream to Pipeline for Prosperity

It is important that Pakistan does everything within its power to ensure that the ambitious Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline is built. Turkmenistan is home to the world's second-largest deposit of natural gas, and TAPI would allow the Central Asian country to diversify its exports away from China by delivering energy to India and Pakistan. The \$10 billion project has been repeatedly delayed by difficulties in securing investors. Without the possibility of an equity stake, which Turkmenistan has refused to allow for foreign companies, major Western oil companies have so far balked at the project.

That said, in 2015, Turkmen President Gurbanguly Berdimuhamedov announced that Turkmenistan had started work on the pipeline. The 1,814 km pipeline will run from gas fields in Turkmenistan through Afghanistan and Pakistan to India. It starts from the Galkynysh gas field. In Afghanistan, the pipeline will be constructed alongside the Kandahar–Herat Highway in western Afghanistan, and will pass through Quetta and Multan in Pakistan. The final destination of the pipeline will be the Indian town of Fazilka, near the border between Pakistan and India. The pipeline will be 1,420 mm (56 in) in diameter, with a working pressure of 100 standard atmospheres (10,000 kPa). The capacity will be 33 billion cubic meters (1.2 trillion cubic feet) of natural gas per year, of which 5 billion cubic metres (180 billion cubic feet) will be provided to Afghanistan and 14 billion cubic metres (490 billion cubic feet) to each Pakistan and India.

If trade and transit agreements involving Pakistan, Afghanistan, India and the Central Asian states are worked out, TAPI is the most feasible and cost-effective energy transit route between Central and

South Asia. If TAPI is further connected to the Godavari gas hub in India's east coast, it will create an integrated India-Pakistan-Central Asia oil and gas network, servicing a large and rapidly growing market. This market will also offer western energy companies' attractive financial opportunities. Another positive outcome would be that it will allow Central Asian producers to better leverage their energy resources, as the new pipeline would reduce their dependence on the Russian and Chinese markets. However, TAPI is currently facing delays and problems due to the uncertain situation in the Pakistan-Afghanistan region.

TAPI NATURAL GAS PIPELINE

FIG. 1



3.3-Looking beyond the energy prism

Central Asia and Afghanistan's importance to Pakistan's international economic engagement matrix is not limited to energy. As indicated before, the Central Asian region has enormous

potential for economic development based on its other industrial raw materials and agricultural produce. Pakistan, with the help of western and Middle East-based investors, can emerge as a partner for Central Asian economies in their economic transformation and modernization, including the development of third country markets for joint ventures in various sectors. Development of integrated production networks that combine Pakistan's competitively priced skilled and unskilled labor and capital with Central Asian energy, natural resources and agricultural products, will go a long way in alleviating the region's economic troubles. Afghanistan, an important transit country, will gain as a central part of this production network.

Currently, Central Asian states including Afghanistan account for less than 8% of Pakistan's total trade. The major constraining factor limiting Pakistani trade with Central Asia is that transport and logistical connections between Pakistan and Central Asia remain under-developed, and make economic interaction with the region extremely expensive. The other major constraining factor is the lack of trade-related border protocols and efficient trade facilitation measures on Central Asian trade routes. The inefficient and mostly inadequate transport network connecting the Central Asian states to its southern neighbors, and the relatively very high costs of moving goods are important factors that are holding back the economies of the region, as this stifles cross-border exchange and entrepreneurial initiatives. Part of the problem is historical – all roads, rail and pipeline routes connecting Central Asia head north to the Russian heartland that was the centre of the former Soviet Union. Transport infrastructure heading south from the former Soviet Central Asian states is limited, of poor quality, and tends to be through politically unstable geographies.

For Afghanistan and Pakistan, the problems are related to inefficient borders that require too many days for export. On the other hand, Central Asian states have relatively more efficient borders (though there are problems with transparency and lack of

protocols with neighboring countries), the problems are more to do with the Soviet era orientation of their infrastructure that makes transport costs prohibitive.

3.4-People to People connectivity

A concerted effort to improve this infrastructure led by Pakistan with support from the western economies will help to kick-start the region's economies and enhance livelihoods in this vast region, spreading out from north-western Pakistan to the steppes of Kazakhstan. But infrastructure development is not the only thing that Central Asian states can gain from a dynamic economic relationship with Pakistan; there are opportunities for Central Asia to attract expertise and FDI. In 2007, Pakistan had almost a million students enrolled at the tertiary level, many of them in professional fields such as engineering, business, and medicine. In the same period, total enrollment at the tertiary level in Central Asian countries was around 1.4 million students. The addition of Pakistan's skilled workforce in the Central Asian matrix would increase the availability of skilled labor by 65%, or almost two-thirds. Pakistani skilled workers have strong English language skills that are an asset in international business, and many are strongly networked in regional financial centers such as Dubai and Bahrain. Pakistan, with its population of 220 million plus, offers a large number of semi-skilled workers, many of whom have experience working in the oil and natural gas sector and infrastructure as migrant workers in the Gulf states.

Pakistan can leverage its human resource to add value to Central Asian economies, while at the same time creating economic opportunities for Pakistani firms and individuals in the Central Asian states. Pakistan can also play a lead role as an investment hub for Central Asia. Middle East-based Pakistani entrepreneurs can combine their managerial skills and networks with financial backing from Gulf based investors to develop ventures in Central

Asia. Pakistan-based industrialists can use their experience to invest in Central Asian markets. While it is true that the Central Asian economies, with the exception of Kazakhstan, and to certain extent Uzbekistan, are not very diversified, focused efforts to harness the region's potential can lead to increased diversity and more imports from the region. Rising incomes from successful commercialization of the region's natural resources will also open up the potential for more exports from Pakistan. Thus, Pakistan has a long-term interest in the development of its extended neighborhood.

Investment opportunities will also arise because Central Asian economies are undergoing an economic transformation, leaving the old Soviet style production systems behind and developing new industries and processes. Pakistani firms and companies, with their unique technological and entrepreneurial know-how suited to low cost, low-technology environment, can partner with Central Asian efforts by investing in new ventures in the region's countries, and by helping them develop new export markets.

3.5-Challenges Pakistan must overcome to harness the opportunities afford as a hub

Pakistan, in order to achieve shared prosperity through better connectivity and transit trade has to settle the following issues¹⁹:

- a. Effective implementation of Transports Internationaux Routiers (TIR) Convention 1975;
- b. Reactivation of Quadrilateral Transit Trade Agreement (QTTA) among Pakistan, China, Kyrgyz Republic and Kazakhstan; and
- c. Settling Trade Transit issues with India and seeking Trade Transit for its export through India to markets in Bhutan, Nepal and Bangladesh.

¹⁹ https://www.tdap.gov.pk/pdf/trade_policy_18.pdf Ministry of Commerce, Pakistan

3.6-Afghanistan - Unlocking the key- Renewal of Afghanistan-Pakistan Trade and Transit Agreement (APTTA)

Afghanistan stands at the center of trade and transit routes connecting Central and Southern Asia. Ever since ancient times, Afghan cities like Herat, Kapisa, and Kabul have been at the center of trade and exchange between South Asia and Central Asia. Afghanistan's endowment of arable land, agricultural variety, and natural resources is low on a relative scale. Thus, the objective of harnessing its strategic location as a means for economic development has been historically critical for Afghanistan. A major reason behind Afghanistan's lack of development and poverty has been its inability to play that role, given political fault lines in the 20th century, and the ongoing conflict in the 21st century.

Seen in this context, it is easy to understand why a successful APTTA,²⁰ and comprehensive post-APTTA Central Asian trade and transit initiative could emerge as the economic lifeline of Afghanistan. Some of the benefits of a Pan-Central Asia trade and transit network going through Afghanistan on its way to South Asia are obvious: Afghanistan will earn substantive revenues from transit fees, both on vehicular container traffic, and from pipelines. But the very establishment of such a transit arrangement will create new jobs for the Afghan economy. Several thousand people would be required for the development, maintenance and security of this trade and transit infrastructure.

As trade flows and traffic grows on these transit routes, new jobs in the logistics sector in areas such as warehousing, trucking, packaging would also be created in the Afghan economy. Besides direct employment from the transit economy, small-scale manufacturing and agro-based industries can potentially develop in

²⁰ Section 3, USAID Trade Project report, 2014.

Afghanistan, given the accessibility to Southern Asian and Central Asian markets. Access to cheap energy resources and Afghanistan's relatively cheap labor will result in the development of labor intensive export oriented manufacturing geared towards western and other markets. Given that access to ports will be less costly, thanks to APTTA and post-APTTA logistical developments, such an export oriented strategy has the potential to takeoff and create a large number of jobs.

Western aid tied to the development of such trade-related projects will intensify the positive externality of better cross-border infrastructure and trading regime post-APTTA, leading to significant development of urban areas. Such development is most likely to happen in the border areas with Pakistan and the northern areas bordering Uzbekistan and Tajikistan, leading to better prospects of peace and stability in the region. Since the benefits of a well-developed cross-border infrastructure and improved trade regime is most likely to be felt in the border areas of Afghanistan, the population in these regions would have the most to lose from the disruption of APTTA and post-APTTA developments due to war and strife. Thus, a successful APTTA and post-APTTA Central Asian initiative in the medium to long-term will create a significant incentive for the local population to lend their support and sustain such agreements, thus creating a strong domestic constituency for peace and economic development.

3.7-Recognize that it is key for Pakistan to become a regional trade and energy hub

While Pakistan has great potential to be a regional trade and energy hub, it is not ready to take on the role. Its infrastructure needs work, as does the infrastructure of its neighbor India and Afghanistan, in order to make trade between them as monetarily and temporally efficient as possible. On the political side, Pakistan must improve trade relations with Afghanistan and India in order to be put in place agreements that allow for goods and people to move across

its borders without much hindrance. It is a difficult task, given Pakistan's icy relations with Modi government and the challenges currently faced by Afghanistan, but one that Pakistan must see through if it has any chance of becoming a trade hub.

Pakistan must convince the government in Kabul to renew the expired Afghanistan-Pakistan Trade and Transit Agreement (APTTA). This is not only in Pakistan's interest but also Afghanistan's and the entire region. APTTA addresses key issues such as prevention of cross-border smuggling, better implementation of customs rules, and the movement of vehicles across borders. But even more importantly, it will encourage investment in cross-border infrastructure and create institutional harmonization that will facilitate trade between the two neighbors. Harmonization and rationalization of tariff-rates and non-tariff barriers will remove incentives for smuggling that result in the loss of several millions in revenue to Pakistani authorities. It would encourage industry in the border areas, as it seeks synergy in each other's markets, and spurs local development in the process.

Pakistan's exports to Afghanistan are about 6% of the total exports of the country. This makes Afghanistan an important trade partner for Pakistan. Afghanistan's official exports to Pakistan are much lower. Economic development of Afghanistan and the development of the border regions infrastructure in Pakistan are expected to create opportunities for Afghan exporters.

It is important to note that Pakistan's trade with Central Asia is almost insignificant; the region accounted for 0.5% of exports and less than 0.1% of imports for Pakistan in 2020. This reflects Pakistan's inability to reach out to Central Asia in a big way, despite attempts to carve a niche for itself in that region. The main constraining factor is infrastructure and lack of transport linkages between Pakistan and Central Asia. APTTA can serve as the first-step in Pakistan's strategy to secure better long-term market advantages in Central Asia. As Pakistan and Afghanistan

work closely together to establish an effective trade and transit corridor under the aegis of APTTA, it would result in developing institutional linkages and infrastructure connecting Afghanistan to Pakistan. These linkages can then, over the longer-term, be interlinked with some of the initiatives already underway in Afghanistan-Central Asia to develop transport and trade infrastructure, creating an integrated network connecting Central Asia with South Asia.

In order for free-trade initiatives between Pakistan and Afghanistan to be effective, the two countries have to construct Border Crossing Points (BCPs) that meet the following criteria in order to make exchange feasible:

- Establishing a mechanism to facilitate movement of people, i.e. traders who can go back and forth across the border
- Free movement of goods
- Free movement of vehicles

Implementing the three conditions would require the governments of both Pakistan and Afghanistan to convince vested interests in their respective economies not to resist such reform. Especially difficult would be to convince Pakistan's powerful transport lobby, as well as key lobbies in Afghanistan who see the entry of cheaper Pakistani goods and services as a threat to their economic interests.

3.8-Everyone is a winner

Far greater economic benefits will flow to Pakistan from APTTA, CPEC and Central Asia-South Asia (CASA) energy projects in the medium to long term. APTTA is a key first step in securing large untapped market access for Pakistani goods in Central Asia, and in return Pakistan can tap the latter's vast natural resources sectors, including oil and natural gas, bauxite and aluminum, and iron and steel. Given its economic size, Pakistan can emerge as a hub for Central Asian states. The trade between the two can increase

substantially from the abysmally low level of trade at present. APTTA and CASA will help Pakistan to achieve energy security.

Pakistan, working in conjunction with Afghanistan and China, can offer the Central Asian region a comprehensive menu of export options and routes, leading to the development of an interconnected market for oil and gas for South and South-East Asia as a whole. The completion of Central Asia-South Asia (CASA) energy projects and CPEC between Pakistan and China shall make Pakistan the pivot between Central and South Asia.

APTTA will also set the stage for completing the outstanding reforms in trade and transport facilitation, which will reduce the cargo dwell time for exports and imports; make cross-border trade much more efficient; and help implement a transparent procedure for exporting and importing.

The ultimate benefit from APTTA and CPEC can be the development of a new “silk route” linking Central Asia, Afghanistan, Pakistan, India, and South-East Asia, integrating transport infrastructure and trade networks spreading from Kazakhstan to Singapore. This book highlights that the institutional basis for the new “silk route” should be seamless borders dedicated to the issues of transit and trade facilitation (including the movement of people, electricity, and energy). This would revolutionize economic engagement across Asia and would bring economic development with better livelihood for millions of people, and create a strong constituency for peace and stability in Afghanistan, Pakistan, and Central Asia. This will have ample reward for Western efforts of providing the much-needed foreign aid and FDI to implement APTA, and possibly setting up ROZs in the troubled border areas.

3.9-India - Seeing through the geopolitical lens and beyond towards economic growth

Pakistan needs a source of growth that is geographically balanced and thus can be sustained politically. A liberalized economic relationship between Pakistan and India and other neighbors can help achieve a high growth rate that is regionally balanced, and can therefore be sustained for a longer period than Pakistan has ever achieved in the past.

In 2009, combined worldwide trade for India and Pakistan was \$462 billion, while their bilateral trade was a mere \$1.7 billion. While a more conducive trade regime with all regional neighbors is important, the critical area of focus for Pakistan is its trade and broader economic relations with India.

Trade relations between India and Pakistan have been difficult in the past because the two countries have viewed each other through a geopolitical lens, and not as potentially vibrant trading partners. This outlook has to change.

The key question for Pakistan is how it can turn India's growing economic capability to its own advantage, and thus bridge the income gap, and then overtake India's growth rate—as it did in the 1960s and 1970s. This is not as ambitious as it might seem, when looking only at the current performance of the two economies. In most years in the 1980s, Pakistan's GDP growth was higher than India's. Furthermore, even now, Pakistan ranks higher than India on many indicators of the cost of doing business. Thus, a solid foundation already exists to build a mutually beneficial economic relationship with India.

Nisha Taneja, a professor at New Delhi's Indian Council for Research on International Economic Relations, points out transport and transit obstacles, also mentioned above, which prevent trade normalization between Pakistan and India. Presently, Pakistan-

India trade is permitted on only one land route (via the Attari-Wagah border crossing). Road border infrastructure—warehousing, parking facilities and testing laboratories—is poor, and extensive security checks cause major congestion. Meanwhile, rail routes for trade can carry goods across an expanse of only 30 kilometers. Train cars are in scarce supply, and only certain types are permitted for trade. These problems on direct trade routes have been so widespread, according to Taneja’s research, that a few years ago several circuitous indirect routes were found to be twice as trade-efficient (as measured by transaction costs incurred per container per kilometer).²¹

Intra-industry trade between Pakistan and India can play a pivotal role in promoting regional integration in South Asia. This is because this type of trade can flourish even in situations where the trade and production structures of the trading partners lack strong complementarities. It results in trade expansion and dynamic scale economies. Therefore, trade linkages among the South Asian countries need to be strengthened by devising mechanisms to promote intra-industry trade within the region. One way to accomplish this is through regional production sharing arrangements that involve the initiation of part of a manufacturing process for a specific good in one country, and the transfer of the activity to another for further processing. The South Asian countries can achieve greater economic cooperation and integration by evolving a vertically integrated regional production structure in sectors that are of economic significance in the regional context. This would allow the South Asian economies to specialize in different lines of production within a particular industry, and thus achieve benefits of specialization and scale economies. It must, however, be pointed out here that the regional production sharing arrangements generally emerge in response to a combination of factors including low tariffs, wage differentials, low transportation

²¹ Nisha Taneja (2007). Pakistan India Trade: The View from the Indian Exporters.

costs, and favorable government policies, and, needless to say, these arrangements are unlikely to succeed in the absence of political commitment.²²

Intra-industry trade facilitation will result in gains not only for India and Pakistan, but for South Asia as a whole. The region is one of the world's least integrated, and is plagued by poor electricity grids, railways, and roads; damaging trade costs, as illustrated by the long waiting periods for trucks at border crossings (lines at the India-Bangladesh border can last 99 hours), and crushing poverty. However, better trade facilitation would generate such an increased flow of commerce that regional growth could increase by 1 to 2 percent. At the same time, Pakistan-India trade need not be accompanied by trade facilitation measures in order for broader South Asia to benefit; a mere increase in the exchange of goods can increase the prospects for a variety of region-wide boons—from increased FDI flows to trans-boundary gas pipelines.

It would be far cheaper and logistically easier for India to export its goods to Afghanistan and Central Asia by going through Pakistan. However, poor relations between the two South Asian countries leads to an unnecessary inefficiency: India increases its cost of shipping as well as its infrastructure expenditures by working on developing Chabahar Port, while Pakistan misses out on a great opportunity to serve as and profit from being a trade hub between two of its neighbors, and transit for its exports, through India, to markets in Bhutan, Nepal and Bangladesh.

²² Kemal, A. R., M. K. Abbas, and U. Qadir (2002). A Plan to Strengthen Regional Trade and Cooperation in South Asia.

4-LEVERAGING THE ADVANTAGES OF BEING PART OF GVCs

Despite its large and youthful population, large foreign brands have ignored Pakistan as a production hub for labor-intensive products like textiles, agro-food products and footwear, all of which generate huge volumes of exports from host countries. According to the United Nations Conference on Trade and Development (UNCTAD)²³, as much as 80% of trade takes place in ‘global value chains’ (GVCs) linked to Multi National Corporation (MNCs), which play a vital role in boosting exports in the developing world. This has been the model followed by China to boost its exports, and more recently the same model has been adopted by Vietnam, both countries acting as export-processing platforms for MNCs.

In order to improve the Pakistani industrial sector’s global competitiveness and become part of GVCs, it needs to increase the country’s global and regional linkages and boost investment, which in turn should help expand exports. This will require reduction in tariffs and para-tariffs for intermediate and capital goods in agriculture, while lowering restrictions on services trade and foreign investment in enabling services. Pakistan still maintains the third-highest average weighted tariff among the 68 countries having more than \$20 billion annual exports. It will also require establishing FTAs with many more countries and blocks other than just China. As the analysis in this section shows, countries that have multiple FTAs have distinct advantage in accessing cheaper raw material than those that do not, and, therefore benefit from cheaper input costs.

²³UNCTAD, “80% of trade takes place in ‘value chains’ linked to transnational corporations, UNCTAD report says”<https://unctad.org/press-material/80-trade-takes-place-value-chains-linked-transnational-corporations-unctad-report>

In addition to easing import restrictions, the time, cost, and documentation required to process imports and exports at Pakistan's borders needs to be minimized; import duty suspension and refund programs need to be redesigned to provide apparel exporters with access to high-quality inputs—particularly synthetic fibers—at world prices; raw materials for manufacturing items need to be made available; and the government should help exporters harness the potential of online marketing platforms by leveraging artificial intelligence and big data.

Pakistan needs to accelerate the steps being taken towards comprehensive trade reforms simultaneously and urgently, keeping in mind their interconnectedness, if it is to leverage its inherent strategic advantages. These include potential access to over US\$ 2 trillion import market that is possible as a result of the China-Pakistan Economic Corridor, proximity to Central Asia and Middle East, and a large domestic market and human resource base.

We discuss below in detail the empirical evidence for the potential available for Pakistan if it were to fully participate in GVCs. We define the structures of GVCs and using data extracted from Asian Development Bank Multi-Regional Input-Output (ADB MRIO) database²⁴, we look at Pakistan's participation in different sectors.

Trade data for 2019 at HS six-digit level is extracted from BACI dataset available at CEPII²⁵. The classifications on different channels of participation in global value chains is extracted from RIVA provided by United Nations ESCAP, while the trade data at six-digit HS codes is classified according to the global value chain categories defined in the reference list provided by World Bank's World Integration Trade Solution (WITS). The data on tariffs is borrowed from World Bank's WITS, while the data on NTMs

²⁴ Asian Development Bank's Multi-regional Input Output, <https://mrio.adbx.online/>

²⁵ BACI: International Trade Database at the Product-Level. The 1994-2007 Version http://www.cepii.fr/cepii/en/bdd_modele/presentation.asp?id=37

(non-tariff measures) is extracted from UNCTAD's NTM Hub^{26,27}. The data on GDP per capita at purchasing power parity (constant 2017 international dollars) is extracted from World Bank's World Development Indicators.²⁸

4.1-Defining Global Value Chains

The following definitions of the indicators involving the structure of value added is borrowed from technical notes presented at RIVA Value Chain Analyzer.²⁹

Structure	Definition	Linkage
Domestic production used in the importer's exports	Domestic value-added (DVA) in a country's intermediate exports used by the importer for the production of further exports to all other countries except the initial exporter.	Forward linkages
Domestic production that returns via the importer's exports	Domestic value added (DVA) in a country's intermediate exports used by the importer for the production of further exports to the initial exporter (DVA that returns home)	
Foreign production consumed by the importer	Foreign value added (FVA) embodied in a country's exports, i.e. value-added in exports that originate in foreign economies (imports used in further exports).	Backward linkages
Double counted exports from repeated border crossings	Double counted exports that originate in the exporting economy (referred to as domestic double counted or DDC) and double counted exports that originate from foreign economies	-

²⁶ World Bank's World Development Indicators, <https://wits.worldbank.org/>

²⁷ UNCTAD NTMs. <https://unctad.org/topic/trade-analysis/non-tariff-measures>. Note: The researcher file used in this study was previously available online.

²⁸ World Bank's World Development Indicators, <https://data.worldbank.org/indicator/NY.GDP.PCAP.PP.KD>

²⁹ United Nation ESCAP's RIVA Value Chain Analyzer, <https://riva.negotiatetrade.org/note/>

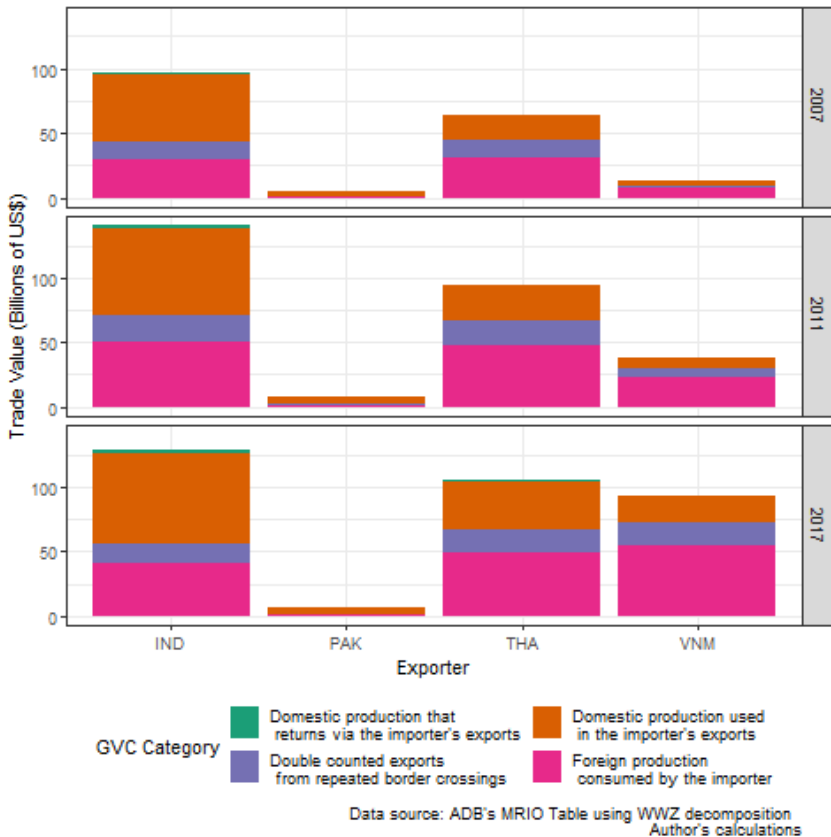


Figure 1: Global Value Chain Participation by Exporters (in Value)

The level of participation in global value chains by selected list of exporters is presented in Figure 1. The total value for global value participation for Pakistan is approximately \$5.4 billion. In comparison, the value exceeds \$125 billion for India and \$100 billion for Thailand. Vietnam has been a success story in terms of the increase it has experienced in the participation in global value chains between 2007 and 2017. The total value for Vietnam was \$12 billion in 2007. It increased to more than \$90 billion in 2017, 7.5 times

increase between 2007 and 2017. The increase in value added from foreign production consumed by the importer (backward linkages) was \$48 billion. The increase in backward linkages, as Vietnam increased the linkage between its imports and exports, was a major contributor in creating its export-growth based success story.

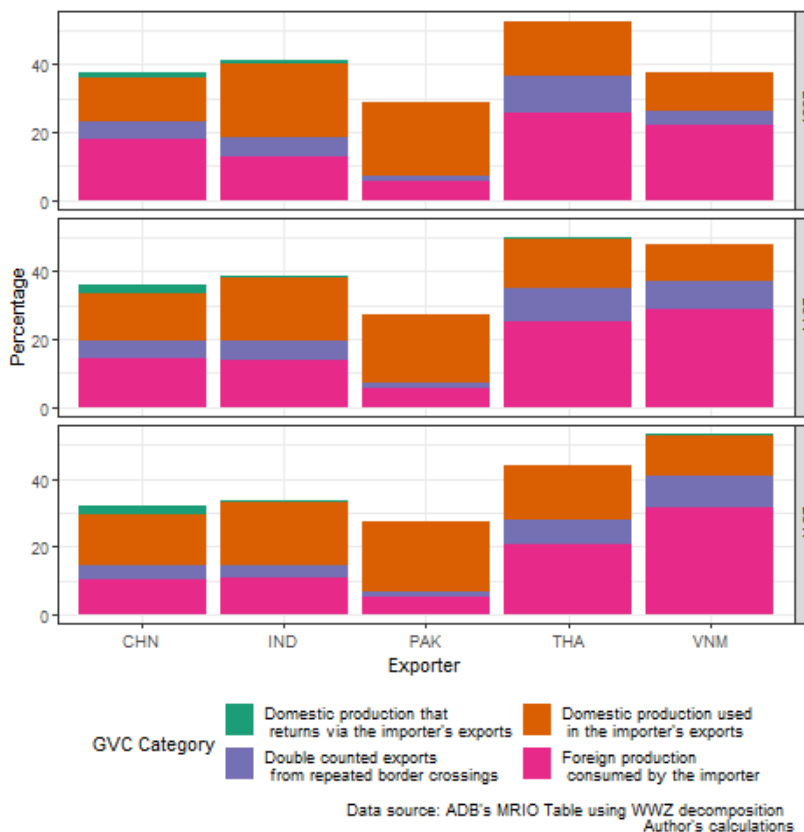


Figure 2: Global Value Chain Participation by Exporters (Percentage of Gross Exports)

The participation in global value chains in percentage terms is presented in Figure 2. Both Vietnam and Thailand report the highest values for foreign production consumed by the importer, exceeding 20 percent in 2017. On the other hand, Pakistan reports the highest value for domestic production used in the importer's

exports, exceeding 20 percent in 2017. In essence, Pakistan relies on forward linkages, where its participation in GVCs is based on the provision of inputs to its trading partners which are then converted into exports. Thailand and Vietnam focus on backward linkages by converting imported inputs into exports. The following analysis considers the various differences in trading patterns between Pakistan and its regional counterpart.

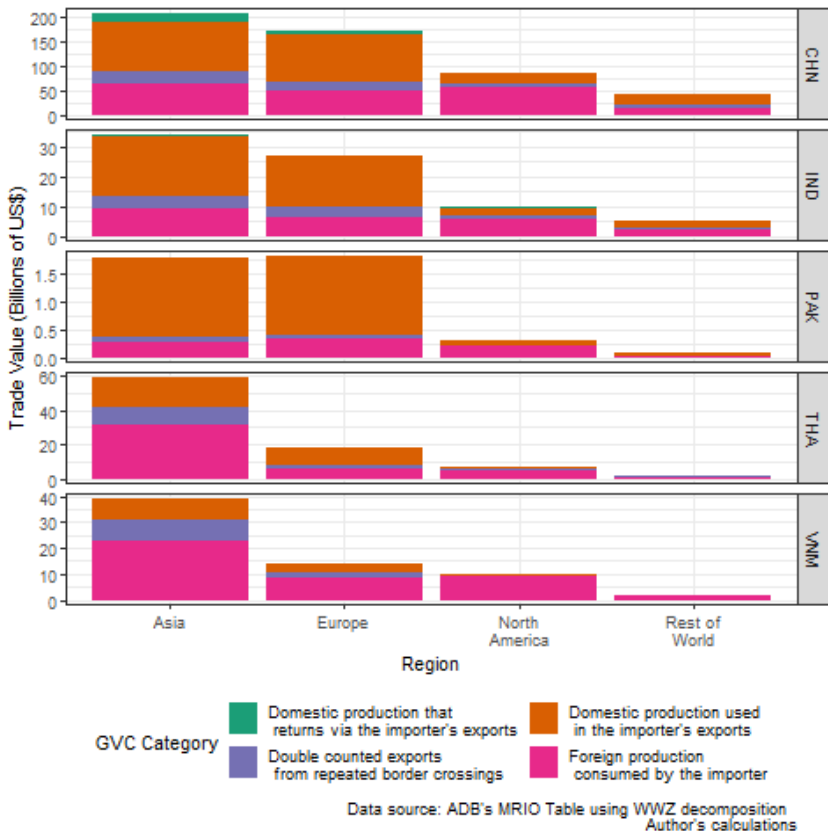


Figure 3: Global Value Chain Participation by Exporters Distributed by Region (in Value)

The total value generated from participation in global value chains for the exporters distributed by importing region is presented in

Figure 3. China dominates the flow to all regions as it has successfully developed its trading relationships across the world. Thailand and Vietnam mainly participate in global value chains within the Asian region. Europe has almost the same share as Asia in terms of participation in global value chains from India and Pakistan. In essence, while Thailand and Vietnam have focused primarily in developing value chain linkages within Asia, India and Pakistan trade with Europe as well with Asia. China has developed more established linkages with Asia, Europe and North America, showcasing its strength as a global export powerhouse with value chain linkages across different regions.

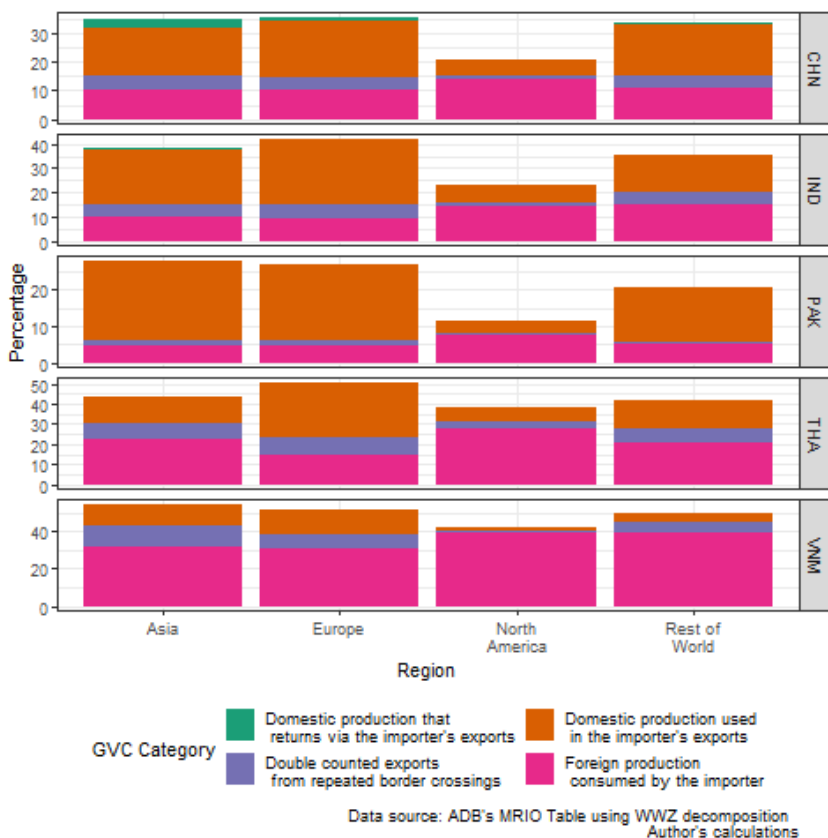
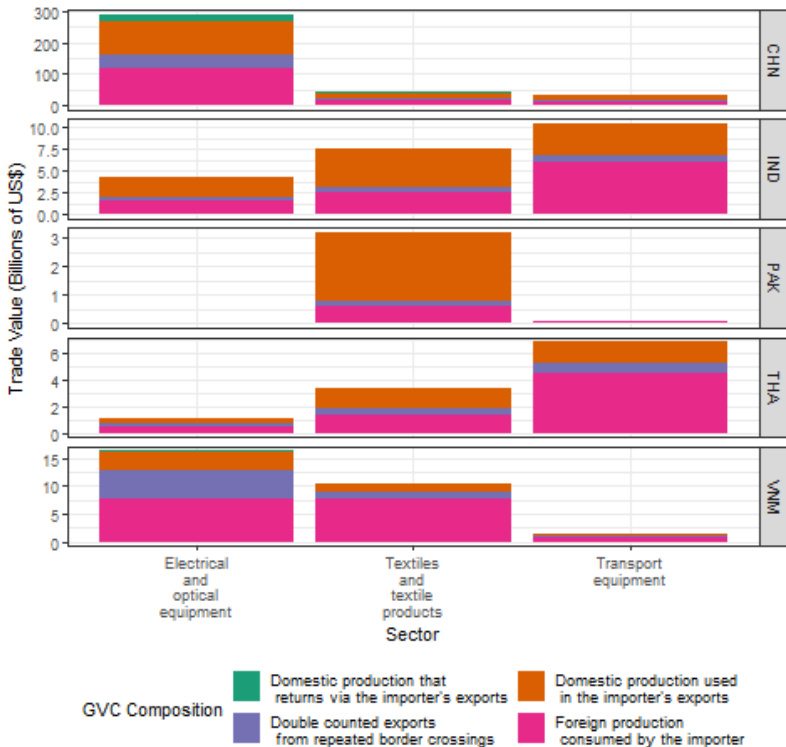


Figure 4: Global Value Chain Participation by Exporters Distributed by Region (Percentage of Gross Exports)

The value in terms of percentage of gross exports from participation in global value chains for the exporters distributed by importing region is presented in Figure 4. As shown in the earlier figures, both India and Pakistan are more likely to have their domestic production used in importer’s exports, while Thailand and Vietnam are likely to incorporate foreign production in their exports. Even within the Asian region, the share of such linkages is high for Thailand and Vietnam. Therefore, India and Pakistan are likely to supply inputs to their export destination markets to be converted to further exports, Thailand and Vietnam are more likely to convert imported inputs into exports consumed in the export destination markets.



Data source: ADB's MRIO Table using WWZ decomposition
 Author's calculations

Figure 5: Global Value Chain Participation by Exporters Distributed by Sector (in Value)

The total value generated from participation in global value chains for the exporters distributed by sectors is presented in Figure 5. The total value generated from China is concentrated mainly in electrical and optical equipment, while that for Pakistan is concentrated in textile and textile products. Interestingly, although Thailand and Vietnam have several similarities in terms of geographic location and in their trade patterns, they differ in terms of the sectors that generate value addition. While transport equipment dominates the amount of value addition from Thailand, electrical and optical equipment dominates for Vietnam. However, the contribution of electrical and optical equipment and transport equipment in the gross exports from Thailand and Vietnam respectively is minimal.

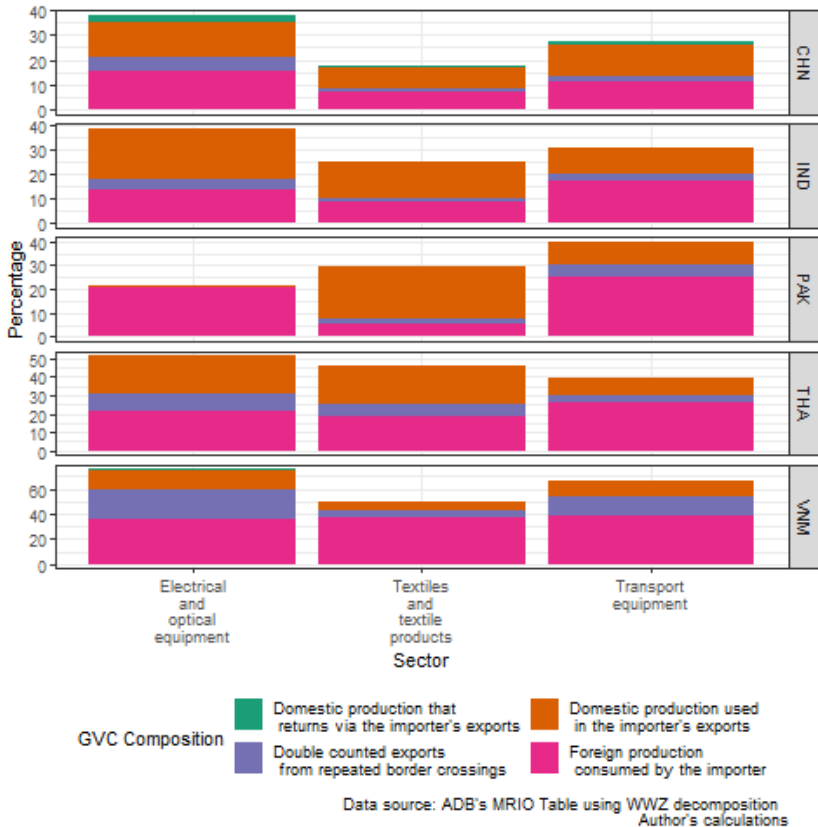


Figure 6: Global Value Chain Participation by Exporters Distributed by Sector (Percentage of Gross Exports)

The value in terms of percentage of gross exports from participation in global value chains for the exporters distributed by importing region is presented in Figure 6. China and India are more likely to rely to produce goods that contribute to their trading partner’s exports across the three sectors, while Vietnam is more likely to incorporate foreign inputs into its exports across the selected exporters. However, it is interesting to note that even though Pakistan has little contribution in value addition in terms of participation in global value chains in electrical and optical equipment as well as transport equipment, it does rely heavily on

the imports of foreign inputs to produce its exports in these sectors. However, the textile sector is mostly dependent upon the production of domestic resources that are further exported by its trading partners. In essence, Pakistan needs to re-evaluate its import policies to boost exports of electrical and optical equipment and transport equipment as the current policies are likely to severely restrain the growth in value terms.

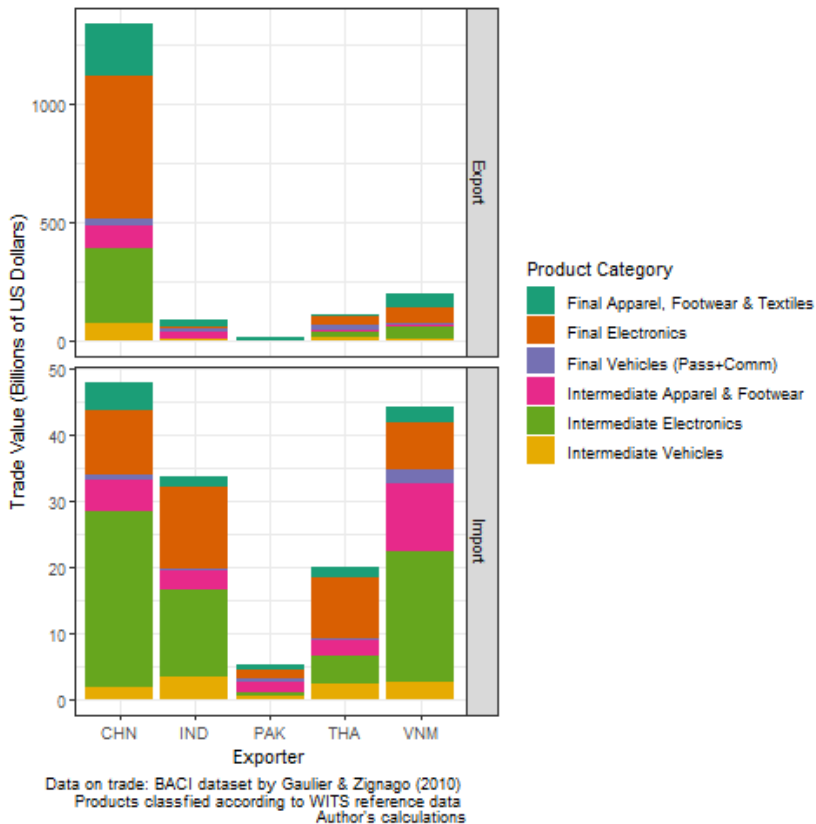


Figure 7: Global Value Participation as Classified by WITS Product References by Exporters (Contribution in Trade Flow)

The level of imports and exports in 2019 as classified by the WITS product references is presented in Figure 7. China exported

approximately \$600 billion worth of final electronic goods, \$320 billion worth of intermediate electronics and \$223 billion worth of final apparel, footwear and textiles. Considering its imports, China imported \$26 billion worth of intermediate electronics, the largest among the listed categories. As noted earlier, China primarily relies more on domestically produced resources than its East Asian counterparts, Thailand and Vietnam. Vietnam exported \$67 billion worth of final electronics goods, \$60 billion worth of intermediate electronics goods and \$60 billion worth of final apparels, textiles and footwear.

However, Vietnam imported \$20 billion worth of intermediate electronics, and \$10 billion worth of intermediate apparel and footwear. Vietnam also imported \$7 billion worth of final electronics. Thailand exported \$37 billion worth of final electronics and \$22 billion worth of final vehicles and imported \$25 billion worth of intermediate electronics. India exported approximately \$28 billion worth of final apparel, textiles and footwear and intermediate apparel and footwear. The total imports of the two products were \$10 billion. India imported intermediate and final electronics worth approximately \$13 billion each, while India exported final electronics worth \$9 billion.

India exported final vehicles worth \$11 billion and imported intermediate vehicles worth \$3 billion. Pakistan exported approximately \$16 billion worth of apparel, footwear and textiles and imported \$2 billion. Pakistan imported \$600 million worth of intermediate electronics and \$1.4 billion worth of final electronics. The exports of vehicles and electronics, both intermediate and final, did not exceed \$103 million for each of the four categories. While other economies are mostly trading electronics and vehicles, Pakistan is mainly dependent upon the trade of textile products. Further, Vietnam reports significant flow in both directions for electronics, intermediate and final. This highlights its levels of participation in global value chains in electronic goods.

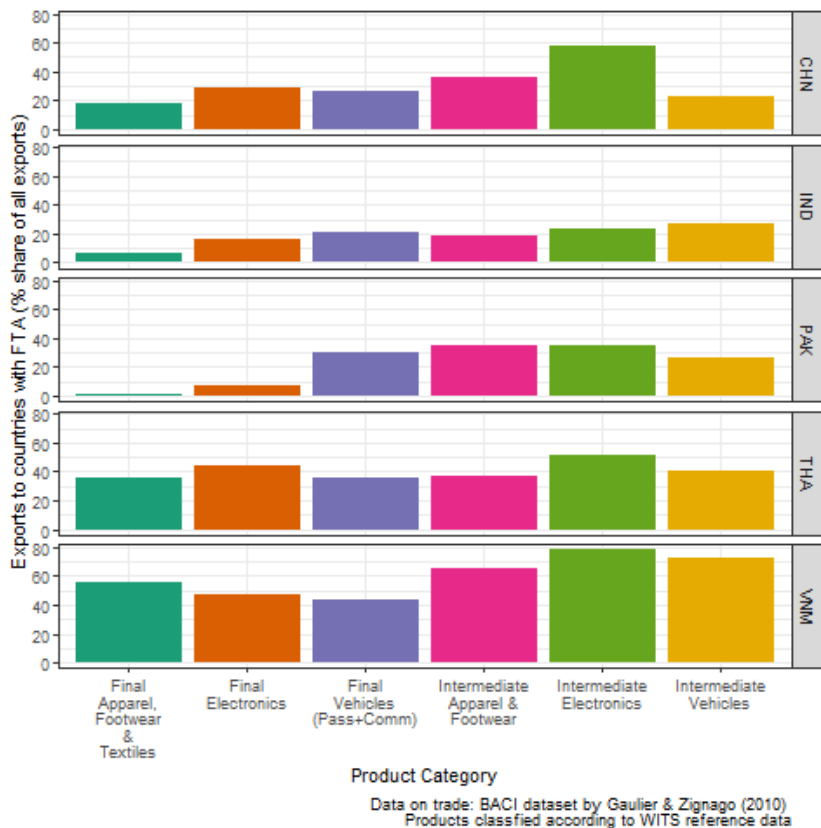


Figure 8: Exports to Countries with FTA as a Percentage of Total Exports by Product Category

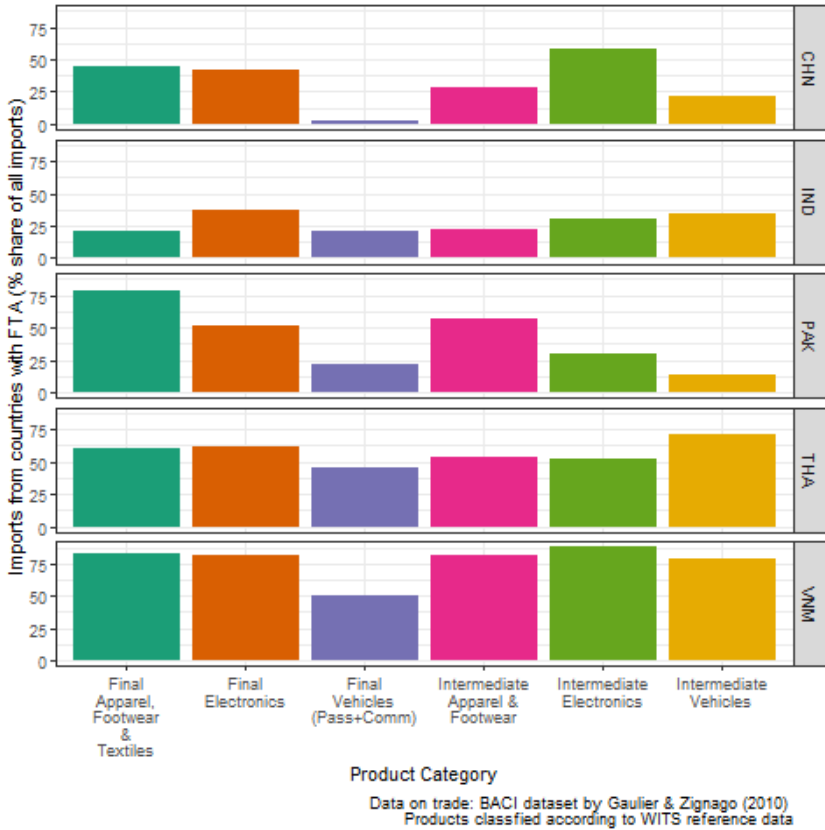
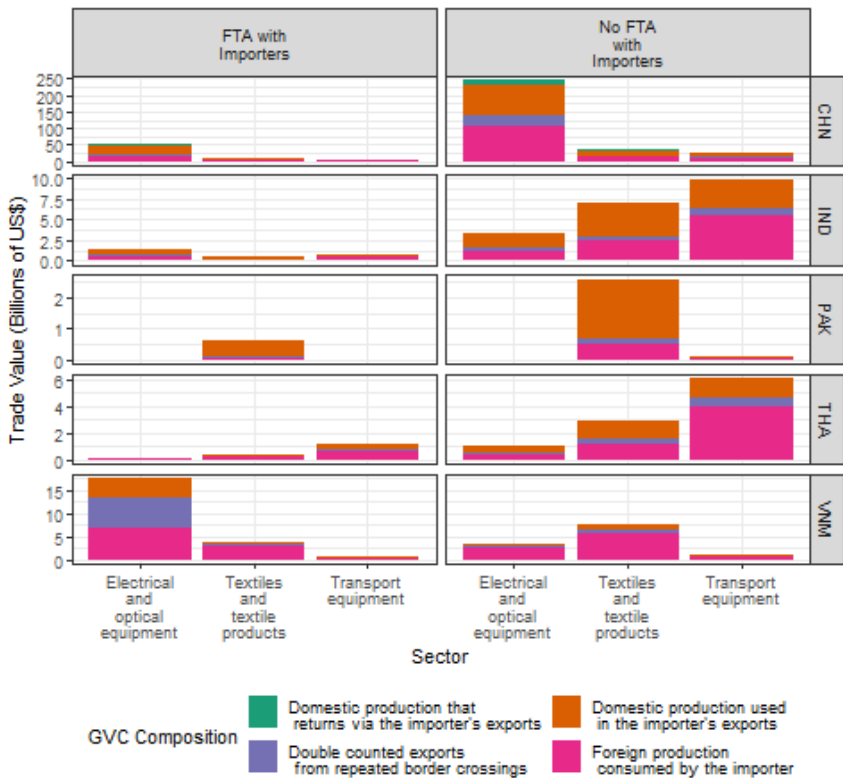


Figure 9: Imports from Countries with FTA as a Percentage of Total Imports by Product Category

The trend in exports to countries with which the exporting country has a free trade agreement (FTA) as a percentage of total exports in the selected products is presented in Figure 8. The trend in imports into countries with which the importing country has a free trade agreement (FTA) as a percentage of total imports is presented in Figure 9. The East Asian economies are more likely to export to countries with FTAs than the South Asian economies. The exports of intermediate goods are more likely destined to economies with FTAs than the exports of finished goods. The imports into Thailand and Vietnam are more likely to be from countries with which they

have a FTA relative to the other economies. Overall, imports are more likely to be from trading partners with which the importer has a FTA relative to exports. In essence, FTAs play an important role to promote participation in global value chains. Both Thailand and Vietnam are involved in backward linkages, which involve conversion of foreign inputs into products consumed in export markets. The intermediate goods are more likely to be imported into Vietnam and Thailand from countries with which they have a FTA, suggesting a crucial role of FTAs in establishing such value chains.



Data source: ADB's MRIO Table using WWZ decomposition
 Data on FTAs from WTO's RTA Database
 Author's calculations

Figure 10: Total Value in Global Value Chain Participation in Different Sectors by Exporters Distributed by FTAs with Export Destination

The total value in global value chain participation in different sectors distributed by the status of FTA with export destination market is presented in Figure 10. All countries except Vietnam generate greater value from participation in GVCs with countries they have not negotiated an FTA with. The value generated by Vietnam in electrical and optical equipment highlights the importance of FTAs in this sector for Vietnam. As observed earlier, Vietnam is likely to be more dependent upon its FTAs in terms of GVC participation relative to other countries in the region. It is also important to note again that FTAs may play an important role in acquiring inputs that are converted into exportable output, particularly in the case of Vietnam.

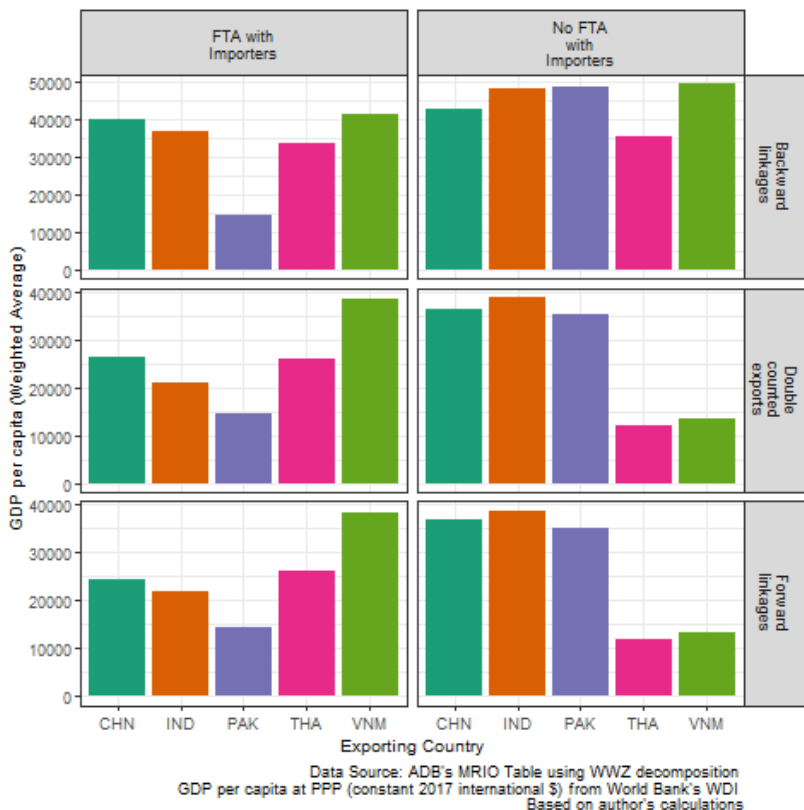


Figure 11: Average Weighted GDP per Capita of Importing Countries based on FTA Status with Export Destination Distributed by GVC Participation Channels

The average weighted GDP per capita of importing countries based on the status of FTA with destination market distributed by GVC participation channels is presented in Figure 11. The relationship between export sophistication and economic development is highlighted earlier by the Economic Advisory Group. It is likely that Pakistan is importing less sophisticated products from its trading partners. The average weighted GDP per capita of importers is higher for Vietnam and Thailand than Pakistan across the three different channels when there are no FTAs involved but lower for forward linkages and double counted exports when there are FTAs involved. It is likely that Pakistan has negotiated FTAs

with countries that report lower levels of GDP per capita than the countries with which its regional counterparts have negotiated a FTA. Apart from China, Vietnam has FTAs with the European Union, Japan and Republic of Korea, while Thailand has FTAs with Japan, Republic of Korea, New Zealand and Chile. Interestingly, both Thailand and Vietnam reported higher levels of average GDP per capita for backward linkages regardless of the status of FTAs, which suggests that they are converting imported inputs into exportable outputs destined for more advanced trading partners.

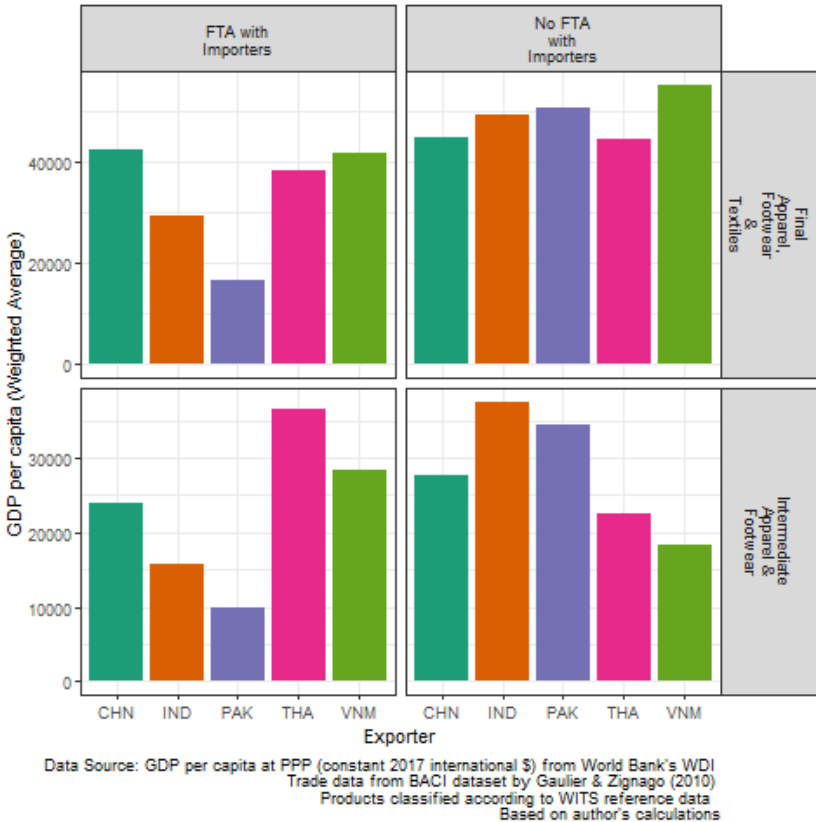


Figure 12: Average Weighted GDP per Capita of Importing Countries based on FTA Status with Export Destination Distributed by GVC Product Categories

The average weighted GDP per Capita of Importing Countries based on FTA Status with Export Destination Distributed by GVC Product Categories is presented in Figure 12. This reasserts the findings that Pakistan’s export destinations for textile products with which it has a FTA are likely to report lower levels of GDP per capita relative to the regional counterparts. Interestingly, the other countries report similar levels across both statuses, while the average GDP per capita for export destinations of Pakistan drops sharply for countries with which it has a FTA.

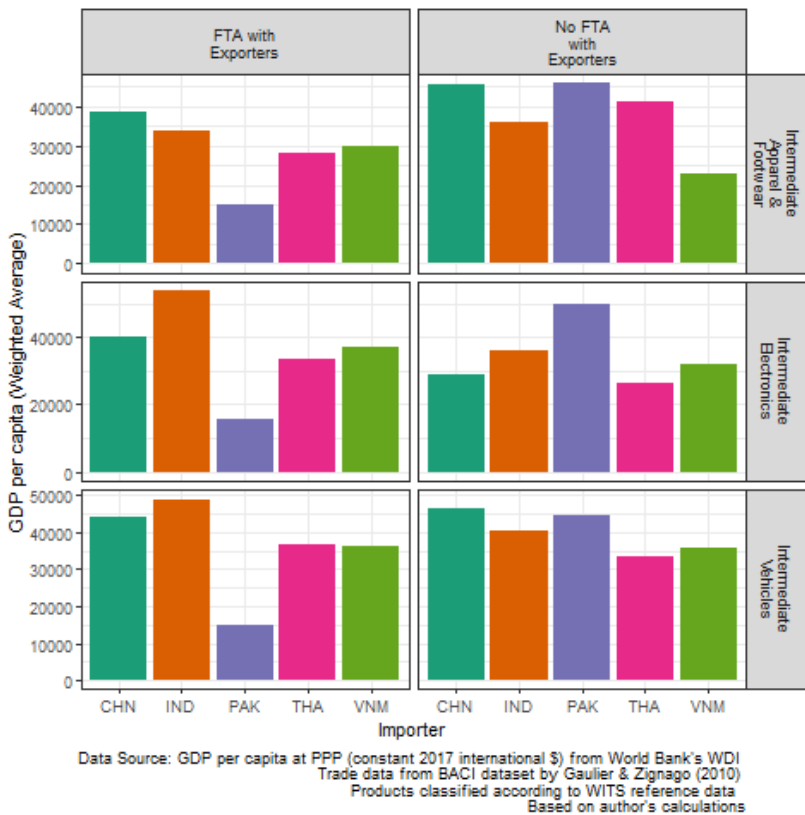


Figure 13: Average Weighted GDP per Capita of Exporting Countries Status with Import Sources Distributed by GVC Product Categories

The average weighted GDP per Capita of Exporting Countries based on FTA Status with Import Sources Distributed by GVC Product Categories is presented in Figure 13. This reasserts the findings that Pakistan's import sources for different intermediate products with which it has a FTA are likely to report lower levels of GDP per capita relative to the regional counterparts. The results are similar to that reported in the previous figure. This has one major implication as FTAs are likely to provide producers in Pakistan with access to cheaper raw materials. Pakistan mainly depends upon China for import of goods under the free trade agreement, while regional competitors who have negotiated several free trade agreements have options to access raw materials at a competitive rate from different sources. Unfortunately, the lack of FTAs may have limited the ability of Pakistani producers to compete in the global market.

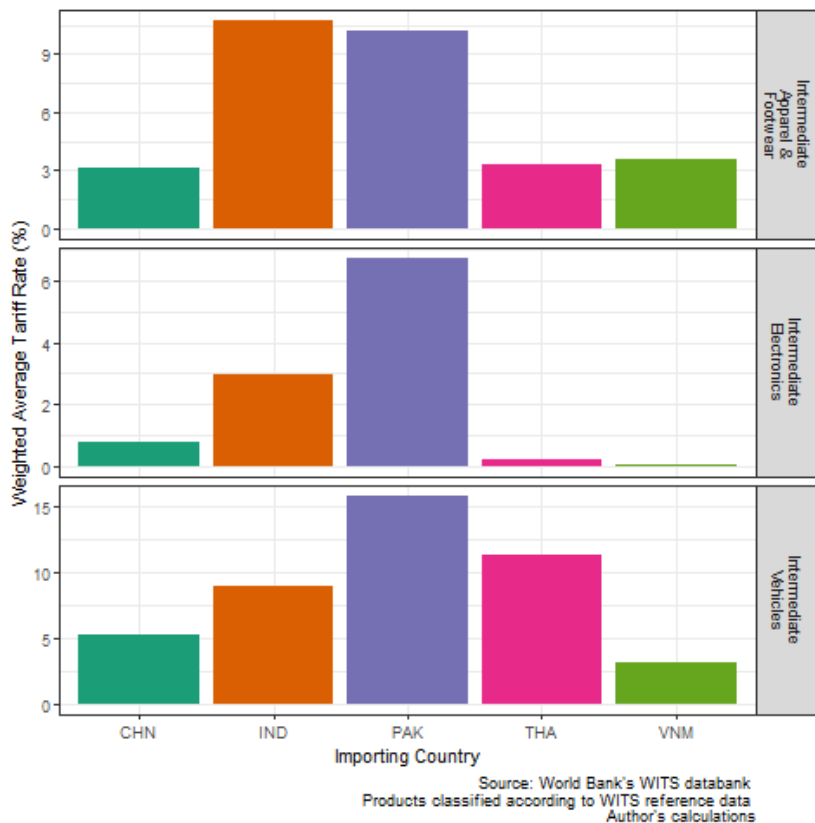


Figure 14: Weighted Average Tariff Rates in 2019 Imposed by Importers Distributed by Intermediate Goods as Classified under GVC Product Categories

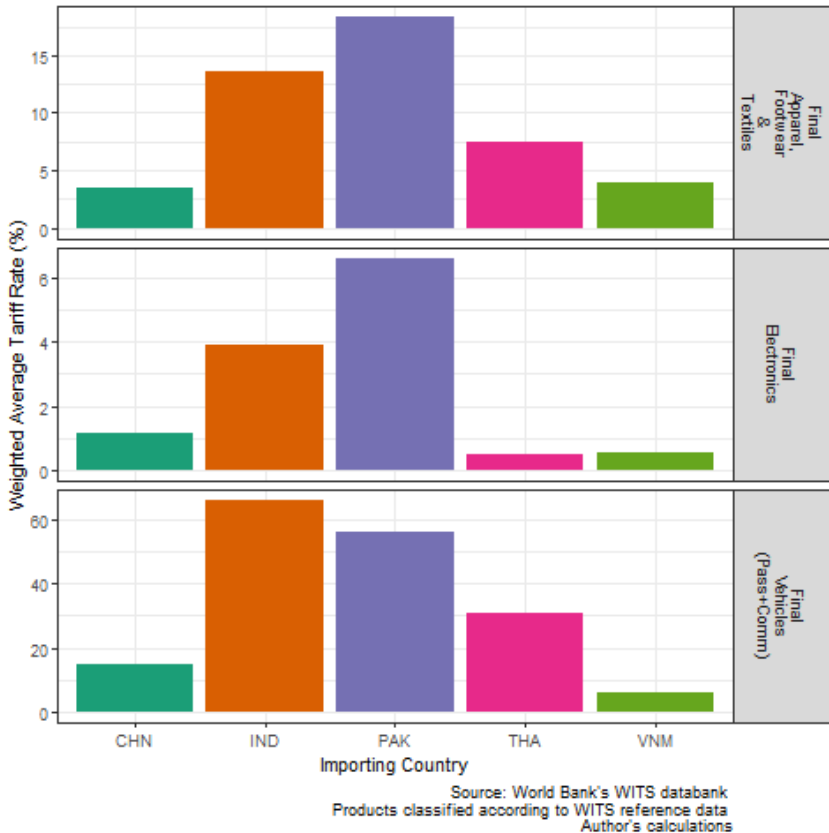
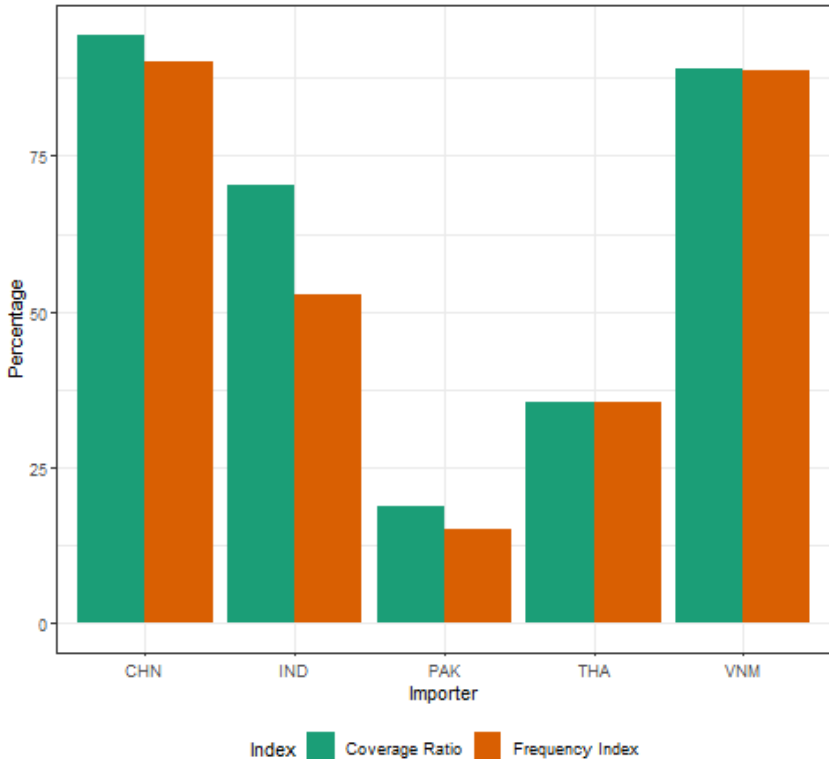


Figure 15: Weighted Average Tariff Rates in 2019 Imposed by Importers Distributed by Final Goods as Classified under GVC Product Categories

The weighted average tariff rates of importing countries for different categories of intermediate goods and final goods is presented in Figure 14 and Figure 15 respectively. Pakistan reports the highest tariff rates for intermediate and final electronics, intermediate vehicles and final apparel, footwear and textiles. The weighted average tariff rates for Pakistan is just below that of India for intermediate apparel and footwear and final vehicles. This clearly suggests that Pakistan has one of the most protective markets. The tariff rates imposed by Vietnam are one of the lowest among the aforementioned importers. They are almost non-existent

for intermediate electronics, while the lowest for final electronics. The low levels of tariffs in electronics, both for intermediate and final goods, by Vietnam has likely helped it become one of the major suppliers of electronics goods in the world.

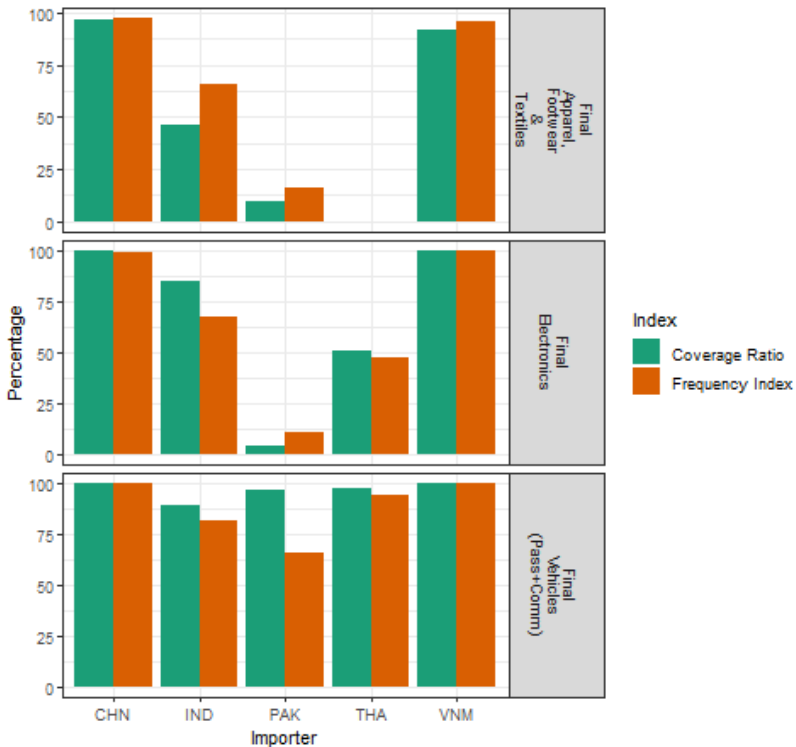


Data Source: Data on NTMs from UNCTAD's NTM Hub
 Trade data from BACI dataset by Gaulier & Zignago (2010)
 Author's calculations

Figure 16: NTM Indices by Importers

The NTM indices calculated for the selected importers is presented in Figure 16. Pakistan reports the lowest coverage ratio and frequency index, indicating the lack of presence of NTMs on its imports. On the other hand, Vietnam and China report the highest coverage ratio and frequency index for their NTMs. Vietnam imposes the lowest tariffs on the imports but has high presence of

NTMs. It is important to mention here that not all NTMs are trade restrictive or protective in nature, such as quantitative restrictions and licensing requirements. Several NTMs can be imposed in order to ensure that only the imports of substandard and dangerous products are restricted, providing an opportunity to exporters of high-quality products to benefit. For instance, quality certifications and proper packaging and labeling requirements imposed by the importers may improve trading relationships and consumer welfare.



Data Source: Data on NTMs from UNCTAD's NTM Hub
 Trade data from BACI dataset by Gaulier & Zignago (2010)
 Author's calculations

Figure 17: NTM Indices Distributed by Final Goods of GVC Product Categories

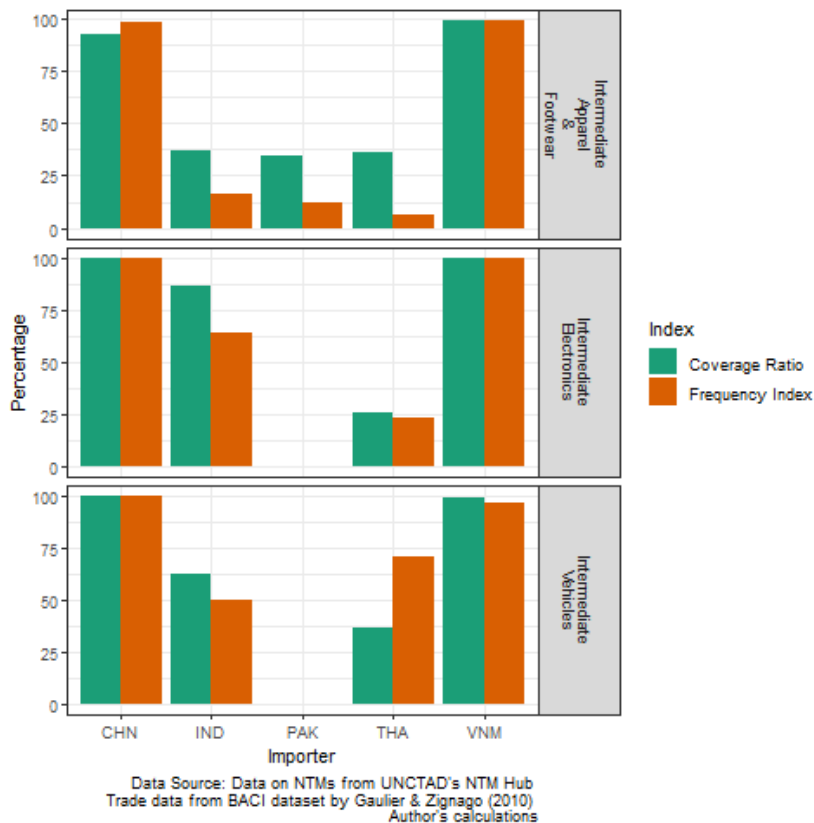


Figure 18: NTM Indices Distributed by Intermediate Goods of GVC Product Categories

The NTM indices of the selected imported by GVC product categories are presented in Figure 17 and Figure 18. The former involves the imports of final goods, while the latter involves the imports of intermediate goods. Except for the imports of final vehicles, Pakistan imposes comparatively the least amount of NTMs on the imports of goods. Here it is important to mention that NTMs can be differentiated as technical and non-technical, with the former to limit the imports of substandard products and the latter involving quantity limits to imports. In essence, Vietnam imposes NTMs rather than tariffs on the imports of its goods. As

most of its participation is reported in terms of backward linkages as it imports inputs to produce exports, the NTMs are likely to play an important role to ensure that imported inputs are not substandard and dangerous for consumption. The lack of NTMs imposed by Pakistan may imply poor quality and standard checks on imports, limiting the linkage between exports and imports.

5-SELECT CURRENT SECTORAL POLICIES AND HOW THEY CAN BE IMPROVED WITH GREATER CONNECTIVITY

5.1-Mobile Sector Policy:

The mobile device manufacturing policy introduced in 2020 to stimulate local manufacturing/assembly has created some controversy as it has increased the price of mobile phones. Imported phones are subject to an overall tax rate of up to 37.5 percent of the import price, which imposes a significant burden on consumers. However, the government desires to increase local production of mobile phones that could eventually reduce the imports of mobile phones and also increase exports to different markets globally. Further, the tax collected on imports of mobile phones adds to the national exchequer.

The Economic Advisory Group is concerned that the high taxes on the imports will result in high prices and the tariff proffered to the assemblers may, through reduced competition, deter the adoption of new technology and eventually result in obsolete technologies in Pakistan. This could allow the assemblers to raise the price of locally assembled phones as import competition is reduced. The example of the automobile sector over the last four decades, with its high prices and low levels of technological adoption should serve as a warning sign.

PRIME Institute has carried out a survey of the local prices, imported prices and the lowest prices across China, Malaysia and Dubai to determine the impact of higher import tax rates on mobile phones. The survey was conducted in Islamabad in early 2022, around the time when local assembly of Samsung mobile phones started.

The purpose of the study is to determine whether the taxes on mobile phones provide good grounds to assemble phones cheaply as well as a viable alternative to imported phones. In order to justify the taxes on imported phones, the study considers (i) the extent of the protection offered to the local assemblers in the form of taxes on imported phones and (ii) the price advantage to consumers of importing from the cheaper markets relative to purchasing from the local market.

It is important to mention that Pakistan is likely to assemble relatively low priced phones, i.e. below \$500 in the local market. 17 out of the 28 locally assembled phone models surveyed are available for less than \$200.

If we take the assumption that the mobile phone industry is competitive, phones should be sold at the lowest price relative to regional competitors. The amount of tax imposed on the imported variants of each model is the difference between the import price and the local price of the mobile phones. Hence, the percentage difference in the import price and the local price (calculated as the difference in the import price and local price divided by the local price) suggests how much protection is awarded to local assemblers of each model. The greater the margin, the larger the cushion available to raise the prices of locally assembled phones.

The percentage difference between the local price and the lowest price of the mobile phones suggests the price advantage a consumer could obtain if they were to import the phone, without any additional taxes imposed by the Pakistani government, from the cheapest seller across Dubai, Malaysia and China rather than purchase from the local market. A negative number indicates an advantage to domestic consumers as locally assembled phones are cheaper than the alternatives in regional markets. If so, the locally assembled mobile phones can be competitive in the regional as well as global markets.

Tax Rates:

The following are the price slabs for which the tax rates on the imports of mobile phones are set:

<u>Tax on Mobiles with CNIC if imported (amount in Rs is fixed PTA tax)</u>
\$1-30, Rs. 550
\$30-100, Rs. 4323
\$100-200, Rs.11561
\$200-350, Rs. 14,661 + 17 % sales tax
\$350-500, Rs. 23,420 + 17 % sales tax
Above \$500, Rs. 37,007 + 17 % sales tax

Note: The import price of phones covered in this survey range from \$100 to \$500.

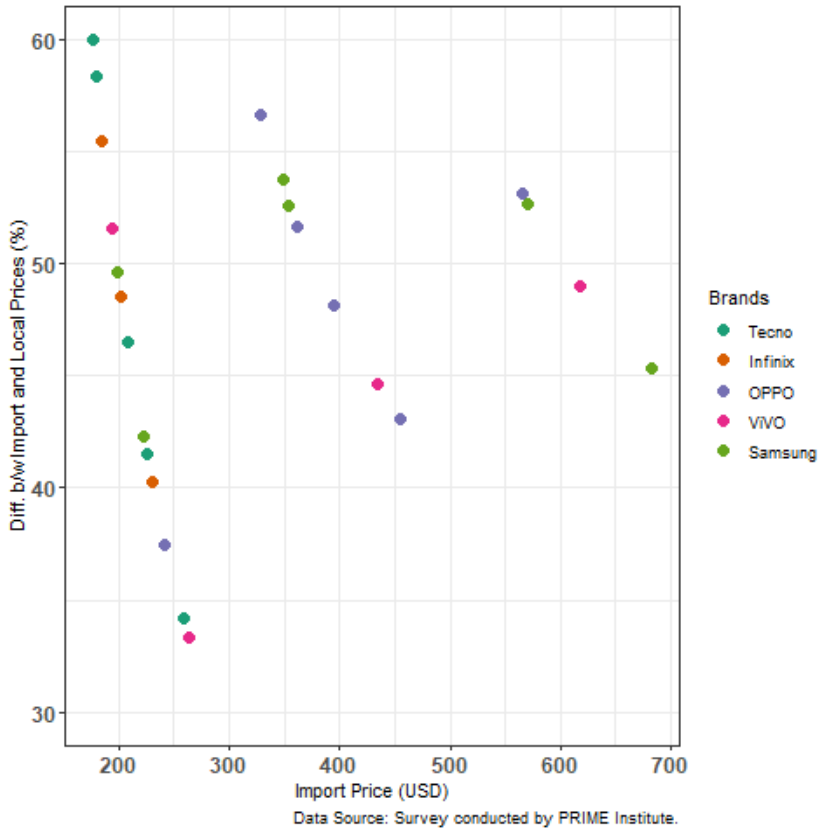


Figure 19: Scatterplot for the Import Price of a Mobile Phone after taxes and the Percentage Difference its Import and Local Prices

The scatterplot for the import price of a mobile phone and the percentage difference between import and local prices is presented in Figure 19. As the imported mobile phones are taxed according to different slabs based on their prices, the percentage difference between import and local prices decreases within each price slab. It is at the highest level for the cheaper phones within a certain price slab and decreases as the import price increases. This study covers phones that belong to three different price slabs as noted earlier.

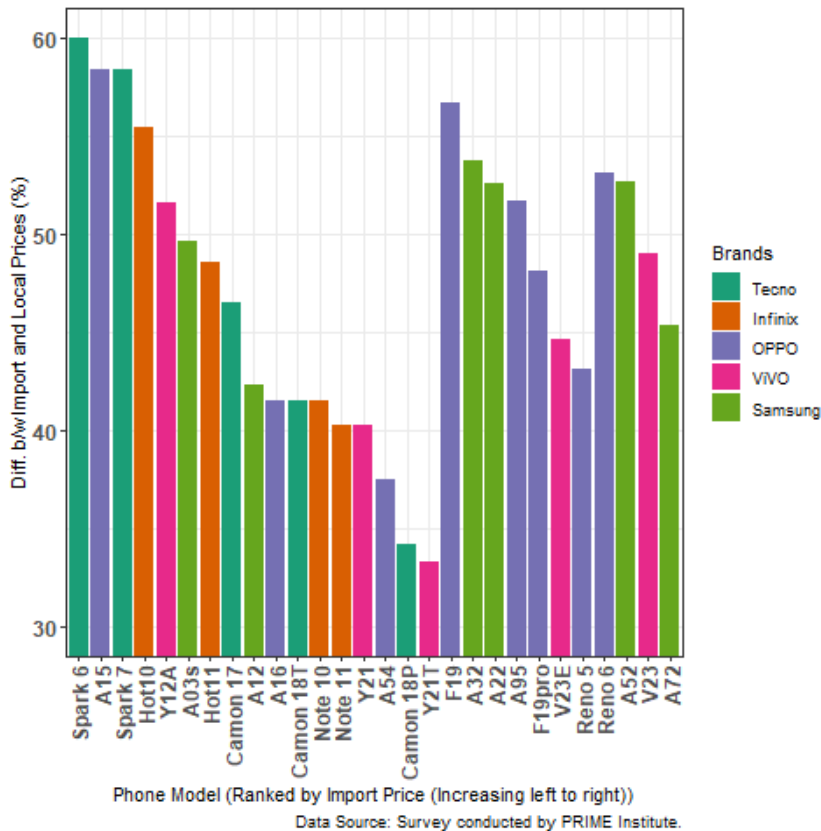


Figure 20: Bar plot for Percentage Difference between Import and Local Prices of Phone Models

The bar plot for percentage difference between import and local prices of various phone models assembled in Pakistan is presented in Figure 20. The difference is higher for the cheapest variants within each tax slab, ranging from 60 percent for Spark 6 by Tecno to approximately 30 percent on Y21T by ViVo. It is also likely that the difference decreases for the more expensive phones. In essence, the current tax policy is likely to create a larger distortion in the price of the cheaper phones available in the market in comparison

to the more expensive phones. The following analysis, comparing the lowest prices in major regional markets from where phones are likely to be imported and the prices in Pakistan, will help determine whether any advantage from the tax policy is transferred to the mobile phone consumers in terms of lower prices.

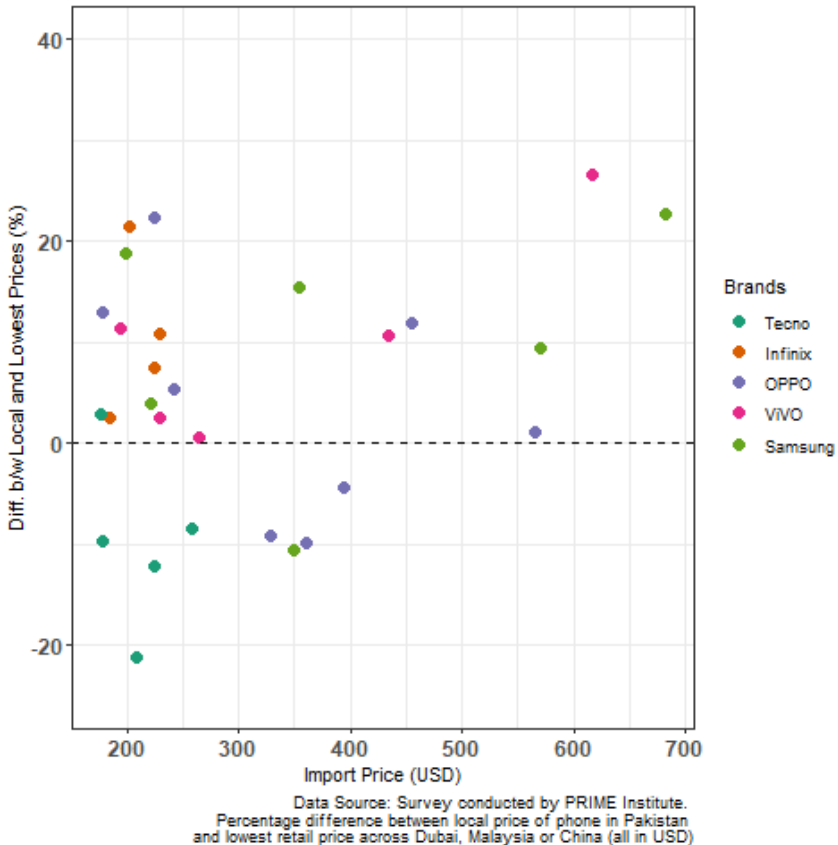


Figure 21: Scatterplot for Import Price of Mobile Phone Model after Taxes and Percentage Difference between Local Price of Mobile Phone and Lowest Prices in Regional Countries of Mobile Phone Models Assembled in Pakistan

The scatterplot for import prices after taxes and percentage difference between local prices and lowest prices in the region of

mobile phone models assembled in Pakistan is presented in Figure 21. Only eight models out of 28 models surveyed report a lower price in the local market than the price in one of the regional countries specified in the survey. Four out of the eight models are sold by Tecno and three are sold by OPPO. One of the eight is sold by Samsung. All mobile phones sold by Infinix and ViVo report higher prices in the local market. All mobile phones sold by Infinix and ViVo report higher prices in the local market.

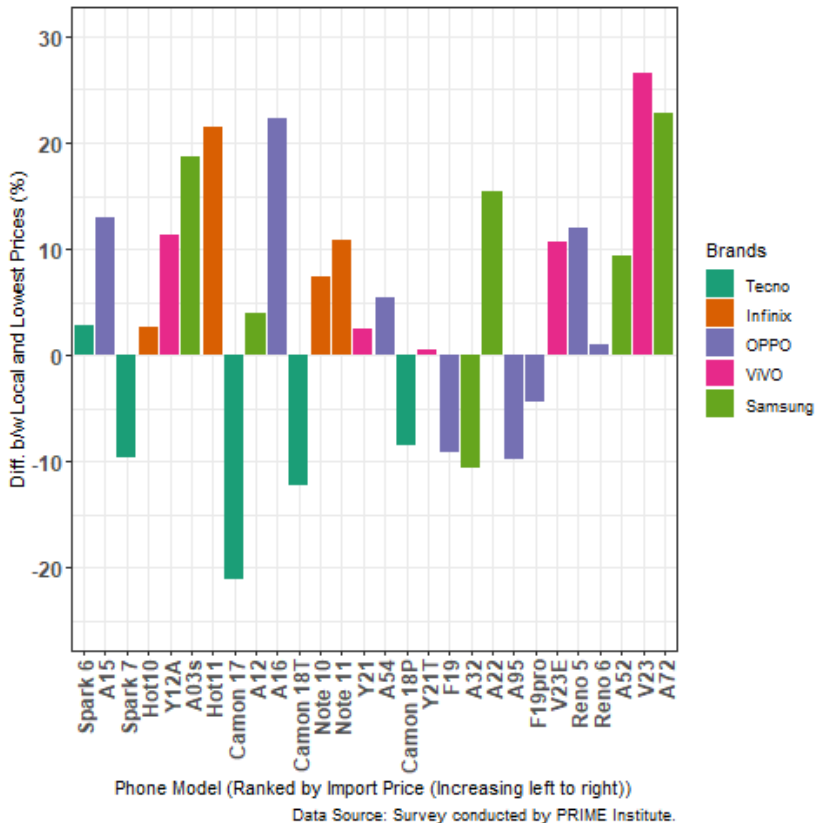


Figure 22: Bar plot for the Percentage Difference between Local Price and the Lowest Prices in Regional Countries of Mobile Phones Assembled in Pakistan

The bar plot for the percentage difference between local price and the lowest prices in regional countries of mobile phones assembled in Pakistan is presented in Figure 22. Except for the four models released by Tecno, none of the models in the lowest price range, below \$200, report lower prices in the local market. Within the mid-price ranges of phones imported in Pakistan, between \$200 and \$350, OPPO has three models with the lowest prices in the local market and Samsung has one model. Considering the more expensive phones assembled in Pakistan, none of the phone models have lower prices in the local market. Hence, the benefits to the consumers from local assembly of mobile phones are quite limited as the protection offered to producers has not resulted in benefits being passed onto the consumers. Except for Tecno, none of the brands have released phone models, which were previously imported for less than \$200, that are likely to be the cheapest in the region. Similarly, none of the phones assembled in Pakistan for which the import price is above \$350, are the cheapest in the region. Further, it is unlikely exports from Pakistan will increase based on price competition as the prices set by majority of the local assemblers are not yet regionally competitive.

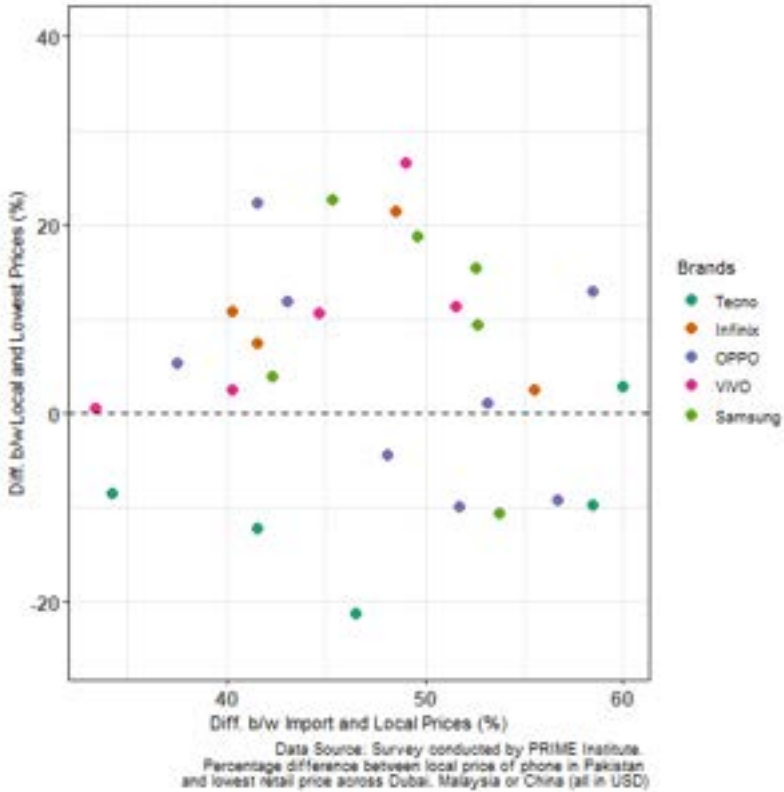
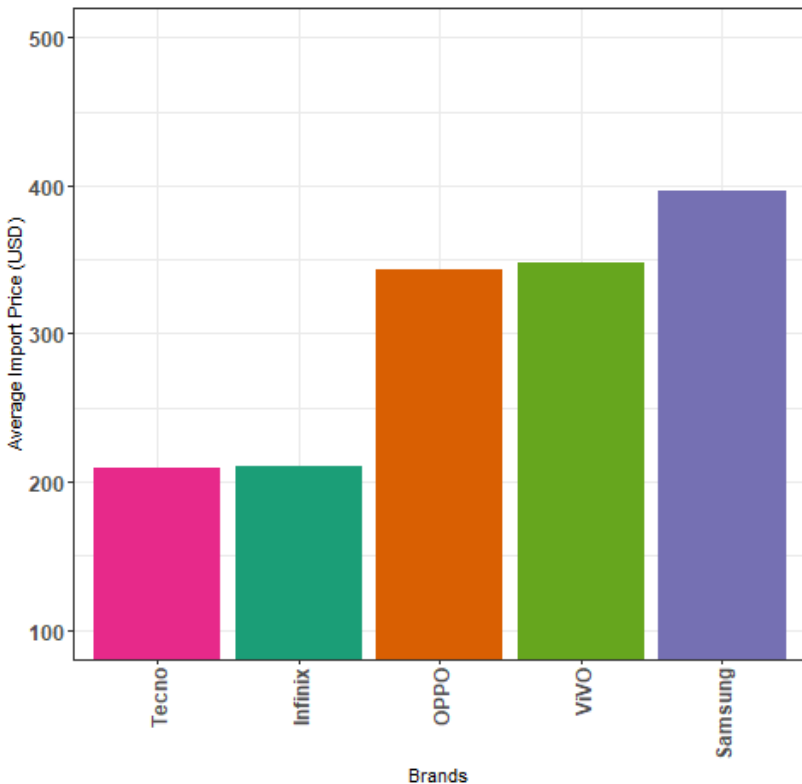


Figure 23: Scatterplot for Percentage Difference between Import and Local Prices and Percentage Difference between Local and Lowest Prices of Mobile Phones Assembled in Pakistan

The scatterplot for the percentage difference between import and local prices and percentage difference between local and lowest prices of mobile phones assembled in Pakistan is presented in Figure 23. There does not seem to be a clear pattern between the margin in the import and local prices of mobile phones and the margin between local prices and the lowest price of mobile phones in the regional countries. The graph does suggest an inverted u-shaped relationship, particularly among those phones which report a higher local price than the price set in regional countries. In essence, the lack of relationship between the two variables suggests

that the protection offered to the mobile phone assemblers are unlikely to result in an advantage to the consumers of mobile phones in terms of low prices. For instance, different models of Tecno, Infinix and ViVo report the same level of protection in terms of the percentage difference in import and local prices, but the latter two sell a model at 20 percent higher price than the lowest in the region while Tecno sells a model which is 20 percent cheaper in Pakistan relative to the lowest price in the other regional countries.



Data Source: Survey conducted by PRIME Institute.

Figure 24: Average Import Price of Mobile Phones by Brand

The average import price of mobile phones imported into Pakistan by brand is presented in Figure 24. Only those models are considered that have a locally assembled alternative. Tecno and Infinix sell the cheapest models of mobile phones while OPPO, ViVo and Samsung sell the more expensive models.

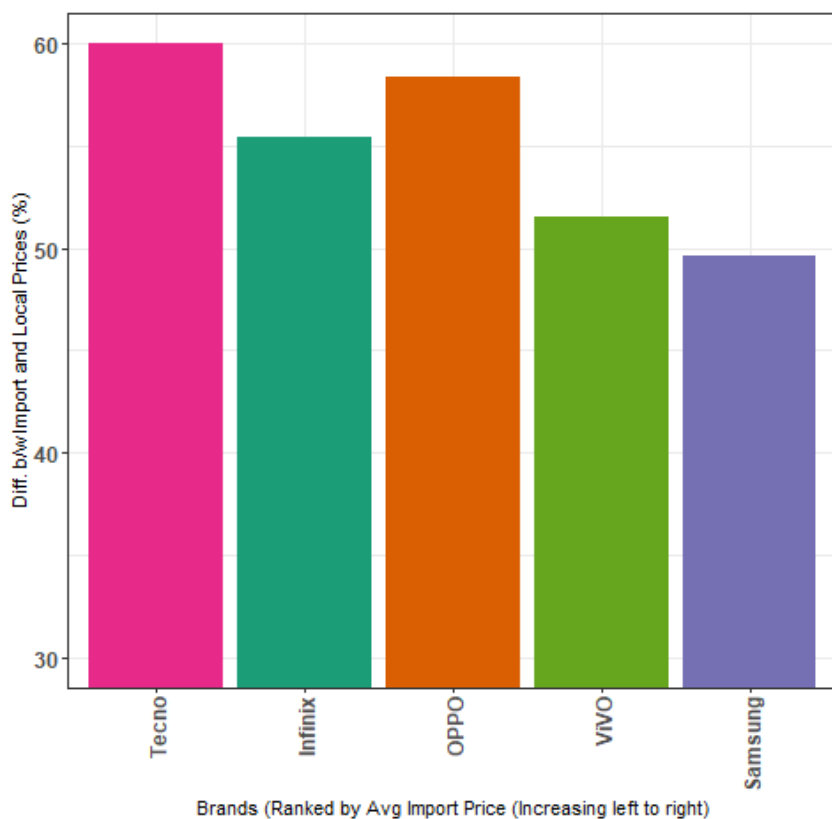
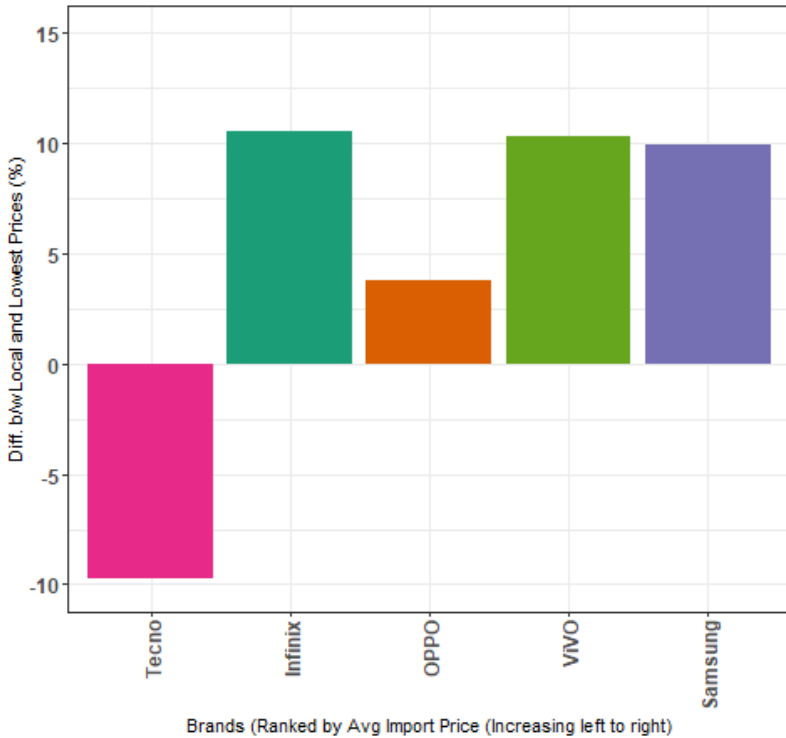


Figure 25: Average Percentage Difference between Import and Local Prices of Mobile Phones Assembled in Pakistan by Brand

The average percentage difference between import and local prices of mobile phones assembled in Pakistan by brand is presented in Figure 25. Tecno has the highest percentage difference, followed by OPPO and Infinix. ViVo and Samsung report the smallest average difference. Although, Tecno and Infinix sell the cheapest

mobile phones across all brands, they enjoy the largest level of protection in terms of taxes on their phones. This is likely as the taxes imposed on the phones have a larger impact on cheaper phones within each of the tax slabs than on the more expensive phones. The import price on average is almost 50 percent more than the local prices of the same models for all brands except Samsung. The relatively higher prices of Samsung phones reduces the impact of taxes.



Data Source: Survey conducted by PRIME Institute.
Percentage difference between local price of phone in Pakistan
and lowest retail price across Dubai, Malaysia or China (all in USD)

Figure 26: Average Percentage Difference between Local Prices and Lowest Prices in the Region of Mobile Phones Assembled in Pakistan by Brand

The average percentage difference between local prices and lowest prices in the region of mobile phones assembled in Pakistan by

brand is presented in Figure 26. Except for Tecno, all mobile phone brands are sold on average at a higher price in Pakistan than the lowest price in the region. Cheaper alternatives are likely to be available in either China, Malaysia or Dubai. While all mobile phone brands benefit from the taxes which has raised the price of imported variants of the local models sold in Pakistan by an average of more than 50 percent, majority of the brands have failed to pass the benefits on to the consumers by offering them the models at the lowest prices relative to the final retail price in either Dubai, Malaysia or China.

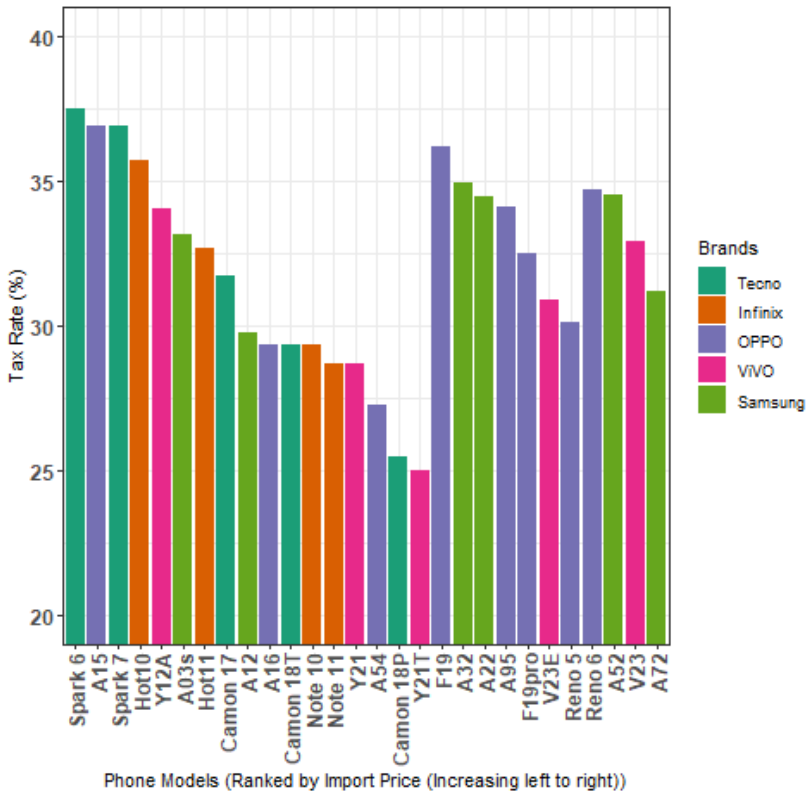


Figure 27: Tax Rate on Phone Models by Brands

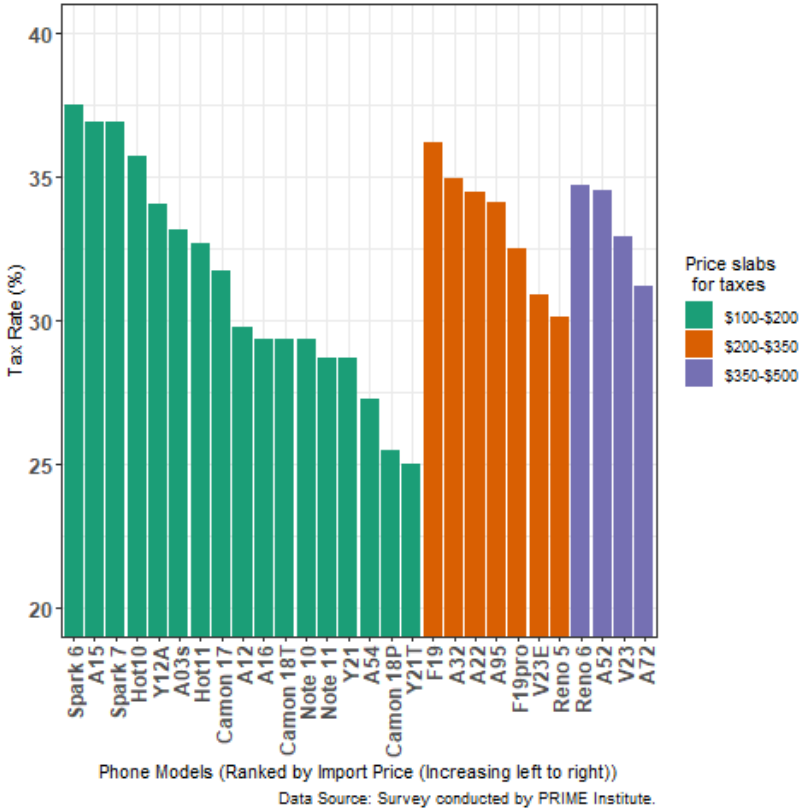


Figure 28: Tax Rates on Phone Models by Price Slabs for Tax Purposes

The results presented in Figure 27 and Figure 28 confirm that the tax rates fall as the import price of a mobile phone increases within each price slab and that all brands have model variants that face different tax rates. The tax rate on imported phones is calculated as the difference between the final import price of a phone and the local price divided by the final import price. This differs from the earlier indicator, which considers the difference between final import price and local price divided by the local price. The assumption is that the total amount paid on taxes is equivalent to the extra price paid on imported phones. In essence, the higher the price within a specific price slab, the lower the tax rates. For

instance, the difference in price between Y21T by ViVo and F19 by OPPO is \$12^{29A} but the differences in taxes is \$65.

Summary and Recommendations:

1. The taxes on the import of mobile phones are likely to be higher on the cheapest variants across different mobile phone models based on the price slabs. This strategy penalizes the poorer consumers rather than the richer consumers. The fixed or specific portion of the tax that often creates such a distortion must be eliminated, replaced by an ad-valorem rate.
2. Only 8 out of 28 models are sold at the lowest prices in comparison to the final retail price in Dubai, Malaysia and China. Tecno dominates with 4 out of 5 of its models surveyed. Interestingly, Tecno has the cheapest mobile phones in the local market. This is disconcerting as other brands are not only regionally uncompetitive but the protection offered may help them increase their prices in the future. In essence, the mobile phone prices may increase and become more uncompetitive if the protective measures on mobile phones continue unabated.
3. If the purpose is to protect brands with investments in local assembly, a tax rate of more than 10 percent on imported phones is still unlikely to be justified as it provides enough cushion for local assemblers to compete with the imported variants of their localized models. The large margin offered by the government through higher taxes will otherwise lead to inefficiencies in the local mobile assembly as it lowers competition and fails to provide incentives to firms to innovate and adopt the latest technologies. Further, any new taxes imposed must be accompanied with a sunset clause.

^{29A} Sources for the prices of mobile phones in respective markets:

For Pakistan: Whatmobile.com and Survey by PRIME Institute of local market

For China: Phoneaqua.com, Mobilewithprices.com and Electrorates.com

For Malaysia: Hhoneaqua.com, Mobilewithprices.com and Technave.com

For Dubai: Phoneaqua.com, Technave.com, Electrorates.com and Carrefouruae.com

4. It is highly recommended that government reduces taxes on imports of electronic and technological equipment and goods, and rather shifts focus on taxing the usage at the intensive margin. For instance, usage of higher bandwidth could be taxed instead of the equipment. The IT industry, which is dependent on the imports of electronic goods, can generate massive export and tax revenue.

5.2-Auto Sector needs to move from protection and indigenization to liberalization and integration

Existing high levels of protection³⁰

The auto industry has enjoyed heavy protection since the 1980s. Protection to infant industries are granted in the expectation that over the long-run domestic producers would achieve scale, become efficient and the prices would fall and the industry would no longer need protection against imports. Since protection through tariffs and non-tariff barriers may at least partly be responsible for the inefficiencies in the production structure, the country suffers losses and consumers have to pay higher prices. While such losses in the short run are expected, the industry over the long run should be able to compete in the international market. In Pakistan, however, the protection levels to automobile industries have been high and until recently there has been hardly any reduction in import duties.³¹

The auto industry has received protection from government for more than three decades without a robust analysis of requisite pre-conditions, which has been standard practice in most trading blocs (e.g. EU) for several decades. For instance, researchers use empirical efficiency tests like the Mill test and Bastable test, and analyze the welfare implications of the incentive structure to objectively measure the impact of protectionist measures in place. On both these measures, the auto industry and, implicitly, auto-policies fail. This relaxed approach to providing incentives at the expense of consumer explains why the industry continues to struggle at achieving the economies of scale necessary for competing globally.

³⁰ <https://primeinstitute.org/a-case-study-of-auto-industry-in-pakistan/>

³¹ The import duties on cars beyond 1600 cc were reduced from 200 to 150 and upto 1000 cc from 100 to 75 during the 2003-04.

Tariff rates and the differential in the domestic and world market prices

As long as tariffs are prohibitive, they are not a good indicator of the difference between domestic and world market prices. A part of the tariff that is redundant is known as water in the tariff. Since differences in the features of cars imported from various countries may well be quite different from the cars assembled within the country, price comparisons are hazardous. The C&F prices of cars of various brands show sharp variations in prices of the same brand and cylinder capacity in different countries mainly because of different specifications.

Effective Protection Rates

The tariff rate on finished products is not a good indicator of the protection that an industry enjoys. The Effective Rates of Protection measure the percentage increase in the value added by the differential in world and domestic prices resulting from the tariffs imposed on the finished goods and the tariff rates on inputs. The effective protection rate is not necessarily a measure of inefficiency; it could be a combination of inefficiency, excess profits earned by the producers and the distortions in the economy.

When the value added coefficient, i.e. value added as a percentage of total value of production in an activity, is very small, the difference in the tariffs on output and inputs would be magnified and effective protection rates would become very high. If the tariffs on inputs and outputs is the same then the protection enjoyed by the economic activity is equal to the tariff rate.

Weakness of present policies

The current policies do not present a path for transformation of the sector to either meet the needs of the domestic consumer or become

globally competitive. Specifically, they fall short at both providing a mechanism to bring down prices on sustainable basis, and ensuring development of Pakistan's industrial capabilities necessary for competing in international markets.

The incentive structure in place is not designed to leverage the country's latent comparative advantage. This is precisely the reason why, despite decades of protection, the industry has failed to become competitive internationally. Instead, a more efficacious policy would focus on exploiting Pakistan's inherent latent comparative advantage, which would incentivize greater concentration of resources in segments of auto-industry supply chain where Pakistan has necessary capabilities to compete globally. For example, although by no means guaranteed, an auto-policy which moves away from specializing in the end-product (e.g. assembly) and, instead, focuses on subsectors where comparative advantage is more probable is better suited for achieving policymakers' objectives – consumer welfare and increase in industrial capabilities.

The efficacy of any policy is contingent upon prudent allocation of resources. The prevailing policies have allocated country's resources in production activities where Pakistan has an inherent disadvantage. The 1.8 million people currently employed throughout the supply chain could be reemployed across activities where Pakistan enjoys a latent comparative advantage. The misuse of resources remains the least appreciated point and needs to be brought to the policymakers' attention.

The evolution of trade has prompted countries to realize comparative advantage, cars made in Germany compete with cars made in Japan, and specialize in the stages of supply chain, it is impossible to say where a car is manufactured. Data shows we are likely to have a comparative advantage in auto-parts and two/three-

wheel automobiles, and for which, there are significant primary/secondary markets in Africa and Asia.

Elements of a progressive auto policy

The EAG proposes that the upcoming auto policy should promote integration of domestic parts manufacturers with global value chains through two actions. First, liberalization of trade regime to give market access to international automobile manufacturers in exchange for integrating domestic parts manufacturers in their value chains. Second, identify and engage with key auto markets across the world with the aim to reduce frictions to cross border trade and provide certainty to international auto players vis-a-vis operating their supply chains from Pakistan.

Policy should focus on securing access to African and Asian markets to expand exports to primary/secondary markets, which can be accomplished through actively seeking FTAs with African Union, RCEP, and Central Asian countries.

Investment in the enhancement of domestic capabilities for the expansion of potential areas of comparative advantage should be the central stage of transformation. First, businesses need to be incentivized to invest in research and development and produce new products. Second, coordination between relevant business associations, domestic manufacturers, and global players is needed for the standardization of both products and production processes.

Furthermore, it is imperative to identify emerging skills' requirements and liaise with engineering universities and NAVTTC to ensure appropriate intervention at the earlier stage.

6-APPENDIX

6.1-CONTEXT OF INTERNATIONAL TRADE LAWS AND WTO REGIME

- **The General Agreement on Tariffs and Trade**

The international trade law regime is regulated by a series of agreements, the most significant of which is the General Agreement on Tariffs and Trade (GATT), which instituted the World Trade Organization (WTO) in 1995, an international body focusing on international trade and its regulation.

- Article 1 of the GATT requires countries to give all imports equal market access.
- Article 3 requires parties to treat imports and domestic products similarly in local markets.
- Article 5 guarantees the free transit of goods through a country between two trading partners.
- Articles 7 and 8 ensure fair customs valuations and procedures.
- Article 10 requires parties to publish their trade regulations in an easily accessible and transparent format.
- Article 11 requires parties to move away from quantitative restrictions to a system of tariffs so that trade restrictions can be better monitored and quantified. The main principles of the GATT and several provisions that allow deviations from the general GATT regime are discussed later on.³²

³² The World Trade Organization. WTO | Understanding the WTO - What is the World Trade Organization?.[online] Available at: http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact1_e.htm.

- **Article 36 and the Developing World**

Article 36 recognizes that developing countries may require some concessions that developed countries do not qualify for. Article 36(1) contains an extensive recitation of reasons to help developing countries obtain higher trade levels. From a legal perspective, the most promising part of this Article is 36(8), whereby:

- “The developed contracting parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties.”
- This means that developing countries will not be assumed to have given developed trading partners the same concessions that they have received.

- **The General Agreement on Trade in Services**

This agreement, otherwise known as the GATS³³, extends free trade principles from trade in goods to trade in services.

- Articles 1(3)(b) and 1(3)(c) explain that the agreement applies to all trade in services except trade in government services, or “services in the exercise of government authority,” which are defined as services that are provided on a non-commercial basis and in an uncompetitive context.
- Article 2 requires each party to award MFN status to foreign services providers. As explained earlier, this means that services providers from a foreign country are to be treated as favorably as the most favored foreign service-providers.

³³ Available online at http://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm

- Article 3 requires countries to publish all measures that may adversely affect free trade in services.
- Article 13 carves out an exemption from the MFN principle for government procurement, that is, for “procurement by governmental agencies of services purchased for governmental purposes and not with a view to commercial resale or with a view to use in the supply of services for commercial sale.”
- Article 20 requires each member to publish a schedule of its specific commitments under the GATS, and;
- Article 17 requires each Member to afford National Treatment to the services specified in its schedule, unless the schedule specifies different treatment.

- **The Agreement on Technical Barriers to Trade (TBT)**

The Agreement on Technical Barriers to Trade (TBT Agreement)³⁴ governs technical regulations and standards. The Agreement defines a technical regulation as a “Document which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory.” In contrast, it defines a standard as a document which “provides, for common and repeated use, rules, guidelines or characteristics for products or related processes . . . with which compliance is not mandatory.” Thus, the host government requires mandatory compliance with technical regulations, but not with technical standards. Both regulations and standards apply to “terminology, symbols, packaging, marking or labeling requirements [.]”

- Article 2 is the crux of the Agreement. It requires States to ensure that technical regulations or standards “are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international

³⁴ Available online at http://www.wto.org/english/docs_e/legal_e/17-tbt_e.htm

trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfill a legitimate objective.” Article 2 proceeds to mention some legitimate grounds for technical barriers, such as national security and the prevention of deceptive trade practices. It then commits each party to adopt international standards to harmonize technical requirements across borders.

- Article 12 of the Agreement carves out some limited exemptions for developing countries. These are relevant to Pakistan, India, and Sri Lanka. In particular, Article 12(4) notes that developing country members who adopt certain technical regulations, standards or conformity assessment procedures aimed at preserving indigenous technology and production methods should not be expected to use international standards, as a basis for their technical regulations or standards, which are not compatible with their development, financial and trade needs.

- **Foundational Principles: Most Favored Nation and National Treatment**

The international trade law framework is based upon two core principles: The Most Favored Nation Principle; and the National Treatment Principle. Economically, these two principals have slightly different affects. The former ensures that all importers are treated equally while the latter ensures that imported goods are treated similarly to local goods. We will consider each principle in turn.

The Most Favored Nation Principle

The first, the principle of ‘Most Favored Nation’ status, is predicated upon the notion of equality between the members of the WTO. Under this notion, countries cannot normally discriminate

among their trading partners. If a WTO member State were to grant one of its trading partners a particular benefit – such as a lower customs duty rate for one of its exports – the State would also have to extend the same benefit to all other members of the WTO. The principle of MFN status finds expression in article 1 of the GATT, as well as in article 2 of the General Agreement on Trade in Services (GATS), and article 4 of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which are two more of the foundational agreements informing international trade law. For Example, Article 1 of GATT requires that “any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.”³⁵

While its phrasing suggests a discriminatory approach, the MFN principle actually encourages the equal treatment of goods from all trading partners. Exceptions to the MFN regime do exist, such as free trade agreements which apply only to goods traded within a group of States, special access to markets granted to developing States or barriers against products considered to be unfairly traded by specific States. However, these exceptions are narrowly construed and permitted only under specific instances. The overarching regime, therefore, is informed by the notion of equal treatment to all like products, regardless of their State of origin.

The National Treatment Principle

The second foundational principle of contemporary international trade law is that of ‘National Treatment.’ According to this notion, locally produced and imported goods, services and intellectual

³⁵ The World Trade Organization.n.d.WTO | Understanding the WTO - Principles of the Trading System. [online] Available at: http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm.

properties must be treated equally within the domestic market. Again, this concept is predicated upon notions of equality and nondiscriminatory treatment of like goods or services. This principle, however, only applies to goods once they have entered the domestic market; therefore, for example, levying a customs duty on a particular good would not constitute a violation of this principle even if a similar tax were not imposed upon like goods, services or intellectual properties in the domestic context. By way of contrast, imposing a domestic consumption tax on imported goods once the goods had entered the domestic market – and not imposing a similar tax on domestically-produced substitutes – would constitute a violation of the National Treatment principle³⁶. The notion of national treatment finds expression in article 3 of the GATT, article 17 of the GATS and article 3 of the TRIPS. For example, Article 3(4) of the GATT states: “The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favorable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.”

Exceptions to Free Trade Principles under International Law

The international legal regime on trade under the GATT (1994)³⁷ and its associated legal texts allows for non-trade barriers (NTBs) under particular circumstances. The GATT itself allows for the imposition of certain non-trade measures (NTMs) under particular circumstances which operate to restrict imports. These measures include anti-dumping measures, countervailing duties, emergency

³⁶ 03Ministry of Trade, Economics and Industry - Japan. Part II WTO Rules and Major Cases - Chapter 2: National Treatment Principle. [online] Available at: <http://www.meti.go.jp/english/report/downloadfiles/gCT0002e.pdf>

³⁷ 5General Agreement on Tariffs and Trade, WTO, http://www.wto.org/english/docs_e/legal_e/gatt47_e.pdf

protections for domestic industries and protective measures for the protection and promotion of economic development in a developing State. Instances which allow for the imposition of restrictions on imports by the importing State include:

- **Antidumping Measures**

Under the GATT, Importing States are allowed to impose restrictions on goods which have been ‘dumped’ – i.e. which have been exported by an exporting State – at prices lower than in the exporting State’s domestic market, provided that such ‘dumping’ causes “material injury” to the competing domestic industry in the importing State. These goods are often excess produce which is exported to external markets at lower-than-domestic prices and article 6 of the GATT (relevant portions reproduced below) discusses anti-dumping measures allowable under the GATT regime: In order to offset or prevent dumping, a contracting party may levy on any dumped product an anti-dumping duty not greater in amount than the margin of dumping in respect of such product. In Pakistan, the National Tariff Commission (NTC) has initiated several anti-dumping investigations³⁸. For example, Chinese exporters have been investigated for dumping tiles, polyester staple fiber, and paper; Indian exporters have been investigated for dumping Phthalic Anhydride, which is a chemical used in the production of plastics.

- **Countervailing Duties**

Similar to antidumping measures, countervailing duties are duties imposed by the importing State on goods produced by industries subsidized by the exporting State. As per the Agreement on Subsidies and Countervailing Measures (SCM), following a

³⁸ The World Trade Organization.n.d.WTO | Understanding the WTO - Anti-dumping, subsidies, safeguards:contingencies, etc. [online] Available at: http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm

determination that the subsidies extended by the exporting State to the goods being exported materially advantage those goods over those produced domestically in the importing market, a State is allowed to impose a duty to offset the effect of the subsidy³⁹. Similarly, article 6 of the GATT defines the term “countervailing duty” as a special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly, or indirectly, upon the manufacture, production or export of any merchandise.

▪ **Safeguard Measures**

These are temporary measures initiated in order to protect the importing market from a dramatic increase in imports if such an increase injures or threatens to injure it. Such an increase can be in the form of an absolute increase the amount of imports or a relative increase vis-à-vis the imported goods’ market share.⁴⁰ Emergency measures – ‘safeguard measures’ in the parlance of the WTO legal texts – implemented by a State to protect domestic industry are covered in article 19 of the GATT, which enables an importing State to restrict imports in the event of unforeseen developments such that imports would cause or threaten serious injury to domestic producers of like or directly competitive products. A definition of the term “serious injury” has not been provided in the GATT; instead, the term finds definition in the Agreement on Safeguards [SG], which sets out forth the rules for the application of safeguard measures pursuant to article 19 of the GATT. Article 4(a) of the SG defines “serious injury” to a domestic economy as:

³⁹ The World Trade Organization.n.d.WTO | Understanding the WTO - Anti-dumping, subsidies, safeguards:contingencies, etc. [online] Available at: http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm.

⁴⁰ Article 19 of the General Agreement on Tariff and Trade (GATT) 1947, World Trade Organization. Available at: https://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm#articleXIX

[A] significant overall impairment in the position of a domestic industry.

- **Allowances for Developing States**

The GATT – recognizing their economic realities – makes allowances for developing States in article 18 to:

- Protective or other measures to raise the general standard of living of their people

Implement programmes and policies of economic development designed to raise the general standard of living of their people, to take protective or other measures affecting imports. For example, a developing State with a struggling local industry may institute trade barriers restricting imports of goods produced by those industries, thus reducing the competition such industries face. Examples of such protectionism include ‘buy domestic’ policies instituted in China, which prioritize domestic products in the local market over imported goods; import restrictions including quotas, such as those instituted in Pakistani textile industries; and the outright prohibition on the importation of chicken meat in order to protect the domestic poultry market in Sri Lanka.

- The Protection of Life and National Security

The Agreement on Technical Barriers to Trade (TBT) recognizes the right of States party to the agreement to take certain trade-related measures that would, in effect, constitute NTBs.⁴¹ These measures are justified by the State’s responsibility to ensure:

- [The] quality of its exports... the protection of human, animal or plant life or health, of the environment... [and] the prevention of deceptive practices.

⁴¹ Agreement on Technical Barriers to Trade, WTO, Tokyo Round of GATT trade negotiations, http://www.wto.org/english/docs_e/legal_e/17-tbt.pdf

- Similarly, article 20 of the GATT provides for general exceptions, enabling member States to institute measures that might restrict trade as long as they are not applied in an arbitrary or unjustifiable manner to discriminate between countries where the same conditions prevail or effect a disguised restriction on international trade.
- Article 20 allows member states to institute measures necessary to protect public morals, human, animal or plant life or health, national treasures of artistic, historic or archaeological value, secure compliance with laws or regulations (otherwise consistent with the provisions of the GATT), conserve exhaustible natural resources (provided such measures are made effective in conjunction with restrictions on domestic production or consumption), deal with products of prison labor and import or export of gold or silver and ensure acquisition or distribution of products in general or local short supply.

- **Limitations on Exemptions from Free Trade**

These provisions are, however, subject to the overarching obligation upon States to refrain from engaging in unfair means of protectionism vis-à-vis the domestic market. The underlying reasoning in this provision of the GATT, therefore, is that – within the rubric of the WTO legal regime – a State is allowed to impose restrictions upon certain imported goods in order to protect “human, animal or plant life or health” within the importing State. This right is paralleled by the duty imposed by the perambulatory text of the TBT quoted above, which obliges the exporting State to maintain adequate standards of quality for the goods exported. The TBT continues in this vein, recognizing that:

- [No] country should be prevented from taking measures necessary for the protection of its essential security

interest. To cite an example, the US imposes export restrictions on the exportation of oil extracted within its territory; this is in line with its domestic policies of conserving the domestic oil reserves and – more pertinently – to discourage excessive reliance upon imports.⁴²

- This recognition of a State's ability to affect trade in order to secure its domestic interests is not a blanket condonation of NTBs but is instead subject to the requirement that it is not exercised in a manner which would result in an arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade.

⁴² The World Trade Organization.n.d.WTO | Dispute Settlement - the Disputes - DS48. [online] Available at: http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds48_e.htm

6.2-REGULATORY FRAMEWORK TO PROTECT PAKISTAN INTEREST

Pakistan has over several years have drafted new laws and have introduced amendments in the regulatory frame work to protect its Trade Interest and make them compatible with International Trade Laws and practices. Most of these laws are within the ambit of the Federal government. However, recent constitutional changes raise the possibility of provincial governments affecting international trade through their representation on the National Economic Council.

- **Constitutional Change: the 18th Amendment’s devolution of regulatory power to the provinces**

The 18th Amendment to the Constitution of Pakistan devolved regulatory authority from the federal government to the provinces⁴³. For example, the 18th Amendment modified Article 156 of the Constitution to include the Chief Ministers of the provinces in the National Economic Council, and to require the National Economic Council to promote “equity” among the provinces. Said article vests the President with the power to set up a National Economic Council comprising of the Prime Minister, assuming the responsibilities of the Chairman of the Council, the Chief Ministers and one member from each Province nominated by the Chief Minister. The National Economic Council is in turn responsible for formulating sound financial, commercial, social and economic policies in line with principles of balanced development and regional equity. This constitutional shift is potentially significant. Insofar as the National Economic Council is a planning body, it should not erect specific NTBs against imports. However, the Council sets the economic policy that the ministries and other departments must pursue. Planning from the

⁴³ Page 18. Non-Tariff Barriers and Pakistan’s Regional Trade. IGC. Sikander Shah & Uzair Kayani.

perspective of “balanced development and regional equity” may diverge from planning for absolute growth. The National Economic Council now has a constitutional mandate to promote equity among the provinces. It can use this mandate to prefer imports that benefit all the provinces over trade that benefits only provinces with agricultural lands, coastlines, or rich mineral deposits, even where the latter would create gains from trade.

▪ **Statutory Authority**

After the Constitution and treaties, the most important laws in Pakistan are its statutes. These are Acts passed by the elected parliament. Several statutes create prohibitions, inspection regimes, or other procedures that may inhibit trade with foreign countries. Seven of these are discussed below, viz:

- The Imports and Exports (Control) Act;
- The Customs Act;
- The Pakistan Animal Quarantine Act;
- The Pakistan Plant Quarantine Act;
- The Pakistan Standards and Quality Control Act;
- The Drugs Act;
- The Drug Regulatory Authority Act;
- And the Imports and Exports (Control) Act, 1950

▪ **The Imports and Exports (Control) Act**

The Ministry of Commerce is the organ of the Federal government that is responsible for trade regulation. It controls the Trade Development Authority of Pakistan and several other agencies. The Ministry derives its authority to regulate trade primarily from the Imports and Exports (Control) Act, 1950. Article 3 of the Imports and Exports (Control) Act entrusts the Central government with the authority to prohibit, restrict or otherwise control the import or export of any goods and regulate all practices and procedures involved in import and export. Applications for licenses, the grant, use, transfer, sale or cancellation of such licenses, the

determination of the form, manner and period of any associated appeals and the fees charged in respect of any such matters falls within the ambit of powers conferred by the same article. The Ministry of Commerce uses its statutory authority to regulate trade by passing Statutory Regulatory Orders, or SROs. We consider the key statutory regulatory orders under one head below.

- **The Customs Act, 1969**

The Customs Act⁴⁴ sets up potential NTBs against electronics, technology, and other knowledge intensive goods. In general, the Act empowers the Federal Board of Revenue (FBR) to collect duties and other tariffs on imports. However, in Chapter IV, the Act also bans both the import and export of items that may infringe on intellectual property rights. Thus, Section 15(c) of the Customs Act bans import and export of goods with a counterfeit trademark (within the meaning of the Pakistan Penal Code, 1860 (Act XLV of 1860), or a false trade description as defined in the Copyright Ordinance, 1962 (XXXIV of 1962), the Registered Layout-Designs of Integrated Circuits Ordinance, 2000 (XLIX of 2000), the Registered Designs Ordinance, 2000 (XLV of 2000), the Patents Ordinance, 2000 (LXI of 2000), and the Trade Marks Ordinance, 2001 (XIX of 2001). Similar provisions ban the import and export of goods that may infringe copyright, layout design, or patents. In theory, this measure should discourage piracy. However, the Act empowers customs officials to decide whether or not an item violates intellectual property. Customs officials may therefore restrict trade by interpreting intellectual property rights to block imports and aid exports. Section 15 explains that the appropriate customs officer shall adjudicate goods imported or

⁴⁴ Available online at <http://download1.fbr.gov.pk/Docs/201381118549633FinalCustomsAct1969.pdf>

exported in violation of Intellectual Property Rights, regardless of any other law in force at the time, under section 179.

Sections 179 to 192 explain the adjudication procedure under the Act. Adjudication is conducted by “Special Judges,” who must have previously worked as Sessions Judges, and is subject to appeal to a Special Appeals Court. Insofar as the special judges under the Customs Act can find intellectual property violation in imports, they can use section 15 to ban these imports. These are the two main statutes that are used to erect NTBs in Pakistan

- **The Pakistan Animal Quarantine Act, 1979**

The Animal Quarantine (Import and Export of Animal and Animal Products) Act of 1979⁴⁵ empowers the Federal government to prohibit, restrict or otherwise regulate the import or export of any animal, class of animals or animal products likely to introduce disease to other animals, animal products or man. Section 3 of the Act explains that the Act shall be applied as though it were part of the Customs Act, supra. So, in addition to the quarantine officer created by this act, customs officers will also have jurisdiction over animal imports. Quarantine officers are empowered by the act to set testing and certification requirements, destroy animal products that they find to be contaminated, and deport unsatisfactory imports at the exporter’s expense.

⁴⁵ See Animal Quarantine (Import and Export of Animal and Animal Products) Act of 1979, reproduced in SMALL AND MEDIUM ENTERPRISE DEVELOPMENT AUTHORITY, Pakistan (SMEDA), Regulatory Procedure for Export of Livestock and Livestock Products, Annexure at p.34. Available online at http://www.smeda.org/index.php?option=com_phocadownload&view=category&download=42:export-of-live-stockand-live-stock-products&id=18:export-import

- **The Pakistan Plant Quarantine Act, 1976**

The Plant Quarantine Act⁴⁶ instructs the Federal government to set quality controls on imports of goods that potentially infect plants and their products. Section 3(1) empowers the Federal Government to restrict or otherwise regulate the import of any article/class of articles, likely to cause infection to any crop/plant, or of any pest/class of pests. Pursuant to this Act, the Government enacted its Plant Protection Rules, 1967. These rules were passed before the Act, but were amended and retrospectively incorporated by the Plant Quarantine Act in 1976. Plant Protection Rules 14 to 28 restrict the import of 14 products into Pakistan from countries that have had instances of pest or disease infestation. The controlled items are potatoes, rubber, sugarcane, tobacco, citrus plants, coffee plants, bananas, coconuts, ground nuts, maize, teas, onions, garlic, shallots, soil, compost, and cotton. These items are not restricted entirely, but are only banned from countries where specific infestations have been recorded or suspected. The Department of Plant Protection has considerable discretion to decide whether an imported item under the Plant Quarantine Act is infested, and whether it should be destroyed, disinfected, or deported.

- **The Pakistan Standards and Quality Control Authority Act, 1996**

This Act established the Pakistan Standards and Quality Control Authority (PSQCA),⁴⁷ which is responsible for setting standards for both exports from and imports into Pakistan. Section 8 of the Act lists the powers of the PSQCA. These include the creation and implementation of tests, the granting and withdrawal of licenses,

⁴⁶ Available online at

<http://www.plantprotection.gov.pk/pdf%20stuff/Pq176.pdf>

⁴⁷ See Pakistan Standards and Quality Control Authority Act, 1996, available online at

<http://www.psqca.com.pk/about/PSQCA%20Act%20VI%201996%20WEB.htm>

the establishment of voluntary standards and mandatory standards, and registration of inspecting agencies, inter alia. The PSQCA has borrowed 15,000 standards from the International Standards Organization (ISO), adopted 6,000 standards from the International Electro-Technical Commission (IEC), and developed 5,764 standards through its Standards Development Centre (SDC) for a total of 27,764 standards.

The Ministry of Commerce has extended the application of PSQCA standards to all imports. Under its Strategic Trade Policy Framework 2012-2015, the Ministry has decided that all domestic standards formulated by Pakistan Standard Quality Control Authority (PSQCA) will be made part of Import Policy Order in order to ensure uniformity between standards of locally produced and imported goods such that they conform to notified domestic standards.

▪ **The Drugs Act, 1976 and the Drug Regulatory Authority Act, 2012**

Under section 4(2) of the Drugs Act⁴⁸, the Government may direct that a drug or class of drugs may not be imported or exported save for the issuance of a license or indent or registration in accordance with rules or through a Government agency, in addition to prohibiting the import or export of any drugs. The Drug Regulatory Authority (DRA) ceased to exist after the 18th Constitutional Amendment returned the provision of health services to the provinces. In the absence of the DRA, the Cabinet Division was to approve drug registration and licenses, but close to 14,000 drug registration cases remained pending in 2012. On October 15, 2012, the National Assembly approved the Drug Regulatory Authority Act, re-establishing the DRA. The Drug Regulatory Authority Act, 2012 creates the new Drug Regulatory Authority. In addition, it prohibits several items under its second schedule. These include

⁴⁸ Available online at

<http://www.pdma.org.pk/pdf/The%20Drugs%20Act,%201976.pdf>

any unregistered therapeutic drug not in conformity with the registration dossier and associated pharmaceutical evaluation or in contravention of any of the provisions of this Act or rules and any drug that is dangerous to health even when used according to prescribed usage. The restrictions in this Act have been incorporated into the Import Control Policy (infra).

▪ **Statutory Regulatory Orders (SROs)**

- SROs much abused vehicle for protective practices

After statutes come regulations, which are passed by the various ministries or departments under statutory authority. The most important regulations passed by a ministry are its statutory regulatory orders or SROs. The Federal government passes statutory regulatory orders in order to regulate the areas that a particular statute allows it to govern. Put differently, the statutory regulatory order is a means of implementing the policy and purpose of a given statute. Several SROs have been used to restrict imports over time. The most important ones are discussed below:

▪ **The Import Policy Order, 2013**

These orders are also SROs. The Import Policy Order is SRO 766(I) 2009 and the Export Policy Order is SRO 767 (I) 2009, but they have been replaced now by the Import Policy Order 2013, SRO 193 (I) 2013 and the Export Policy Order 2013, SRO 192 (I) 2013. We will consider the 2013 Import Policy Order in this section. Under section 21 of the Import Policy Order, 2013, “The Federal Government may, where it deems it to be in public interest, suspend for a specified period or ban the import of any goods from all or any source.”

Pakistan’s 2013 Import Policy Order bans the import of 44 categories of products, mostly on religious, environmental, security, and health grounds. Pakistan also bans the import of live animals i.e. cattle, buffalo, sheep and goats, meat and bone meal, tallow containing protein and feed ingredients from any BSE affected countries. Any dispute or clarifications regarding the

import status of any product, which cannot be resolved by the Customs Authorities, are referred to the Ministry of Commerce for the final decision.

Appendix A of the Import Policy order bans import of products that offend national or Islamic religious sensibilities, such as obscene materials, problematic translations, and controlled substances. It also bans hazardous materials such as Asbestos and Benzedrine.

Under sections 5(b)(i) and 11 of the Order, Appendix B sets health and safety inspection requirements on the import of animal, plant, vegetable, and fruit items. Health and safety inspections are regulated by the Ministry of National Food Security & Research⁴⁹ through its various departments. For example, import of live animals, animal semen and embryos is subject to the quarantine requirements of the Animal Quarantine Department and the Marine and Fishery Department.

- **The Pakistan Animal Quarantine Act, 1979**

The Animal Quarantine Act, supra. enables animal quarantine restrictions.

- **The Pakistan Plant Quarantine Act, 1979**

The Department of Plant Protection and the Federal Seed Certification Agency enforce plant quarantine regulations.

- **The Pakistan Standards and Quality Control Authority Act, 1996**

Manufactured goods are subject to testing by Pakistan Standards and Quality Control Authority as explained above. Chemicals are monitored by the Pakistan Environmental Protection Agency

⁴⁹ see website: Government of Pakistan, Ministry of National Food Security and Research, <http://www.mnfsr.gov.pk/>

(PEPA),⁵⁰ which operates under the Ministry of Climate Change and is empowered by The Pakistan Environment Protection Act, 1997. Article 13 of this Act states that, “No person shall import hazardous waste into Pakistan and its territorial waters, Exclusive economic Zone and historic waters.” The export policy order primarily affects exporters from Pakistan.

- **Other Pakistani laws and policies that affect trade**

Pakistan has made progress over the past decade in constructing a more open and transparent trade policy regime, eliminating significant quantitative restrictions on imports and eliminating a series of preferential regulations advantaging domestic concerns, however significant barriers to trade still persist that disadvantage foreign goods in the domestic market.

- **Government Procurement**

Political pressures on the allocation of procurement awards are common. These include corruption on the part of officials, unnecessary delays in decision-making and opacity of process. Several reports by suppliers have revealed that instead of giving awards to those with the lowest bid, awards have been used as bargaining chips in unrelated negotiations.

- **Intellectual Property Rights**

Pakistan remains on the Priority Watch List in the 2012 Special 301 report⁵¹. The report cites weak protection and enforcement of intellectual property rights, particularly with respect to copyrights, pharmaceutical data, and media piracy. 2012 saw the government taking some positive steps by way of improving intellectual

⁵⁰ See website: <http://www.environment.gov.pk/>

⁵¹ See United States Trade Representative, 2012 Special 301 Report, available online at www.ustr.gov/sites/default/files/2012%20Special%20301%20Report.pdf

property protections. The Intellectual Property Organization law of 2012 provides for special tribunals to adjudicate cases and a policy board with private sector representation to assess policy decisions. However, litigation on violations of intellectual property rights has left a lot to be desired, as few arrests have resulted in prosecutions. Furthermore, even when there were prosecutions, punishments accorded to the perpetrators were minor in nature, doing little to dispense the belief that the intellectual property regime is not implemented strictly. More worrying is the fact that Pakistan is used as a conduit for infringing products by smugglers from Russia and China. Continuing piracy in books discourages legitimate trade and investment. Misappropriation of pharmaceutical test data and other proprietary data is also a problem. There is ineffective regulation of marketing approvals for pharmaceuticals. This regulation is further undermined by an Ordinance issued in 2009, which effectively removes the 18-month time limit for the processing of patent applications.

○ **Other Barriers**

The domestic security situation, systemic corruption and an ineffective judicial system have historically made investment in Pakistan relatively unattractive. Laws dealing with corruption in Pakistan are: the 1947 Prevention of Corruption Act, the 1973 Efficiency and Discipline Rules, and the 1999 National Accountability Bureau (NAB) Ordinance. In 2002, Pakistan's Cabinet approved the National Anti-Corruption Strategy (NACS). This bill aims to combat certain corrupt practices and recognizes the NAB as the sole federal anticorruption agency.

Contract enforcement can be difficult for foreign investors in Pakistan. Parties pursuing legal remedies in the Pakistani judicial system may face years of delays and unpredictable outcomes in the country's overloaded courts. In July 2005, the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) was ratified by ordinance through Pakistan's Cabinet, however this ordinance expired in 2010 and in

2011 a law ratifying the New York Convention was enacted by the Parliament. The challenges faced by potential investors in Pakistan are similar to those faced in several other developing economies. These include regulatory risk and opacity when it comes to governmental departments and arbitration issues.

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The study titled “Trade Connectivity” by Economic Advisory Group analyses the contemporary trade dynamics of Pakistan, existential flaws in our policies, and the way forward for better prospects. This study contemplates that the growth of a country is linked to its ability to promote trade liberalization and reduce barriers to trade. It is imperative to expand connectivity and trade ties with regional blocs. It lays out a plan to overcome structural and policy weaknesses, and promote the integration of Pakistan into global value chains.

The Economic Advisory Group is an independent platform of individuals drawn from economics, policy and the private sector. The EAG deliberates on Pakistan's economic policies regularly and shares its views with the public and government. It was formed in January 2021, under the auspices of PRIME Institute, an independent think tank, which serves as its secretariat.

