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## Article

# China-Pakistan economic relations: Lessons for Pakistan

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## **China-Pakistan Economic Relations: Lessons for Pakistan**

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### **Abstract**

The 60<sup>th</sup> anniversary of China-Pakistan relations was celebrated in 2011. Pakistan was the third non-communist and the first Muslim country to recognize China in 1950. The diplomatic relations between China and Pakistan were established in May 1951. The friendship between China and Pakistan is all weather and everlasting. The relationship is deeper than the oceans and higher than the mountains. The bolstering relations of China and Pakistan have become a model for a friendly co-existence of developing neighboring countries. China and Pakistan are enjoying strong bilateral cultural, economic and military relationships. Both of the countries are striving together for promoting peace, stability and economic prosperity in Asia. In the past, China-Pakistan ties were mainly of military and strategic importance. But now the economic relations of China-Pakistan are strengthening specially after the conclusion of Free Trade Agreement (FTA) in 2007. In this paper we would focus upon the economic relations of China and Pakistan. We also used the granger causality test to understand the relationship between Chinese Inward FDI and Economic Growth. We took the annual data from 1980 to 2012. We found that growth in China caused inward FDI. Furthermore, it has been discussed that what Pakistan can learn from the miraculous economic progress and prosperity of China?

**Keywords:** Chinese economy; Flying Geese model; foreign direct investment; free trade agreement; Pakistan's economy.

## 1. Introduction

The Islamic Republic of Pakistan came into being on 14<sup>th</sup> of August, 1947 and the People's Republic of China on 1<sup>st</sup> of October; 1949. Pakistan recognized China in 1950. Pakistan was the third non-communist and the first Muslim country to recognize China. Pakistan was also among those countries that opposed the United Nations resolution recognizing China as an aggressor in the Korean War. The diplomatic relations between China and Pakistan were established in May 1951. In 1961, the relations were further strengthened when Pakistan voted for a bill concerning the restoration of China's legitimate rights in the UN.

In 1963, China-Pakistan signed the agreement for settling the border issues and for the construction linking China's Xinjian-Uygur autonomous region with the northern areas of Pakistan. Chinese diplomatic assistance during the Indo-Pakistan War of 1965, further solidified the China-Pakistan relationships (Kumar, 2006). Afterwards the state visits by different leaders of both sides kept on cementing the mutual ties. Particularly, in 1996, a state visit by Chinese President Jiang Zemin to Pakistan helped in establishing a comprehensive friendship. In 2005, China and Pakistan signed a landmark Treaty of Friendship and Co-operation (Aneja, 2006).

Close China-Pakistan ties have been mainly of military and strategic importance. Pakistan always stands up to India against his hegemonies over the region, thus fulfilling the key objective of China's South Asia policy. As long as Pakistan and India are preoccupied with one another China would be at peace on the Tibetan borders (Malik, 2001). China wants to focus more and more upon economic progress and prosperity by avoiding the confrontations with India. Atul Kumar also expressed same kind of views. A strong Pakistan is in the interest of China as it ensures that Indian dreams of regional lordship will not go unchallenged (Kumar, 2006).

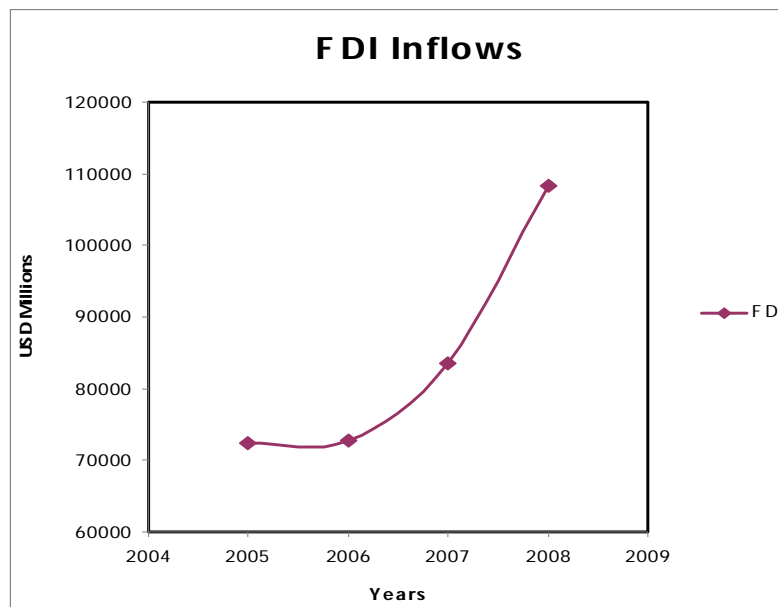
China-Pakistan political relations are extremely deep but economic relations are shallow. China-Pakistan "all-weather" friendship requires the strengthening of the bilateral economic relationship. In this regard China-Pakistan Free Trade Agreement is supposed to be a stepping stone in augmenting the economic relations between China and Pakistan. China-Pakistan Free Trade Agreement was signed on 24 November 2006 and entered into force on 1 July 2007. The Agreement comprised of phased and gradual program of elimination of tariff on substantially all bilateral trade. Through bilateral efforts, the bilateral trade of goods between China and Pakistan is expected to reach 15 Billion US Dollars in 2011. Pakistan's trade deficit with China is expanding. Pakistan's economy is seriously struggling at the moment. In this paper we would also discuss that what Pakistan can learn from the economic development of China since 1978.

## 2. Economic Indicators of China and the Policy of Opening up (1978)

After more than three decades of opening up China has achieved remarkable economic growth. From 1980-2005, the annual GDP growth rate of China averaged 9.4%. World Bank projected Chinese GDP growth of 8.5 percent for 2011. In 2009 The Exports of China were \$1.204 trillion. The exports commodities of China are electrical and other machinery, including data processing equipment, apparel, textiles, iron and steel, optical and medical equipment. In 2009 the Imports of China were \$954.3 billion. The Imports commodities of China are electrical and other machinery, oil and mineral fuels, optical and medical equipment, metal ores, plastics, organic chemicals. The Labor force of China

is 813.5 million (2009 Estimated). The Labor force by occupation for agriculture is 39.5%, industry: 27.2% and services: 33.2% (2008 Estimated).

China is the largest and third largest country in the world in terms of population and area respectively. Its population is 1.3 billion and its area is 9.6 million square kilometers. In 1978, the Chinese government decided to move away from Soviet-style economic policies and to gradually reform the economy towards free market principles. As the architect of Chinese economic reforms Deng Xiaoping said “It doesn’t matter if the cat is black or white as long as it catches mice”. In 2008, foreign direct investment (FDI) in China totaled \$108312 million, making it the hottest destination for FDI. China opened its borders for foreign firms in 1979 with the creation of Special Economic Zones in Guangdong and Fujian Provinces with an objective to attain high-tech technology from the advanced countries for improving the domestic capabilities. SEZs offered tremendous advantages to foreign investors, including export and import duties exemptions for equipment and instruments (Chen, 1997b).



**Figure 1 Graphical Representation of Chinese FDI (2005 to 2008)**

**Source:** UNCTAD FDI/TNC Database ([www.unctad.org](http://www.unctad.org) FDI statistics)

Chinese FDI is ever increasing and mushrooming at tremendous pace. It is obvious from graph that FDI inflow in 2005 was 74406 million and 108312 in 2008. The reasons of high FDI in China are mainly the availability of cheap labor and the domestic market of 1.3 billion people. Further the provision of excellent infrastructure by China is also a one of the reason of high FDI.

**Table 1 : Granger Causality Test**

Pair-wise Granger Causality Tests			
Sample: 1980-2012			
Lags: 2			
Null Hypothesis:	Obs	F-Statistic	Probability
INWARDFDI does not Granger Cause GROWTH	31	0.19629	0.82298
GROWTH does not Granger Cause INWARDFDI		4.56702	0.01996

It can be said that growth in China is caused due to inflow of FDI.

### 3. The Facts about Pakistani Economy

Pakistan is a sixth-largest population with an estimated population of 170 million. Despite a weak economic base at the time of independence; Pakistan's growth record is quite acceptable. On average the growth rate of GDP has exceeded 4 percent. In 2009, economy grew by a 4.1 percent. The agriculture contributes for 21 percent of GDP and is the second largest sector of Pakistan's economy. It also employs 45 percent of the country's total labor force. Manufacturing accounts for 18.5 percent of GDP and is the third largest sector of economy. Pakistan is 4<sup>th</sup> largest producer of cotton. In terms of foreign currency earnings and job creation, the textile and clothing industry has been the main driver of the economy.

It is important to note that Pakistan's industrial base at the time of independence was almost non-existent. The manufacturing sector contributed only 1.83 percent of GDP. Keeping this thing in context, it is praiseworthy that Pakistan has made major strides in the industrialization process since its creation. For the period July to April 2010, Pakistan received US\$ 1.8 billion as a FDI as compared to US\$ 3.2 billion in the same period of 2009. This represents a decline of 45 percent. The low FDI in Pakistan is attributed to two main factors. Firstly, poor law and order situation in the country especially in the form of terrorism events over last 10 years. Secondly, the lack of better infrastructure is also a hurdle in attracting the foreign investors. Comparatively China is the success example of FDI attraction because it provided better infrastructure and world's best law and order environment to the investors. In 2009, the exports and imports of Pakistan were US\$ 18.44 billion and US\$ 28.47 billion respectively.

#### 3.1 The Sixth Most Populous Country

Pakistan is the world's sixth most populous country. According to Economic Survey of Pakistan 2010, the estimated population of Pakistan is 169.9 million as at end June 2009. The annual population growth rate of Pakistan is 2.05 percent. It is expected that by 2050, Pakistan would become the fourth largest nation. With a median age of around 20 years, Pakistan is a young country. Approximately 104 million Pakistanis are below the age of 30 years. Total working age population is 121.01 million. The size of the employed labor force is estimated at 52.71 million as of 2008-09. About 36% of Pakistani population is residing in urban centers. Since 1950, it is stated that Pakistan's urban population has expanded over sevenfold.

**Table 2: Population Statistics of Pakistan and Neighboring Countries**

<b>Demographics/ Countries</b>	<b>Pakistan</b>	<b>China</b>	<b>Bangladesh</b>	<b>India</b>
Births per 1,000 population	25.1	12.2	23.8	21.3
Deaths per 1,000 population	7.1	6.9	9.1	7.5
Population million	177.2	1,300	158.1	1,100
Growth rate (percent)	1.51	0.49	1.27	1.38

Source: US Census Bureau International Database, 2010

*3.2 Agriculture Sector*

The agriculture is the second largest sector of Pakistan's economy. It contributes for 21 percent of GDP and absorbs 45 percent of the country's total labor force. Around 62 percent of the Pakistani population is residing in rural areas and relies upon agriculture either directly or indirectly for their livelihood. "Kharif" and the "Rabi" are the two main crop seasons of Pakistan. The sowing season of "Kharif" begins in April-June and harvesting during October-December. The sowing season of "Rabi" begins in October-December and harvesting during April-May. Rice, sugarcane, cotton, maize, jawar and bajra are "Kharif" crops. Wheat, gram, tobacco, barley and mustard are "Rabi" crops. The four major crops i.e. wheat, rice, cotton and sugarcane on average account for 33.1 percent to the value added in overall agriculture and 7.1 percent to GDP.

**Table 3: Production of Major Crops**

<b>Year</b>	<b>Cotton (000 bales)</b>	<b>Sugarcane (000 tons)</b>	<b>Rice (000 tons)</b>	<b>Maize (000 tons)</b>	<b>Wheat (000tons)</b>
2004-05	14265	47244	5025	2797	21612
2005-06	13019	44666	5547	3110	21277
2006-07	12856	54742	5438	3088	23295
2007-08	11655	63920	5563	3605	20959
2008-09	11819	50045	6952	3593	24033
2009-10 (Provisional)	12698	49373	6883	3487	23864

Source: Ministry of Food and Agriculture, Pakistan

### 3.3. Textile Industry

Pakistan is 4<sup>th</sup> largest producer of cotton and 3<sup>rd</sup> largest consumer of cotton. In terms of foreign currency earnings and job creation, the textile and clothing industry has been the main driver of the economy. There is no alternative industry or service sector. It will continue to be an important engine for economic growth of Pakistan. Due to shortfall in Chinese crop, the foreign demand for Pakistan's cotton yarn has risen exceptionally. It is important to mention here that China is the biggest consumer and producer of cotton in the world. China procured huge quantities of yarn from Pakistan, although China is the biggest competitor of Pakistan in the world market.

**Table 4: Textile and Clothing Exports (US \$ Millions)**

<b>Textile &amp; Clothing/Years</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
World Textile	195,541	202,657	220,367	240,364	250,198
World Clothing	260,569	276,802	309,142	345,830	361,888
Total	456,110	479,479	529,509	586,194	613,086
Pakistan Textile	6,125	7,087	7,469	7,371	7,186
Pakistan Clothing	3,026	3,604	3,907	3,806	3,906
Total	9,151	10,691	11,376	11,177	11,092
% Age of World Trade	2.01%	2.23%	2.15%	1.91%	1.81%

Source: Ministry of Textile, Pakistan

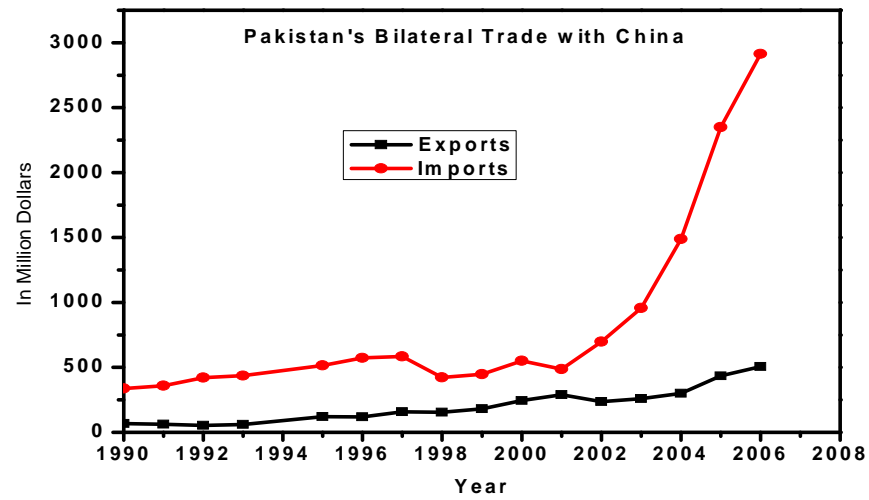


Figure 2 Pakistan's Bilateral Trade with China

Table 5: Pakistan's Bilateral Trade with China (1990 to 2006) US Million Dollars

Year	Exports	Imports
1990	66.91	336.68
1991	61.36	358.44
1992	54.12	420.78
1993	59.97	436.59
1995	121.16	515.26
1996	118.88	574.27
1997	158.20	584.80
1998	154.96	422.75
1999	180.72	446.76
2000	244.65	550.11
2001	289.38	487.02
2002	236.37	698.54
2003	259.64	957.33
2004	300.58	1,488.77
2005	435.68	2,349.39
2006	506.64	2,914.93

Source: Din, Ghani and Qadir (2009)



It is obvious from the above table and graph that from 1990 to 2006, the imports of Pakistan from China have always exceeded the Pakistan's exports to China. Pakistan always had trade deficit with China and with the passage of time this deficit is increasing. In 1990, the Pakistani exports were 66.91 US million dollars and the imports were 336.68 US million dollars. But in 2006 the exports were 506.64 million dollars and imports were 2914.93 million dollars. In 1990, the imports of Pakistan from China were 5.03 times of exports to China and in 2006; the imports of Pakistan are 5.75 times of exports to China. From 1990 to 2006, not for even a single year Pakistan had a trade surplus with China. In 1960s, the main exports of Pakistan to China were raw cotton, raw wool and jute but still today the Pakistan's export to China are based on narrow range of products i.e. raw cotton, cotton yarn, cotton, fabrics and synthetic textiles. There is a need that Pakistan should expand its range of exports to China.

#### **4. China-Pakistan Free Trade Agreement**

The real economic engagements between China and Pakistan started to begin in November, 2003 with the signing of bilateral Preferential Trade Agreement (PTA). Thereafter, a Joint Feasibility Study for a bilateral FTA was conducted and simultaneously an Agreement on an Early Harvest Program (EHP) of the FTA was also negotiated in 2005 as explained by Commerce Ministry of China and Pakistan. Meanwhile negotiations on a comprehensive bilateral Free Trade Agreement continued. In spite of all the difficulties, the negotiations were completed in five Rounds of discussions on 11<sup>th</sup> November, 2006 at Beijing.

The China-Pakistan Free Trade Agreement covers Trade in both i.e. Goods as well as Investment. Pakistan was the first country which had the component of Investment in the FTAs being initiated and implemented by China up to that time. The Agreement was notified to the WTO on 18 January 2008 under Article XXIV: 7(a) of GATT 1994. For both the countries tariff reductions or eliminations for the first phase are to be completed by 1 January 2012 i.e. within a period of five years. The Parties agreed to review and modify the tariff reduction modalities every five years.

The FTA between China and Pakistan would open new avenues and vistas for the investors of both the countries. The bilateral FTA will help the two countries to fully take advantage of each other's comparative advantages and tap the cooperation potentials up to the maximum. Pakistan will be welcoming Chinese Foreign Direct Investment in canning of fruits, vegetables, seafood and livestock products, electrical and non-electrical machinery, electronics, automobiles, textile and engineering. Pakistani firms also need to fully exploit the opportunities being presented by China's opening-up policy. Therefore, China and Pakistan should actively promote investment facilitation and explore new forms of investment cooperation.

#### **5. The Lessons from the Economic Development of China**

Chinese economic development is attributed to the adoption of Flying Geese Model. China attracted a large amount of FDI by switching over from import-substitution strategy to export-promotion policy. Culturally speaking in the Chinese society the symbol of flying geese "A" signifies an "order" based on leadership and collective action within a nation-state. Pakistan should also give importance to export promotion strategy over import substitution policy for augmenting the economic growth. Pakistan can become a fifth-tier of flying geese model. Due to the rising wage costs Japanese firms

shifted the labor-intensive stages of the production to Newly Industrialized Countries i.e. South Korea, Taiwan, Singapore and Hong Kong. After these NIEs the turn was of main ASEAN countries i.e. Philippines, Indonesia, Thailand and Malaysia. Now, the China and Vietnam are trying to catch up with the West as a part of a regional hierarchy. It is very important that Pakistan should follow the flying geese model. The embarking upon this model would ensure the export-led growth of Pakistani economy.

## **6. Conclusion**

The diplomatic relations between China and Pakistan were established in May 1951. Since then, China and Pakistan experienced very strong political and military relations. The China-Pakistan economic relations started to bolster after the conclusion of Free Trade Agreement in 2007. China-Pakistan Free Trade Agreement is appearing to be a stepping stone in augmenting the economic relations between China and Pakistan. In 1978, China switched over to export promotion policy from import-substitution strategy. China became the fourth-tier of the flying geese model and attracted a tremendous amount of FDI. Only in 2011, China received worth of US\$ 106 billion as FDI. Pakistan can become a fifth-tier in the hierarchical structure of the flying geese model by following the open-door policy just like that of China. Chinese model can serve Pakistan as an opening door for the export-led growth.

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