

The Potential Impact of Trade Liberalization on Poverty and Inequality in Pakistan: A CGE Approach

Topic: Income Distribution

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It is generally believed that increased regional trade could provide Pakistan with an opportunity for increased sustainable economic growth. External economic liberalization policies have been adopted by a large numbers of developing countries in the hope of increasing economic growth. Pakistan has also embraced trade liberalization since 1988 when the government of Pakistan implemented the maiden International Monetary Fund's (IMF) Structural Adjustment Program (SAP). In the year 1995, this action plan achieved a boost with the WTO and its associated agreements persuading Pakistan to take further steps to reduce import duties and eliminate various subsidies. Pakistan has signed a series of trade agreements with developing Asian countries- China and India as well as developed countries such as EU and USA. In this study, we evaluate the two most important FTA signed by Pakistan with Asian giant such as China and EU-27 in recent period.

China has always been an important trade partner for Pakistan even before the free trade agreement between the two countries was signed. The signing of a Free Trade Agreement (FTA) between Pakistan and China in 2007 presented Pakistan with an ideal opportunity to improve its overall trade performance while steering its trading relations towards China. There was a substantial increase in the share of Pakistan's imports from China after the FTA was employed. By the end of the fiscal year 2012, Chinese imports to Pakistan expanded to 15% of the Pakistan's global imports. That is a 172% increase during the first phase of FTA. The increase is mainly the result of increased imports of electric and electronic tools, machines, chemicals, fertilizers and manufacturing raw substance. It was observed that while the tariff concessions given to Pakistan appeared impressive, nearly all the tariff concessions had been matched or exceeded in China's negotiations with ASEAN countries. Hence in most cases, including in those products Pakistan holds a comparative advantage, China had awarded higher or equal reductions in tariffs to ASEAN countries. As a result the gains to Pakistan from the FTA are expected to be considerably less than first anticipated.

With this new backdrop, we evaluate the impact of the Pakistan-China FTA and Pakistan- EU GSP plus agreement and potential changes that could be incorporated into the agreement to improve the outcome for Pakistan.

In this research we incorporate more detailed information on labor and household groups for the Pakistan economy in the global GTAP framework, to allow for detailed analysis of the China and EU27 FTA at the household level. A newly developed MyGTAP program by Minor and Walmsley (2013) is used to modify the Pakistan data in the Global GTAP Data Base to include multiple households and labor types with the help of Social Accounting Matrix. Two types of datasets were applied in the model: the GTAP Data base 8.1 and the latest available Pakistan SAM 2007-08 (Darosh et al. 2012).

The economy wide results show that current Pakistan-China FTA will have an adverse effect on the Pakistan economy. At the household level, an increase in income inequality is observed. However, if Pakistan renegotiates the FTA with China to have equal tariff concession as it has offered to the ASEAN countries under the China-ASEAN FTA then there will be a significant increase in Pakistan economic growth as well as an overall decrease in income inequality in Pakistan. This re-negotiation offers a win-win situation for both parties.

The study results recommends Pakistan to renegotiate the Pak-China FTA in such a way that China

award equal tariff concession to Pakistan as it has offered to the ASEAN countries under the China-ASEAN FTA. The EU GSP plus status will cause a modest increase in economic growth. However, keeping in view the capping mechanism set by the European Parliament the scope for growth gets limited. Considering these limitations, the GSP Plus scheme can only be optimized if the Pakistan local industry is pushed to increase capacity and make products cheaper by lowering per unit costs while maintaining quality and keeping up with the changing demands. The empirical evidence in terms of household welfare and inequality from these two exercises supports the overall view that Pakistan can gradually liberalize their regional trade after a careful assessment.