CHINA PAKISTAN FREE TRADE AGREEMENT PHASE 2

A PRELIMINARY ANALYSIS

The Pakistan Business Council

FOSTERING ECONOMIC GROWTH

(A Company set up under Section 42 of the Companies Ordinance 1984)

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Consortium for Development Policy Research

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The Pakistan Business Council (PBC)
and
The Consortium for Development Policy Research (CDPR)

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Forward

This Study titled "China Pakistan Free Trade Agreement Phase II – A Preliminary Analysis" has been commissioned by the Pakistan Business Council (PBC) as part of its "Make-in-Pakistan" initiative.

Market access for Pakistani exporters especially in markets of FTA / PTA partner countries is an important component of the Make-in-Pakistan initiative. Phase I of the China Pakistan Free Trade Agreement (CPFTA) came into operation in 2007 and was widely criticized for failing to provide preferential access for Pakistani exports into the large Chinese markets.

Phase II of the CPFTA which had been under negotiation since 2012 was finally signed in early 2019. This Study aims to identify the likely wins for Pakistani exporters from the coming into operation of Phase II of the FTA.

The Pakistan Business Council (PBC) is a business policy advocacy platform, established in 2005 by 14 (now 82) of Pakistan's largest private-sector businesses and conglomerates, including multinationals. PBC businesses cover nearly all sectors of the formal economy. It is a professionally-run organization headed by a full-time chief executive officer.

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The PBC's Founding Objectives

- To provide for the formation and exchange of views on any question connected with the conduct of business in and from Pakistan.
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- To promote and facilitate the integration of businesses in Pakistan into the World economy and to encourage in the development and growth of Pakistani multinationals.
- To interact with governments in the economic development of Pakistan and to facilitate, foster and further the economic, social and human resource development of Pakistan.

More information about the PBC, its members and its workings can be found on our website: www.pbc.org.pk

Ehsan A. Malik
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Acronyms

ACFTA	ASEAN-China Free Trade Agreement
ASEAN	Association of Southeast Asian Nations
BoI	Board of Investment, Pakistan
CIF	Cost, Insurance, and Freight
CNCA	Certification and Accreditation Administration of the People's Republic of China
CPEC	China Pakistan Economic Corridor
CPFTA	China Pakistan Free Trade Agreement
CPFTA1	China Pakistan Free Trade Agreement Phase 1
CPFTA2	China Pakistan Free Trade Agreement Phase 2
DTRE	Duty Tax Remission for Exports
ECI	Economic Complexity Index
EDI	Electronic Data Interchange
EDS	Export Development Surcharge
FBR	Federal Board of Revenue, Pakistan
FOB	Free on Board
FMD	Foot and Mouth Disease
FTA	Free Trade Agreement
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GIFF	Growth Identification and Facilitation Framework
GSP	Generalized System of Preferences
HS	Harmonized System of tariff nomenclature
HVTP	Highest Value Trade Partner
ICT	Information and Communication Technology
ITC	International Trade Center
JV	Joint Venture
MFN	Most Favored Nation
MMF	Man-Made Fiber
MoC&I	Ministry of Commerce and Industries, Pakistan
MoU	Memorandum of Understanding
NTB	Non-Tariff Barriers
PBC	Pakistan Business Council
PRGMEA	Pakistan Readymade Garments Association
R&D	Research and Development
RMG	Ready-made Garments
SME	Small and Medium-sized Enterprises
SPS	Sanitary and Phyto-sanitary
SRO	Statutory Regulatory Order
TBT	Technical Barriers to Trade
TDAP	Trade Development Authority of Pakistan
TRM	Tariff Reduction Measure
USD	United States Dollar

List of Figures

List of Tables

Executive Summary

The second phase of the China Pakistan Free Trade Agreement (CPFTA) spanning 2019-2024 was recently finalized between the two countries. There is a wide perception that the terms of Phase 1 of the CPFTA (CPFTA1) over 2007-2012 disproportionately favoured China. In light of the growing trade deficit of Pakistan, renegotiating the free trade agreement (FTA) had been very high on the agenda of Government of Pakistan and local industry. The signing of the second phase of the FTA (henceforth CPFTA2), therefore, is a significant milestone for the economic and trade relations between the two countries.

Negotiated well, CPFTA2 should significantly improve Pakistani exporters' access to the USD 2 trillion Chinese import market and thus help address the country's ballooning trade deficit. To understand how CPFTA2 can help Pakistan's exporters meet that objective, Pakistan Business Council (PBC) has commissioned the Consortium for Development Policy Research (CDPR) to undertake a preliminary assessment of China's tariff provisions in CPFTA2.

The assessment starts with the construction of a comprehensive dataset of all 8238 tariff lines at the HS-8 digit level that China has included in CPFTA2, which merges three types of data for each tariff line: tariffs offered under CPFTA1 and Phase 2 (for year 0, year 5 and year 10), trade data on volumes for China and Pakistan, as well as growth rates for Pakistan, China and China's top trade partners, and thirdly, tariff data for all countries that export to China by product. This dataset is used to compare tariffs offered by China to Pakistani products under CPFTA2 with those offered under CPFTA1 to determine if market access in China has improved, as well as with the tariffs offered to other countries that export those products to China. These countries represent Pakistan's main competitors in China, and Pakistan's tariff access relative to these competitors is used to determine the opportunity canvas for Pakistan's exporters. The report also examines, albeit briefly, the non-tariff factors that impede access to the Chinese market, and the issue of misreporting of trade data between the two countries. While the tariff concessions offered by Pakistan to Chinese products are an important second aspect to the FTA, these are outside the scope of this report.

The top-level results indicate that the tariff structure offered to Pakistan under CPFTA2 is a marked improvement over CPFTA1. On over 80 per cent of the CPFTA2 product lines that China imports, Pakistan is now offered tariffs that are lower than or equivalent to China's main trade partner. Nearly 40 per cent of the CPFTA2 products that China imports have seen a lowering of tariffs under CPFTA2 as compared to CPFTA1, and 45 per cent of the tariff lines will now be offered duty free access into China. A disaggregated analysis for Pakistan's high priority products shows substantial opportunities to expand and diversify exports to China, though there remain a small but significant number of product lines for which Pakistan still does not face competitive access to China, including rice, durum wheat, paper and paper board articles, as well as medicaments of hormones.

In order to translate the improved tariff concessions into sustained exports, Pakistani exporters and the Government of Pakistan will now have to work on addressing non-tariff impediments to export. These relate largely to capacity issues amongst Pakistani businesses, and Pakistan's poor ease of doing business, both of which affect the ability to deliver orders of the scale required in China within the specified time. There is also a substantial information deficit

amongst Pakistani businesses on: market research and scoping in China, identifying reliable Chinese partners, and meeting regulatory requirements in China. Government capacity is also required to actively take stock of other countries' FTAs with China and to re-negotiate with China as required to ensure that Pakistan's access remains competitive. The ASEAN-China FTA that followed quick on the heels of CPFTA1 was a sobering reminder that preference margins can be eroded when competitor countries in China successfully negotiate relatively better tariffs.

Background

In 2007, China and Pakistan implemented the first phase of the China-Pakistan Free Trade Agreement, initiating a reduction in bilateral tariffs. In the period following CPFTA1, bilateral trade flourished, growing by 242 per cent between 2007 and 2018—nearly six times faster than the growth of Pakistan's trade with the rest of the world in the same period. In that sense, CPFTA1 achieved its objective of promoting bilateral trade ties.

However, while the growth in Pakistan's exports to China outpaced Pakistan's exports to the rest of the world, Pakistan's imports from China grew even more (Table 1). The result of this was that the trade deficit with China ballooned. It already represented a quarter of Pakistan's total trade deficit in 2007. By 2018, this had grown to 35 per cent. The CPFTA also received widespread criticism amongst business groups in Pakistan, who believed that Pakistan had negotiated poorly, both in terms of getting access for the products for which it was better placed to export to China, and also in terms of granting access to Chinese goods that were perceived to have inundated the Pakistani market, contributing to premature deindustrialization.

Table 1 Pakistan's trade following CPFTA1, 2007-2018, in USD bn

		2007	2018	Growth (%)
Trade with all countries		**50**	**84**	**66**
China	Exports	0.6	1.8	196
	Imports	4.2	14.5	249
	Trade balance	*(3.6)*	*(12.7)*	*258*
	Total trade	**4.8**	**16.4**	**242**
Rest of the world (excluding China)	Exports	17	20	16
	Imports	28	46	60
	Trade balance	*(11)*	*(26)*	*129*
	Total trade	**46**	**66**	**44**

Data source: ITC Trademap

To evaluate the CPFTA, it is important to contextualize it with Pakistan's trade performance in general. Pakistan's global export performance has declined over the last two decades, with global exports, expressed as a share of GDP, halving from 16.5 per cent in 2008 to 8.5 per cent in 2018. Reasons for this include low competitiveness and an export offering that is concentrated in lower value-added and non-unique products. Pakistan's exports are also undiversified, both in terms of product offering and in terms of destination countries. Apart from knitwear and woven ready-made garments, Pakistan has largely lost world market share over the last five years.

Exports to China, in contrast, have flourished after the FTA. While it is outside the scope of this report to undertake a comprehensive evaluation of the causal impact of CPFTA1 on exports, a brief review of Pakistan's exports to China is undertaken with a view of observing changes following the FTA. Pakistan's exports to China have grown much more than they have to the world, but this is largely a continuation of the trend prior to the FTA. To see this clearly, two counterfactuals are proposed to evaluate the impact of the CPFTA1 on Pakistan's exports. The first is to explore time trends before and after the FTA, to see if there are any discontinuities at or around the time that the FTA was implemented. Sharp changes are observed around 2007 for cotton and ores, slag and ash. The other top ten exports, while increasing, roughly continue the pre-FTA trend.

The second counterfactual is to adjust the growth rate of Pakistan's exports to China with the growth rates of Pakistan's exports to the world. This would rule out any Pakistan-specific or world-specific factors that might be influencing the time trend. Growth rates for the top ten exports to China are explored using this methodology, calculating a "margin of overperformance" for China i.e. the difference between growth in exports to China and growth in exports to the world. Cotton shows the strongest margin of overperformance after the FTA, growing sharply from pre-FTA levels. In general, if Pakistan's top ten exports to China at the point of implementation of CPFTA1 (2007) are considered, growth of exports to China outperformed growth to the world for eight of them even **before** the FTA (2004-2007). After the FTA too, exports to China continue to grow faster than they do to the rest of world for seven of these products. However, the margin of China's overperformance has declined after the FTA. This is consistent with the finding than Pakistan's competitors were offered greater concessions following CPFTA1.

Some products saw export growth to China underperform relative to the world after CPFTA1. These are (at the two-digit level) seafood, machinery and parts thereof, and organic chemicals. For these, there is likely to be a China specific issue (e.g. tariff or non-tariff barriers, or China's own superior competitiveness in these products) in exporting these products to China.

Another important aspect of bilateral trade between Pakistan and China is the misreporting of trade data between the two countries. Similar to other literature on this topic, we find large scale asymmetries in the values reported by the two countries at HS 8-digit level. However, such discrepancies are also found for other country pairs such as France-Spain, USA-Australia and China-Japan. These discrepancies are commonly ascribed to under- and over-invoicing, yet the scale of the discrepancies indicate that there are several other factors at play, including differences in converting between classification systems and currencies, and differences in data quality and reporting guidelines. While the products that suffer most from reporting asymmetries are identified, an important point of departure from other literature on the topic is that this is not completely ascribed to deliberate misreporting by importers and exporters.

The China-Pakistan Free Trade Agreement Phase 2[1]

With this backdrop, the report assesses the concessions offered by China to Pakistan under CPFTA2. The CPFTA2 provides details of tariffs levied by China on 8238 product lines at the HS 8-digit level. The most basic yardstick of the quality of concessions offered by China is how many of these tariff lines it actually imports from the world. In 2018, China did not import 1035 of the 8238 tariff lines included in CPFTA2 (at the HS 8-digit level). On the remaining (87 per cent) product codes, tariffs range from 0 to 65 per cent. China has given immediate duty-free access on 3707 lines (45 per cent of total tariff lines). A further 30 per cent of tariff lines will have duty-free access by 2030. Tariffs on 412 lines will be reduced by 20 per cent in five years, while tariffs will remain at base year (2013) rates for 1867 tariff lines (or 20 per cent of the tariff lines).

To make the analysis of tariff lines more useful and tractable, the lens of analysis will be Pakistan's exports to the world. This approach is distinct from the approach taken in earlier studies of CPFTA1 that have looked at the distribution of priority exports within the different tariff categories of the FTA. In contrast, our approach looks at the distribution of tariffs for CPFTA2 **within** the priority products. This is an important difference and impacts the interpretation of the results. For example, earlier literature notes that even though 7,550 products at 8-digit HS code were part of CPFTA1, Pakistan's exports to China were concentrated along only 350 product lines. It appears that Pakistan utilized a meagre 5 per cent of the lines on which concessions were available, while China exported along 57 per cent of the preference tariff lines under CPFTA1 (PBC, 2016). This is, however, somewhat misleading given that Pakistan only exported around 400 of those 7,550 tariff lines to China in 2006, the time when the details of the FTA were finalized. By that token, the utilization of the FTA, at the point of negotiation, could not possibly be higher than 5 per cent.

This analysis is therefore conducted separately for three main categories of products which are, in order of decreasing priority: Priority 1 products, which are defined as those products that Pakistan currently exports to China; Priority 2 products, which Pakistan exports and which China imports, but Pakistan does not export to China; and Priority 3 products, which China imports but Pakistan does not export. The tariffs offered to Pakistan under CPFTA2 are compared with i) those offered earlier under CPFTA1, and ii) those offered to Pakistan's competitors in China.

Priority 1 products

Priority 1 products are the highest priority for Pakistan with respect to negotiating access to China, as they have the highest potential for expansion of exports. These are Pakistani products for which there is an established market in China, and any non-tariff impediments have also been successfully circumvented. There are 401 products in this category in CPFTA2 at the 8-digit level, for which Pakistan exported USD 1.6 billion to China, against Chinese global imports of USD 148.4 billion. Pakistan exports USD 13.8 billion of these products to the world, which indicates that it has the export capacity to expand exports to China. It will be important,

[1] All tariff data pertaining to the CPFTA Phase II has been retrieved from the Ministry of Commerce website at http://www.commerce.gov.pk/protocol-on-phase-ii-china-pakistan-fta//. All trade data, unless otherwise mentioned, is retrieved from ITC TradeMap, accurate as of August 2019.

however, to focus on creating new exports, rather than diverting exports from existing markets to China.

By the final year of CPFTA2, 83 per cent of Priority 1 product lines will have duty-free access to China and 93 per cent of the product lines will face tariffs of less than 10 per cent. Relative to CPFTA1, 44 per cent of the product lines will now face a lower tariff under CPFTA2. In terms of the value of these product lines, almost USD 11.5 billion worth of exports now have duty-free access. The important exceptions are the rice categories, on which Pakistan continues to face tariffs of 65 per cent.

There have also been considerable improvements in access relative to competitors. For 87.5 per cent of the Priority 1 product lines, Pakistan will have better or equivalent access from the date of implementation of CPTFA 2. There remain 50 product lines (at the HS 8-digit) for which Pakistan faces higher tariffs than the top exporter to China, which will have gone down to 35 product lines by the end of year 10.

The largest opportunities, in terms of value of imports that will have better access to China, are in miscellaneous edible preparations, cotton, plastics, vehicle parts and footwear. Highest value products in which competitive access was not negotiated include paper and paperboard and rice.

Priority 2 products

Pakistan is well placed to take advantage of tariff concessions for Priority 2 products, in which Pakistan is already globally competitive, and in which China already has an established import market. These could help diversify Pakistan's export offering to China.

There are 1436 products in this category at the HS 8-digit level, in which Pakistan exported USD 2.5 bn to the world, while China imported USD 464.7 bn from the world. By the last year of the CPFTA2, 70 per cent of Priority 2 product lines will have duty-free access to China—an increase of 575 product lines relative to CPFTA1. Compared to CPFTA1, 47 per cent of the product lines face lower tariffs under CPFTA2.

Uncompetitive tariffs in the past could be an important factor that has precluded Pakistani exporters from the Chinese market where other countries have flourished. Comparing the access under CPFTA2 to that offered to China's other trade partners, we find that for 77 per cent of Priority 2 tariff lines, Pakistan faces better or equivalent access as compared to its top five competitors in China effective immediately. The largest opportunities in product lines that have better access under CPFTA2 (relative to CPFTA1 and relative to competitors) also represent a sizeable portion of Chinese imports, equivalent to USD 89.5 billion in 2018. The data shows that the tariffs faced by Pakistan are lower than those faced by its top 5 export competitors in China for 603 out of 1436 Priority 2 product lines. These include products from machinery and mechanical appliances (129 codes), plastics (39 codes) and articles of steel and iron (29 codes).

There are 391 codes for which Pakistan's access is worse than its top competitors in China, which includes important categories such as cotton yarn (15 codes), non-cotton and man-made fiber (MMF) men's and women's knitted and woven garments (56 codes), as well as machinery and mechanical appliances along with their parts (46 codes), vegetable and edible oils (13

codes), along with some items from processed food and edible fruit (19 codes). China's global imports in these products lines are USD 306.8 billion.

Priority 3 products

These products, that China imports but Pakistan does not export, could be potential new exports for Pakistan, providing opportunities to diversify and expand Pakistan's export offering to the world, starting with China. These products represent the highest opportunities for true trade creation, rather than diversion. For these products, more competitive tariff access is a necessary but insufficient condition. Further conditions for successfully tapping the Chinese market are that Pakistan must i) have latent competitive advantage in producing these goods, and ii) be able to resolve any non-tariff impediments that have precluded access so far.

This is the largest group of products, encompassing 5872 product lines at the HS 8-digit level. Of these, 80 per cent, or 4701 product lines will have duty-free access to China by the final year of the CPFTA2. 34 per cent of Priority 3 product lines face improved access under CPFTA2 relative to CPFTA1.

Relative to tariffs offered to the country that had the highest value of exports to China in 2018, Pakistan already faced lower tariffs in 60 per cent of these products— this has now increased to just over 70 per cent. However, 12 per cent of the product lines continue to face higher tariffs than those offered to China's highest value trade partner for that product. In order to shortlist opportunities for Pakistan, several filters are applied to Priority 3 products. The first filter is to shortlist those products which will face competitive access under CPFTA2—competitive access is defined as lower tariffs than CPFTA1 **and** lower tariffs than the average of the top five exporters to China for that category. This brings the shortlist down to 1836 product lines, or 40 per cent of Priority 3 products. The highest value product groups amongst these are machinery, mechanical appliances, electrical equipment and parts, optical and surgical equipment, plastics and essential oils.

A second filter is to identify latent competitive advantage by selecting those products that are currently produced by countries with capabilities that are not too different from Pakistan. Justin Lin's Growth Identification and Facilitation Framework (GIFF) is employed to select suitable comparator countries for Pakistan, using income per capita as a rough measure of capability. A third filter of minimum wage is applied to the benchmarked countries, narrowing down those countries with higher minimum wages than Pakistan, as an approximate indication of Pakistan's potential cost advantage.

One example of the results that emerge from this are the products that China currently imports from Bangladesh. For men's and boys' trousers and babies' garments, Pakistan faced tariffs of 7-8 per cent under CPFTA1, while Bangladesh had tariff-free access. Under CPFTA2, Pakistan will have tariff-free access for these products. All three product categories are also within Pakistan's traditional strength of garments. Men's or boys' trousers (HS 62034290) in particular has a large and growing market: China currently imports approximately USD 386 million in this category, growing at 3 per cent per annum. Bangladesh's exports to China in this category have been growing at 18 per cent per annum in the last five years. On that basis, this category looks like a promising segment for Pakistan to consider on the basis of market access and underlying comparative advantage. However, there are other impediments to trade that must be considered.

The report then explores non-tariff impediments to accessing the Chinese market, based on findings from a focus group discussion and one-to-one interviews with exporters, some of whom had attempted to export to China. The key impediments were agreed to be Pakistan-specific issues, rather than non-tariff barriers in China. The impediments reported include capacity issues pertaining to internal factors like factory infrastructure and skilled labor, and to external factors such as uncertainties and delays in import and export procedures that hamper the ability of firms in committing to faster delivery times. Another critical issue was the information gap regarding China at the firm-, association- and sector-level. This arises from the inability to scope, research and target markets, to identify suitable partners, and to find the relevant regulatory or tariff information for themselves and also for comparison with their competitors in China. Lack of price competitiveness, inadequate trade facilitation and an unfavorable business environment were also brought up as important impediments.

In conclusion, the CPFTA2 offers substantial improvements in Pakistan's tariff access to China. In order to capitalize on this opportunity, Pakistan will need to ensure that its exporters can compete with China's other trade partners for market share in China. For this, it will be important to address the non-tariff impediments identified in this report, first and foremost through the provision of market information for China and through support services in matching business partners between the two countries. At the same time, Pakistan's competitive market access in China must be widely publicized internationally to attract interest from big multinational firms to enter China through Pakistan.

This work of this report can continue to be extended by consolidating the experiences of exporters that try to export to China, as these reveal non-tariff impediments in real time, and help build capacity to address these impediments in Pakistan (such as meeting Chinese standards and SPS requirements) and in China (such as negotiating the removal of unnecessarily burdensome requirements, mutual recognition of standards, expedited data-sharing and so on).

The report ends by giving sector-specific suggestions for two priority sectors: ready-made garments and agro-processing. In an ideal world, the business environment should be improved for all products, and information and trade facilitation should be provided across the board. In the interim period, however, a realistic strategy would be to focus on specific products with high export potential that now have competitive access under CPFTA2, and to relieve constraints for and facilitate these product lines first. This report identifies not just the product lines that offer the greatest opportunities, but also, for a subset of these items, the actions required to translate the opportunities into actual exports.

In addition, the database that was generated for this report can be developed into a software that enables potential exporters to access the consolidated information for specific product lines. This includes not just the tariffs offered to Pakistan, but also an identification of the top exporting competitor country for each product line in China, the tariffs offered to this country, and the average tariff offered to the top five exporters to China. It also consolidates in one place both the value and growth rates of Chinese imports, which are helpful for sizing the market.

1 Introduction

Phase 2 of the China Pakistan Free Trade Agreement (2019-2024) is being described as a turning point in trade ties between Pakistan and China. The terms of Phase 1 of the agreement (2007-2012), henceforth referred to as CPFTA1, were widely believed by businesses to be disproportionately in favor of China, and therefore a renegotiated free trade agreement (FTA) was high on the agenda of local businesses, and given Pakistan's trade deficit, on the agenda of policymakers as well.

This report explores the new FTA from the perspective of Pakistan's access to the Chinese market, comparing tariffs offered to Pakistani products under Phase 2 of the Free Trade Agreement (henceforth referred to as CPFTA2) with those offered under CPFTA1. For each product line, it also compares the tariff schedule under CPFTA2 with the tariffs offered to countries that successfully export the product line to China. This comparison is made with i) the tariff offered to the country that exports the item the most to China, in value terms and ii) the average tariff offered to the top five countries that export the product to China. In doing so, the report evaluates the opportunity canvas offered under the CPFTA2 both for expanding current exports to China, and for diversifying Pakistan's export offering to China.

The impact of changes in Phase 2 would not be limited to industry but would also inform government policies that are currently in formulation stage (for example, the industrial, SME and textile policies) for the next five years. In this context, a preliminary analysis of Phase 2 of the CPFTA is required to broadly determine the contours of trade and industrial policy support that the federal and provincial governments can provide to maximize the potential gains for domestic industry from Phase 2. Given the severe balance-of-payments crisis the government is currently facing, plugging the trade deficit with China and boosting export earnings could provide much needed relief to the economy.

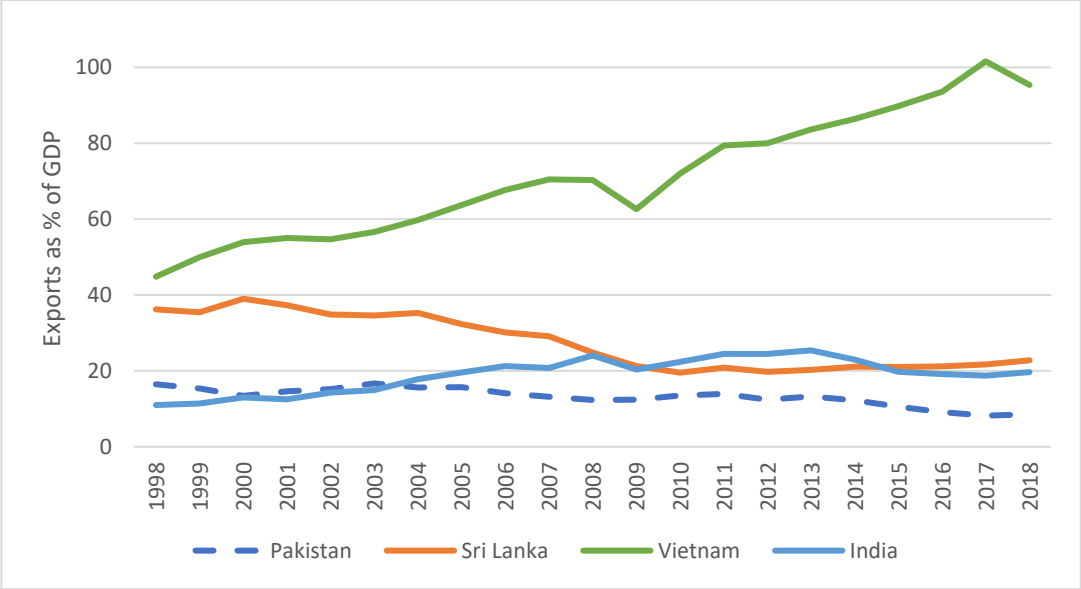
While the tariff concessions offered by Pakistan to China also have a strong impact on Pakistan's economy, they are outside the remit of this report, and so will not be discussed further.

2 Pakistan's trade performance

This section first explores Pakistan's trade performance in general, and then focuses specifically on its bilateral trade relationship with China.

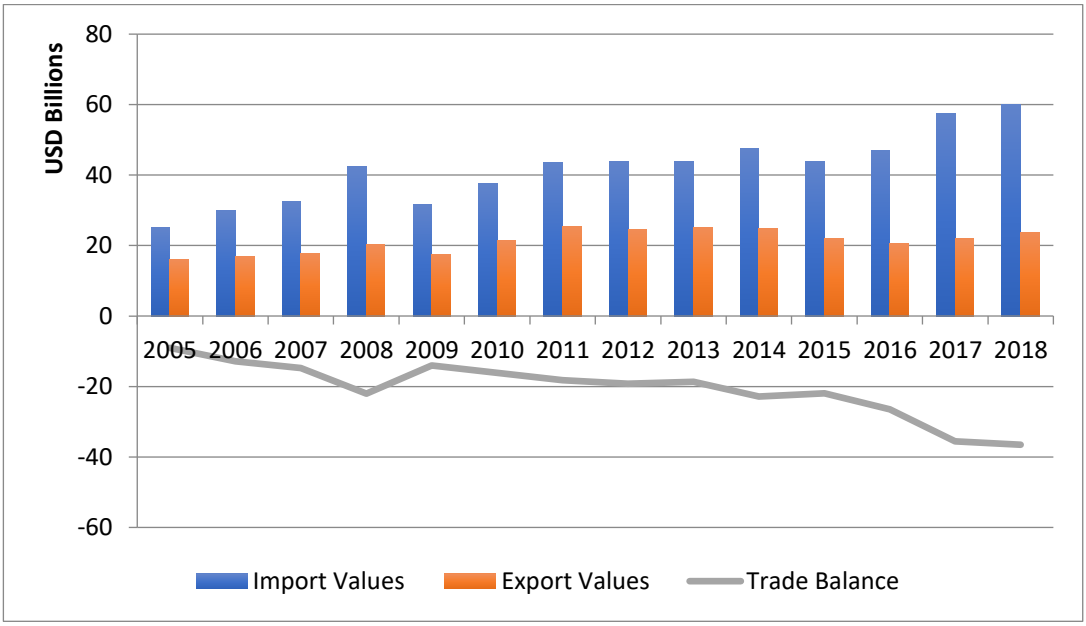
Pakistan's trade performance has declined steadily over the last decade. Its exports as a percentage of GDP have halved in the last 2 decades from 16.5 to 8.5 per cent. This decline is particularly problematic when compared to other countries in the region (Figure 1). Furthermore, as indicated in Figure 2, Pakistan's trade deficit has been increasing since 2005. While Pakistan's global exports have increased by 47 per cent in the last two decades, from USD 16 billion in 2005 to around USD 23.5 billion in 2018, imports have gone up by 140 per cent in the same period, from around USD 25 billion to 60 billion. Hence, the deficit in 2018 reached around USD 36.5 billion.

Figure 1 Exports of goods and services (% of GDP), 1998-2018



Source: World Development Indicators

Figure 2 Pakistan's Global Exports and Imports



Source: UN Comtrade

Pakistan's export growth has also not kept pace with global trends. While world exports almost doubled between 2005 to 2018, Pakistan's exports lagged, increasing only by two-thirds in the same period (Figure 3).

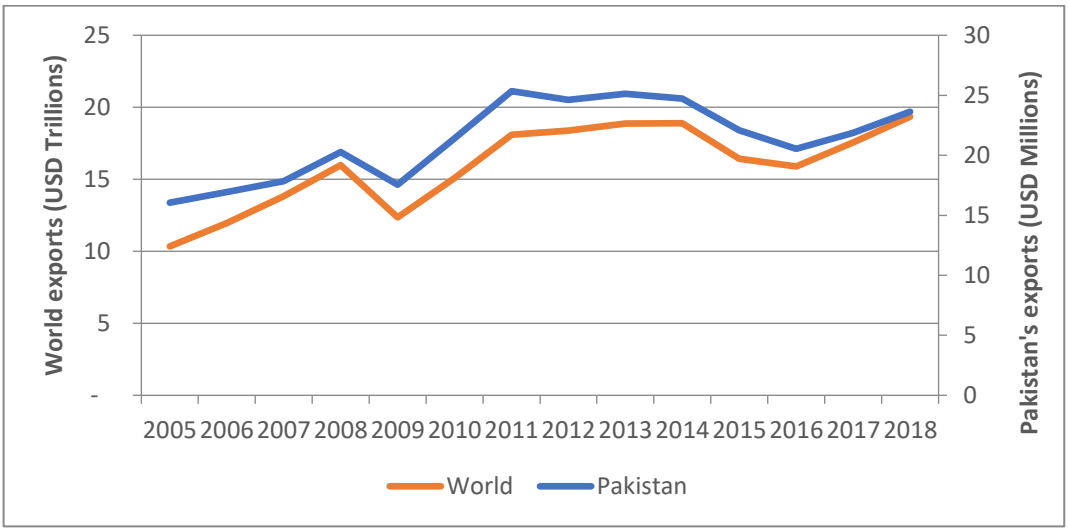
Pakistan's declining competitiveness has contributed to its trade performance. Pakistan currently ranks 107th out of 140 countries in the Global Competitiveness Index (GCI) 2018[2]

[2] The GCI calculated by the World Economic Forum, analyses competitiveness along 12 pillars: institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labor market efficiency, financial market development, technological readiness, market size, business sophistication and innovation.

(Figure 4), performing particularly poorly on the labor market (where it ranks 121st), product market (ranked 122nd) and ICT adoption (ranked 127th). Pakistan's ranking has improved consistently since 2013, but it remains in the lowest quartile of countries in terms of competitiveness.

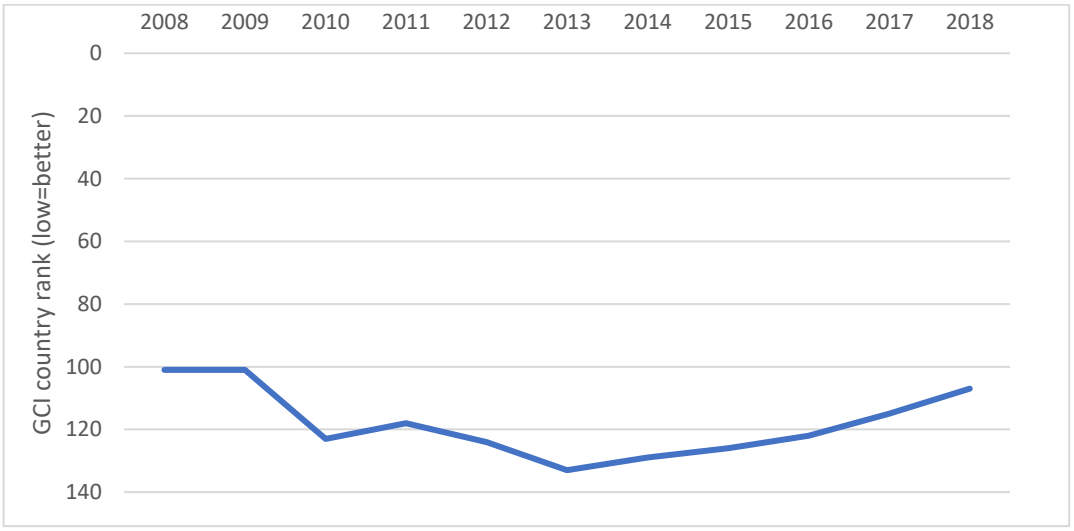
Another indicator of performance that reflects where Pakistan is lagging is the Economic Complexity Index (ECI).[3] According to the ECI, Pakistan ranks 94th in terms of the complexity of products it exports. In the last 10 years, Pakistan has fallen 2 positions, indicating that its exports have become relatively less complex in an increasingly complex world. This shows that Pakistan has been unable to diversify its exports, particularly in making products that add value and are unique. Its top products continue to be restricted to textiles and agriculture products, which are low complexity products (Atlas of Economic Complexity).

Figure 3 Pakistan vs. Global Trends



Source: ITC Trade Map

Figure 4 Pakistan's ranking on the Global Competitiveness Index, 2008-2018

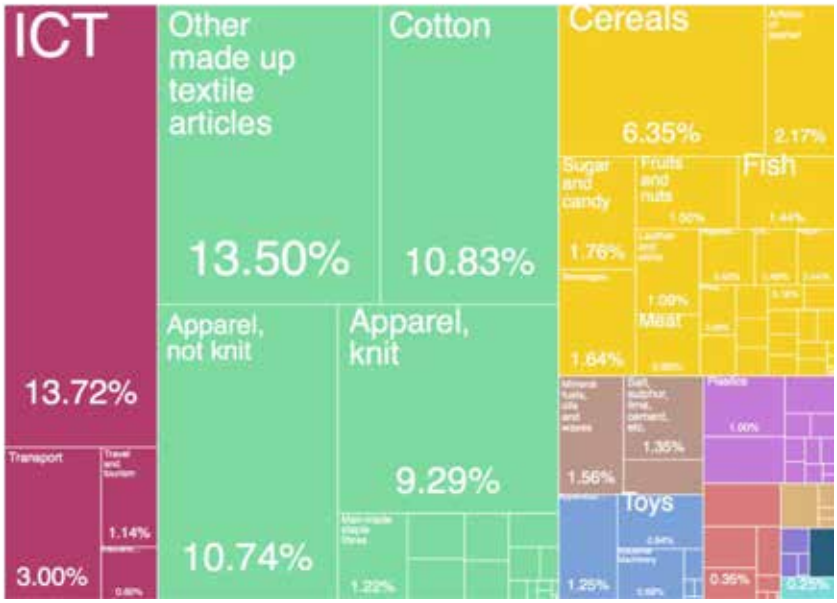


Source: World Economic Forum (2018). Global Competitiveness Index

[3] Ranking of countries based on how diversified and complex their export basket is.

Zooming into product categories allows for a deeper analysis of Pakistan's trade performance. Pakistan's exports are concentrated largely in textiles and clothing (Figure 5). While Pakistan has moved towards higher value addition through garments exports, other top products such as vegetables, food products, hides and skins, reflect low value addition.

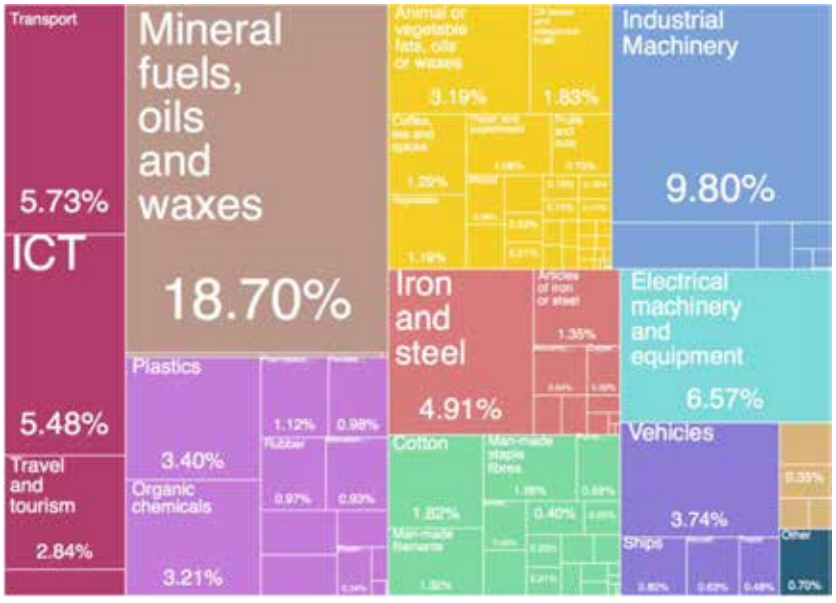
Figure 5 Pakistan's top world exports in 2017



Source: World Integrated Trade Solution (WITS)

In terms of imports, Pakistan's top categories are dominated by import inputs for manufacturing. Hence, 24 per cent of the imports comprise fuels and 20 per cent consist of mechanical and electrical machinery (Figure 6).

Figure 6 Pakistan's top world imports in 2017

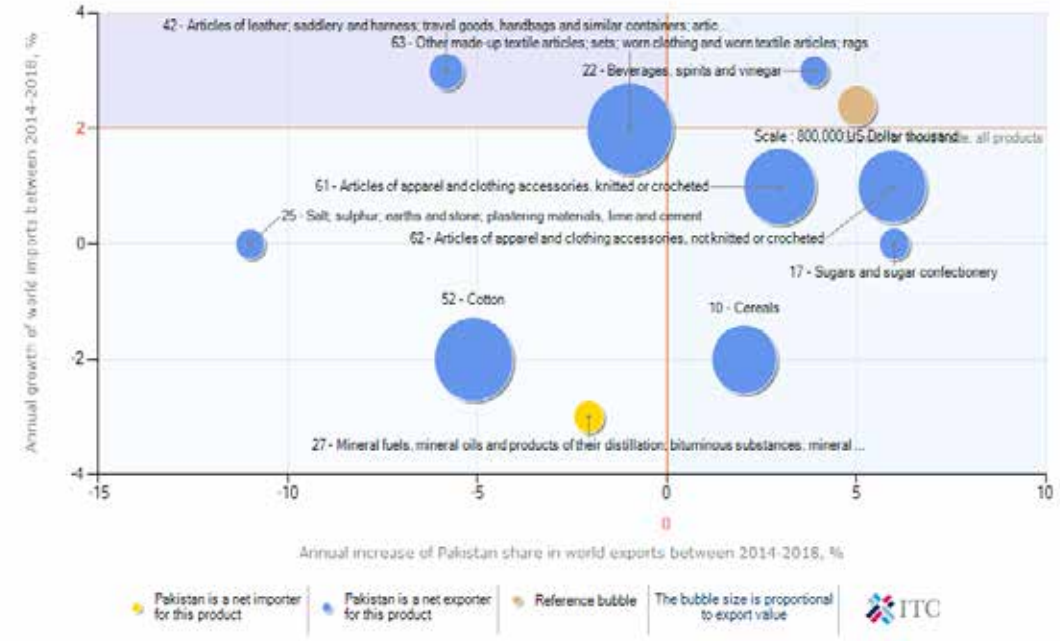


Source: World Integrated Trade Solution (WITS)

Figure 7 shows Pakistan's top ten export categories (at HS 2-digit level), comparing the growth in Pakistan's share of world exports to the growth in world imports. The size of the bubble

represents the volume of exports. Pakistan's share of world exports for its highest volume export (made-up textile articles) has shown a decline of 1 per cent over the last five years, compared to world import growth of 2 per cent. The second highest value export, cotton, also shows a similar trend: while global imports have declined at 2 per cent, Pakistan's share has declined much more, by 5.1 per cent. However, Pakistan's performance in ready-made garments contrasts with this. For both knitted and woven ready-made garments (HS 61 and HS 62 respectively), Pakistan has gained market share more rapidly than the growth in world imports.

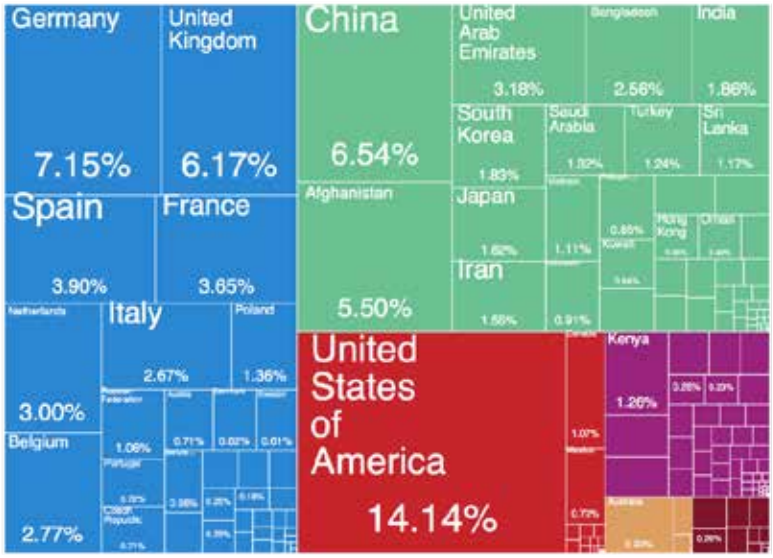
Figure 7 Growth of Pakistan's share of world exports vs. growth in world imports, 2018



Source: ITC Trade Map

Pakistan's export destinations are concentrated largely in Europe and the United States (Figure 8). Around 7 per cent of Pakistan's exports were destined for China in 2018.

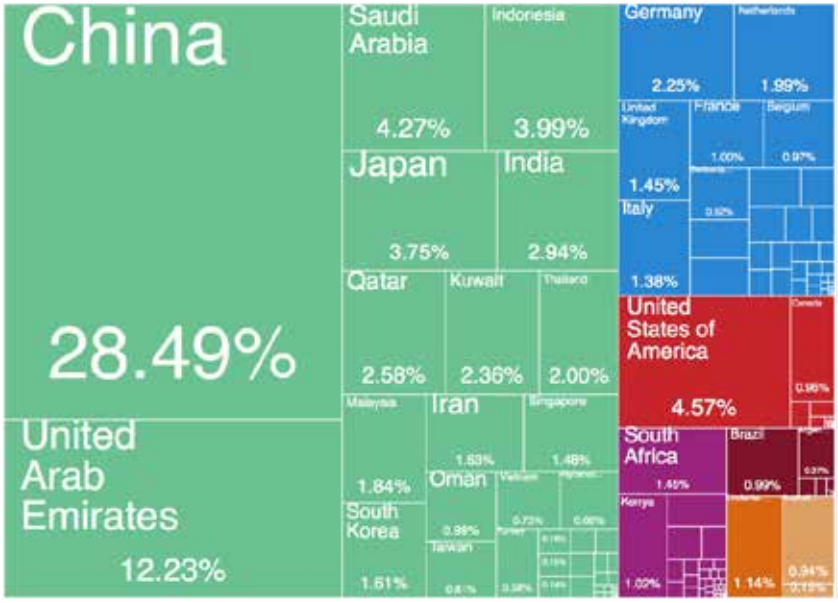
Figure 8 Pakistan's Top Export Destinations in 2018



Source: The Atlas of Economic Complexity

On the other hand, the top import partner is China with a share of 28.5 per cent of Pakistan's imports. China is followed by UAE and USA with a share of 12.23 and 4.57 per cent of its imports (Figure 9).

Figure 9 Top import partners in 2018



Source: The Atlas of Economic Complexity

Pakistan's global export performance has been on a declining trend over the last two decades, with global exports as a share of GDP halving from 16.5 in 1998 to 8.5 per cent in 2018. This

is largely due to an export offering of low value-added products (with little economic complexity) that are uncompetitive in world markets (as measured by the GCI), and destined for a small number of countries. Apart from knitwear and woven ready-made garments, Pakistan has largely lost world market share over the last five years, i.e. its exports to the world have grown slower than the world's demand for those products. Addressing the rising trade deficit (which was USD 36.5 billion in 2018) remains a key priority— given that China's share of this trade deficit is almost 35 per cent in 2018, the next section examines the dynamics of Pakistan-China trade and the impact of Phase 1 of the FTA with China.

3 Bilateral trade with China and China-Pakistan Free Trade Agreement Phase 1

3.1 Overview

The China-Pakistan FTA was signed in November 2006 to promote bilateral trade. Under the CPFTA, both countries agreed to phased elimination or reduction of MFN tariffs on 7550 tariff lines at the HS 8-digit level. The agreement was to be implemented in two five-year phases, with Phase I spanning 2007-12. Both parties agreed to tariff reduction modalities (TRMs) as part of Phase I as detailed in Table 2 below.[4]

Table 2 Summary of concessions offered in CPFTA1 (2007-12)

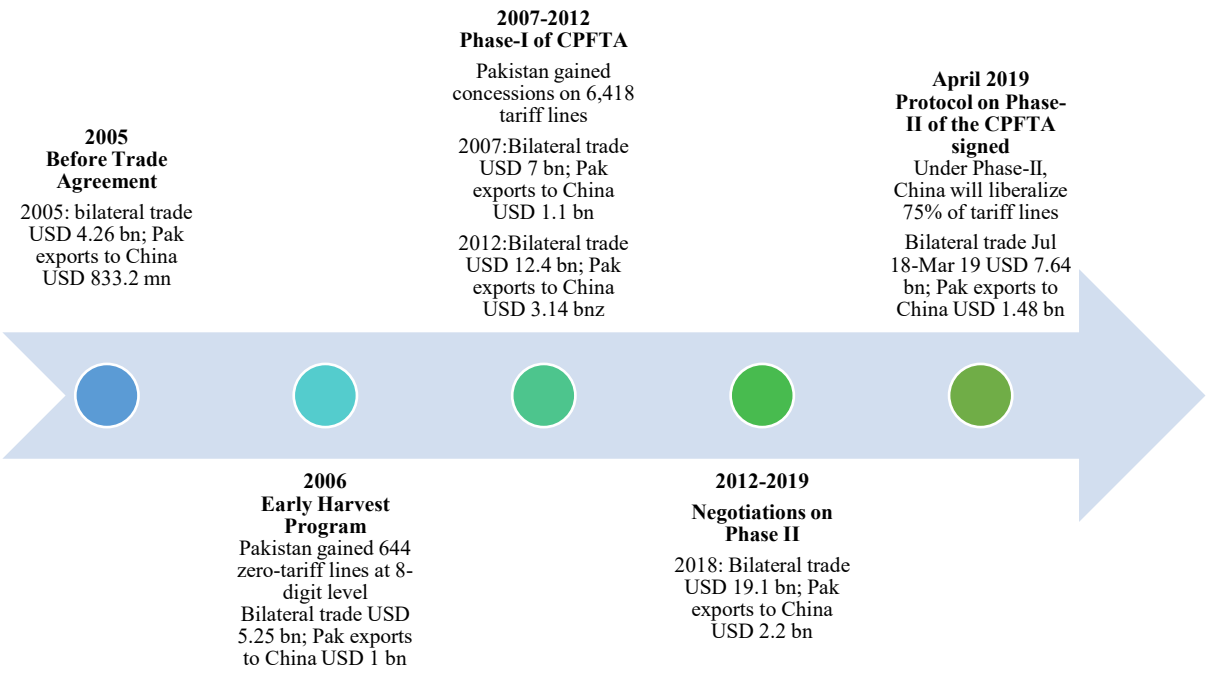
Category	**Tracks**	**Pakistan TRMs**		**China TRMs**	
		# of TLS	% of TLs	# of TLS	% of TLs
I	Elimination of tariffs (3 years)	2423	35.6	2681	35.5
II	0-5 per cent (5 years)	1338	19.9	2604	34.5
III	50 per cent of margin of preference	157	2	604	8
IV	20 per cent of margin of preference	1768	26.1	529	7
V	No concession	1025	15	1132	15
VI	Exclusion list	92	1.4	-	-
	Total lines (at the HS 8-digit level)	6803		7550	

Source: Ministry of Commerce (2019)

The figure below illustrates the timelines and summarizes the concessions granted in both phases of the FTA.

[4] PBC (2019). *Fifth review of the China-Pakistan Free Trade Agreement*.

Figure 10 Timeline of the CPFTA



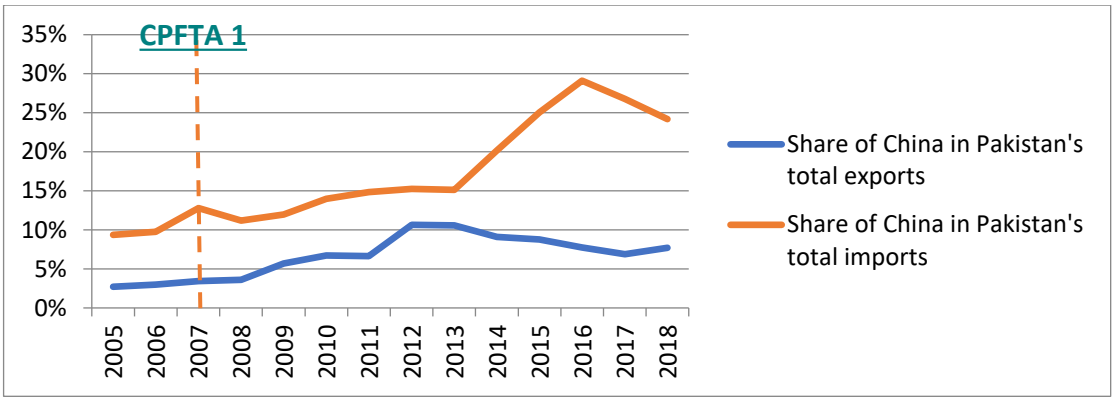
It has been suggested that the first phase of the FTA did not offer equitable access to both countries, and that a lot more could have been negotiated for Pakistan (PBC reports, 2013-19). In this section, Pakistan bilateral trade relationship with China is explored in order to ascertain the impact of the FTA both on the volume and the structure of Pakistan's exports to China. Top level trends in imports from China are also explored, but since the concessions offered to China are outside the remit of this report, imports will not be discussed in detail.

3.2 Structure and volume of bilateral trade

Total trade with China has increased rapidly since CPFTA, growing over three-fold to USD 16.4 billion in 2018.[5] However, while imports from China grew rapidly, Pakistan's exports could not secure similar gains in China. Over the last five years in particular (2014-18), exports to China have declined by 7 per cent per annum, while imports have risen at an annual rate of 12 per cent. China's share in Pakistan's exports and imports has risen steadily too, though China's share in Pakistan's imports has grown much more rapidly than its share in exports (Figure 11).

[5] Trade data used in this section is taken from ITC TradeMap unless otherwise stated. Retrieved June 2019.

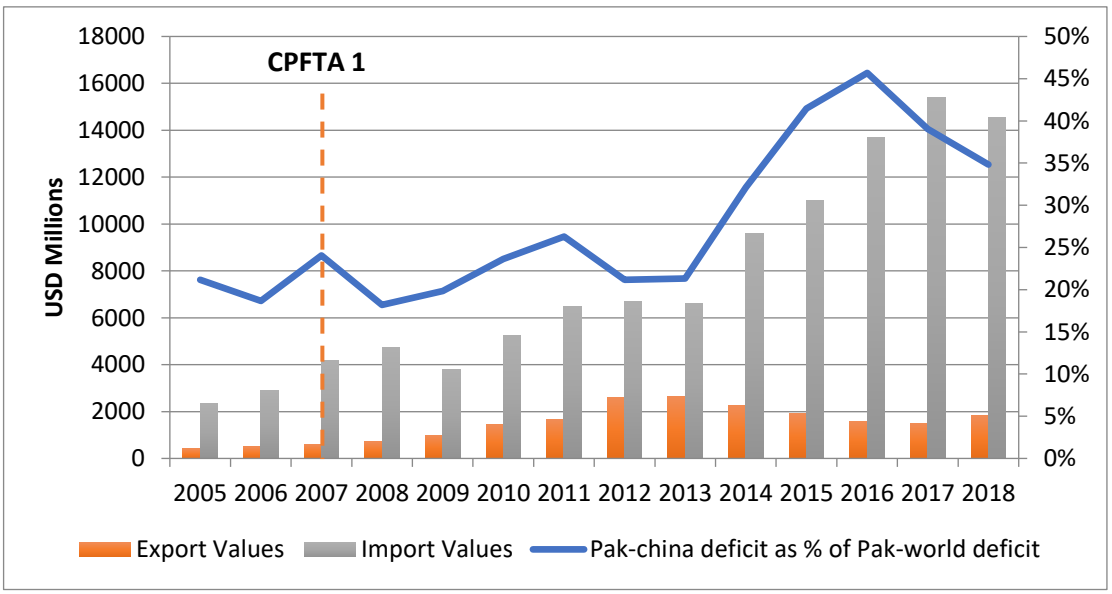
Figure 11 Share of China in Pakistan's global exports and imports



Source: UN Comtrade

As a consequence, Pakistan's trade deficit with China has widened to roughly USD 13 billion in 2018, representing around 38 per cent of Pakistan's overall trade deficit (Figure 12).

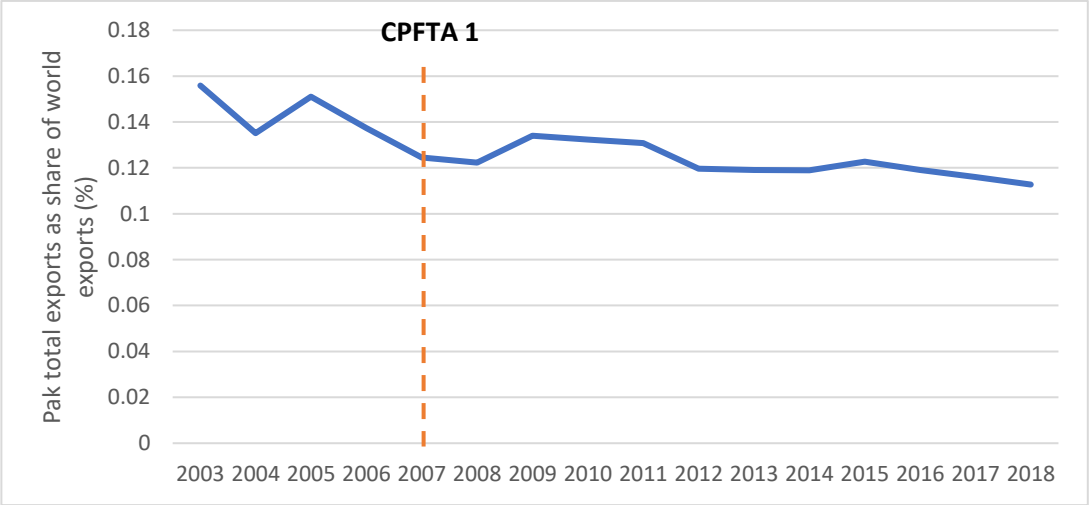
Figure 12 Pak-China trade flows and deficit



Source: UN Comtrade

The share of China in Pakistan's world trade deficit has risen by almost 45 per cent since 2007. This rising trade deficit with China would not be troubling if Pakistan's exports to the world were increasing at the same time—it could then be argued that cheaper imports from China were making Pakistan's exports more competitive in global markets. As Figure 13 shows, this is not the case. Pakistan's share in world exports has shown a declining trend, never fully recovering after 2003, when Pakistan's share in world exports was 0.16 per cent. Pakistan's trade deficit with the world excluding China has also increased steadily, from USD 11.2 billion in 2007 to USD 23.8 billion in 2018.

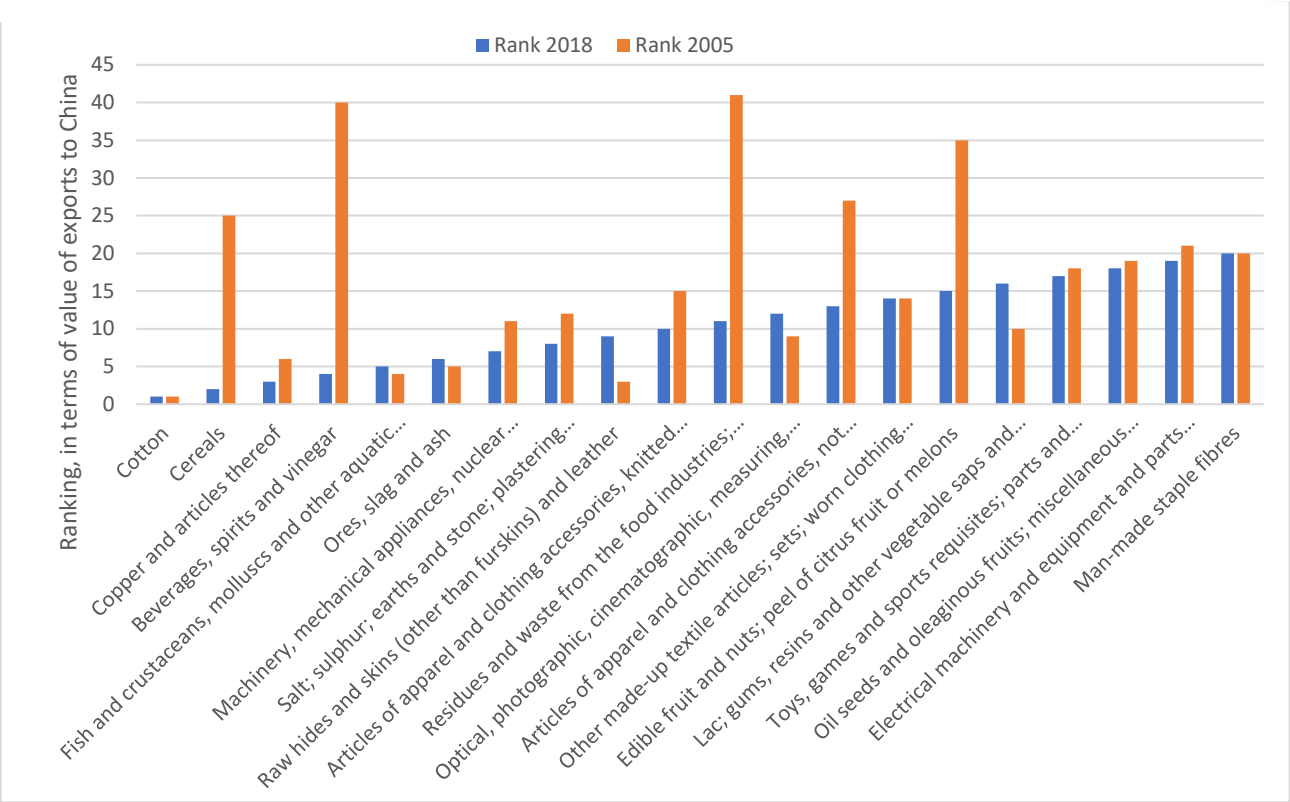
Figure 13 Share of Pakistan in global exports



Note: World exports exclude Pakistan's exports to China
Source: ITC TradeMap

Figure 14 shows the top twenty product categories exported to China in 2018 and compares the ranking of the products with 2005. Cotton remains the top exported category, and while cotton exports to China have grown from USD 271 million to USD 873 million between 2015-2018, the share of cotton in Pakistan's exports has declined from 62 per cent in 2005 to 48 per cent in 2018. It may be concluded that exports are more diversified post-CFTA Phase 1. Another indication of this is that the top 15 exports categories each represented more than 1 per cent of Pakistan's exports in 2018. In contrast, in 2005, only the top 5 product categories had a share of over 1 per cent in exports in 2015, i.e., exports were more heavily concentrated in 2005 than in 2018. Still, compared to a country like UAE, a smaller export destination, Pakistan has half the number of firms and variety of products that it exports to China (Ali, 2015).

Figure 14 Ranking of products exported by Pakistan to China in 2018 and 2005



Source: ITC Trade Map

In terms of the composition of Pakistan's exports to China, several export categories are growing rapidly. These include copper and copper articles, fish and crustaceans, machinery and ready-made garments. Interestingly, as evident from Table 3, there appears to be a movement away from the primary sector towards value-added exports in Pakistan's offering to China.

Table 3 Pakistan's top 20 exports to China, 2018

Product Code	Product Label	Value of Pakistan's exports to China (USD mn)	Annual growth in value of Pak exports to China between 2014-2018, %, p.a.
TOTAL	All products	1,818.07	-7
52	Cotton	872.85	-14
10	Cereals	161.30	-2
74	Copper and articles thereof	150.26	38
22	Beverages, spirits and vinegar	133.36	
03	Fish and crustaceans, molluscs and other aquatic invertebrates	91.21	14
26	Ores, slag and ash	66.89	-3
84	Machinery, mechanical appliances, nuclear reactors, boilers; parts thereof	45.97	49
25	Salt; sulphur; earths and stone; plastering materials, lime and cement	43.36	-6
41	Raw hides and skins (other than furskins) and leather	35.08	-10
61	Articles of apparel and clothing accessories, knitted or crocheted	30.51	33
23	Residues and waste from the food industries; prepared animal fodder	27.54	-8
90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical ...	25.32	46

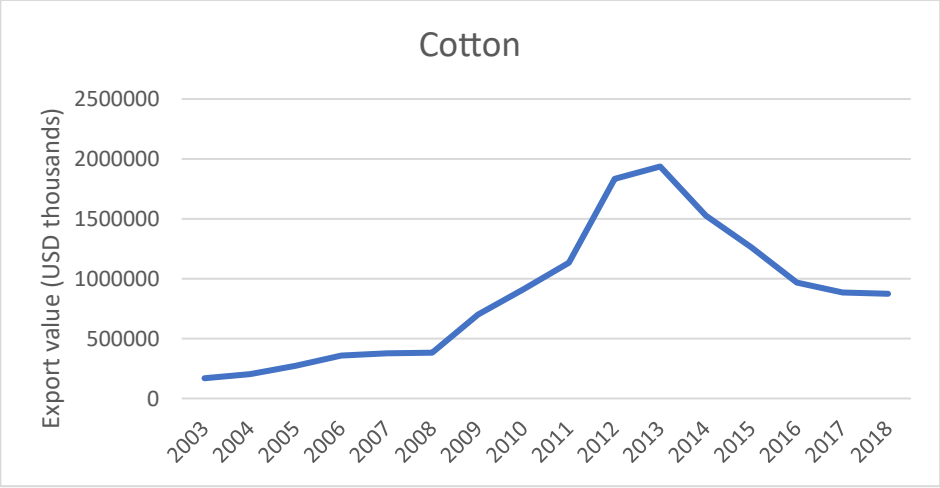
62	Articles of apparel and clothing accessories, not knitted or crocheted	21.23	12
63	Other made-up textile articles; sets; worn clothing and worn textile articles; rags	19.95	-11
08	Edible fruit and nuts; peel of citrus fruit or melons	11.22	-18
13	Lac; gums, resins and other vegetable saps and extracts	11.13	-12
95	Toys, games and sports requisites; parts and accessories thereof	5.53	12
12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal ...	5.28	-1
85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television ...	5.26	15
55	Man-made staple fibers	5.15	-13

Source: ITC Trade Maps

These changes have meant that there has been some reshuffling in the top twenty exports. There are a few new products in the top twenty list in 2018 that were not present in 2005. These include product lines from beverages (HS 22), food waste and animal fodder (HS 23), electrical machinery (HS 85), woven apparel (HS62) and edible fruit (HS 08). Some products that featured in the top twenty exports in 2005 are no longer there now. These include products lines from organic chemicals (HS 29), tools and cutlery (HS 82), plastics and plastic articles (HS 39), leather products (HS 42), articles of stone, plaster or similar materials (HS 68), and articles of iron and steel (HS 73).

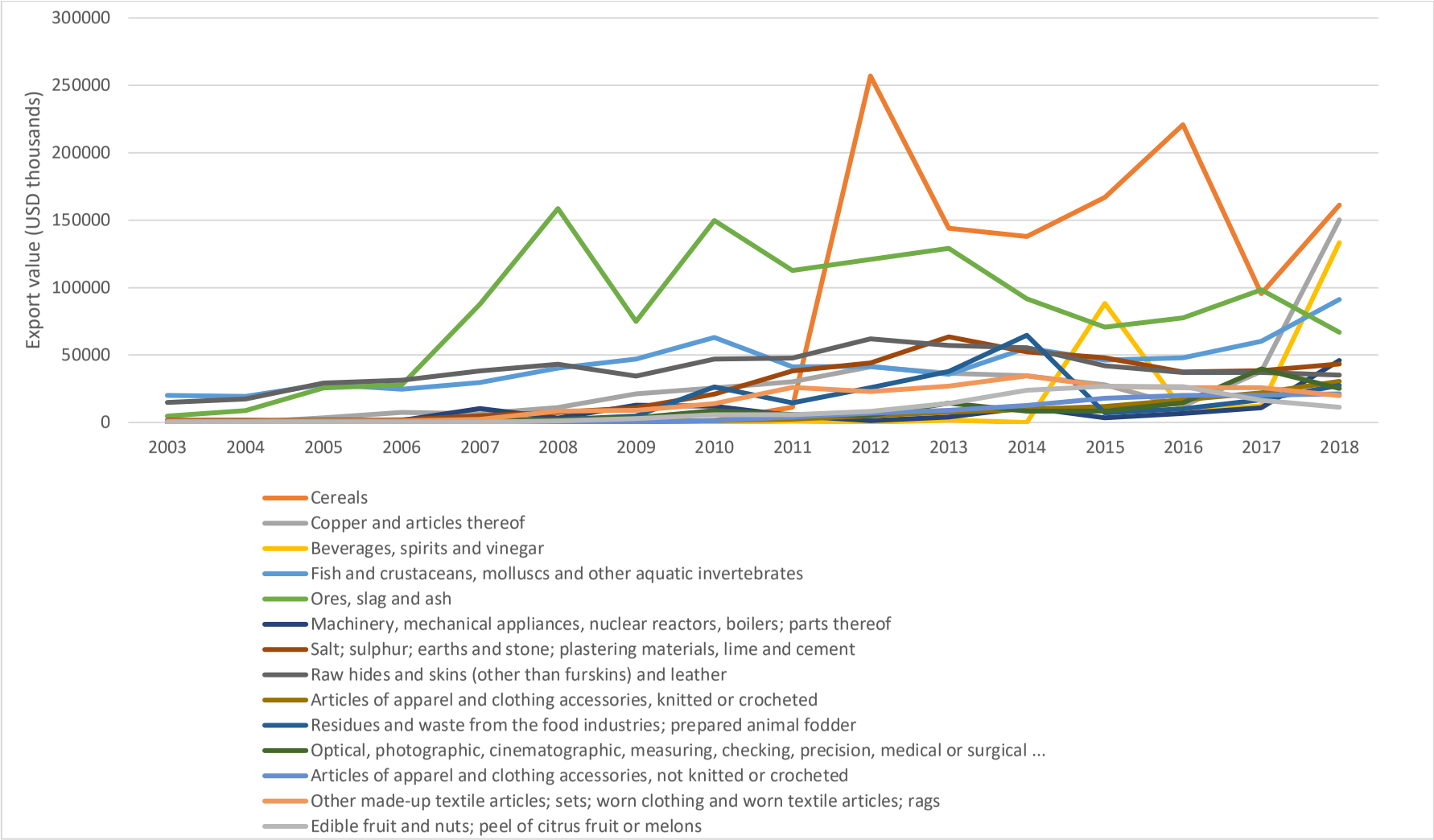
Trends pertaining to export volume and structure are shown in Figures 15 and 16. While cotton shows a sharp upward trend following the signing of the FTA, the remaining products appear to follow the pre-FTA trend, and if there are any sharp changes, they occur well after 2007, and so cannot be ascribed to the FTA.

Figure 15 Pakistan's top export to China: Cotton, 2003-2018



Source: ITC Trade Map

Figure 16 Pakistan's top 15 export products to China (excluding cotton), 2003-2018

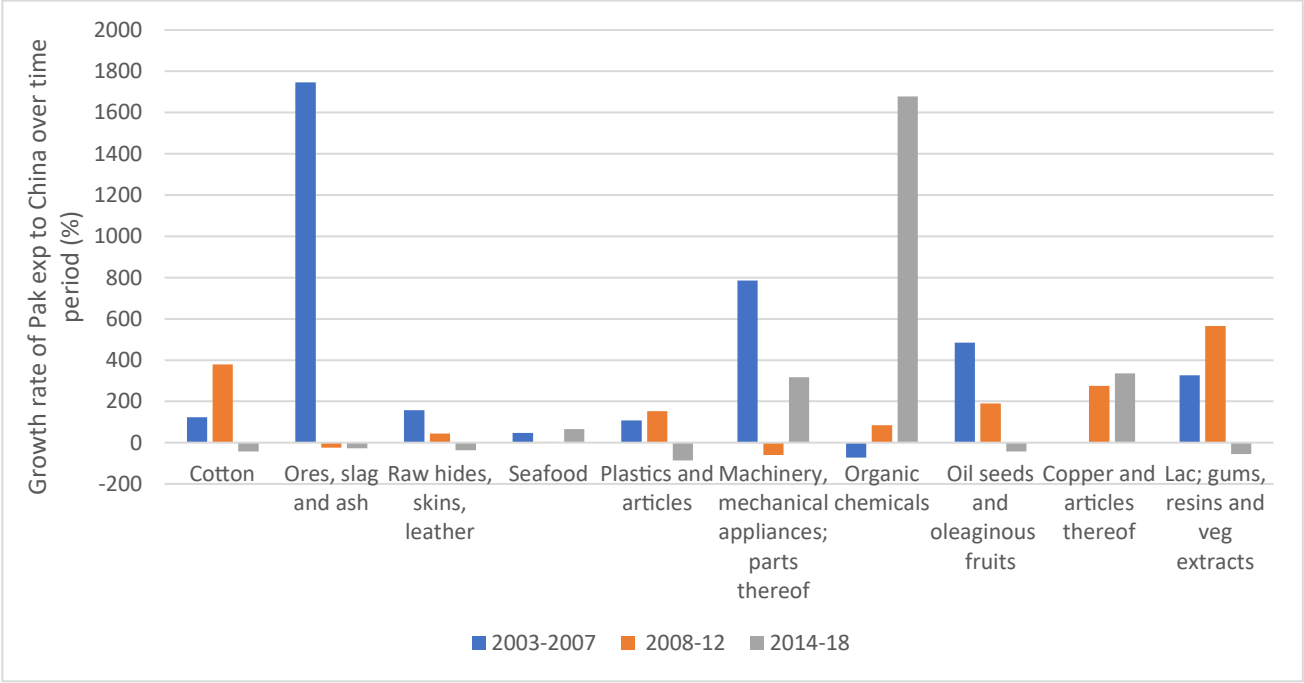


Source: ITC Trade Map

It is worth exploring Pakistan's export performance under CPFTA1 in more detail to draw important lessons for Phase 2. Figure 17 compares the growth rates of Pakistan's top exports to China prior to CPFTA1 (2003-2007) and after CPFTA1 (2008-12). For this exercise, the top 10 exported products to China were selected for 2007, the year Phase 1 came into force, as these items should have been at the top of Pakistan's priority list for negotiation.

Prior to Phase 1 (2003-2007), Pakistan's fastest growing exports to China were raw materials such as ores, slag and ash; raw hides and leather; machinery and mechanical appliances & their parts; oil seeds; and copper and articles thereof. Once CPFTA1 was signed in 2007, this changed—now Pakistan was sending more cotton, plastics, organic chemicals, and lac, gums and resins—but relatively less seafood, raw hides and leather, machinery and mechanical appliances.

Figure 17 Comparison of growth rates for Pakistan's top 10 exports to China in 2007, pre- and post CPFTA1



Note: The growth rate of copper & its articles is not shown for 2003-2007, as it is too high—around 80,000%
Source: ITC TradeMap

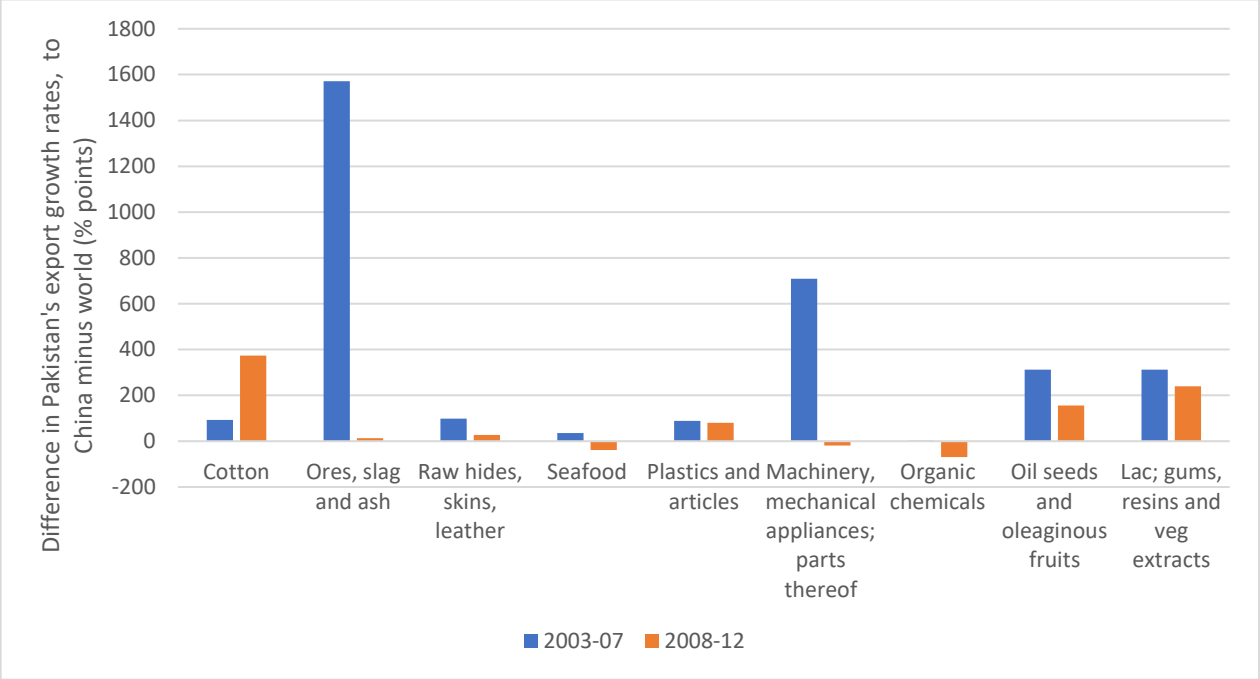
Figure 18 shows how the same products perform in the global markets. It presents the margin of overperformance of exports in China over the world for the top ten exported products to China both before and after the CPFTA1. This is calculated by subtracting the export growth of the product to the world from the export growth to China. There are several noteworthy features of this chart.

Firstly, it shows that the margin of overperformance is positive for eight of the top ten products in the period before the FTA i.e. growth in exports to China was higher than growth in exports to the world for these products. For ores, slag etc. and machinery and parts thereof, however, it was negative, i.e. exports to China grew slower than exports to the world.

Secondly, after the FTA the margin of overperformance grew sharply for cotton, raw hides, plastics and lac gums and resins. These products were therefore able to take advantage of the FTA. Cotton, in particular, shows the largest change.

Thirdly, the margin of overperformance shrunk from pre-FTA levels for copper and articles thereof, seafood, organic chemicals, ores, slag and ash, and machinery and parts thereof. Since tariff rates under CPFTA1 came down or remained equal to pre-FTA levels, a possible explanation for this is that Pakistan's competitors for these products were able to secure better access than Pakistan.

Figure 18 Difference between export growth for China and world, pre- and post-CPFTA1, top ten products at HS 2-digit level, 2008-18

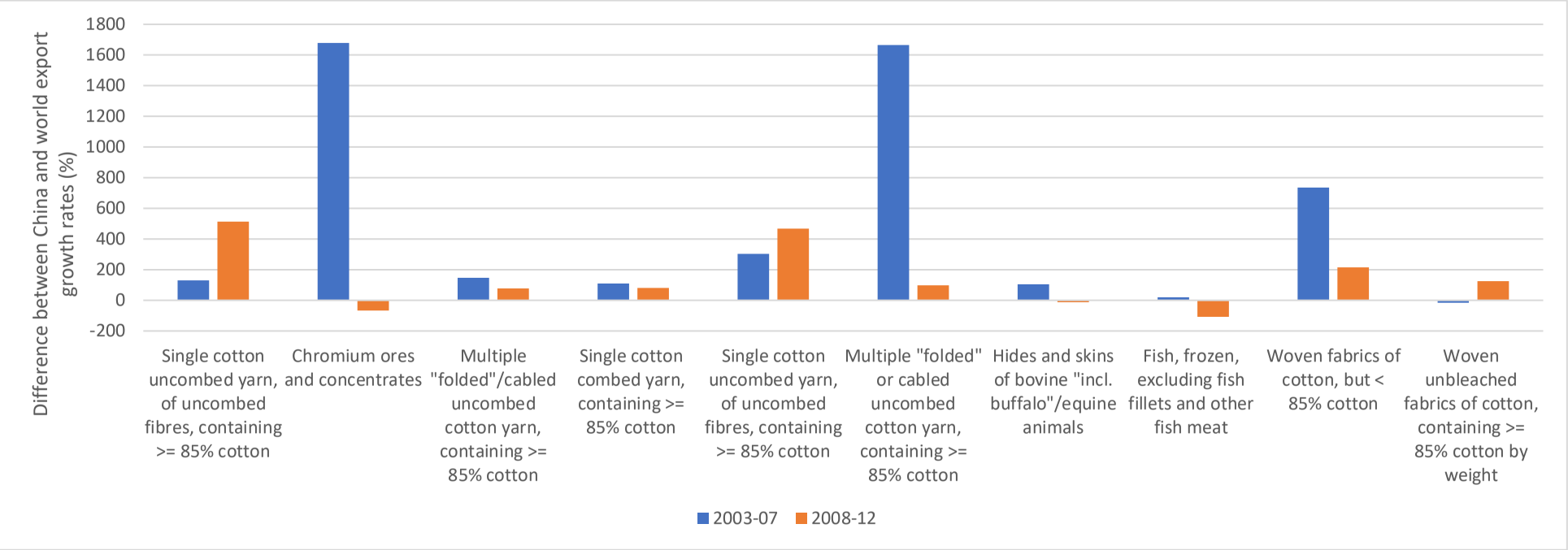


Note: World exports exclude Pakistan's exports to China. Copper and articles thereof are excluded because the it is an outlier: margin of performance was 80,000 per cent in 2003-2007, due to a surge in exports of copper from 2007 onwards. This has gone down in the period 2008-12 to -2 per cent
Source: ITC TradeMap

Taken together, these results suggest that for seafood, organic chemicals and machinery and parts thereof, there may be a China-specific problem as Pakistan's exports to China have not kept pace with Pakistan's exports to the world. For the remaining seven products, export growth to China is higher than to the world, indicating that these products were able to benefit from the FTA. For ores, slag and ash, machinery and parts thereof and oil seeds, even though exports to China overperform relative to the world, the margin between the two has declined, indicating the need to negotiate more competitive access relative to China's other trade partners.

These findings resonate in Figure 19, which repeats the analysis above for the top ten products at the HS 8-digit level, i.e. the margin of preference is largely positive, but has gone down for many products following the FTA.

Figure 19 Difference between export growth for China and world, pre- and post-CPFTA1, for Pakistan's top 10 exports of 2007 (HS 8-digit level)



Note: World exports exclude Pakistan's exports to China
Source: ITC TradeMap

The possible reasons for this are discussed below in section 3.3 and range from poor quality of concessions to erosion of preferences when China signed an FTA with some of Pakistan's main competitors in seafood, organic chemicals as well as machinery and parts thereof.

3.3 The weaknesses of CPFTA1: a literature review

Pakistan Business Council (PBC) has commissioned several reports (2013-2019) to assess the impact of CPFTA1, and to ascertain the main FTA related factors that contributed to the impact. Generally, these reports find that Pakistan has been unsuccessful in fully benefiting from the FTA. This section summarizes the main factors that the reports have ascribed for this, without in any way endorsing these findings.

Utilization and quality of concessions

The quality of concessions Pakistan has granted to China's exports were reported to be much better than those China has extended to Pakistan's exports (PBC, 2013). Preferential tariffs offered by Pakistan were reported to have been on a larger variety of goods that China actually exports. Resultantly, the utilization rate of preferential tariff lines by China is significantly higher at 57 per cent as compared to Pakistan's 5 per cent (PBC, 2016). This led to the domestic market being flooded by China's exports of finished products comprising clothing and shoes, medical and surgical items, and fans and rubber tires, thereby curtailing local production in Pakistan and preventing local producers from achieving economies of scale in the face of low profitability (PBC, 2013).

In contrast, the items on which Pakistan was given duty-free access were low value-added products such as woven greige fabric and cotton bedsheets, as well as chemicals or minerals such as chromium and copper (PBC, 2019). In many cases concessions were given by China on goods that either Pakistan does not export—for example, Pakistan had no exports of 1400 tariff lines that were covered under Phase 1 (IGC,2017) or that China does not import from the world—for example, 3 out of the 13 items it offered duty-free access to in the readymade garments sector (CDPR, 2019). China did not offer any concessions on many of Pakistan's top exports (for example, rice, frozen flat fish and crab, leather hides, knitted cotton menswear shirts and t-shirts, as well as automotive parts) despite having considerable imports of the same. This can explain the decline in seafood exports shown in Figures 17-19. Maximum concessions were given on low value-added items such as cotton yarn, which accounted for 40 per cent of Pakistan's total exports to China in 2017. Tariffs on more value-added goods in the textile sector such as woven and knitted (cotton) apparel were barely lowered, making up just 2 per cent of Pakistan's exports to China in 2017 (PBC, 2019).

In summary, these studies find that Pakistan provided relatively better market access on a much wider variety of goods that China actually exports or that Pakistan significantly imports

Erosion of preference margins on Pakistan's traditional exports

The ASEAN-China FTA (ACFTA) was signed in 2010, lowering preference margins on Pakistan's exports to China. This marked the beginning of a significant downturn of Pakistan's exports to China. Despite receiving generous tariff reductions of up to a 100 per cent, Pakistan's comparative advantage in trade with China under the FTA was greatly offset as China offered better tariff reductions to ASEAN members and Bangladesh—Pakistan's main competitors (PBC, 2018). In 2013, as a result of ASEAN countries being offered zero-rated tariffs by China, Pakistan exported significantly less of 8 products on which it faced tariffs in China. Overall, the ASEAN-China FTA (ACFTA) of 2010 is estimated to have led to a loss of almost 80 per cent of export volume to China (PBC,2019).

Non-tariff measures imposed by China

Pakistan's inability to reach its export potential under CPFTA1 was not only due to elevated tariff rates imposed on its exports—reaching up to a maximum of 65 per cent— but also non-tariff barriers (NTBs) in safety and quality standards as per the sanitary and phytosanitary (SPS) agreement (PBC, 2018). As a result, in 2016, Pakistan's highest exported product, which was semi-milled or wholly milled rice (HS-10063090), could not meet its USD 1.14 billion export target. This product category was the highest ranked export from the list of products not given any concessions by China—rice makes up 40 per cent of total exports in this category (PBC, 2019).

3.4 Misreported data

At the same time, new mechanisms in CPFTA2 of real-time efficient electronic data exchange are expected to curb under- and over-reporting of trade data between the two countries. Misreported or under-invoiced import data between China and Pakistan is a serious concern for revenue authorities in Pakistan, and for businesses in Pakistan that have to compete with under-invoiced products. At the same time, exports are also under and over-invoiced. For sectors that are zero-rated (i.e. can claim back the duties paid on imported imports used in the manufacture of exported products), there is a tendency to over-invoice exports to claim back a greater value of import duties than are due. For other product lines, there is a tendency to under-invoice exports since there is an incentive to receive payments to bank accounts outside Pakistan, which are then routed to Pakistan under the "remittances" category.

The standard way that the scale of misreporting is estimated is by comparing exports to Pakistan reported by China with imports from China reported by Pakistan, after CIF/FOB adjustment (see for example Mahmood and Qureshi (2016), Jha and Nguyen (2014), Demir and Yalta (2010)). Conceptually, both values should be identical as they measure the same flow. Discrepancies in the data are therefore attributed to under-invoicing.

However, it is important to understand the limitations of this approach. There are enormous differences in data when compared this way, not only between two developed country pairs, but also between two European Union country pairs that are part of a common market and use the same currency. For example, in 2017, while Spain reported importing 4722 product lines from France, valued at USD 37.5 billion, France reported exporting 4585 product lines to Spain, valued at USD 40.2 billion.[6] Several of the product lines reported by France are not in Spain's list, and vice versa. Even for the 4352 product lines that match in the two lists, there are just four exact matches for the value of trade, with differences of up to a whopping 5 million per cent between the values reported by the two countries. If the absolute difference is expressed as a percentage[7] for each of the 6-digit product codes, and the average of this is taken across all matched codes, the average discrepancy works out to be 7000 per cent. The sheer scale of the discrepancies, that too between two neighboring countries in a common market (the European Union), is so large that it is difficult to imagine that it could be caused by under-

[6] All trade values for reported for 2017 from UN Comtrade (the last year China reported trade data, as of August 22, 2019). The number of product lines is at HS 6-digit level.
[7] Absolute difference in reported values expressed as a percentage of the value of exports to Spain reported by France

invoicing alone. Moreover, the findings described here resonate with other country pairs that were checked, including China-Japan and Australia-USA.

Such asymmetries are in fact a recognized feature of international trade data, for several reasons that are not related to deliberate misreporting:[8]

1. Imports are recorded with cost of insurance and freight (CIF), while exports are "free on board" (FOB). This can cause a difference of 10-20 per cent—the studies cited above all adjust the value of misreporting by 10 per cent
2. Variation in data quality among different countries, even if procedural instructions are identical
3. Greater accuracy in the measurement of import data (which has revenue repercussions) than in the measurement of export data
4. Differences in the detailed HS code categorization of a specific good between the two trade partners
5. Related to the above, differences in the commodity classification system used, or the version of the commodity classification system used, which leads to differences when converting
6. Partner country is typically the country where the product originated from, not the country that directly exported the product
7. There may be differences in the exchange rates used when converting to USD
8. Missing data for codes at a higher level of disaggregation, which some countries may withhold as confidential (but which may still be included at an aggregated level such as at the HS 2-digit level)

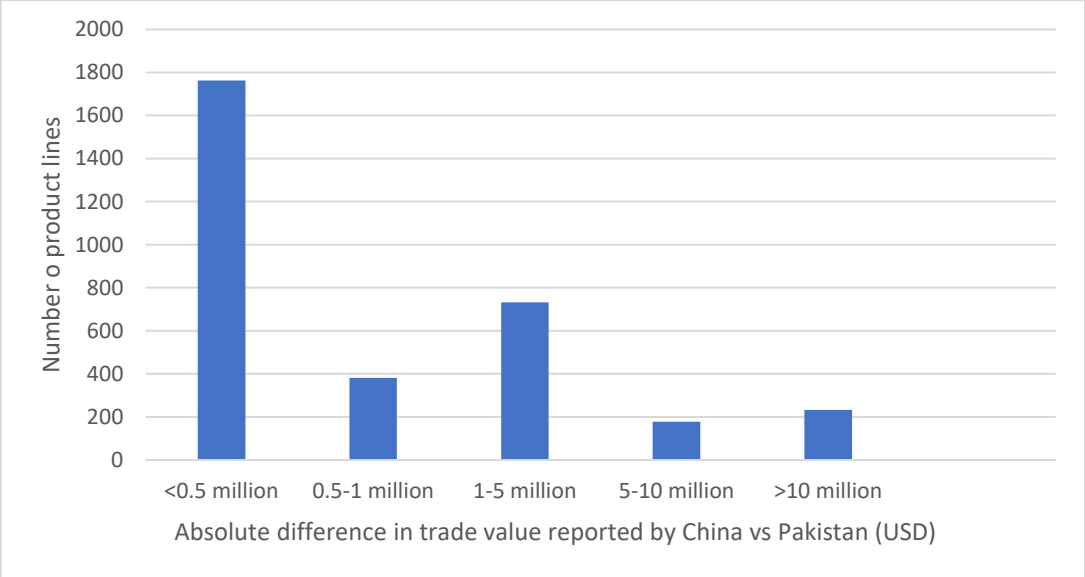
Elaborating on the data quality point further, in the trade data on Pakistan, for example, the research team has noted discrepancies of mistyping—millions typed as thousands, or codes mistyped. In many cases, these discrepancies cannot be picked up quickly.

Keeping these reasons in mind, it would be unwise to draw conclusions on under-invoicing based on differences in reported trade data alone. Therefore, this section provides a brief summary of trade discrepancies between Pakistan and China, without attributing them entirely to under-invoicing.

In 2017, Pakistan reported importing 3807 product lines at the HS 6-digit level from China, valued at USD 15.4 billion, while China reported exporting 3494 product lines, valued at USD 18.25 billion. Only 3284 codes match on both lists. The percentage difference in reported value was calculated for each HS 6-digit code. The average for this is 1788 per cent (around a quarter of the 7000 per cent calculated for Spain-France). Figure 20 illustrates the distribution of differences in reported trade value. The difference in reported value is less than USD 0.5 million for the large majority of traded items. At the same time, there are over 200 codes at the HS 6-digit level for which the discrepancy is over USD 10 million each.

[8] These reasons are compiled from the online support pages of World Bank's World Integrated Trade Solution (WITS) and UN Comtrade

Figure 20 Distribution of reported discrepancies in Pakistan-China trade



Source: Author's calculations based on UN Comtrade data

Tables 4 to 7 report this discrepancy in more detail. Tables 4 and 5 list the 6-digit and 2-digit products respectively, at the very top of the distribution with reporting discrepancies of over USD 100 million. Naturally, these are some of the most traded items between the two countries. Table 6 reports the top fifteen product lines (at 2-digit level) in terms of the percentage of the absolute difference in reported values. These products show a different set, with some unusual results. For example, the largest reported discrepancy is in aircrafts and their parts. The discrepancy arises largely from HS 880330 (aircraft and spacecraft; parts of airplanes or helicopters n.e.s. in heading no. 8803). While China reported exporting approximately 22,000 kg in this category (presumably parts, based on weight and value per unit of around USD 1000), Pakistan reported receiving imports of just 8 kg (Table 7).

A more detailed investigation into trade reporting asymmetries is beyond the scope of this exercise. Suffice to say that there exists a very substantial asymmetry, which both revenue authorities and policymakers interested in the trade balance of Pakistan must address in Phase 2. Sharing real-time data with China would enable the government to identify the specific consignments where there is a discrepancy, and address these at the point of clearance, thereby helping resolve the issues of misreporting and corruption at the border.

Table 4 HS 6-digit Product lines that report differences in trade values of more than USD 100 million, Pakistan-China trade, 2017

HS code (6-digit)	Label	Exports to Pakistan reported by China (2017, USD)	Imports from China reported by Pakistan (2017, USD)	Difference in reported values (USD)
840211	Boilers; water tube boilers with a steam production exceeding 45t per hour	1,268,570	430,161,060	428,892,490
854140	Electrical apparatus; photosensitive, including photovoltaic cells, whether or not assembled in modules or made up into panels, light-emitting diodes (LED)	277,448,936	627,009,492	349,560,556
850300	Electric motors and generators; parts suitable for use solely or principally with the machines of heading no. 8501 or 8502	340,615,562	37,790,229	(302,825,333)

850231	Electric generating sets; wind-powered, (excluding those with spark-ignition or compression-ignition internal combustion piston engines)	75,361,690	319,029,242	243,667,552
840290	Boilers; parts of steam or other vapor generating boilers	251,046,102	30,821,182	(220,224,920)
640299	Footwear; n.e.c. in heading no. 6402, (other than just covering the ankle), with outer soles and uppers of rubber or plastics	204,756,176	7,149,098	(197,607,078)
841510	Air conditioning machines; comprising a motor-driven fan and elements for changing the temperature and humidity, of a kind designed to be fixed to a window, wall, ceiling or floor, self-contained or split-system	182,243,939	25,436,604	(156,807,335)
730890	Iron or steel; structures and parts thereof, n.e.c. in heading 7308	227,003,956	89,625,356	(137,378,600)
540752	Fabrics, woven; containing 85 per cent or more by weight of textured polyester filaments, dyed	208,084,543	74,011,578	(134,072,965)
851712	Telephones for cellular networks or for other wireless networks	380,425,591	513,252,560	132,826,969
850239	Electric generating sets; (excluding those with spark-ignition or compression-ignition internal combustion piston engines), other than wind powered	3,077,057	124,518,598	121,441,541
851762	Communication apparatus (excluding telephone sets or base stations); machines for the reception, conversion and transmission or regeneration of voice, images or other data, including switching and routing apparatus	141,780,291	257,143,859	115,363,568
500720	Silk; woven fabrics, containing 85 per cent or more by weight of silk or of silk waste other than noil silk	117,311,160	3,217,478	(114,093,682)

Source: Author's calculations based on UN Comtrade data

Table 5 HS 2-digit product lines that report differences in trade values of more than USD 100 million, Pakistan-China trade, 2017

HS code (2-digit)	Label	Imports from China reported by Pakistan (USD. 2017)	Exports to Pakistan reported by China (USD 2017)	Difference (USD)
85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers; television image and sound recorders and reproducers, parts and accessories of such articles	3,645,855,852	3,393,879,840	251,976,012
55	Man-made staple fibers	336,608,406	576,741,046	(240,132,640)
64	Footwear; gaiters and the like; parts of such articles	99,806,855	328,832,095	(229,025,240)
54	Man-made filaments; strip and the like of man-made textile materials	552,080,860	774,531,953	(222,451,093)
73	Iron or steel articles	534,239,346	755,219,085	(220,979,739)
39	Plastics and articles thereof	424,699,197	592,151,703	(167,452,506)
94	Furniture; bedding, mattresses, mattress supports, cushions and similar stuffed furnishings; lamps and lighting fittings, n.e.c.; illuminated signs, illuminated nameplates and the like; prefabricated buildings	140,200,385	291,392,030	(151,191,645)
52	Cotton	54,265,596	201,113,599	(146,848,003)
62	Apparel and clothing accessories; not knitted or crocheted	18,376,863	146,002,397	(127,625,534)
60	Fabrics; knitted or crocheted	205,012,177	320,868,549	(115,856,372)
61	Apparel and clothing accessories; knitted or crocheted	46,246,602	157,715,160	(111,468,558)

Source: Author's calculations based on UN Comtrade data

Table 6 Top 15 HS 2-digit product lines that report the largest differences in trade values, (% difference) Pakistan-China trade, 2017

HS code (2-digit)	Label	Imports from China reported by Pakistan (USD. 2017)	Exports to Pakistan reported by China (USD 2017)	Difference (USD)	per cent difference (absolute difference expressed as % of imports)
88	Aircraft, spacecraft and parts thereof	716,022	22,051,748	(21,335,726)	2,980
24	Tobacco and manufactured tobacco substitutes	150,064	2,395,361	(2,245,297)	1,496
13	Lac; gums, resins and other vegetable saps and extracts	2,108,658	26,452,085	(24,343,427)	1,154
62	Apparel and clothing accessories; not knitted or crocheted	18,376,863	146,002,397	(127,625,534)	694
8	Fruit and nuts, edible; peel of citrus fruit or melons	6,464,832	50,252,569	(43,787,737)	677
80	Tin; articles thereof	67,965	504,974	(437,009)	643
67	Feathers and down, prepared; and articles made of feather or of down; artificial flowers; articles of human hair	4,461,775	19,134,098	(14,672,323)	329
42	Articles of leather; saddlery and harness; travel goods, handbags and similar containers; articles of animal gut (other than silk-worm gut)	32,951,474	129,967,125	(97,015,651)	294
52	Cotton	54,265,596	201,113,599	(146,848,003)	271
21	Miscellaneous edible preparations	8,687,250	31,070,698	(22,383,448)	258
50	Silk	38,118,794	135,917,561	(97,798,767)	257
6	Trees and other plants, live; bulbs, roots and the like; cut flowers and ornamental foliage	446,355	1,527,013	(1,080,658)	242
61	Apparel and clothing accessories; knitted or crocheted	46,246,602	157,715,160	(111,468,558)	241
64	Footwear; gaiters and the like; parts of such articles	99,806,855	328,832,095	(229,025,240)	229
71	Natural, cultured pearls; precious, semi-precious stones; precious metals, metals clad with precious metal, and articles thereof; imitation jewelry; coin	9,893,644	31,570,471	(21,676,827)	219

Source: Author's calculations based on UN Comtrade data

Table 7 A detailed investigation of HS 88

HS code (6-digit)	Label	Exports to Pakistan reported by China (USD. 2017)	Imports from China reported by Pakistan (2017, USD)	Difference (USD)
880330	Aircraft and spacecraft; parts of airplanes or helicopters n.e.c. in heading no. 8803	21,810,348	10,402	(21,799,946)
880390	Aircraft and spacecraft; parts thereof n.e.c. in chapter 88	6,395	685,376	678,981
880400	Parachutes (including dirigible parachutes and paragliders) and rotochutes; parts thereof and accessories thereto	1,713	3,260	1,547
880100	Balloons and dirigibles; gliders, hang gliders and other non-powered aircraft.	10,000	10,468	468

Source: Author's calculations based on UN Comtrade data

This section has shown that bilateral trade between China and Pakistan flourished after the FTA, with both exports to and imports from China growing at rates that far outpaced Pakistan's export and import trends with the world. However, imports from China exhibited higher growth

than exports to China, with the result that the trade deficit with China increased. In itself this is not problematic, as it could indicate that Pakistan is accessing cheaper inputs from China which enable it to increase competitiveness and expand exports to the world. However, Pakistan's trade deficit with the world excluding China has also increased steadily.

There has been some change in the composition of Pakistan's exports to China following the FTA. Cotton in particular showed the strongest growth. If Pakistan's top ten exports to China at the point of implementation of CPFTA1 are considered, growth of exports to China outperformed growth to the world for eight of them **before** the FTA. In general, after the FTA too, exports to China continue to grow faster than they do to the rest of world. However, the margin of overperformance has declined after the FTA. This is consistent with the finding that Pakistan's competitors were offered greater concessions following CPFTA1. Some products saw exports to China underperform relative to the world. These are (at the HS two-digit level) seafood, machinery and parts thereof, and organic chemicals.

This section also explores misreporting of trade data between the two countries, identifying large scale asymmetries in the values reported by the two countries at 8-digit level. However, this is caveated with similar findings for other country pairs such as China-Spain, USA-Australia and China-Japan. These discrepancies are commonly ascribed to under- and over-invoicing, yet the scale of the discrepancies indicate that there are several other factors at play, including differences in converting between classification systems and currencies, and differences in data quality and reporting guidelines. While the products that suffer most from reporting asymmetries are identified, these differences are not ascribed to deliberate misreporting by importers and exporters.

With this background of the CPFTA1, the following section will present the key features of the CPFTA2 using official documents made available by the Ministry of Commerce. The focus will be on whether prior weaknesses identified in Phase 1 have been adequately addressed in Phase 2 and their addressal mechanism.

4 China Pakistan Free Trade Agreement Phase 2

4.1 Overview

After a seven-year long period of negotiations on the China-Pakistan Free Trade Agreement, a protocol that forms an integral part of the CPFTA2 was signed in April 2019. Once enforced, Phase 2 of the CPFTA will be implemented for five years. For the purpose of this report, only China's tariff concessions to Pakistan are considered. A total of 8238 tariff lines at the HS 8-digit level have been offered to Pakistan. As shown by Table 8, these concessions are described in 7 categories. China has granted Pakistan's exports immediate duty-free access on 3707 items, or 45 per cent of total tariff lines in CPFTA2. Apart from the duty-free items, there are 2 other categories on which tariffs have to be reduced to 0 per cent in 5 and 10 years (A-5 and A-10, respectively). Margin of preference has to be reduced by 20 per cent on base rates for MOP1 and MOP2, while for the last two categories, tariff rates will remain at base rates for Category 1 and Category 2 (no concession list). By 2030, tariffs are to be reduced by China on 75 per cent of the total lines.

Table 8 Description of CPFTA2 concessions offered to Pakistan by China

Category	Description	Tariff lines (HS 8-digits)	Tariff lines (per cent)
A-0	Duty-free access immediately	3707	45
A-5	Duty-free access by year 5	1235	15
A-10	Duty-free access by year 10	1236	15
MOP-1	Reduce base rates by 20 per cent in year 5	273	3
MOP-2	Reduce base rates by 20 per cent immediately	139	2
C1	Tariffs remain at 2013 base rate	835	10
C2	No concession (MFN rates apply)	813	10
Total lines		8238	100

Source: Ministry of Commerce (2019)

The most basic yardstick of the quality of the concessions offered by China is how many of these tariff lines it is actually importing from the world. In 2018, China did not import from the world 1035 tariff lines (at the HS 8-digit level) or 13 per cent of the 8238 tariff lines included in CPFTA2. On the remaining 87 per cent of product codes, tariffs range from 0 to 65 per cent. China has given immediate duty-free access on 3707 lines (45 per cent of total tariff lines). A further 30 per cent of tariff lines will have duty-free access by 2030. [9] Tariffs on 412 lines will be reduced by 20 per cent in five years, while tariffs will remain at base year (2013) rates for 1867 tariff lines (or 20 per cent of the tariff lines) (Table 8).

Other top-level features of the CPFTA2 (2019-2024) are outlined below (Ministry of Commerce, 2019)

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1. Pakistan has been granted immediate duty-free access by China on 783 tariff lines which did not attract 0 per cent tariff in CPFTA1.
2. In terms of tariff lines that Pakistan exports, 845 lines will have duty-free access by 2030 (at the HS 8-digit level).
3. At the same time, 813 tariff lines fall in Category 2 where China has given no concession. Exports to China would attract tariffs ranging from 2-65 per cent.
4. Safeguard clauses have been included that feature as standard in FTAs over the world. Pakistan could levy additional duties in the face of balance-of-payment crises.
5. Real-time electronic exchange of trade data has been allowed to curtail misreporting and under-invoicing that was exposed during Phase 1. This will reduce revenue losses for Pakistan.

Table 9 Tariff reduction modalities for CPFTA Phase 2

Category	Tracks	Pakistan TRMs		China TRMs	
		per cent of TLs	Years	per cent of TLS	Years

[9] All tariff data pertaining to the CPFTA Phase II has been retrieved from the Ministry of Commerce website at http://www.commerce.gov.pk/protocol-on-phase-ii-china-pakistan-fta/

I	Elimination of tariffs	45	Entry into force	45	Entry into force
II	0-5 per cent	15	7years (2^{nd}-7^{th} year)	15	5 years
III	50 per cent of margin of preference	15	15 years (4^{th} -15^{th} year)	15	10 years
IV	20 per cent of margin of preference	5	Entry into force	5	Entry into force
Sensitive List	No concession	20	Entry into force	20	Entry into force

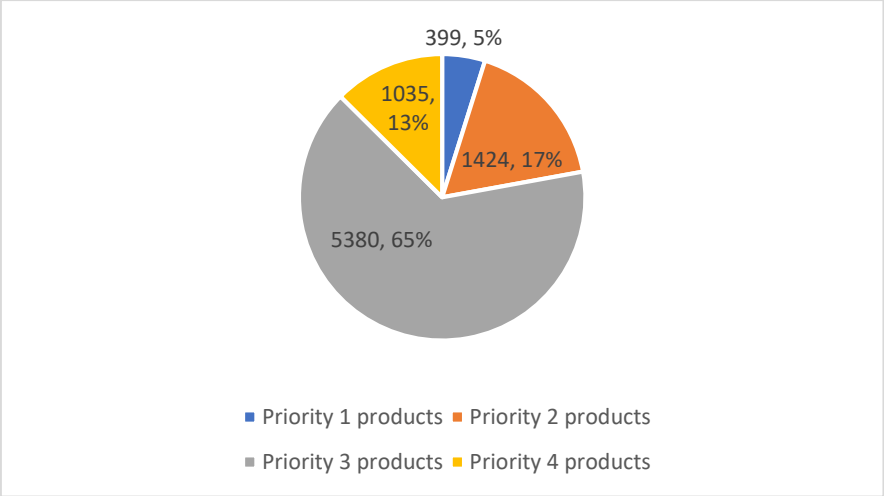
Source: Ministry of Commerce (2019)

As mentioned above, the CPFTA2 provides details of tariffs levied by China on 8238 product lines at the HS 8-digit level. To make the analysis of tariff lines more useful and tractable, the lens of analysis will be Pakistan's exports to the world. This approach is distinct from the approach taken in the CPFTA1 analysis reports earlier commissioned by the Pakistan Business Council (2013-2019). These have looked at the distribution of priority products within CPFTA1 tariff categories, whereas our approach looks at the distribution of tariffs within the priority products. This is an important difference and impacts the interpretation of the results. For example, the PBC reports noted that even though 7,550 products at the HS 8-digit level were part of the CPFTA1, Pakistan's exports to China were concentrated along only 350 product lines. It appears that Pakistan utilized a meagre 5 per cent of the lines on which concessions were available, while China exported along 57 per cent of the preference tariff lines under CPFTA1 (PBC, 2016). This makes it appear that the utilization rates for Pakistan were extremely low. This is however somewhat misleading given that Pakistan only exported around 400 of those 7550 tariff lines to China in 2006 when the FTA was being negotiated—by that token, the utilization of the FTA, at the point of negotiation, could not possibly be higher than 5 per cent.

For Pakistan, some product lines have greater priority than others, for example the products that it exports to China. To enable a more nuanced analysis for CPFTA2, four product categories are defined. These are, in order of decreasing priority for Pakistan:

1. Priority 1 products: Products that Pakistan exports to China (399 codes, or 5 per cent of the tariff lines covered at HS 8-digit level). These are the highest priority products for Pakistan. Exports to China are already established and can be expanded further. These will be explored in more detail in Section 4.3
2. Priority 2 products: Products that Pakistan exports and China imports, but Pakistan does not export to China (1424 codes, or 17 per cent of the tariff lines covered at HS 8-digit level). These are also high priority for Pakistan as they are those products for which Pakistan has established global competitiveness, and China has an established import market. Pakistan can diversify its export offering to China with these products. These will be explored in more detail in Section 4.4
3. Priority 3 products: Products that China imports, but Pakistan does not export at all (5380 codes, or 65 per cent of the tariff lines covered at HS 8-digit level—these will be explored in more detail in Section 4.5
4. Priority 4 products: Products that China does not import (1035 codes, or 13 per cent of the tariff lines covered at 8-digit level) (these are low priority, as it is unlikely that Pakistan will be able to create substantial demand in China for these in the time frame covered by CPFTA2, so will not be discussed further)

Figure 21 Categorization of product concessions offered under CPFTA2



Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

4.1.1 Tariff distribution of CPFTA2

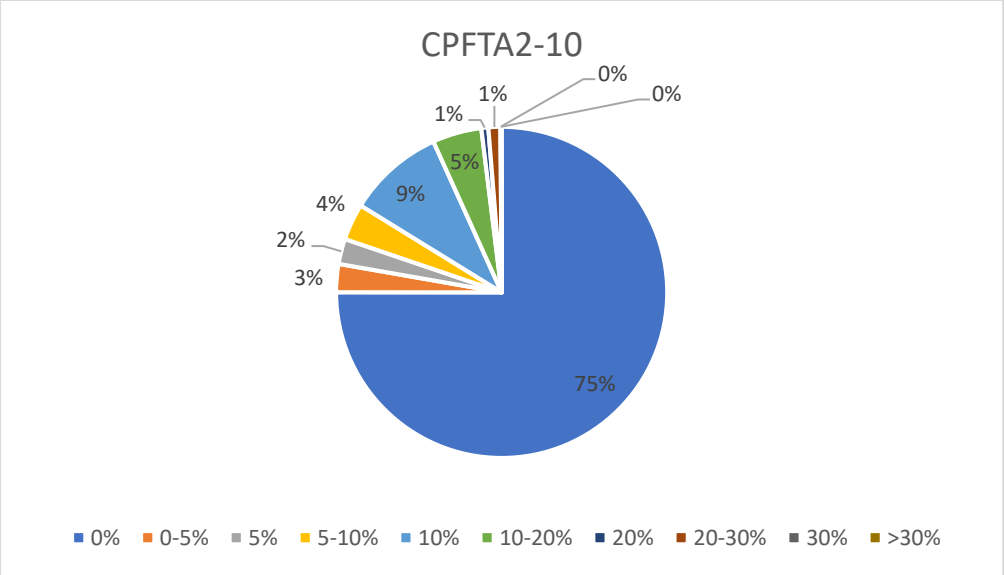
Figure 22 shows the distribution of product lines with tariff access improvements across these four categories. Firstly, tariff access in Phase 2 has either remained at Phase 1 levels, or improved. Just over 44 per cent of the products that Pakistan exports to China (Priority 1) will have lower tariff under CPFTA2 (final reductions in year 10) than under CPFTA1, while the tariff for the remaining 56 per cent is unchanged. Similarly, just under half the product lines for Priority 2 products now have improved access.

Figure 22 Distribution of tariff access improvements under CPFTA2

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

Figure 23 shows the distribution of tariff rates under CPFTA2. 75 per cent of all the products will have zero tariff applied by the final year of the FTA, and 93 per cent of the product lines face a tariff of 10 per cent or less. There are just nine lines out of 8236 that face a tariff of 30 per cent or more.

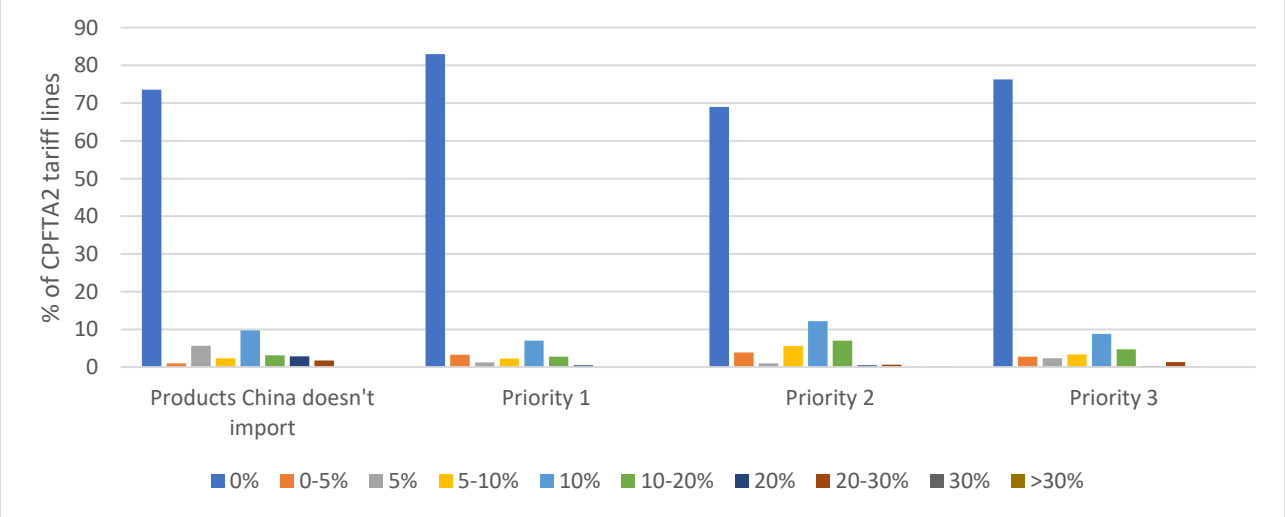
Figure 23 Distribution of CPFTA2 final tariffs



Source: CPFTA data from Ministry of Commerce

The tariff distribution can also be explored by Pakistan's priority categories. This is shown in Figure 24. 83 per cent of Priority 1 product lines (at the HS 8-digit level) have a final tariff of 0 per cent, which is the highest percentage among the four categories.

Figure 24 Distribution of CPFTA2 tariff rates by category of products



Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

To summarise, the overall data shows substantial improvements in tariff conditions under CPFTA2, in general for all products, and especially for the high priority product lines that Pakistan exports to the world or China, for which China has import demand. At the HS 8-digit level, this means that by 2030, Pakistan could export additional duty-free tariff lines ranging from anywhere between 720 (if only Pakistan's exported tariff lines to China or the world in 2018 are considered) to 2906 tariff lines (if China's import demand of 2018 is taken into consideration).

4.2 Market access for Pakistan's exports

As mentioned above, this report has defined Pakistan's priority lists by Pakistan's exports to the world. Products that Pakistan exports to the world but China does not import are excluded. As shown in Table 10, China imported 7737 product lines in 2018 and Pakistan exported 3396 product lines at the HS 8-digit level. Out of these, 1861 product lines overlap (i.e. China imports and Pakistan also exports them). In this report, these products are referred to as Priority 1 and Priority 2 products. However, trade data for 24 product codes is missing, and the product lines fall to 1837. From these matched product codes, 401 are exported by Pakistan to China directly and comprise the Priority 1 list, while the remaining products are categorized as Priority 2 products, which Pakistan exports— but not to China. This means that there are 1535 products that Pakistan exports, but China does not import from the world. These exports of Pakistan that China does not import at all are dropped from the analysis. It may be the case that an import market in China develops for such products, but there is unlikely to be a substantial market for these products in the timeframe covered under the FTA. Sections 4.2, 4.3 and 4.4 will focus on the 1837 product codes that Pakistan exports and China imports.

Table 10 Summary of tariff lines under analysis (based on trade data for 2018)

		Tariff lines (HS 8-digit)
China's imports from the world		7737
Pakistan's exports to the world		3396
Overlapping products that Pak exports and China imports		1861
Trade data missing		24
Remaining overlapping products		1837
	Pak exports to China	401
	Pak exports to world not China	1434
Pak exports but China does not import		1535

Source: ITC TradeMaps

It is worth investigating in more detail those product lines that Pakistan exports for which China has a demonstrated demand, i.e. China imports these products from the world (Priority 1 and Priority 2 products). These amounted to 1861 product lines at the HS 8-digit level in 2018. However, as mentioned in Table 10, data for 24 codes is not available, making the total 1837 codes. A breakdown of these product lines is shown in Table 11. Pakistan's exports to the world for these products are USD 16.4 billion, while China's imports from the world of these product lines that Pakistan exports are USD 613.9 billion. In other words, based on 2018 figures, the potential market on offer in China is USD 613.9 billion, or 29 per cent of China's total global imports in 2018. To put the size of China's market into perspective, China's imports in product lines that Pakistan also exports are 37 times larger than Pakistan's total world exports of those same product lines in 2018.

Table 11 Summary of Priority 1 and Priority 2 codes, HS 8-digit level

	Number of 8-digit Tariff lines in CPFTA	**China's world imports in these tariff lines**	**Pak world export in these tariff lines**	**Pak exp to China in these tariff lines**
Included in FTA	1837	613.9 bn	16.4 bn	1.58 bn

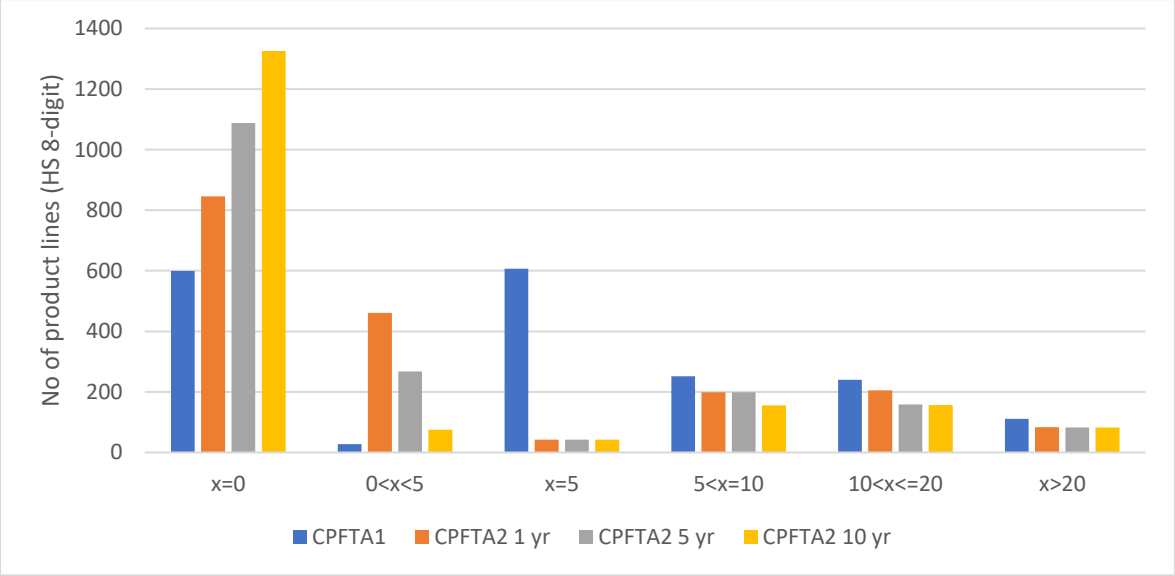
Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

As mentioned above, China did not import 1535 HS 8-digit product codes that Pakistan exported in 2018—this represents 38.4 per cent of Pakistan's total exported tariff lines (at the HS 8-digit level) to the world in 2018.

4.2.1 Tariff Distribution

Tariff access is compared across both phases of the CPFTA for Priority 1 products that Pakistan exports and for which there is an import market in China (Figure 25). These 1837 codes represent 22.3 per cent of total product lines that were included by China in CPFTA2.[10] The tariff distribution for these 1837 products is shown for CPFTA1 and 2 immediately (year 1), in the medium-term (year 5) and by the end (year 10). As can be seen from Figure 25, 1326 product codes attract 0 per cent tariffs under CPFTA2, an additional 727 product lines as compared to Phase 1. This means that 70 per cent of the 1837 product lines that Pakistan exports (to the world or to China) now fall in the duty-free category.

Figure 25 Comparison of tariff distribution for products Pakistan exported in 2018, CPFTA1 and CPFTA2 (HS 8-digit level)



Notes: On the x-axis, x represents the tariff rate e.g. x=0 indicates duty free tariff access

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

The distribution of tariffs has shifted out of 5 per cent from CPFTA1 to 0 per cent and 5 per cent in Phase 2. Two features of the comparison between market access under CPFTA1 and CPFTA2 stand out. As Table 12 shows, there is no product for which tariff access worsened under CPFTA2. This is true for all the product lines that Pakistan exports.

Table 12 Tariff access CPFTA2 compared with CPFTA1

	CPFTA2 (Y1)	CPFTA2 (Y5)	CPFTA2 (Y10)
Worse	0	0	0

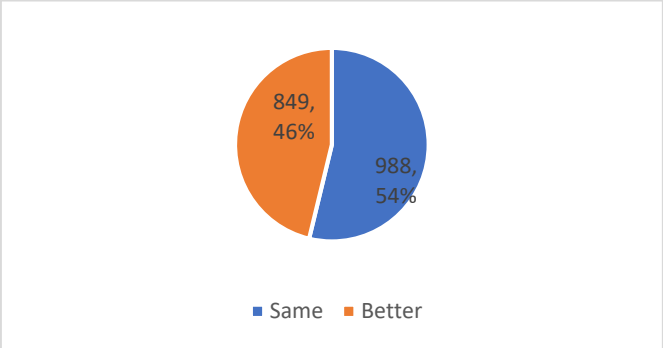
[10] Effectively, this means that Priority 1 and 2 tariff analysis of Pakistan's exports to the world or China is limited to products that China offers concessions on and imports from the world. As mentioned previously, 24 codes are excluded for which data was missing

Same	989	988	988
Better	848	849	849

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

Roughly 82 tariff lines continue to face tariffs exceeding 20 per cent in CPFTA2—however this is still an improvement of 29 product lines from CPFTA1. On the whole, Figure 26 reveals that CPFTA2 tariffs were lower than CPFTA1 for 46 per cent of product codes (at the HS 8-digit level).

Figure 26 Number of tariff lines Pakistan exported in 2018 (to world or China) with improved access under CPFTA2 (Year 10) versus CPFTA1



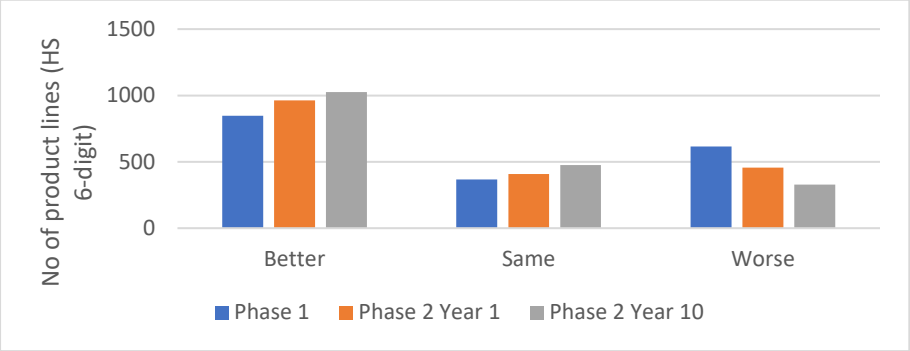
Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

4.2.2 Market access relative to competitors

Prior analysis of the CPFTA1 by PBC noted that China's tariff regime was slanted in favor of Pakistan's key competitors of Bangladesh and ASEAN members, thus intensifying Pakistan's disadvantage (PBC, 2018). In order to evaluate the CPFTA2, this report compares market access for Pakistan relative to what China offers to its top import partners. To explore the relative position of Pakistan, tariffs offered to Pakistan under CPFTA2 (for year 1 and year 10) were compared with China's highest value trade partner (HVTP) as well as the average tariffs it offers to its top 5 import partners (Figure 27). [11] Three conclusions can be drawn from Figure 27. First, there is an improvement in market access under CPFTA2 compared to CPFTA1, as there is a redistribution from worse to better access—fewer products have worse access than China's top import partner under CPFTA2. Secondly, Pakistan faces lower tariffs than China's top import partner for 56 per cent of the tariff lines that Pakistan is exporting, while it faces equivalent market access for 26 per cent of the product lines that it exported in 2018. Thirdly, the difference between market access in year 1 of CPFTA2 is not much different than for year 10, indicating that China has given better market access to Pakistan's exports effective immediately.

[11] Data on tariffs for all of China's import partners was obtained from ITC TradeMaps as of July-August 2019 for all products imported by China. Tariff data was available only at the HS 6-digit level, and only for 1830 products. Highest value trade partners in defined in terms of the value of imports from the trade partner.

Figure 27 Tariff comparison, by product line at HS 6-digit, with China's top import partner (2018) under CPFTA1 and CPFTA2

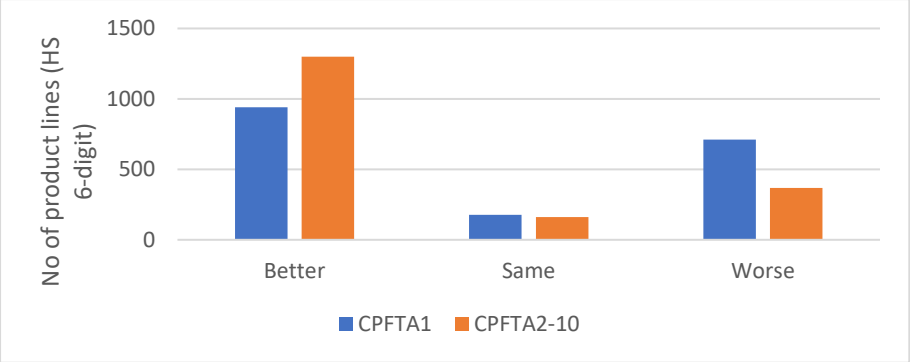


Notes: 1) Trade and tariff data for China's trade partners was not available for 7 out of 1837 product lines in section 3 (at 8-digit level). These product lines are excluded from this chart. 2) The total number of codes used in the comparison with China's import partners is 1830. 3) The average tariff for the 6-digit product lines was used for this chart, as tariff data for 8-digit product lines is not accessible on the large scale required

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

The results are similar when tariff access for Pakistani exports under CPFTA1 and 2 is compared with the average tariff faced by the top 5 exporters to China in 2018.[12] Under Phase 1, Pakistan had better access than its top 5 competitors in China in 2018 in 941 product lines—this has risen to 1300 products under Phase 2 (71 per cent of the products it exported in 2018). At the same time, the number of products with worse access than China's top 5 import partners will halve from 712 to 369 codes by 2030 (Figure 28). A detailed discussion of which products now face better access as compared to Pakistan's competitors in China will be discussed in sections 4.3 and 4.4. Instead the discussion turns to those 369 products which have worse access than Pakistan's competitors in China for 2018.

Figure 28 Tariff comparison, by product line at HS 6-digit, with China's top 5 import partners (2018) under CPFTA1 and CPFTA2 (Y10)



Note: 1830 product codes analysed at HS 6-digit level, using the average estimated tariff for top five import partners of China in 2018

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

[12] For product lines where there were less than five exporters of the product, the average for all available partners is taken. For many product lines, China was in the top five exporters itself, due to re-exports. In those instances, the 6th trade partner is included, which China is, naturally, discarded.

Of the 369 tariff lines which face worse access than China's top 5 import partners, the 10 most important products for Pakistan include semi- or wholly milled rice, men's knitted cotton coats, cotton blankets & rugs as well as footwear (see Table 13). As may be seen, Pakistan faces a tariff that is higher than Vietnam for rice (by 15 per cent) and knitwear coats (by 14 per cent), and India for cotton blankets (by 4.8 per cent). This continues the trend under CPFTA1, where the largest export in the "no concessions" list was Semi-milled or wholly milled rice (HS-10063090) which accounted for 40 per cent of the total exports in the category (PBC, 2019).

Table 13 Pakistan's exports that fare worse under CPFTA2 compared to China's top 5 import partner, HS 8-digit

Code	Product label	China imports in 2018 (USD 000)	Pak exports in 2018 (USD 000)	Pak Exports to China (USD 000)	Tariff under CPFTA2 Year 10 (%)	Average tariff China offers to top 5 TPs (%)	Largest volume trade partner	Share in China's Imports (%)	Average tariff China offers to top partner (%)
10063010	Semi or wholly milled long grain rice	514,972	613,181	16,917	65	43	Viet Nam	52	50
10063090	Other semi or wholly milled rice	294,890	1,144,666	101,913	65	43	Viet Nam	52	50
61012000	Men's or boys' coats, etc., of cotton, knitted	20,409	7,548	0	14	3.2	Viet Nam	41.9	0
94052000	Electric table, desk, bedside or floor-standing lamps	18,665	5,723	129	16	6	Italy	37.1	10
63013000	Blankets (excl. electric blankets) & travelling rugs, of cotton	4,233	17,622	2	12.8	3.6	India	41.2	8
64059090	Other footwear,nes	2,860	10,622	0	7.5	3.6	Italy	40.4	6
11081200	Maize (corn) starch	2,474	11,133	33	20	16	United States of America	32.3	20
61121100	Tracksuits of cotton, knitted or crocheted	1,862	7,202	75	6.4	2.4	Cambodia	19.1	0
02042100	Fresh or chilled sheep carcasses&half carcasses (excl. lamb)	1,115	8,078	0	23	15.84	New Zealand	100	0
61029000	Woman's or girls' coats, etc, of other textiles, knitted/crochetd	876	11,676	507	10	6	United States of America	30.9	10

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

To get a better sense of the opportunities on offer under CPFTA Phase 2, these 1837 product codes (HS 8-digit level) are explored in more detail below, separately for Priority 1 and Priority 2 products.

4.3 Priority 1 products

This section explores Priority 1 products, i.e. those products that Pakistan currently exports to China, which China has included in CPFTA2. These amount to 401 products or 5 per cent of the total 8238 products (at the HS 8-digit level) under CPFTA Phase 2. China imports USD 148.4 billion worth of these goods, while Pakistan exports USD 13.8 billion to the world, of which USD 1.6 billion, or 11.6 per cent is exported to China (Table 14).

Table 14 Summary of Priority List 1, HS 8-digit level, 2018

	Number of 8-digit Tariff lines in CPFTA	China's world imports of these tariff lines	Pak world export of these tariff lines	Pak exp to China of these tariff lines
Included in FTA	401	USD 148.4 bn	USD 13.8 bn	USD 1.59 bn

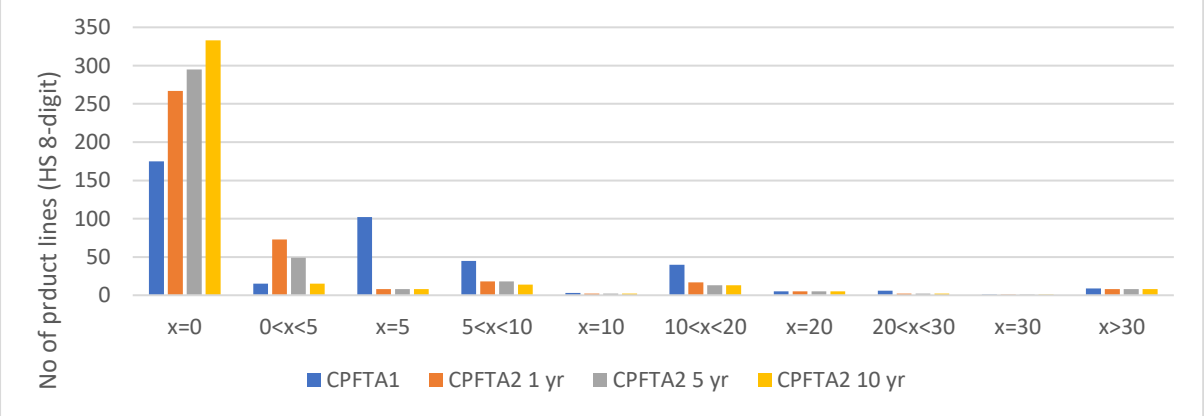
Source: Ministry of Commerce for CPFTA2 details, ITC TradeMaps for remaining data. Author's calculations

Pakistan's exports for the latest year available (2018) are used for this analysis to provide a measure of the relative success in negotiating better market access to China under Phase II. While this is a static analysis and Pakistan's exports would be expected to change in the coming years, the export basket of 2018 is used as a benchmark. These are lines which have a high potential to increase trade volumes in the short-term as for these product lines, Pakistan is familiar with China's market and is already overcoming any other behind-the-border constraints when exporting to China.

4.3.1 Tariff Distribution

The distribution of tariffs under CPFTA2 (years 1, 5 and 10) for Priority 1 products is compared with CPFTA1. An additional 158 tariff lines will have duty-free access to China under CPFTA2. A substantial 83 per cent of Priority 1 product lines will face zero duties by year 10. As can be seen, Phase 2 tariffs are concentrated at the lower end of the spectrum, mostly in the range of 0 to less than 5 per cent (Figure 29).

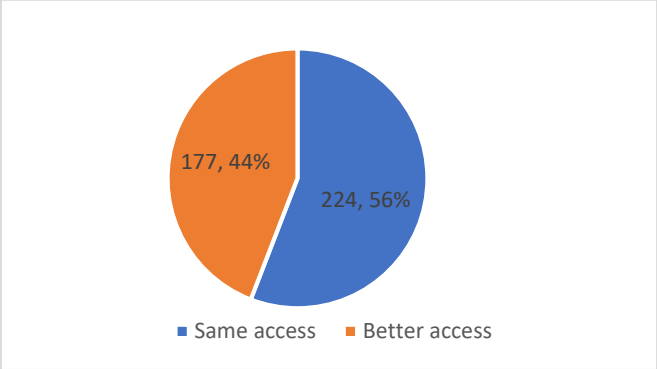
Figure 29 Comparison of tariff distribution of Priority 1 products, CPFTA1 and CPFTA2 (HS 8-digit level)



Source: Ministry of Commerce for CPFTA2 details, ITC TradeMaps for remaining data. Author's calculations

By the end of year 10 of CPFTA2, Pakistan would face duties of less than 10 per cent on 372 product codes (at the HS 8-digit level) that it exported to China in 2018, or 93 per cent of total tariff lines Pakistan exported to China in 2018. Of Priority 1 product lines, 44 per cent attract lower tariffs under CPFTA2 as compared to CPFTA1 (Figure 30).

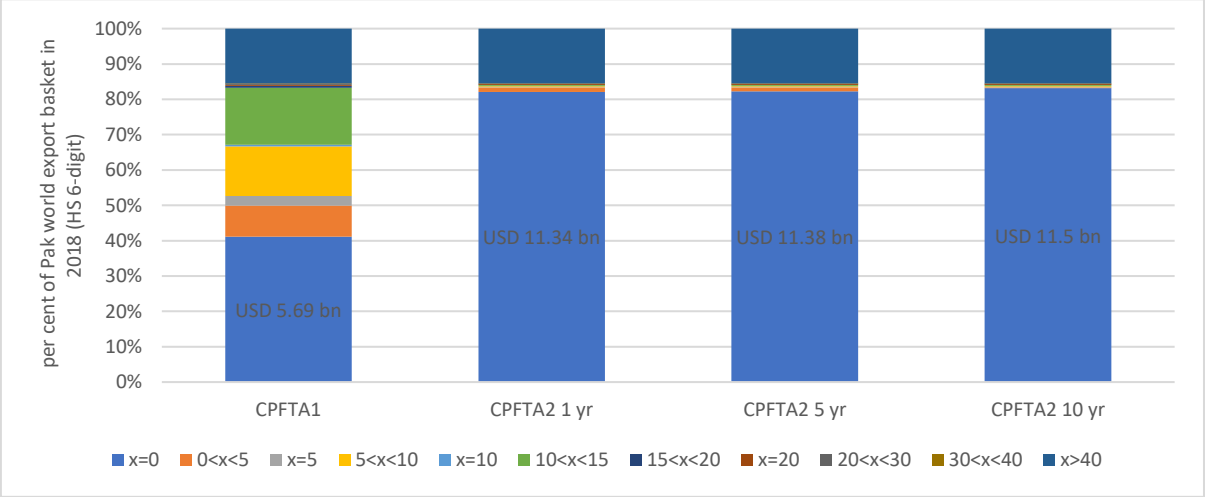
Figure 30 Number of Priority 1 product lines with better access under CPFTA2 (year 10) vs CPFTA1, 8-digit level



Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

The gains in tariff access for the Priority 1 product lines become even more apparent when the tariff distribution is compared between the two Phases, by value of Pakistan's exports to the world in 2018 in those tariff lines (Figure 31). Almost USD 11.5 billion, or more than 80 per cent of the Pakistan's export basket to China now falls in the duty-free category. This is a sharp increase compared to Phase 1, when only USD 5.7 billion of Priority 1 products faced zero tariffs in China. The exception is the rice categories, of which Pakistan exports roughly USD 2.2 billion to the world, yet continues to face tariffs of 65 per cent.

Figure 31 Comparison of tariff distribution Priority 1 products by value of exports, CPFTA1 and CPFTA2 (HS 6-digit level)



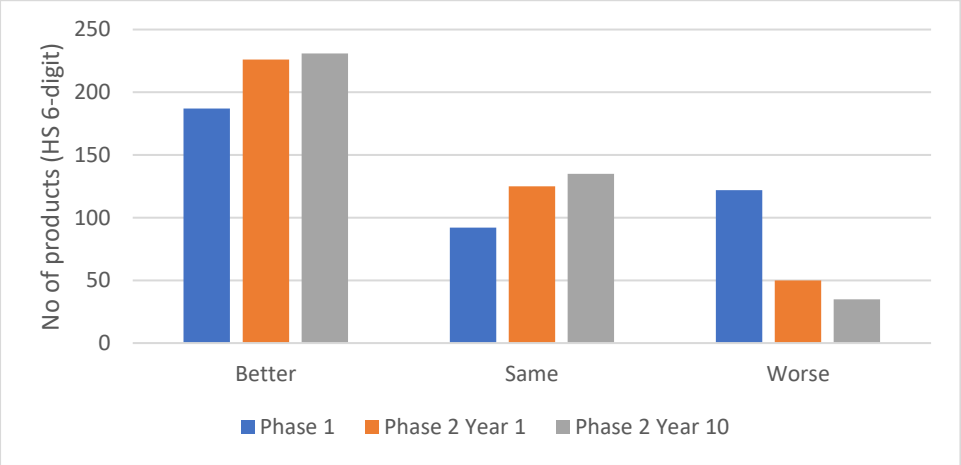
Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

4.3.2 Market access relative to competitors

Figures 32 and 33 show how Pakistan fares under CPFTA2 in relation to key competitors. Tariff data at HS-6 level is used for this as data is not available at the HS 8-digit level. As evident from Figure 32, Pakistan's tariff access to China is now more at par with its top competitors in China. For 351 out of the 399 codes, or 87.5 per cent of product codes that Pakistan exported to China in 2018, Pakistan will have better or equivalent access from the date of implementation of the CPFTA2. In other words, effective immediately, Pakistan will

face higher tariffs than the top exporter to China for only 50 products that it currently sends to China, and by the end of year 10, only 35 products.

Figure 32 Tariff comparison of Priority 1 products at HS 6-digit, with China's top import partner (2018) under CPFTA1 and CPFTA2

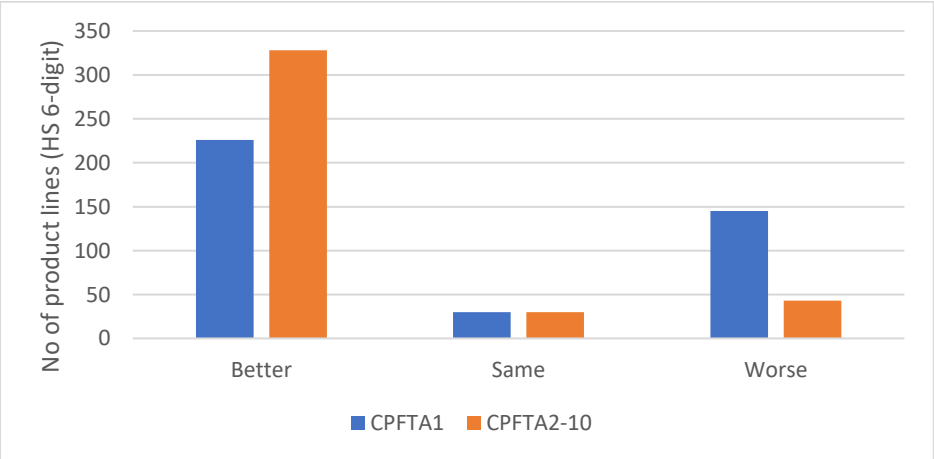


Notes: The average tariff for the 6-digit product lines was used for this chart, as tariff data for 8-digit product lines is not accessible on the large scale required

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

A similar trend is reflected when Pakistan's market access is compared to China's top 5 competitors in China (Figure 33). Pakistan's tariff is better for an additional 102 product lines than in Phase 1. Nevertheless, Pakistan's tariffs are still higher than competitors in 43 product lines (when tariff rates are compared at the HS6-digit level).

Figure 33 Tariff comparison of Priority 1 products at HS 6-digit, with China's top 5 import partner (2018) under CPFTA1 and CPFTA2



Notes: The average tariff for the 6-digit product lines was used for this chart, as tariff data for 8-digit product lines is not accessible on the large-scale required

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

To narrow down products that Pakistan could focus on in Phase 2, opportunities for current exporters to China are identified by defining competitive access. Priority 1 products with

competitive access in CPFTA2 must meet two criteria: 1) final year tariff access is lower than in Phase I; **and** 2) Pakistan's market access is better than its top 5 competitors in China under Phase 2 (as estimated for each HS 6-digit product line that was included in China's CPFTA2 tariff schedule). This yields 166 competitive access codes at the HS 6-digit level, or 41.4 per cent of total Priority 1 codes (Table 15).

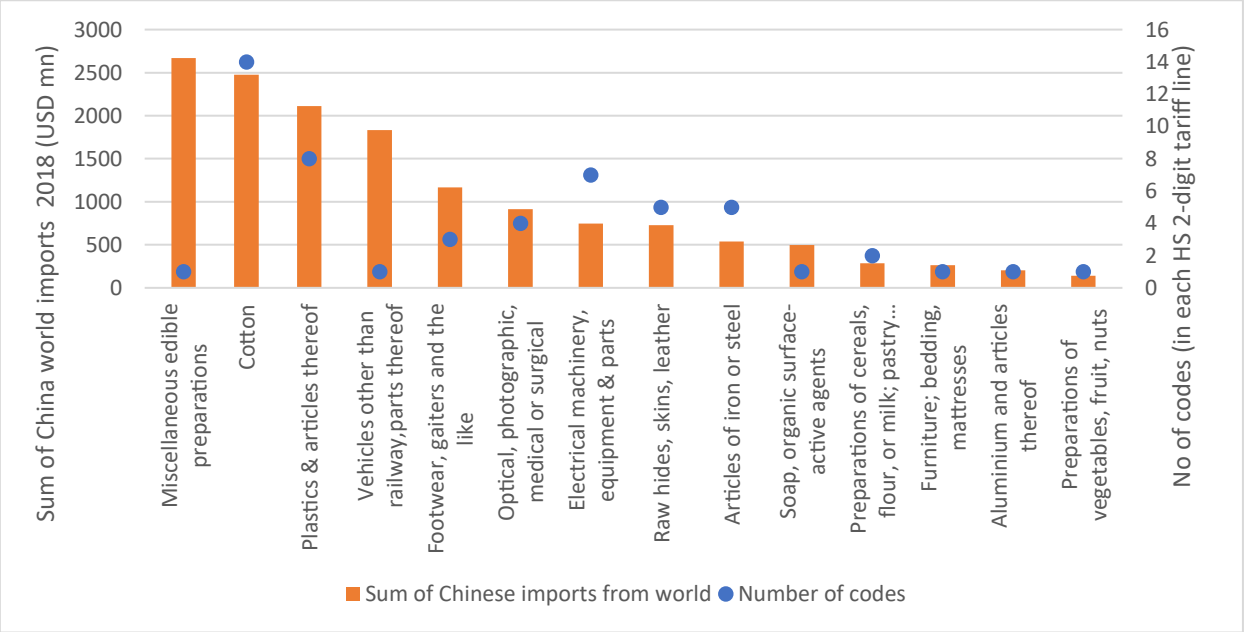
Table 15 Priority 1 codes, compared to CPFTA1 and Pakistan's top 5 competitors in China

Priority 1	No of tariff lines (HS 6-digit)
Same as CPFTA1, same as T5TP	26
Same as CPFTA1, better than T5TP	162
Same as CPFTA1, worse than T5TP	36
Better than CPFTA1, same as T5TP	4
Better than CPFTA1, worse than T5TP	7
Better than CPFTA1, better than T5TP (=competitive access)	166

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

A summary of these codes by HS 2-digit parent code is shown in Figure 34. Export opportunities in these sectors are ranked by size of import market and include product lines from miscellaneous edible preparations (HS 21), cotton (HS 52), plastics (HS 39), vehicles other than railways and their parts (HS 87), as well as footwear and raw leather hides (HS 64 and HS 41). The highest number of codes with superior access than top 5 competitors were from knitwear (HS 61, not shown) and machinery & mechanical appliances (HS 84).

Figure 34 Summary of Priority 1 product lines that have competitive access under CPFTA2, by parent 2-digit code



Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

China's total imports of these goods in 2018 was $15.4 billion, while Pakistan's global exports were $1.4 billion. Very high potential competitive access codes within these sectors comprise those lines where Pakistan's exports to the world exceed $1 million (a total of 96 tariff lines at the HS 8-digit level). Further details of some of these codes, the top competitor in China, the

tariff it faces and its share in China's market are given in Table 16 below. China's import growth rate by product over the last 5 years is also shown as a useful indicator of future demand.

Table 16 Selected Priority 1 product lines with competitive access under CPFTA2, HS 6-digit level

Code	Product label	Tariff under CPFTA2 Y10 (%)	Average tariff offered to top 5 trade partners (%)	Growth in value of China's imports 2014-2018 (%, p.a.)	Largest volume trade partner	Share in China's Imports (%)	Average tariff China applies to HVTP (%)
620332	Men's or boys' ensembles of cotton	0	4.8	-39	Bangladesh	47.9	0
520512	Uncombed single cotton yarn	0	1.4	-1	Vietnam	39.9	0
610349	Men's or boys' trousers of other textiles, knitted/crocheted	0	6	62	Italy	25.3	6
640399	Footwear with rubber soles, leather uppers	0	4.24	7	Vietnam	31.2	0
030319	Other frozen salmonidae	0	6	9	Chile	30	0
410792	Other bovine/equine leather, grain split, further prepd after tanning	0	3.66	-16	Italy	18.3	5
190531	Sweet biscuits	0	5.64	3	Indonesia	26.6	0
200911	Frozen orange juice	0	7.5	5	Brazil	69.8	7.5
210690	Food preparations, nes	0	5.44	27	Australia	23.7	0
040900	Natural honey	0	3	6	New Zealand	72.5	0
420291	Other cases & containers, nes, with outer surface of leather	0	3.6	56	Italy	55.7	6
681599	Articles of stone or of other mineral substances nes	0	15.86	8	Japan	40.7	16.1
630590	Sacks & bags, used for packing goods, of other textiles, nes	0	6	-16	Germany	66.3	6
850300	Parts of other machines of heading No. 85.01 or 85.02	0	4.36	-5	Japan	25.9	6.6
732690	Articles, i/s, not for technical use	0	7.1	3	Japan	21	8
560129	Wadding & articles of wadding	0	6.4	21	Japan	28.5	8
390690	Acrylic polymers prepared, in primary forms, nes	0	3.52	10	Korea, Republic of	23.3	4.6
820510	Drilling, threading, tapping tools	0	7.4	5	Japan	25	8
060390	Cut flowers&buds,other than fresh, for ornamental purpose	0	23	6	Ecuador	78	23
581010	Embroidery without visible ground	0	6.4	0	Chinese Taipei	29.9	8
691490	Articles of ceramics nes	0	9.32	5	Japan	31.2	10
140490	Vegetable products, nes	0	4.68	-1	Malaysia	40.9	0
620990	Babies' garments & accessories of other textiles materials, nes	5.6	6	30	Indonesia	15.6	0
050790	Tortoiseshell, whalebone,antlers, hooves, nails, claws & beaks	0	3.4	30	New Zealand	82.3	0

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

These products include a variety of products including primary commodities such as uncombed single cotton yarn, bovine/equine leather in prepared form, as well as ornamental cut flowers (not fresh). Products from the agro-processing sector such as frozen seafood, sweet biscuits,

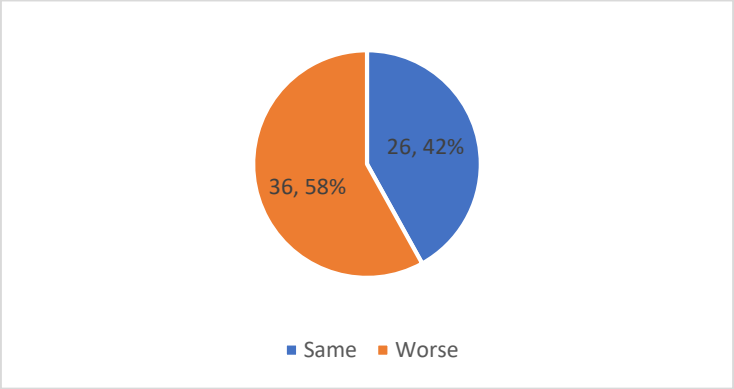
frozen orange juice, food preparations, nes., and natural honey have also secured better tariff access than Pakistan's competing suppliers to China. In addition, some value-added materials from the garments and footwear sector are also represented, including men's knitwear trousers of other textile materials and footwear with leather uppers and rubber soles. In addition, goods such as machine parts, acrylic polymers, and steel parts are also better placed than China's top import partners. This is a positive development— at worst, Pakistan has the same access as China's top partner, and at best, even better (the only exception is babies garments and accessories of other textile materials).For many of these products, China's imports from the world are not only high, but have also been growing consistently over the last 5 years.

In sectors where Pakistan and competing exporters now have equivalent or better market access, the strengths of competitor countries in key focus areas—such as quality, price, capacity, skills or technology— will be examined (in Section 5) for one or two sectors to help domestic firms become significant suppliers of these products to China.

Worse access products on Priority List 1

At the same time, it is important to get a sense of how well negotiated CPFTA2 was by identifying products with worse access relative to China's trade partners. There remain 62 product lines at the HS 6-digit level, or 15.5 per cent of Priority 1 tariff lines for which Pakistan has gotten the same or worse access than the top 5 competing suppliers in China. There are 36 products in which Pakistan is facing higher tariffs under CFPTA2 than its top 5 competing suppliers to China (Figure 35). While Pakistan's tariff rate is no worse than CPFTA1, it is still higher than its top 5 competitors in China. This is a setback for Pakistan, as Figure 36 includes two rice categories that are the 2nd and 4th largest export of Pakistan to the world. Furthermore, analysis reveals that China offers a lower tariff than Pakistan to, on average, 54 countries across these product categories. For example, for rice (HS 1006), Vietnam is being offered a tariff rate of 40 per cent which is much lower than the 65 per cent China continues to offer Pakistan since prior to CPFTA1.

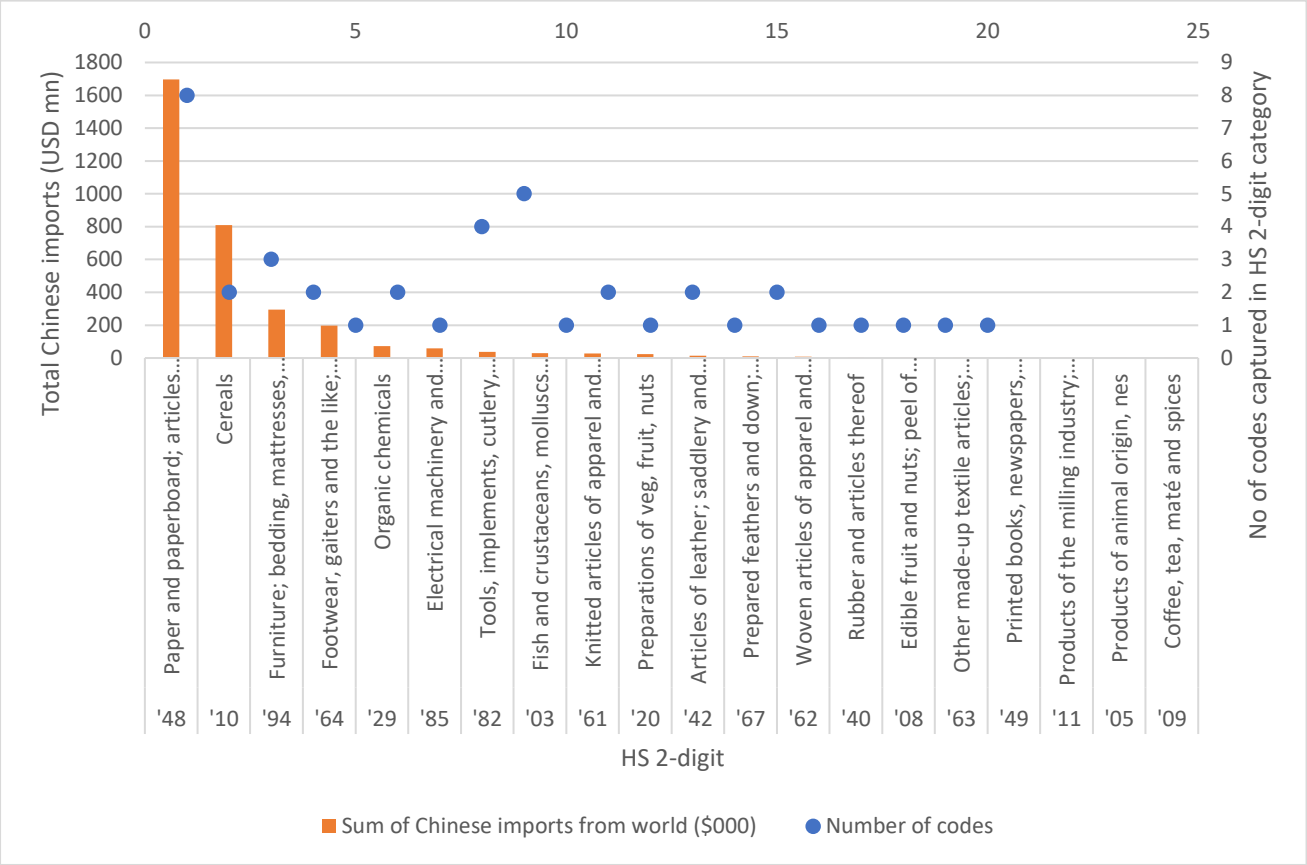
Figure 35 Access for Priority 1 tariff lines that did not see an improvement in CPFTA2



Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

In terms of product codes, Pakistan fares worse than its top 5 competitors in quite a few important export categories, amounting to $1.9 billion. The size of China's market for these products is almost equivalent ($2 billion)—the most important product codes at the HS 2-digit are shown below in Figure 36.

Figure 36 Summary of Priority 1 product lines with worse access than China's top 5 trade partners under CPFTA2, by parent 2-digit code



Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

Apart from rice, Table 17 shows that market access for Pakistan is worse for paper and paperboard articles such as kraft and flute paper, footwear uppers, jams, jellies and fruit purees, frozen jack and mackerel, cotton blankets and travelling rugs, men's ensembles of cotton, non-cotton men's anoraks, synthetic pantyhose and dried apricots.

Table 17 Priority 1 products with worse access than its top 5 competitors in China, by product, HS 6-digit

Code	Product label	Value of China imports in 2018 (USD mn)	Value of Pak exports in 2018 (USD mn)	Value of Pak Exports to China (USD)	Tariff under CPFTA2 Y10	Average tariff offered to top 5 trade partners (%)	China's tariff on HVTP	Growth in value of Chinese imports, 2014-2018 (%, p.a.)	Largest volume trade partner	Share in China's Imports (%)
10063010	Semi or wholly milled long grain rice	515	613.2	16.9 mn	65	43	50	8	Viet Nam	52
48051900	Other fluting paper, in rolls or sheets	479	0.212	0.2 mn	7.5	5.6	5	147	Indonesia	41.3
10063090	Other semi or wholly milled rice	295	1145	102 mn	65	43	50	8	Viet Nam	52
64061000	Uppers & parts thereof (excl. stiffeners)	1,845	0.3	5000	7.5	2.76	0	33	Viet Nam	14.2
29389090	Other glycosides &its salts, ethers, esters	73	346	0.4 mn	5	3.9	0	5	Singapore	42.2
48045100	Unbleached/uncoated kraft paper/paperboard	53	0.6	0.61 mn	2	0	2	22	USA	41.2
82032000	Pliers (incl. cutting pliers), pincers, tweezers & similar tools	37	0.9	8,000	10.5	6.4	0	4	Taipei, Chinese	25.4
48219000	Paper or paperboard labels of all kinds (excl. printed)	31.4	0.94	2,000	7.5	5	6	-1	Japan	25.6
20071000	Jams& marmalades &jellies/puree/pastes of fruit, homogenized	24.6	0.3	5,000	30	4	5	109	Spain	49.3
03035500	Frozen jack and horse mackerel	23.7	11	15,000	5	4.2	0	-10	New Zealand	43.4
61022000	Woman's or girls' coats, etc., of cotton, knitted or crocheted	16.6	0.5	1,000	14	2.64	0	22	Indonesia	25.7
48109900	Paper/paperboard, coated with kaolin, etc., nes	6.8	0.4	0.3 mn	7.5	4.8	6	10	USA	40.1
40114000	New pneumatic tires, of rubber, of a kind used on motorcycles	5.9	3.9	1,000	12	6	0	19	Thailand	27.2
61152200	Panty hose, etc., of synthetic fib knitted/crocheted	5.8	1.8	2,000	8	4.38	6	11	Japan	70.6
42010000	Saddlery and harness for any animal, incl. traces, leads, knee pads, muzzles, saddle cloths	5.5	9.3	8,000	10	7.2	10	38	Germany	41.7
08131000	Dried apricots	5.4	1.3	13,000	25	20	25	54	Turkey	40
61032200	Men's or boys' ensembles of cotton, knitted or crocheted	4.8	2.9	1,000	14.8	2.6	0	30	Viet Nam	57.6
63013000	Blankets (excl. electric blankets) & travelling rugs, of cotton	4.2	17.6	2,000	12.8	3.6	8	21	India	41.2
62019900	Men's or boys' anoraks, wind-cheaters, etc., of other textiles, nes	2.8	1.9	23,000	8	4.8	6	-8	Italy	51.5
11081200	Maize (corn) starch	2.5	11.1	33,000	20	16 20		12	USA	32.3

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

The discussion above detailed the expansion in market access for products that Pakistan already sends to China under the newly liberalized Phase 2 tariff regime. But to explore the possibility of diversifying and expanding the export basket to China in terms of a reasonable second set of exports that Pakistan has already been successfully exporting globally, the analysis must turn to market access gains for Priority 2 product lines.

4.4 Priority 2 products

Priority 2 product codes comprise product lines that Pakistan exports to the world, but not China (based on Pakistan's exports in 2018), that China is importing from elsewhere in the world. These 1436 products (at the HS 8-digit level) constitute the second priority list for Pakistan, as it has established global competitiveness by exporting USD 2.53 billion worth of these product lines to the world, and China has a demand for imports of the same amounting to a substantial USD 464.7 billion in 2018 (Table 18).

Table 18 Summary of Priority 2 codes, HS 8-digit level

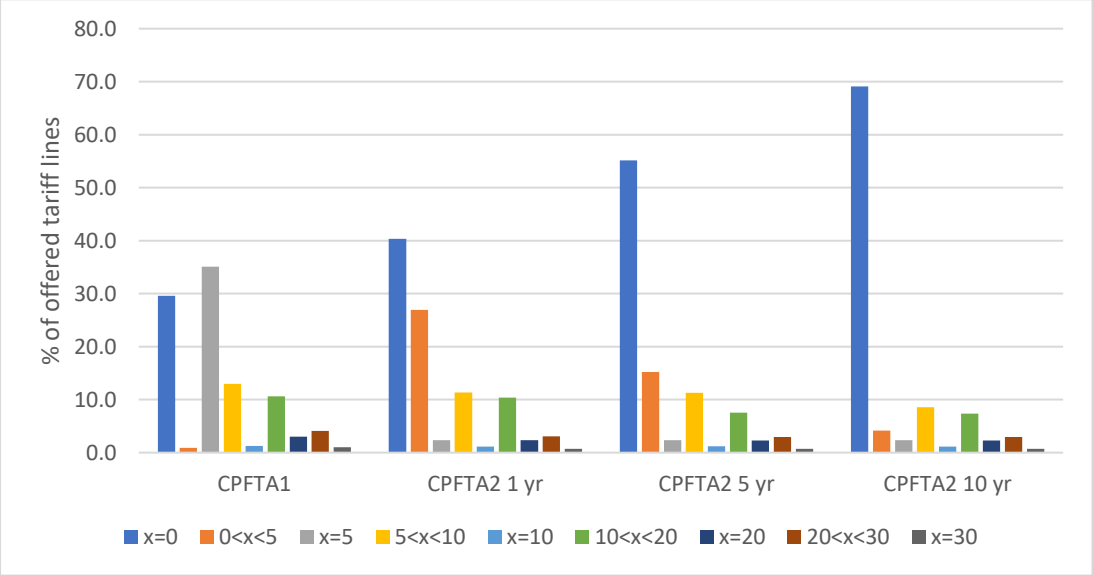
	Tariff lines in CPFTA	China's world imports (2018)	Pak world exports (2018)	Pak exp to China (2018)
Included in FTA	1436	USD 464.7 bn	USD 2.53bn	NA

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

4.4.1 Tariff Distribution

As with Priority 1 tariff lines, there was an improvement in all product lines when comparing tariffs across Phases 1 and 2, with an additional 575 product lines acquiring zero-duty access to China's market by the end of year 10 (Figure 37).

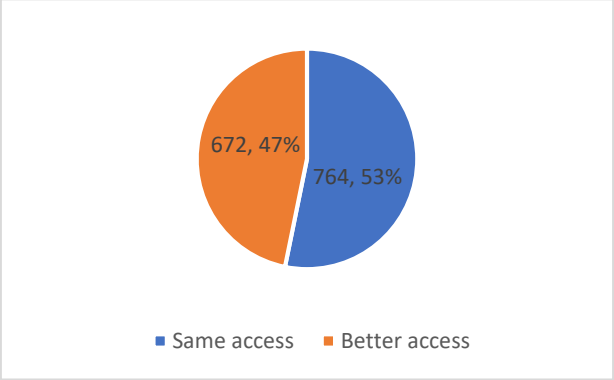
Figure 37 Comparison of tariff distribution of Priority List 2, by tariff lines, CPFTA1 and CPFTA2 (HS 8-digit level)



Source: Ministry of Commerce for CPFTA2 details, ITC TradeMaps for remaining data. Author's calculations

Priority 2 codes saw the largest percentage increase in improved access in terms of product lines (47 per cent) as indicated by Figure 38, which bodes well for Pakistan to diversify its export basket to China in the medium (5 years) to long-term (10 years).

Figure 38 Number of Priority 2 product lines that improved under CPFTA2 (year 10) vs CPFTA1, 8-digit level

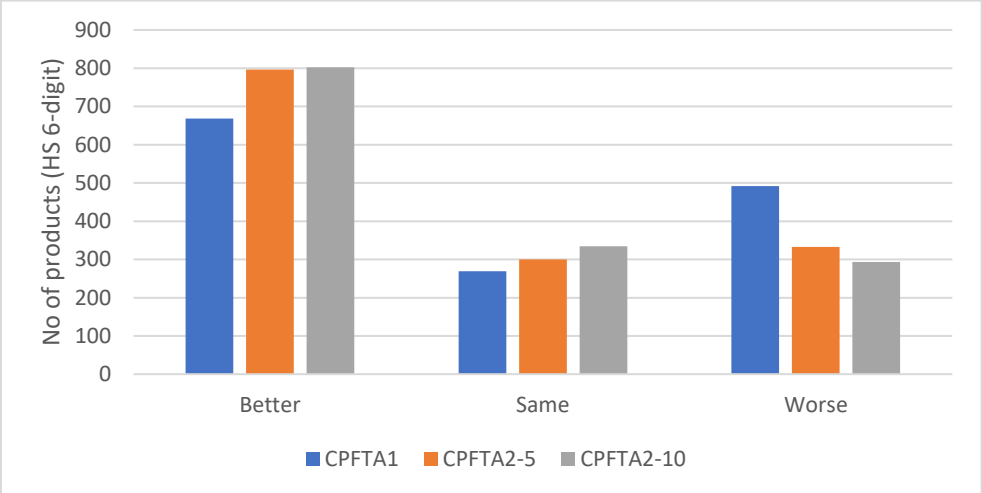


Source: Ministry of Commerce for CPFTA2 details, ITC TradeMaps for remaining data. Author's calculations

4.4.2 Market access relative to competitors

Pakistan must now push to acquire a share for some of these products in China's market. If Pakistan is to succeed in diversifying its current export basket to China to include some of its global exports, it will be useful to have secured better tariff access vis-à-vis key competing suppliers of those product lines to China. Figure 39 shows that access has improved in CPFTA2 relative to China's highest value trade partner for 112 additional products. Despite this, tariffs remain higher for Pakistan in almost 300 product codes in CPFTA Phase 2.

Figure 39 Tariff comparison of Priority 2 products at HS 6-digit, with China's top import partner (2018) under CPFTA1 and CPFTA2

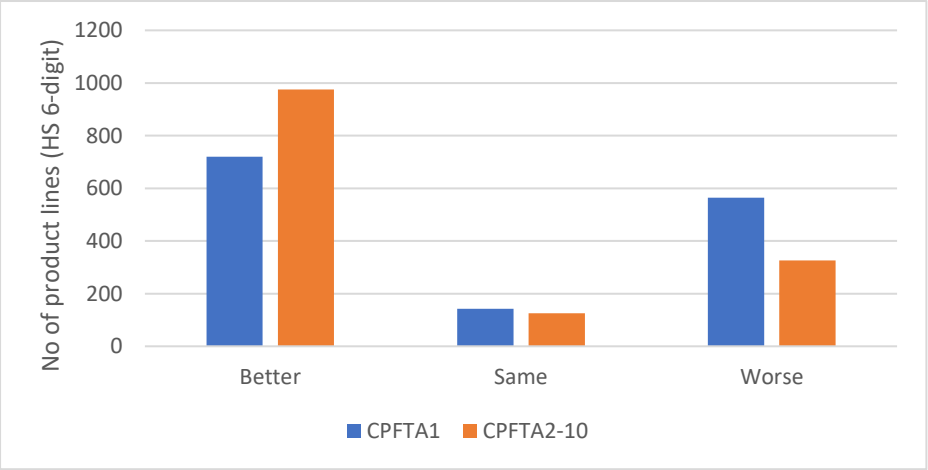


Notes: 1) Trade and tariff data for China's trade partners was not available for 2 out of 1436 product lines in section 3b (at 8-digit level). These product lines are excluded from this chart. 2) The total number of codes used in the comparison with China's import partners is 1436. 3) The average tariff for the 6-digit product lines was used for this chart, as tariff data for 8-digit product lines is not accessible on the large scale required

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

The number of products with better access improve further when comparing Phase 1 and 2 tariff access with respect to China's top 5 import partners as shown in Figure 40. Pakistan faces lower duties on 68 per cent of Priority 2 products.

Figure 40 Tariff comparison of Priority 2 products at HS 6-digit, with China's top import partner (2018) under CPFTA1 and CPFTA2

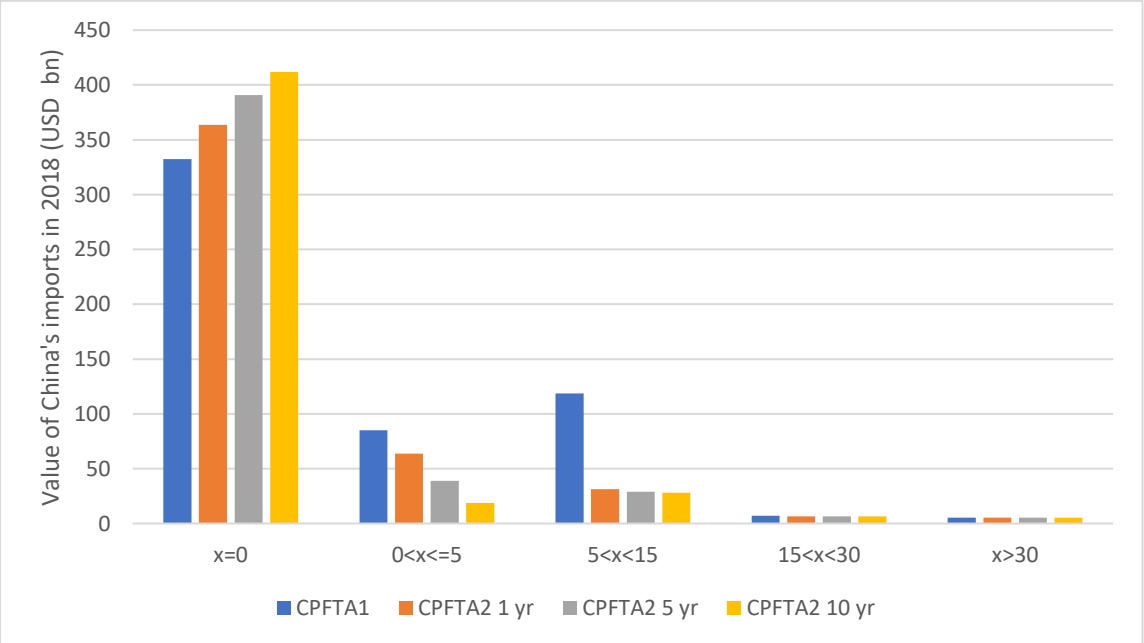


Note: 1434 product codes analysed at HS 6-digit level, using the average estimated tariff for top five import partners of China in 2018

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

To reiterate the opportunity canvas, China's imports from the world of Priority 2 products in 2018 are shown below (Figure 41). Should Pakistan be able to expand exports in these lines, it is looking at an additional duty-free market of USD 79.6 billion, compared to CPFTA1.

Figure 41 Tariff distribution of Priority 2 products, by value of China imports in 2018, CPFTA1 and CPFTA2



Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

With such a large potential market, Pakistan must immediately focus on those products in which its market access is superior than competing suppliers to China. As before, competitive access is defined as those Priority 2 products of CPFTA2 that are doing better than Phase 1 and also face lower tariffs than the average of China's top 5 import partners for that product.

Under Phase 2, Pakistan has competitive access in 603 Priority 2 codes, or 42 per cent of total tariff lines that Pakistan is exporting to the world, but not to China. These represent a sizeable slice of the overall USD 464.7 billion Priority 2 import market in China that was mentioned above in Table 14—a slice that was equivalent to USD 89.5 billion in 2018. The data shows that Pakistan's tariff is lower than its top 5 export competitors in China for 603 out of 1434 tariff lines, or in terms of global exports, worth USD 1.2 billion of the total USD 2.53 billion Priority 2 codes it exported in 2018.

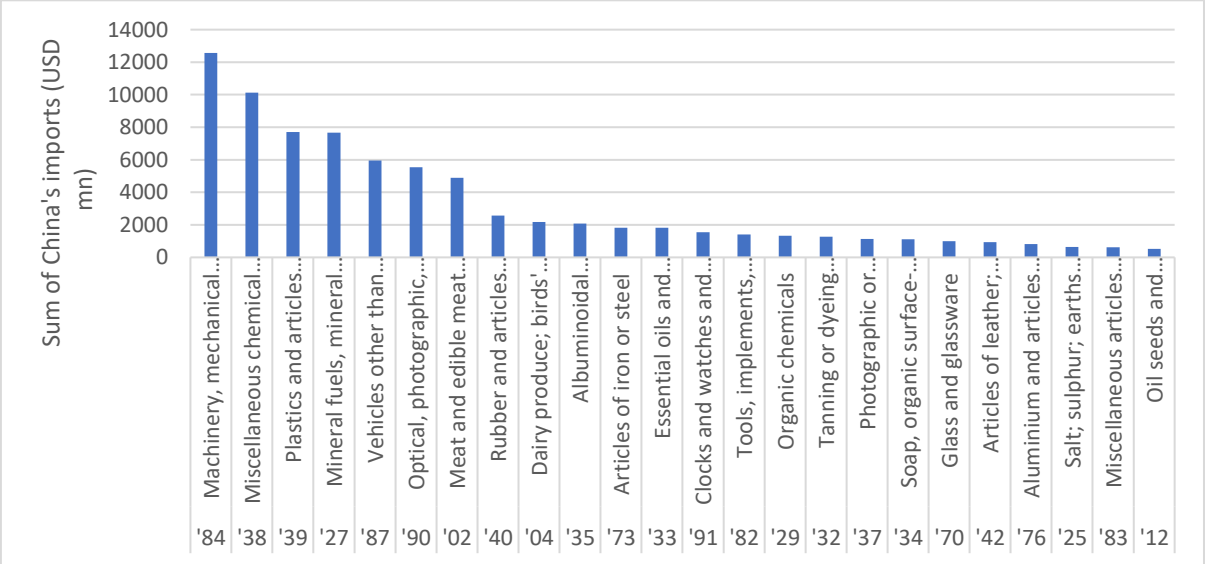
Table 19 Priority 2 codes, compared to CPFTA1 and Pakistan's top 5 competitors in China

Priority 2	No of tariff lines (HS 6-digit)
Same as CPFTA1, same as T5TP	124
Same as CPFTA1, better than T5TP	374
Same as CPFTA1, worse than T5TP	266
Better than CPFTA1, same as T5TP	7
Better than CPFTA1, worse than T5TP	60
Better than CPFTA1, better than T5TP (=competitive access)	603

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

At the HS 2-digit level, these amount to 62 tariff lines, of which only those where China's imports exceed USD 500 million are shown in Figure 42. The remaining product codes (not shown) account for USD 3.8 billion. Top tariff lines under Phase 2 in which Pakistan has competitive access now relative to China's top 5 trade partners and for which China has high import demand are machinery and mechanical appliances, chemical products, plastics, optical and surgical instruments as well as meat and edible offal.

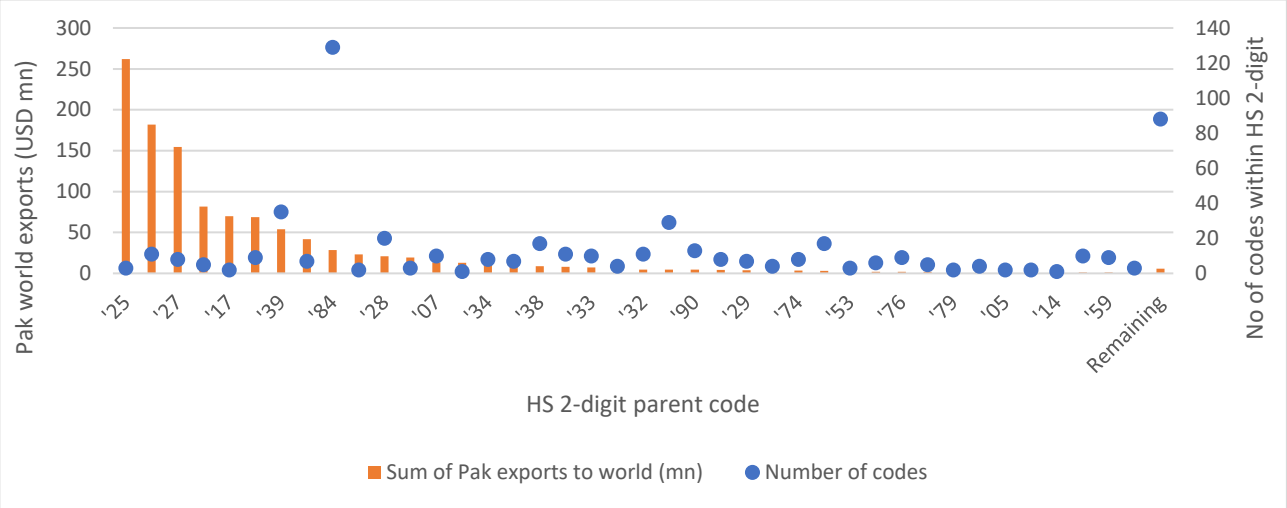
Figure 42 Summary of Priority 2 product lines that have competitive access under CPFTA2 (HS 2-digit), by no. of codes and Pakistan world exports in 2018



Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

The figure above shows sizeable import demand in China for many of the competitive access Priority 2 product codes, and as
Figure **43** shows, Pakistan exported considerable amounts of the same globally (the figure excludes competitive access product lines where the total value of Pakistan world exports is lower than $1 million in 2018). The highest number of competitive access product codes that Pakistan has been exporting globally belongs to machinery and mechanical appliances (129), plastics (39) and articles of steel and iron (29).

Figure 43 Summary of Priority 2 product lines that have competitive access under CPFTA2, by parent 2-digit code, by no. of codes and Pakistan world exports



Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

Table 20 presents potential competitive access products where Pakistan's global exports exceed USD 1 million at the disaggregated HS level. These are top candidates that Pakistan should target for China's market, as for these products Pakistan has duty-free access in China, Pakistan's tariff is lower than the existing top trade partner, and China has demand for that product.

Table 20 Top competitive access Priority 2 products, where Pakistan global exports exceed USD 1 million (2018), HS 6-digit level

Code	Product label	China imports 2018 (USD 000)	Pak world exports 2018 (USD 000)
25231000	Cement clinkers	588,171	60,671
61071100	Men's or boys' underpants & briefs of cotton, knitted or crocheted	19,905	58,660
63014000	Blankets (excl. electric blankets), etc., of synthetic fibers	5,672	15,301
89040000	Tugs and pusher craft.	7,094	12,994
52053100	Uncombed cabled cotton yarn, cotton85 per cent, single yarn714.29decitex	1,102	6,987
35030010	Gelatin & derivatives	15,911	5,933

28272000	Calcium chloride	1,861	3,521
32089090	Other paints & varnishes, nes	396,384	3,178
74182000	Sanitary ware & parts thereof, of Cu	23,096	3,165
62059090	Men's or boys' shirts of other textile materials, nes	12,741	2,496
04022100	Milk & cream in solid forms of>1.5 per cent fat, concentrated, unsweetened	1,746,636	2,380
79031000	Zinc dust	20,259	1,738
38260000	Biodiesel and mixtures thereof, not containing or containing less than 70 per cent by weight of petroleum ...	535,737	1,271
05071000	Ivory, its powder & waste, unworked	3,524	1,234
14011000	Bamboos	842	1,223
42022200	Handbags, outer surface of plastic sheeting or of textile materials	473,268	1,076

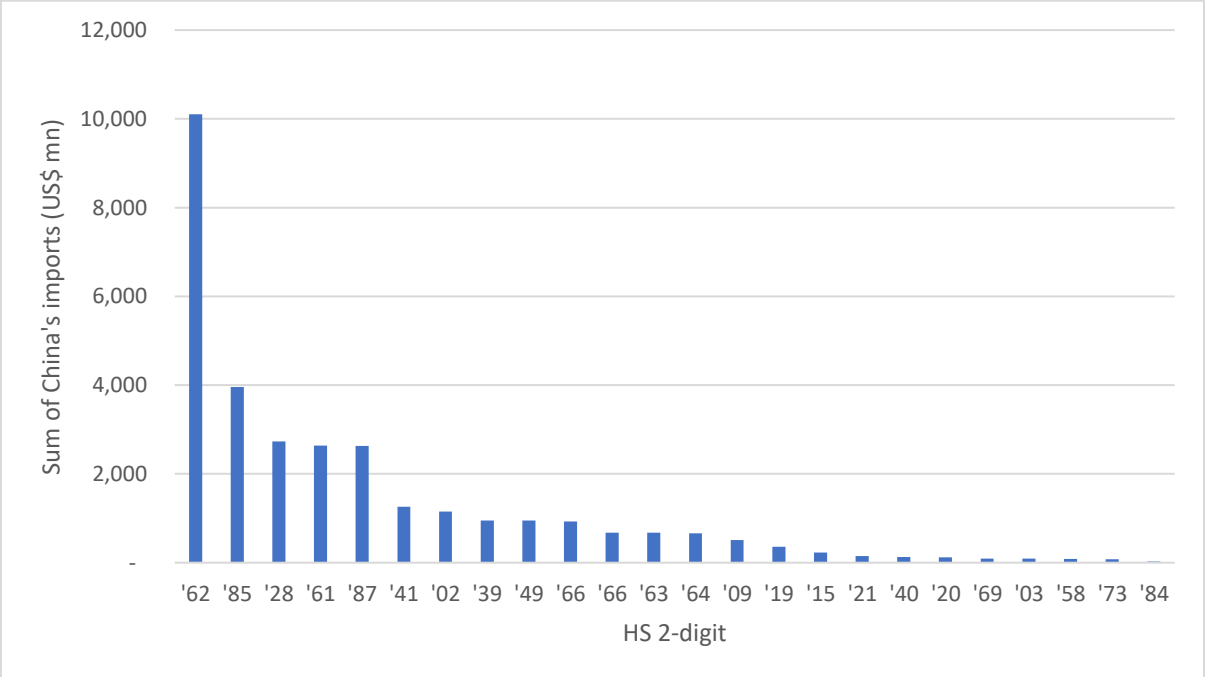
Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

On the face of it, the subset of competitive access Priority 2 codes do not include any of the top 20 Pakistan export categories at the HS 6-digit level—the highest potential Priority 2 code ranks 24th in 2018 (HS 252329, Portland cement). However, when Pakistan's 24th ranked world export has a USD 45.3 billion market in China, it suggests that even a small slice of China's market is a considerable win for Pakistan's exports. Whether Pakistan can translate this tariff access into export gains requires a deeper analysis of sector-wise exports for top potential candidates. This will be discussed in section 6 for two sectors.

Worse access Priority 2 products

Almost 391 Priority 2 products (which comprise approximately 27 per cent of total Priority 2 tariff lines) have not gained competitive access in CPFTA2 relative to China's top import partner. China's global imports in these products lines are $306.8 billion. The top 2 categories are cotton and paper & paper board (not shown on Figure 44), for which China's total imports were USD 285 billion.

Figure 44 Summary of Priority 2 product lines with worse access than China's top 5 trade partners under CPFTA2, by parent 2-digit code

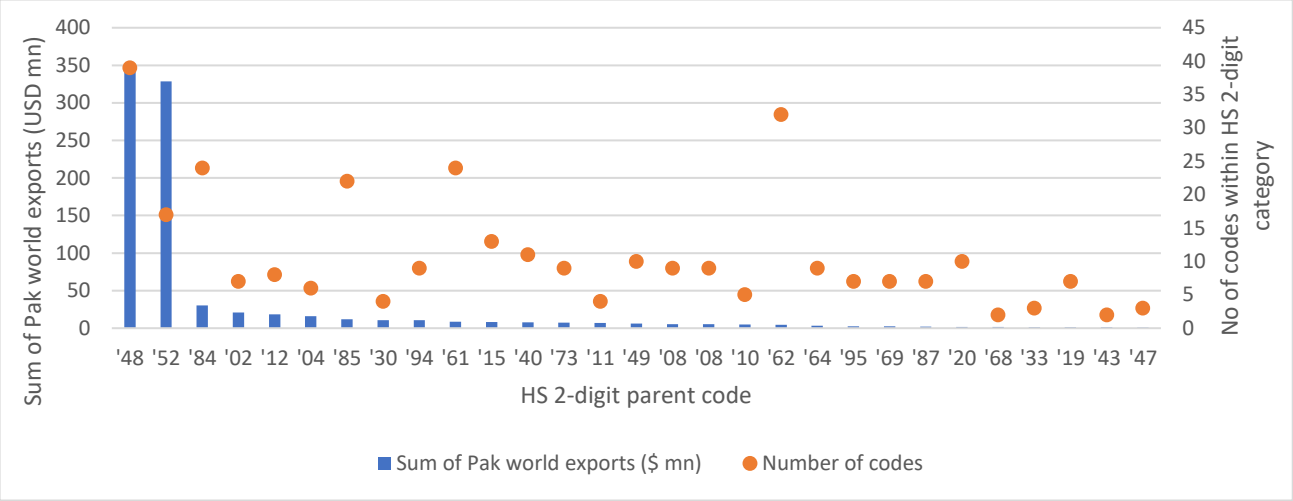


Note: For better visualization, this excludes China's top 2 categories of HS 52 and HS 48

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

As may be seen in Figure 45, these two categories are relatively important in Pakistan's world export basket. Overall, Pakistan's tariff is higher than its competitors in exports worth $883.6 million. These 391 tariff lines collapse to 59 HS 2-digit level codes, which are concentrated in cotton yarn (15 codes), non-cotton and man-made fiber (MMF) men's and women's knitted and woven garments (56 codes), as well as in machinery and mechanical appliances along with their parts (46 codes), vegetable and edible oils (13 codes) and many items from paper and paperboard articles. Processed food and edible fruit (19 codes) also face higher tariffs in China than those it offers its other trade partners (Figure 45). Other tariff lines at the HS 6-digit level that have been poorly negotiated include medicaments of hormones, durum and other wheat (excluding seed), other black tea, men's cotton knitted coats, and new rubber bicycle tires.

Figure 45 Summary of Priority 2 product lines that have worse access under CPFTA2, by parent 2-digit code, by no. of codes and Pakistan world exports



Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

Sections 4.3 and 4.4 have detailed market access improvements between Phases 1 and 2 and also in relation to Pakistan's top competitors in China separately for products exported to China and the world, respectively. Section 4.3 explores market opportunities in the third category of products that are important for Pakistan—those which Pakistan is currently not exporting at all. The focus is now on new product lines that Pakistan could possibly begin exporting on account of competitive market access under CPFTA2 and underlying comparative advantage—starting with China. This could diversify Pakistan's export offering to China. Identifying these products now provides a reasonable timeframe for exporters to gear up to take advantage not only of competitive access, but also of CPEC-related improvements in investment, production and distribution of those goods.

4.5 Priority 3 products

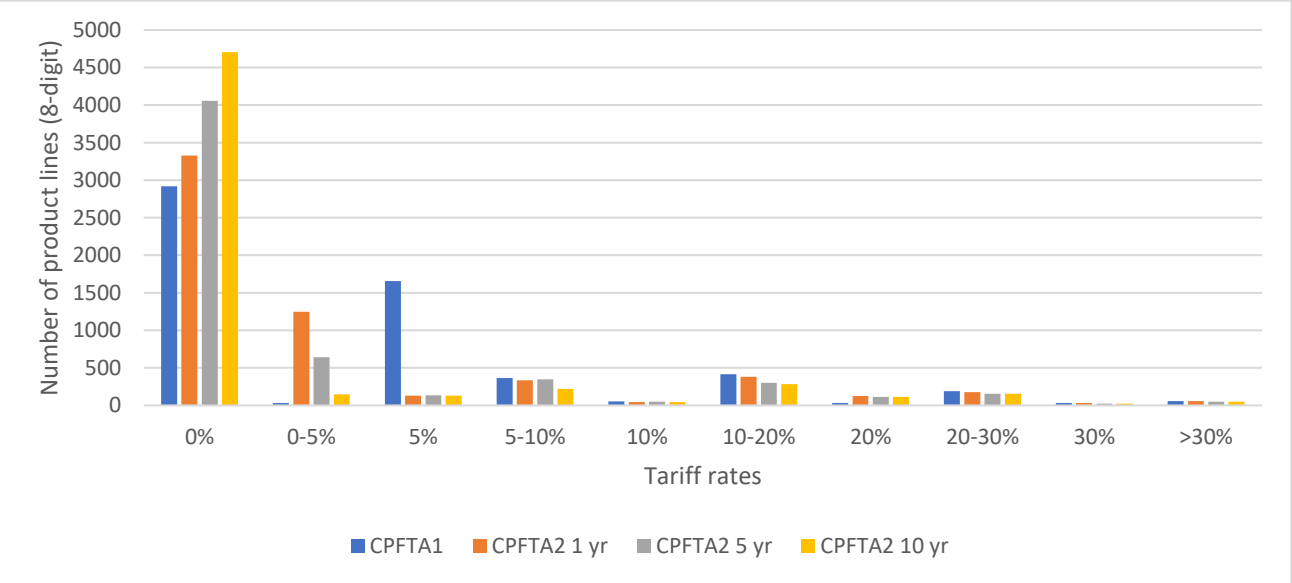
This section explores tariff access given to Pakistan under the CPFTA2 for the products that China imports, but that Pakistan does not export to China or elsewhere. These products could be potential new exports for Pakistan, which were not feasible earlier due to uncompetitive tariff access. For these products, more competitive tariff access is a necessary but insufficient condition. Further conditions for successfully tapping the Chinese market for these products are that Pakistan must i) have latent competitive advantage in producing these goods, and ii) be able to resolve any non-tariff impediments that have precluded access so far.

This section explores the conditions of better tariff access and latent competitive advantage. Non-tariff impediments are discussed further in Section 5.

4.5.1 Tariff Distribution

Figure 46 compares the distribution of tariffs for Priority 3 products under CPFTA1 with three points in time in the CPFTA2: 1 year (immediate access), 5 years (mid-term) and 10 years (final tariff). It is clear that, as with the other product categories examined earlier, there is a redistribution towards better access. The most significant shifts are in the zero-tariff category and in the 5 per cent tariff category, with a shift in number of product lines from the 5 per cent tariff towards the 0 per cent tariff category. Out of these 5872 products in Priority 3, in ten years, 4701 product lines will have tariff-free access, as compared to 2917 product lines under CPFTA1, an increase of over 60 per cent.

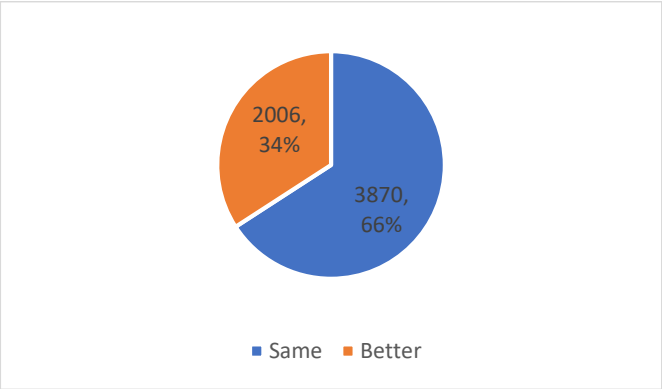
Figure 46 Comparison of tariff distribution of Priority 3 products, CPFTA1 and CPFTA2, 8-digit level



Source: Ministry of Commerce for CPFTA2 details, ITC TradeMaps for remaining data. Author's calculations

In total, just over 2000 product lines (34 per cent of the HS 8-digit Priority 3 product lines) will have access to lower tariffs than they did under CPFTA1. This is illustrated in Figure 47.

Figure 47 Number of Priority 3 product lines that will see lower tariffs under CPFTA2 (year 10) vs CPFTA1, 8-digit level



Source: Ministry of Commerce for CPFTA2 details, ITC TradeMaps for remaining data. Author's calculations

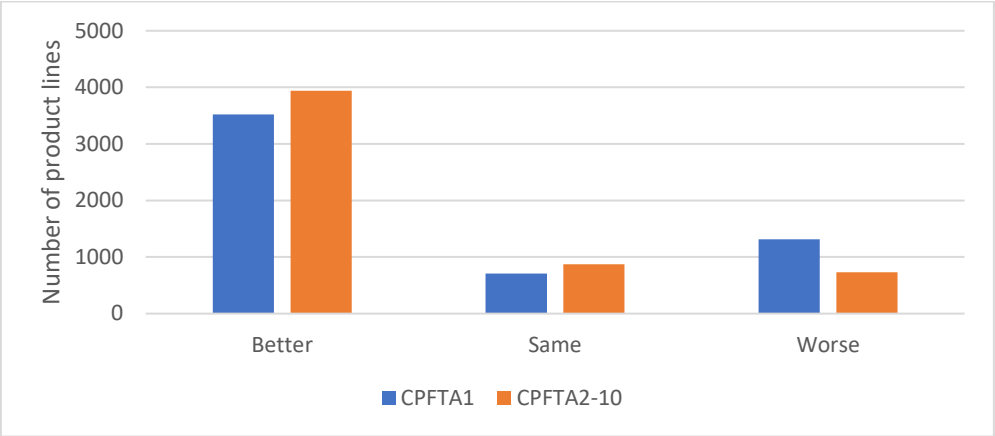
4.5.2 Market access relative to competitors

In order to assess whether this translates into better market access, it is important to consider the tariffs that China offers to other countries. As before, two main benchmarks are used for this: tariffs offered to the top exporter to China, and the average tariff offered to the top five exporters for that specific product line. Figure 48 illustrates. The figure allows several interesting observations to be made. Firstly, for over 60 per cent of the Priority 3 product lines, CPFTA1 tariffs for Pakistan were already less than the tariff offered to the country that exported that product the most to China (in dollar terms). This has now increased further to just over 70 per cent under CPFTA2. Secondly, there are now fewer product lines in which Pakistan faces higher tariffs than the highest value exporter—a decrease of 582 product lines, nearly halving the original set of 1313 product lines that faced higher tariffs than the highest value exporter. There is also an increase of 162 product lines in the category for which tariff access granted to Pakistan is the same as that offered to the highest value trade partner.

Figure 49 shows a similar pattern when the tariff access under CPFTA2 is compared to the average of the top 5 partners.[13]

[13] For product lines where there were less than five exporters of the product, the average for all available partners is taken. For many product lines, China was in the top five exporters itself, due to re-exports. In those instances, the 6th trade partner is included, which China is, naturally, discarded.

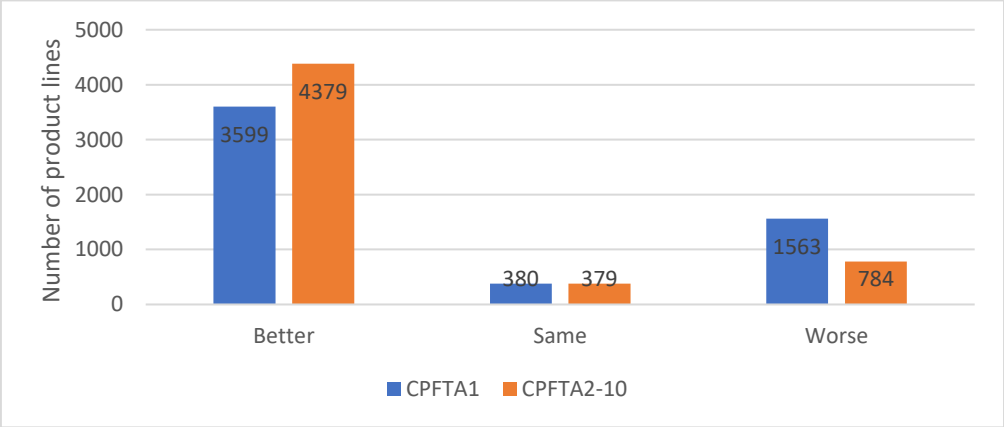
Figure 48 Comparison of tariffs under CPFTA1 and CPFTA2, with tariffs offered to China's highest value exporter for each product category (Priority 3 products)



Notes: 1) Trade and tariff data for China's trade partners was not available for 330 out of the 5872 product lines in Priority 3 (at 8-digit level). These product lines are excluded from this chart. 2) The average tariff for the 6-digit product lines was used for this chart, as tariff data for 8-digit product lines is not accessible on the large-scale required

Source: Ministry of Commerce for CPFTA2 details, ITC TradeMaps for remaining data. Author's calculations

Figure 49 Comparison of tariffs under CPFTA1 and CPFTA2, with tariffs offered to China top 5 value exporters for each product category (Priority 3 products)

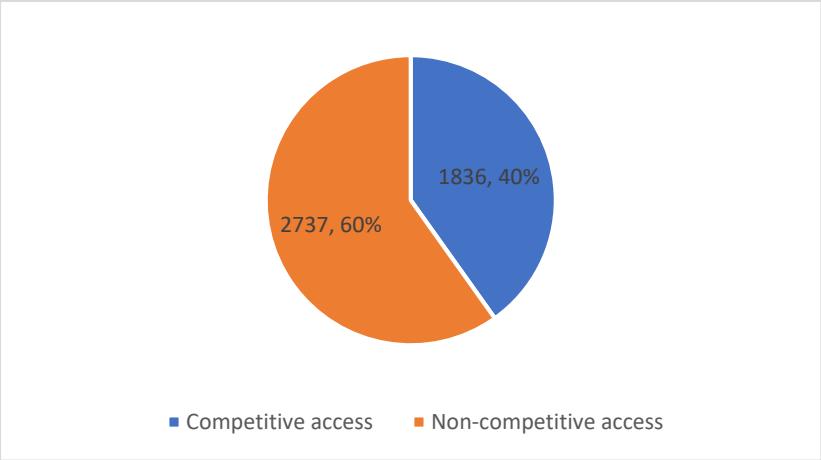


Notes: 1) Trade and tariff data for China's trade partners was not available for 330 out of the 5872 product lines in Priority 3 (at 8-digit level). These product lines are excluded from this chart. 2) The average tariff for the 6-digit product lines was used for this chart, as tariff data for 8-digit product lines is not accessible on the large-scale required.

Source: Ministry of Commerce for CPFTA2 details, ITC TradeMaps for remaining data. Author's calculations

In order to explore the sectors which have enhanced access under CPFTA2 in more detail as done for sections 4.3 and 4.4, the Priority 3 products were short-listed to produce a set of "competitive access" product lines, details of which are available in Annex 4.5.1. These are again defined as those product lines in which final tariff under CPFTA2 is lower than i) the tariff offered under CPFTA1 **and** ii) the average tariff offered to the top five countries that export the product to China (in terms of value in USD). As shown in Figure 50, 40 per cent of the 4573 Priority 3 product lines now have competitive access, as defined by the criteria specified above. The value of Chinese imports for these 1836 product lines that have competitive access now was USD 176.5 billion in 2018.

Figure 50 Priority 3 product lines that have competitive access under CPFTA2

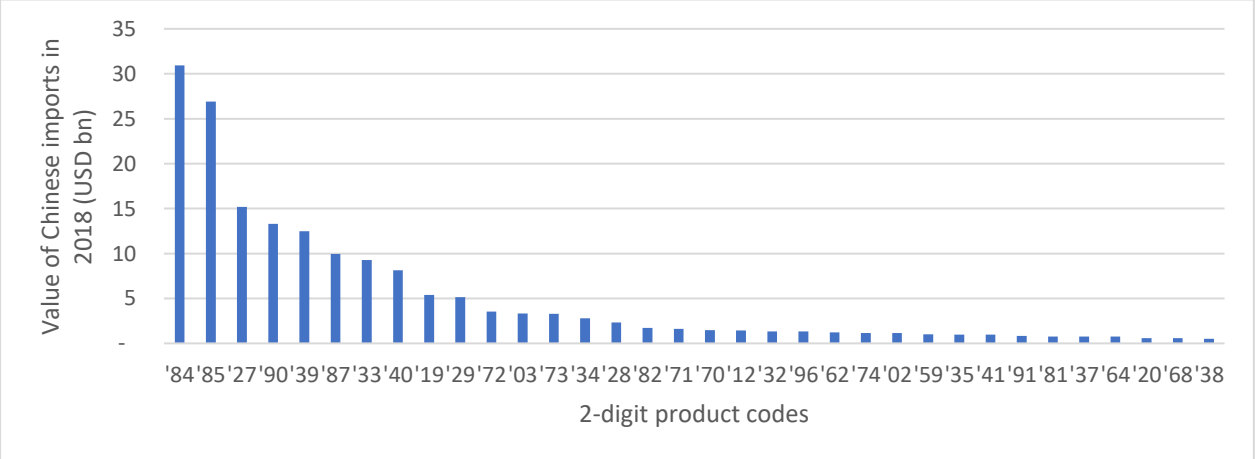


Notes: 1) Trade and tariff data for China's trade partners was not available for 330 out of the 5872 product lines in Priority 3 (at 8-digit level). These product lines are excluded from this chart. 2) The average tariff for the 6-digit product lines was used for this chart, as tariff data for 8-digit product lines is not accessible on the large-scale required

Source: Ministry of Commerce for CPFTA2 details, ITC TradeMaps for remaining data. Author's calculations

These product lines encompass a wide range of products and countries. Figure 51 summarizes the data for the top product lines that have competitive access under CPFTA by 2-digit product families. The chart excludes the 51 2-digit product families in which China imported less than USD 1 billion in 2018. The highest value product lines are machinery, mechanical appliances etc., and electrical equipment and parts. Mineral fuels, optical, photographic and surgical equipment, plastics, vehicles and essential oils are included in the list of products with competitive access.

Figure 51 Summary of Priority 3 product lines that have competitive access under CPFTA2, by parent 2-digit code



Notes: 1) Trade and tariff data for China's trade partners was not available for 330 out of the 5872 product lines in Priority 3 (at 8-digit level). These product lines are excluded from this chart. 2) The average tariff for the 6-digit product lines was used for this chart, as tariff data for 8-digit product lines is not accessible on the large-scale required. 3) 2-digit product families in which China imported less than USD 1bn in 2018 are excluded

Source: Ministry of Commerce for CPFTA2 details, ITC TradeMaps for remaining data. Author's calculations

4.5.3 Latent competitive advantage

Annex 4.5.2 summarizes the Priority 3 product lines that have competitive access under CPFTA, both by 2-digit product family codes, and by the main exporter to China for these codes. These are the main countries that Pakistan will be competing with for market access to China.[14]

The list of countries within each product code also gives an idea of the capabilities required to access the Chinese market. The products that China currently imports from Japan and Germany, for example, require a different capability than the products that China imports from Bangladesh and India.

This idea is formalized in Dr. Justin Lin's Growth Identification and Facilitation Framework (GIFF) (Lin, 2010). This approach identifies realistic new products for countries to expand into based on their latent competitive advantage. This is in turn revealed through an examination of the tradable goods and services that have been produced for around 20 years in dynamically growing countries with a similar endowment structure to the reference country, and per capita income of about 100 to 300 per cent higher than the reference country, or a similar per capita income 20 years ago. The idea is that such countries are realistic benchmarks for what can be achieved, given the set of capabilities that the reference country has to begin with.

These countries are narrowed down further by limiting the set to those for which minimum wage is now higher than the reference country. This subset of countries is referred to as "transfer countries". The top ten exports of these countries, which have been produced for twenty years or so, are shortlisted as products that have driven growth, and in which the reference country could now diversify, building partnerships with the transfer countries for technology as they move out of the products themselves due to rising labor costs. In particular, China has strong potential as a transfer country for Pakistan, as CPEC agreements, trade wars with the US, and increasing disputes with some neighboring countries make relocating production facilities to Pakistan an attractive choice.

Afraz, Khan and Hussain (2019) apply this methodology to Pakistan, the results of which are summarized in Table 21. These are a list of aspirational but realistic product groups for Pakistan to develop export strength in, which have the potential to drive economic growth as they have done in the transfer countries.

Table 21 Products and transfer countries identified using the GIFF methodology

[14] For several products, there are of course several other countries that also export the product to China, and which define the set of competitors for Pakistan. However, the processing requirements for going into that level of detail go beyond the scope of this exercise. For tractability, this more detailed analysis is undertaken for a smaller subset of products in Section 5.

HS Code (4-digit)	Label	Value imported globally in 2018 (USD bn)	Annual growth in global imports between 2014-2018 (%, p.a.)
Transfer country: Belarus			
8708	Parts and accessories for motor vehicles	418.23	3
8704	Motor vehicles for the transport of goods	144.56	4
9403	Other furniture and parts thereof	86.99	3
8701	Tractors (other than works, warehouse equipment)	56.33	1
8418	Refrigerators, freezers and heat pumps NES	46.63	2
5402	Synthetic filament yarn (not sewing thread) not retail	19.46	1
Transfer country: China			
8504	Electric transformers, static converters and rectifiers	101.77	1
3926	Plastic articles NES	78.49	4
4202	Trunks, suitcases, camera cases, handbags, etc.	69.32	3
6204	Women's, girls' suits, jacket, dress, skirt, etc., woven	58.79	1
6110	Jerseys, pullovers, cardigans, etc., knit or crochet	57.29	0
9503	Other toys, scale models, puzzles, etc.	50.78	3
Transfer country: Indonesia			
2603	Copper ores and concentrates	64.47	6
4412	Plywood, veneered panels and similar laminated wood	16.71	3
Transfer country: Viet Nam			
8473	Parts, accessories, except covers, for office machines	140.37	4
6404	Footwear with uppers of textile materials	42.98	13
6202	Women's, girls' overcoats, capes, wind jackets etc., woven	20.37	4

Source: Afraz, Khan and Hussain (2019)

Within these 4-digit product codes, several product lines now have competitive access to China under CPFTA2. A detailed list of all these product lines is available in Annex 4.5.3. As an illustration, it can be seen in Annex 4.5.3 that two-thirds of the Priority 3 product lines for parts and accessories for motor vehicles have competitive access now. China currently imports these products from Japan, Germany and Korea which face tariffs of 5.3-6 per cent in China. Pakistan faced tariffs ranging from 5 per cent to 12 per cent for these products under CPFTA1. Under CPFTA2, most of these products now face zero tariffs, and the highest tariff for any product in this category is 4.85 per cent.

Similarly, for refrigerators, freezers and heat pumps, nearly 75 per cent of the Priority 3 product lines now face competitive access. China currently imports these products from Korea, Germany and the United States, which pay tariffs of 4-8.7 per cent. For Pakistan this varied previously from 5-30 per cent. Under CPFTA2, again, most product lines face zero tariffs, and the highest tariff in this category is now 6 per cent.

Pakistan therefore has better access in a variety of products than China's current main trade partners.

The broad concepts behind the GIFF methodology are also useful to shortlist other opportunities in the Priority 3 competitive access products based on capability, labor cost advantages, price, technology and proximity with China. As a proxy for similar or achievable levels of capability, those products are selected for which the top exporting country to China has a similar income per capita as Pakistan's (100-300 per cent of Pakistan). This short-list includes Bangladesh, Uzbekistan, India, Vietnam, the Philippines and Indonesia. Countries that

produce unique, natural resource-based products are excluded even if they are similar in terms of income, for lack of applicability to Pakistan.

Table 22 lists these countries, adding data on minimum wages to infer labor cost advantages and distance to China to gauge logistical advantages. As described earlier, Lin (2010) uses minimum wage as the single variable that indicates a relative edge over the transfer countries. For the purposes of this report, which is specific to exports to China rather than to the world in general, we can add the logistical advantage that Pakistan has in trading with China, which arises from closer proximity, a shared border and good physical connectivity under CPEC. These factors give Pakistan a relative advantage over several of China's trade partners.

For the list of countries with broadly similar income per capita as Pakistan, however, distance to China does not give much of an edge as these countries are all in the same region. Pakistan's minimum wage, on the other hand, is much lower than the Philippines, Indonesia and Vietnam.

Table 22 Benchmarked trade partners

	Benchmarked country's GDP per capita/Pakistan's GDP per capita	Minimum wage 2018 (current USD)	Geographical distance to China (km)	Shared border with China
Pakistan	1	100	4314	yes
Bangladesh	1.07	94.85	2789	no
Uzbekistan	1.25	57.67	4220	no
India	1.35	106	4046	yes
Vietnam	1.61	180.44	2346	yes
Philippines	2.03	267.34	2431	no
Indonesia	2.62	256.44	4562	no

Notes: 1) Data corroborated by national wage board websites, newspaper articles for Uzbekistan.2) Local currency national minimum wage was converted to USD using nominal exchange rates as of 21.08.2019

Source: ***https://countryeconomy.com/national-minimum-wage***

Detailed data for all the countries in Table 22 is available in Annex 4.5.4. As an illustration, the Priority 3 competitive access products for which Bangladesh is currently the highest value trade partner are shown in Table 23.

Table 23 Priority 3 competitive access products for which Bangladesh is the highest value trade partner

Country	**Bangladesh**		
HS product code for which it is the highest value trade partner (HVTP)	62034290	62034210	62092000
Product label	Men's or boys' trousers, breeches, nes, of cotton	Men's or boys' Arabian trousers, breeches of cotton	Babies' garments & clothing accessories of cotton
Total value of Chinese imports from all countries (USD million, 2018)	385.8	0.004	22.1
Tariff under CPFTA1	8	8	7
Tariff under CPFTA2 YEAR 1	0	0	0
Tariff under CPFTA2 YEAR 5	0	0	0
Tariff under CPFTA2 YEAR 10	0	0	0
Growth in value of Chinese imports from all countries, 2014-2018 (per cent, p.a.) (6-digit)	3	3	-4
HVTP: Share in China's imports (per cent)	28.9	28.9	28.7

HVTP: Growth in imported value between 2014-2018 (per cent, p.a.)	18	18	-7
HVTP: Average tariff (estimated) applied by China (per cent)	0	0	0
Average tariff offered to top 5 trade partners	3.6	3.6	2

Note: The average tariff for the 6-digit product lines was used for this table, as tariff data for 8-digit product lines is not accessible

Source: Ministry of Commerce for CPFTA2 details, ITC TradeMaps for remaining data. Author's calculations

For these products, Pakistan faced a tariff of 7-8 per cent under CPFTA1, while Bangladesh had tariff free access. Under CPFTA2, Pakistan will now have tariff free access too. All three product categories are also within Pakistan's traditional strength of garments. Men's or boys' trousers (HS 62034290) in particular has a large and growing market: China currently imports approximately USD 386 million in this category, growing at 3 per cent per annum. Bangladesh's exports to China in this category have been growing at 18 per cent per annum in the last five years. On that basis, this category looks like a promising segment for Pakistan to consider.

This section has assessed the concessions offered by China to Pakistan under Phase 2 of the FTA. CPFTA2 provides details of tariffs levied by China on 8238 product lines at the HS 8-digit level, which for the purpose of the report have been divided into three priority lists based on Pakistan's exports to the world in order of descending importance. The first pass at the tariff data of Phase 2 reveals that products that Pakistan exports to China constitute 5 per cent of total tariff lines, that it exports to the world but not China comprise 17 per cent of total tariff lines, and products that China imports from the world but Pakistan does not export at all account for 65 per cent of the total tariff lines. While this may present a rather bleak picture, it is because Pakistan exports 1535 tariff lines that China does not import, and there is an overlap of only 1861 product codes between Pakistan's world exports and China's world imports in 2018. In addition, there are 1035 tariff lines or 12.6 per cent of total tariff lines on which China has offered concessions but does not import from the world.

Tariff concessions provided by China in CPFTA2 are generally superior to CPFTA1, especially for the high priority lists 1 and 2. Moreover, unlike with CPFTA1 where the ASEAN-China FTA that was signed in 2010 led to an erosion of preferences for Pakistan on Pakistan's key exports, here it appears that Pakistan has scored competitive access, i.e. better access than its top competitors in China and lower tariffs than in CPFTA1. Within the Priority 1 list, high potential items that Pakistan could export to China include seafood and garments, while for the Priority 2 list this includes synthetic blankets and knitwear shirts of other textile material. Focusing on these items for export to China could present Pakistan with easy gains in the short- and medium-term. At the same time, under CPFTA2, 369 tariff lines face worse access than Pakistan's top competitors in China, including Pakistan's top export of semi-milled rice, which faces 15 per cent higher tariffs than Vietnam as well as knitwear coats that attract tariffs which are 14 per cent higher than for India. Pakistan also does poorly in comparison with its competitors in fruit pulps, jams, and unfrozen orange juice, as well as footwear uppers and boys cotton coats.

In the long-term, i.e. the next ten years, Pakistan needs to venture into exports of Priority 3 items that China imports, but Pakistan does not yet export. As a starting point, Pakistan has competitive access in machinery, mechanical appliances; electrical equipment and parts; mineral fuels; optical, photographic and surgical equipment; plastics; vehicles; and essential

oils. The Priority 3 competitive access products were further shortlisted based on capability, labor cost advantages, price, technology and proximity with China by employing the GIFF methodology. Two-thirds of the Priority 3 product lines at the HS 8-digit level for parts and accessories of motor vehicles have competitive access now, as do refrigerators, freezers and heat pumps, and woven men's cotton trousers and woven cotton babies' garments.

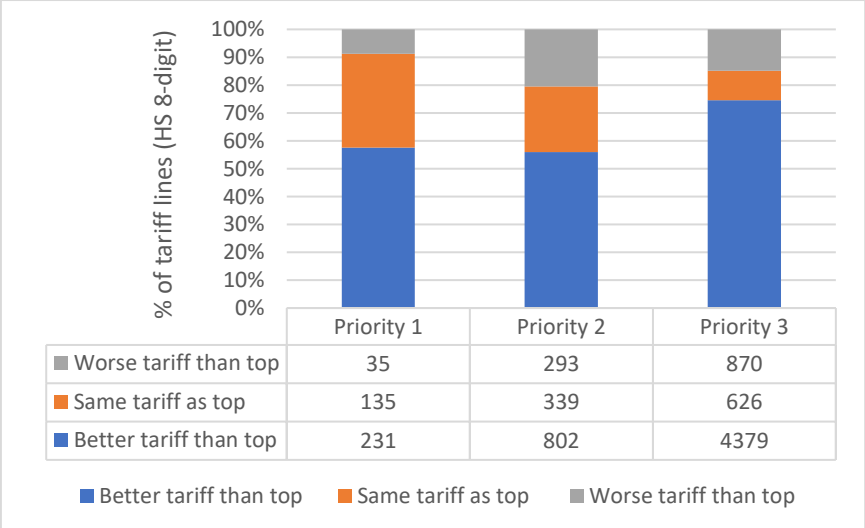
The next set of questions to be addressed are what factors might prevent Pakistan's exporters from availing competitive access for products that it already exports, and from entry into China for those that it currently does not. Section 5 sheds light on some of the most important issues that could nullify these gains from tariff liberalization.

5 Impediments in expanding exports to China

The analysis of Section 4 reveals that Pakistan now has competitive access for a diverse range of products within all three priority lines, i.e. those that Pakistan exports to China (Priority 1), that it exports to the world but not China (Priority 2), and that China imports but Pakistan does not export at all (Priority 3).

Compared to Pakistan's top competitor in China, market access has considerably improved (Figure 52). Across the three priority lists, Pakistan's market access is now better than its top competitor in China for 70 per cent of tariff lines. Access is the same in 14 per cent and worse than the top competitor in 15.5 per cent of total tariff lines in the three priority lists. It is striking that for almost 60 per cent of tariff lines that Pakistan exports to the world or China (priority lists 1 and 2), Pakistan now has better access than its top competitors. In other words, in 3 out of every 5th tariff line that Pakistan exports to the world that China also imports, Pakistan now has better access in China than its top competitor.

Figure 52 Pakistan's tariff access compared to top competitor in China, by category



	Priority 1	Priority 2	Priority 3
Worse tariff than top	35	293	870
Same tariff as top	135	339	626
Better tariff than top	231	802	4379

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018

5.1 Summary of findings

It is also important to weight these gains by Pakistan's world exports and China's global imports. Tables 24 to 26 provide a summary of the top 20 codes that have secured competitive access under CPFTA2, i.e. Pakistan faces tariffs that are lower than its top 5 competitors in China, in each of the priority lists discussed in Section 4. Pakistan's global exports and China's imports of those categories for 2018 are also provided to indicate the opportunity canvas. Priority 1 is the highest priority for Pakistan's industry in the short-run, and Table 24 shows that eleven of the top twenty items (ranked in order of importance in Pakistan's world exports of 2018) belong to knitwear and woven readymade garments (HS 61 and HS 62). For example, Pakistan's top world export of menswear cotton ensembles (woven) now has competitive access, facing lower tariffs than the top 5 import partners of China.

Footwear with leather uppers and rubber soles, goat leather, spice mixtures, frozen flat fish and frozen salmon as well as cotton yarn comprise the other products for which Pakistan is now at better tariff access than its top 5 competitors in China.

Table 24 Summary of top 20 Priority 1 competitive access codes, ranked by Pakistan world exports 2018 at HS 6-digit level

HS code	Product label	Pak world export 2018 (USD 000)	Rank in Pak world exports 2018	China world imports 2018 (USD 000)
'62032200	Men's or boys' ensembles of cotton	1530,213	1	499
'52051200	Uncombed single cotton yarn, cotton≥85 per cent, 232.56<yarn<714.29decitex	777,585	3	2,477,363
'61059000	Men's or boys' shirts of other textiles, nes, knitted	331,633	12	5,992
'61091000	T-shirts, singlets & other vests, of cotton, knitted	242,703	19	600,950
'61034900	Men's or boys' trousers, of other textiles, knitted	230,689	21	5,594
'61159500	Hosiery & footwear, of cotton, knitted, nes	214,767	22	64,945
'61033900	Men's or boys' jackets of other textiles, nes, knitted/crocheted	178,568	28	1,741
'03033900	Other frozen flat fish	160,275	33	292,071
'61099090	T-shirts, singlets, of other textiles, nes, knitted	156,955	34	232,944
'61051000	Men's or boys' shirts of cotton, knitted	152,857	37	125,954
'52053200	Uncombed cabled cotton yarn, cotton≥85 per cent, 232.56<single yarn<714.29decitex	131,786	42	62,844
'52051100	Uncombed single cotton yarn, cotton≥85 per cent, yarn<714.29decitex	114,879	50	298,926
'61161000	Gloves, impregnated... with plastics or rubber, knitted or crocheted	96,707	55	8,667
'64039900	Footwear with rubber soles, leather uppers, not covering the ankle	78,133	62	1,167,781
'52052200	Combed single cotton yarn, cotton>85 per cent, 232.56<yarn<714.29decitex	77,560	63	295,291
'03031900	Other frozen salmonidae	74,593	64	2,807
'41131000	Goat/kid leather, further prepd, no wool, whether or not split	73,996	66	117,202
'61069000	Women's or girls' blouses, etc., of other textiles, knitted/crocheted	69,129	73	944
'61034200	Men's or boys' trousers, etc., of cotton, knitted or crocheted	66,792	77	131,293
'09109100	Spice mixtures of two/more products of different headings	66,383	78	1,009

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018. Trade data is available at the HS 6-digit level

In the second priority list for Pakistan of 1436 tariff lines, Pakistan's top 20 products with better access include 6 lines from knitted and woven garments, and 5 lines from agro-

processing industry including glucose & glucose syrup, fresh/dried bananas, milk & 1 per cent cream, and frozen edible bovine offal (Table 25).

Table 25 Summary of top 20 Priority 2 competitive access codes, ranked by Pakistan world exports 2018 at HS 6-digit level

Product code	Product label	Pak world export 2018 (USD 000)	Rank in Pak world exports 2018	China world imports 2018 (USD 000)
'25232900	Portland cement (excl. white)	199,252	24	45,296
'27101919	Other kerosene distillages, without biodiesel	151,539	38	67,987
'56081900	Knotted netting of man-made textile materials (excl. fishing nets)	81,531	60	19,289
'25231000	Cement clinkers	60,671	87	588,171
'61071100	Men's or boys' underpants & briefs of cotton, knitted or crocheted	58,660	89	19,905
'61159900	Hosiery & footwear, of other textiles, knitted or crocheted, nes	56,773	91	734
'62079100	Men's or boys' singlets, dressing gowns, etc., of cotton	40,393	107	575
'17023000	Glucose & glucose syrup, fructose wt.<20 per cent	38,789	111	2,817
'17041000	Chewing gum	31,245	127	2,619
'61052000	Men's or boys' shirts of man-made fibers, knitted or crocheted	22,679	155	24,292
'08039000	Other bananas, fresh or dried, excluding plantains	21,470	162	896,802
'04012000	Milk&cream,1 per cent	20,822	166	421,165
'39031910	Modified polystyrene (excl. expansible), in primary forms	19,796	177	532,771
'61013000	Men's or boys' coats, etc., of man-made fibers, knitted or crocheted	18,008	192	17,459
'39249000	Household, hygienic& toilet articles of plastics, nes	17,567	196	136,712
'63014000	Blankets (excl. electric blankets), etc., of synthetic fibers	15,301	215	5,672
'62042200	Women's or girls' ensembles of cotton	14,152	225	272
'89040000	Tugs and pusher craft.	12,994	235	7,094
'02062900	Frozen edible bovine offal (excl. tongues & livers)	12,869	236	83,595
'28362000	Disodium carbonate	11,855	246	59,711

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018. Trade data is available at the HS 6-digit level

Pakistan has also been given better access than China's top 5 suppliers in certain products that it currently does not export anywhere (Table 26). Although these remain a relatively low priority in the short-run in terms of providing a quick boost to export earnings, they represent an important opportunity for diversification of the export basket in the medium- to long-run. It is interesting to note that Pakistan now has better market access in automotive parts for the after-market, fuel oils, parts & accessories of ophthalmic and surgical instruments of HS 90, machine parts and plastics—this could generate new exports for Pakistan in the longer run.

Table 26 Summary of top 20 Priority 3 competitive access codes, ranked by China's world imports 2018 at HS 6-digit level

Product code	Product label	Rank in China's imports	China import 2018 (USD mn)
'33049900	Beauty, make-up, skincare (incl. suntan), nes	29	8,824
'27101922	Fuel oils No. 5-No. 7, without biodiesel	36	7,437
'85299042	Camera module, no special purpose	38	7,246
'27011290	Other bituminous coal, not agglomerated	42	6,620
'87084099	Other Gear boxes & parts nes for vehicles of 87.01 to 87.05	51	5,588
'19011010	Powdered formulas for infant use in retail package, containing cocoa <5 per cent	58	4,769
'40028000	Mixtures of any product of 40.01 with any product of 40.02	66	4,248
'90139020	Parts & accessories of appliances of 9013.8030	79	3,590
'87089999	Other parts & accessories nes for vehicles of 87.01 to 87.05	110	2,700
'85044099	Other static converters	130	2,420
'90019090	Unmounted optical elements, nes	132	2,374

'85044091	Semi-conductor modules with converting function	145	2,182
'90021990	Objective lenses, nes	147	2,138
'39023010	Ethylene-propylene copolymers, in primary forms	163	1,841
'84571010	Vertical machining centers	174	1,722
'85299049	Parts for other TV , stilt image video, video, digital cameras	176	1,697
'73269019	Articles, i/s, for technical use, nes	181	1,625
'39072090	Other polyethers in primary forms	203	1,395
'39209990	Plates/sheets/film/foil/strip of other plastics, non-cellular, nes	205	1,391
'84295212	Excavators, track-mounted, with a 360o revolving superstructure	211	1,330

Source: Author's calculations using Ministry of Commerce data for CPFTA tariffs and ITC Trademap for trade data. All trade data is for 2018. Trade data is available at the HS 6-digit level

With tariff impediments out of the way for these sectors, it will be important for policy makers to ensure that non-tariff constraints, both in China and in Pakistan, are also removed for the sectors to realize the potential export gains on offer. This section focuses on the specific constraints faced by Pakistan's exporters to China. Broader internal competitiveness constraints in Pakistan such as energy and availability of skilled labor, are well documented elsewhere and will not be discussed here.

The constraints faced by Pakistan's exporters pertain to information gaps and non-tariff measures in China and, more predominantly, supply-side issues in Pakistan. In order to investigate these, a focus group discussion of 15 exporters was held, with representation from garments, leather, handicrafts, processed food, steel, poultry, livestock, footwear and sugar. In addition, key informant interviews were held with (20) exporters of ready-made garments and agro-processed products. Many of these exporters currently export to China or have attempted to export to China. This section discusses the concerns that make exporting to China difficult.

Information gap about China's market

There is a lack of information at all levels, starting with pre-production, as well as the production and post-production stages. At the pre-production stage, the most critical information gap arises from the firm's inability to scope, research and target markets in China. Exporters have greater familiarity with European and US markets, and relative to these markets, it is difficult to obtain information in China. There is, an addition, a language barrier in China and far more work is required to navigate the unfamiliar market. There is also a smaller margin for error in the Chinese market, as it is such a price competitive market. Constraints specific to China such as preferences and tastes were raised, especially for first-time exporters to the large Chinese market.

Many firms felt that they should be provided Chinese market research information by the government and assisted by Pakistan's commercial councilors in China in identifying opportunities. Other firms are already gearing up their facilities and testing their products with the objective to exporting to China, though the first attempt has yet to be made. The exporters universally showed interest in accessing the database that was generated for this project, in order to see the comparisons in tariff rates with key import partners. They do not have the capacity, at the individual or the association level, to commission such research themselves.

At the same time, Pakistani manufacturers do not have knowledge of Chinese regulatory requirements for their products, as China prefers its own standards and quality certifications over international ones. Exporters report having to meet additional export SPS criteria that they only discovered once they sent their initial shipments. Moreover, many manufacturers reported

never having tried to export to China. For this, they are unsure of where to begin to look for the required information.

Another essential information gap is in finding suitable Chinese firms to partner with to market and distribute Pakistani products. Exporters from some sectors such as garments and automotive parts underscored the absence of Pakistan representation in China's warehousing and distribution sectors, which could give them an edge over competitors from other countries. Many sectors reported signing Memorandum of Understanding (MoUs) with Chinese firms, with no consequent follow-through by the Chinese partner on the firm's export order. In another example, a prominent Pakistani food manufacturer in Pakistan that exported to China was not happy with the Chinese buyer that they partnered with for distribution. After that single bad experience, they have not tried again to find a suitable partner.

Inability to meet large orders

Pakistani manufacturers report that they find it difficult to deliver the quantities required by Chinese importers in the timeframes given. This is due to two reasons. There are capacity issues at the factory level, including skilled labor shortages and low capital. The factories typically deliver smaller orders and cannot upscale quickly to the large order sizes required in China. This in turn prevents them from achieving the scale of production needed to minimize their costs, pricing them out of the low-value added price-competitive global market segments in which Pakistan's exporters usually operate. Secondly, timelines are unreliable due to government export and import procedures such as customs clearances. This makes exporters reluctant to diversify their export offering to China as that would require them to import new inputs, which they want to avoid due to time-consuming and *ad hoc* custom processes. Moreover, their tax rebates are based on input-output ratios that have not been updated since 2014, and therefore do not reflect true costs of importing inputs and exporting goods.

Absence of trade facilitation

There is a general feeling that trade facilitation— normally provided by government agencies, trade bodies, and Pakistan's commercial missions in other countries— is largely missing in Pakistan. The latter is especially important to identify opportunities for Pakistan, to match them with potential parties in China, and to market them extensively once an export order is successfully met. Instead, exporters feel they face hurdles at every stage from procuring inputs to manufacturing and exporting. One-window operations for export to China are absent. For example, many exporters present had no knowledge of the Pakistan-China Joint Business Council. Its role in the private sector should be enhanced to provide matchmaking, branding and promotion services for Pakistan's exporters to China.

In addition to these broader concerns faced by exporters to China, the next sub-section provides a more in-depth discussion of the specific challenges faced by two high priority sectors. These two industries are ready-made garments (knitted, HS 61 and woven, HS 62) and agro-processing (HS 02, HS 03, HS 04, HS 07, HS 08, HS 09, HS 19, HS 20, and HS 21). To get a sense of the market size, in 2018 China's imports of competitive access tariff lines in these two industries was USD 13.6 billion, while Pakistan's global exports were USD 4.4 billion—but Pakistan's exports to China were only USD 96 million. Whether Pakistan can translate better tariff access into export gains in these two industries requires a deeper analysis of constraints.

Policy recommendations based on this discussion will be provided in the concluding section 6 to help exporters from these industries avail the potential opportunities on offer under CPFTA2.

5.2 Readymade garments

The first priority sector is that of readymade garments (RMG), both knitwear and woven. This sector stands out as a clear winner in terms of tariff access, with lower tariffs than the top 5 competing suppliers to China in a range of RMG products of cotton and other textile materials. Pakistan's exports to the world amounted to USD 3.9 billion in these tariff lines, and China's imports of the same were USD 2.2 billion. A closer look shows that for RMG product lines at the HS 8-digit level that China imported from the world in 2018, tariffs have been brought down to 0 per cent under CPFTA2 for 51 tariff lines in HS 61 and HS 62 (except for babies' garments). This means that Pakistan now enjoys duty-free access like China's other developing country partners such as Bangladesh, Thailand, Vietnam, and Cambodia, and faces lower tariffs than competitors such as India, Italy, USA, Sri Lanka, Portugal, Japan and South Korea.

This positive development must be seen in light of recent Chinese investments in CPEC-related projects. In 2017, China invested USD 2.7 billion in Xinjiang (which connects China to Pakistan through CPEC) for cotton textiles production. This is part of a larger vision of "Made in China 2025" which looks to expand China's value-added manufacturing exports to the world (Sheng, 2018). China is looking to import raw materials from Pakistan, add value in Xinjiang, and export via Pakistan to the global market. However, in light of the trade war between the US and China, many firms are also considering outsourcing production from China to South Asia. Lower wages and a relatively complete cotton supply chain affords Pakistan the opportunity to enter into joint ventures (JVs) with Chinese partners. This would allow local producers to accumulate expertise and generate greater value addition, as the final product would be exported from Pakistan. Pakistan also offers the advantage of better access to European markets through its Generalized System Preferences (GSP+) status.

This could provide a much-needed boost to the RMG sector, as China is the second largest apparel market in the world after the US. It is possible that international or even Chinese brands can make cotton-based garments (including denimwear) in Pakistan and export to China using Pakistani producers, as China currently imports cotton fabric from Pakistan and manufactures shirts for Levi, Nike etc. If production from China can be relocated to Pakistan, exporters estimate that RMG demand could rise by 15-20 per cent for Pakistan in the short-term. Moreover, China would prefer Pakistan over Bangladesh, Vietnam and Cambodia for outsourcing production, as they import cotton fabric which makes production more expensive. Exporters are optimistic that global buyers could now turn to Pakistan given that it has equivalent or better market access compared to its competitors in China. However, this is only true for cotton-based (containing greater than 70 per cent cotton) garments. As Pakistan does not produce synthetic or blended fabric locally, it would have to import that from China itself.

Some exporters believe that China will initially not trust Pakistan with meeting fabric supply—even cotton—and will therefore import their own fabric from China, convert to garments in jointly owned plants in Pakistan and export to China. From there, garments would be shipped out to meet China's international orders. This is the model employed by China in Vietnam, Indonesia and Cambodia. These countries have been successful because Chinese firms re-located operations and set up Chinese plants from which they export to China. But the case is different for Pakistan, as they do not have the same understanding of Pakistan as they did with

Vietnam and Cambodia. They cannot handle the labor and they need to have a local partner, so they cannot opt for fully owned operations in Pakistan.

Pakistan can use this to its advantage to attract China as they are looking to outsource their garments production beyond their South China sea neighbors. This is a recent consequence of the US-China tariff war, as there is now greater scrutiny of exports from Vietnam, Myanmar and Cambodia to make sure that China is not re-directing its exports to the USA through these countries. The US-China tariff wars have made Pakistan a good option, as China can bypass tariffs on Chinese manufactured apparel via Pakistan. The CPEC multi-modal (rail, road, sea) transport infrastructure can facilitate this. In 15-20 years, exporters believe that China will also re-locate its fabric production to Pakistan.

Interestingly, while China may be more interested in production JVs due to unfamiliarity with local conditions in Pakistan, Pakistan exporters are keener for JVs in distribution, where Chinese and Pakistani partners split their markets by segment. A Pakistani large-scale manufacturer does have such an arrangement with China, where garments are produced in a in a jointly owned plant in Pakistan. But export destinations are divided, with the Chinese brand directly exporting from Pakistan to some markets that the Pakistani brand cannot target. The benefit for the local firm is that it gets access to an agreed share of the Chinese brand's overall market, which is a slice of a much larger pie. In addition, there are spillover benefits in terms of labor productivity, access to global warehousing and distribution networks, and transmission of know-how and technology.

Information

The most important issue identified by Pakistani RMG exporters is lack of information about the Chinese market and about suitable Chinese partners. These act as a strong entry barrier. On account of the seeming impenetrability of the Chinese market, there was little evidence of any firm expanding its current exports from Europe/USA to China, despite the recent positive developments discussed above. Moreover, the prevailing perception amongst exporters is that doing business in Europe and the US is easier than in China. There is no knowledge of where to begin to look for information on what to export, Chinese brands, Chinese buying houses or any other kind of market information which makes exporters reluctant to target China.

As a result, exporters feel that local presence in China is an important prerequisite before they can directly work with Chinese brands. This is necessary because they are not able to access market research: they are dealing with various unknown factors in terms of pricing structures, payment methods, consumer demand, compliances, retailer presence, and distribution networks. This raises overhead costs considerably, rendering them even more sensitive to price. Chinese partners have been known to use contractual technicalities to re-negotiate shipment prices on delivery and have also reneged on contracts by claiming jurisdictional issues when dealing with triparty production networks. Firms are wary of such high transaction costs in China which requires constant vigilance and prefer to deal in simpler markets such as the EU and USA.

The NTBs levied by China are worsened by lack of information, as many exporters only discover them once their first consignment reaches China. These NTBs are SPS certifications pertaining to chemical composition of fabric, dyes etc. While NTBs are not specific to Pakistan, they are reported to be more stringent than those of European markets, as reported by the exporters who supply to both markets. For example, an exporter reported receiving an order

from a Spanish company in China and had to meet Chinese requirement of a "spit" test, which was not required in European markets. Other exporters also maintain that enforcement of non-tariff barriers in China become stricter at times when Chinese imports rise.

Once these informational issues are resolved, exporters are of the view that competing with Bangladesh and Cambodia on quality and price is possible.

Domestic supply chain

A second problem is an underdeveloped domestic supply chain. Exporters would have to expand capacity to meet orders from China. The scale of Chinese operations is illustrated by the fact that a 200,000-spindle mill in Faisalabad set up by the Chinese has the capacity to use up to 20-30 per cent of total local cotton production. Before exporting to China, upfront investment in technology/machinery would be needed— a rough estimate provided was that adding USD 1 billion worth of exports requires at least USD 300 million of investment.

In addition, there is a severe shortage of fabric blends that have less than 70 per cent cotton, which limits Pakistan's product range and subsequent export offering. Inadequate local supply of blended yarn has stunted Pakistan's exports and caused them to remain concentrated in cotton and denim. The Pakistan Readymade Garments Association (PRGMEA) will receive delegations from China in November 2019 for site visits and market survey on types of fabrics available in Pakistan. Renowned international buying house Li & Fung that already has large presence in China, Korea, and Japan, is taking the lead in connecting Chinese buyers with Pakistani manufacturers. The highest priority of the government should be to streamline and simplify existing support that they have already extended to this sector, with a focus on smaller exporters, who comprise the majority of garment manufacturers. Small and medium sized exporters believe their strength lies in flexibility to quickly add new product lines and adapt to changing global demand as compared to larger manufacturers.

The government has tried to strengthen the supply chain through export facilitation schemes such as bonded warehouses, tax rebates on imported inputs (fabrics) that are used for exports under Duty Tax Remission for Exports (DTRE), as well as SROs that allow import at 0 per cent duty (of trims and accessories) for use in exported products. But these schemes are extremely cumbersome. For example, DTRE requires bi-annual renewal of import licenses, has a lengthy verification period, and is not available to smaller exporters that don't have 100 per cent in-house manufacturing facilities. Very few larger exporters avail these schemes, and those that do, await years of pending refunds.

Similarly, bonded warehouses are unpopular due to bureaucratic delays at the dry port, mostly due to the customs department. SMEs find it expensive to use bonded warehouses as they would have to maintain a large support staff of clerks, security, and lawyers to manage their affairs. In Bangladesh, even a small manufacturer can bond a 10-12 square feet area and use it to secure duty-free supply of inputs such as fabrics. This puts Pakistan at a distinct disadvantage, even when facing the same tariffs in China as Bangladesh.

While this problem is not specific to China, exporters feel that it is a critical impediment. The reality of the garments sector is that if a country cannot clear imported inputs from port of entry

within 24 hours, it is out of global apparel trade. Despite equivalent market access with their competitors, if Pakistani exporters cannot use imported fabric while their competitors easily can, the playing field is tilted in favor of their competitors.

5.3 Agro-processing

The agro-processing industry is taken here to include dried/frozen fruit and vegetables, dairy (milk and cream), frozen orange juice, seafood, cereal, milk or starch preparations, spices, processed poultry and frozen edible bovine offal. These are the tariff lines for which Pakistan has better access than its top competitors in China and some of the more promising ones are discussed below. In 2018, China's demand for just this smaller sub-set of tariff lines was USD 11.4 billion. Unfortunately, Pakistan continues to face higher tariffs than China's top 5 import partners in two key agro-processing segments of rice, along with fruit pulp, purees, jams or unfrozen juices.

Processed meat

Much like in the garments sector, there seems to be an increased interest from China to invest in agriculture in general and food processing in particular, with both countries signing a 5-year agricultural framework agreement where China would not only provide agricultural extension services pertaining to technology and better utilization of inputs, but also support food processing and strengthen pre- and post-harvest crop management in Pakistan. Breeding, genetic resource control of livestock and poultry as well as development of feed fisheries and aquaculture are also part of the agreement. In addition, to boost red meat exports, China will help develop a Foot and Mouth Disease (FMD) free zone in Pakistan which could help meat exporters acquire quality and safety certifications. This would help diversify export destinations beyond the Middle Eastern countries, Vietnam and Malaysia to China, which had an estimated market of USD 12-15 billion in 2018 (The News, 2019). Other recent business delegations from China have explored the poultry sector as well with the aim of developing JVs (The Nation, 2019).

Key informant interviews indicate that these are much-needed initiatives. Exporters of processed poultry and red meat items with established presence in USA, Middle East, Vietnam, Thailand, and other countries reveal that China has placed a ban on import of poultry and red meat from Pakistan. Nevertheless, their products were indirectly entering China through Vietnam, Taiwan and Hong Kong. Although the same products are exported to USA, China cites poor capability in veterinary sciences that they feel makes exporters incapable of controlling disease outbreaks (such as avian flu for poultry and foot and mouth disease for red meat) and fulfilling quarantine requirements. Therefore, the Chinese claim the ban was levied to protect their consumers from low quality processed poultry and meat items from Pakistan. Exporters counter that their products are FDA-approved and that the Gulf countries lifted a similar ban on Pakistan's poultry exports in 2008—they feel that China could be using this ban as a non-tariff measure.

There has been recent talk that China could lift the poultry ban—this would help Pakistan increase its exports of frozen chicken cuts as well, in which Pakistan now has better tariff access than competitors. Exporters are keen to access the *halal* food market in China which they estimate to be worth USD 400 billion. There is suggestion that there is a significant

demand by China's 30 million Muslims for *halal* foods, so this could be a strategic way of entering China's market.

Exporters caution that higher production costs in Pakistan have already lost them business to neighboring countries such as India. Power tariffs and breakdowns in conjunction with costly imported raw materials make Pakistan's exporters less competitive than far away competitors such as Brazil. Currently, for example, one exporter claimed that it must maintain high quality standards by using imported feed and micro-nutrients like vitamins and medicines. This makes it harder for them to sell their better quality albeit more expensive goods in China. In addition, road connectivity through CPEC would not provide them with an additional advantage as shipping is already much cheaper and easier to use.

Equally important is the poor distribution network of Pakistani exporters in China. Many exporters feel that navigating the vast Chinese market with varying consumer tastes requires a local presence in China, a Chinese buyer, or a JV with a Chinese firm. This significantly raises their overhead costs and makes it difficult to remain competitive in light of already higher production costs relative to their competitors. For example, an exporter revealed that their Chinese buyer in Pakistan had shifted to India due to lower production costs such as labor and raw materials.

Seafood

Within the agro-processing sector, seafood exporters now face lower tariffs than their competitors in China and would eventually be given duty-free access by the end of ten years. Moreover, three recent developments that could play to Pakistan's advantage in the seafood industry are the tariff wars between China and the USA, an increase in China's tensions with its neighbors over the South China Sea, as well as the development of Gwadar port in Pakistan. China is the 3rd largest importer of seafood in the world with imports of USD 11.6 billion in 2018, and imports almost 11 per cent from USA, its 2nd largest import partner. With higher tariffs imposed by China making US seafood more expensive, Pakistan could provide China with cheaper seafood (SBP, 2019). Similarly, tensions with Vietnam and other neighbors are on the rise, and Pakistan could also attract additional displaced demand from China's regional seafood import partners. Lastly, there has been increased interest by Chinese firms in developing the seafood sector in Gwadar to cut transport costs from 25 days to 34 hours by air freight via Urumqi in Xinjiang, Pakistan's overland connection to China under CPEC. To cater to demand not just in Xinjiang, but also Shanghai, Shenzhen, and Beijing, a Chinese firm has invested USD 73 million in Gwadar to develop fishing, processing, and refrigeration warehouses (*The News*, 2019). Competitive access in conjunction with these three recent events could allow Pakistan to expand its share in China's seafood market beyond 0.7 per cent in 2018.

Many seafood exporters were very optimistic that now they would be able to directly export to China on account of better market access and the above factors. Under CPFTA1, seafood was not given any concessions and Pakistani seafood entered China through Vietnam and Hong Kong. Lower tariffs under CPFTA2 could lead to a substantial rise in exports to China, as it constitutes 50-55 per cent of Pakistan's seafood export market. In contrast to the RMG sector, Europe is not a key destination for Pakistani seafood due to poor quality—only 2 Pakistani exporters are registered in Europe.

But exporters claim that they face an important non-tariff barrier in China. Despite being registered with the Marine Department in Pakistan for quality certification, exporters must also register with their Chinese counterpart Certification and Accreditation Administration of the People's Republic of China (CNCA). This issue came to light when, over the last two years, China began directly importing from Pakistan due to problems with Vietnam and Hong Kong. Around 200-250 Pakistani exporters have been delayed by a year for their registration, and many exporters interviewed viewed this as the main impediment to trade with China. It is now known that these delays were caused due to a problem with the CNCA in China. It appears that the point authorities in Pakistan had been trying to get Pakistani exporters registered for a year with an entity that no longer exists in the CNCA in China. Similarly, Pakistan has been unable to register some high potential tariff lines such as topshell in China, while India has managed to do so. Pakistani exporters were also not being given visas for exhibitions in China until very recently.

The second issue is that of reliance on wild catch, instead of farming. This leads to a host of problems: depletion, lower product quality (and price), an unpredictable product offering as well as lack of interest of partners to have JVs with Pakistani exporters. These issues are discussed below.

Stakeholders claim that Pakistan is the only coastal country in the world that relies on wild catch for its seafood consumption. Exporters worry that fish stock could become depleted by as early as 2025 if current fishing trends continue. An example was ribbon fish, which is high in demand in China. Seasonal volumes are high in Indian Gujrat and in Pakistan too—but because Pakistan's fish has a superior taste, it attracts a USD $1-2 higher price than others. However, stocks have been depleted, so the need is to focus on better and sustainable fishing techniques.

Moreover, Pakistan exports reliance on wild catch lowers product quality. Almost 90 per cent of fish caught becomes chicken feed, while only 10 per cent of the residual better-quality catch is exported. These exports are seasonal due to which Pakistan's average unit price has remained stagnant at USD 2 over the last 6-7 years. In contrast, Indian fish attracts a higher average unit price of USD 7 because of better quality. Reliance on wild catch reflects poor fishing practices.

As a result, exporters note the absence of a steady supply of high-end products costs them international clients. For example, other countries such as Vietnam supply farm shrimp to China and India. While some is consumed locally, much is exported to America, a market of USD 40-45 billion. Exporters acknowledge marketing support from TDAP in subsidizing their booths in Boston, Brussels/ Barcelona and Qingdao (the 3 largest seafood exhibitions in the world), but there has been little interest apart from 1-2 South Korean JVs. International companies are product specific, and since the product line is not streamlined due to reliance on wild catch and not farming, international companies shy away from uncertainty. For example, one exporter spoke about calamari availability one season, and not in the next, which pushed international buyers to more reliable seafood exporters.

In addition, exporters say that JVs have also not been forthcoming largely due to this issue of reliance on wild catch and low-quality products. This is evidenced by the fact that many exporters themselves prefer to have triparty JVs as opposed to direct JVs. For example, an exporter had a triparty JV with an American company 10-11 years ago, where they exported seafood to China which then sent it to America. Pakistani exporters shy away from direct JVs with China as they would have to arrange the entire order from domestic supply. Risks were

shared in the triparty JVs, where China's various supplying partners such as India, Thailand and Vietnam could meet orders all year round.

A separate issue is that of absence of research and development, despite deducting 0.25 per cent of exported value at customs declaration as an export development surcharge (EDS). This money would amount to Rs.40-50 billion, and should be used to promote R&D. Thailand, India, China and Vietnam are all competing for the American market, and if Pakistan could invest in hatcheries and aquaculture it could also tap into this high demand market, especially in light of the US-China trade wars. Moreover, the government is not providing adequate incentives for joint ventures in technology acquisition or even government support to build a decent harbor for this promising sector. This effectively shuts Pakistan out of lucrative global networks—for example, India has borrowed technology from Thailand to develop its hatcheries and save its shrimp populations. TDAP has initiated a similar program for Pakistan with Vietnam, but progress is slow. Pakistan needs to immediately develop aquaculture by importing technology from other countries. Exporters say there is land in interior Sindh as well as good weather for seafood farming— what they need is government support to push partnerships with countries that have technologies and expertise on aquaculture. This would allow domestic needs to be met through farming, while sea cages could be kept solely for exports. This could ensure that Pakistan can emerge from the low-price and low-quality segment of the Chinese market. Exporters argue that a logistical advantage—freight cost for China is 50 per cent lower in Pakistan than India—is of no use if the product quality is so low—they are already selling at USD 2 per product.

Tuna is in huge demand internationally as well, but most is sold to Iran, as a barter trade for oil, instead of selling it globally. This suggests that within existing product lines, Pakistan can catch a greater share globally through better internal regulation as well.

Dairy products, dried fruit and frozen juices

It is possible that the logistics and distribution investments in agro-economic zones along the CPEC route could provide a much-needed edge to Pakistan for processed fruits and vegetables such as quick freeze vegetables and desiccated vegetable flakes. The sector is investing in pack houses for processing, slicing & dicing, and packaging of frozen fruits; dehydration units, as well as cold stores for maintaining cold storage chain along the CPEC route (Ali, 2019). As Pakistan now attracts the same tariffs as Vietnam, Thailand, and the Philippines in this sector, it is worth investigating whether Pakistan can penetrate this segment.

Not only are tariffs faced by Pakistan lower than those of its top 5 competitors in China, Pakistan's market access is now at par with its top competitor for many of these items. Yet the sector continues to face many impediments in China and behind-the-border in Pakistan. Constraints in China include invasive checking of consignments in China and stricter enforcement of SPS requirements, lack of consumer awareness, and more favorable trading arrangements (such as license to re-export) with ASEAN countries. In Pakistan, the biggest disadvantage is that seeds cannot be imported by growers and TDAP's inadequate support. These issues are discussed for specific products below.

Exporters have attempted to send flavored milk to China but there previously were tariffs imposed on this item. Now that tariff access has improved vis-à-vis top competitors, it remains to be seen whether Pakistan can increase its market share. China currently imports milk from New Zealand, which is quite close to the actual commercial centers of China. In contrast,

exporters feel that Pakistan does not have a logistical advantage on account of CPEC as Western China does not have the purchasing power of the Eastern side. With Pakistan on the western border, consignments still have to travel substantial distances inland to reach the larger markets where most of the demand lies.

Chinese compliances are stricter than international SPS requirements. For the citrus and mango sectors there is a lot of potential as there is a seasonal match with China. However, there are quarantine restrictions from the Plant Protection Department in China that are difficult to meet. For example, in kinnow, quarantine issues are specific to China, as exporters regularly send to Indonesia, Iran, Russia, Ukraine, Philippines, where they successfully meet international quarantine requirements. The situation is even worse for mangoes as exporters find it very difficult to satisfy Chinese import partners. It cannot be a quality problem as they are successfully exporting to Germany and other European countries.
For shipments that reached China, inspections were damaging. Exporters of fruit juices reveal that inspections were so invasive that they ruined the packaging which caused leakages and product damage. This also hurts those exporters who have found partners in China—— they are apprehensive because containers from Pakistan face extra delays and restrictions.

Lack of consumer awareness is another impediment. Dried mango is one of the main exports to China in the desiccated fruit sector, and the biggest competitor is the Philippines. Marketing and branding by Pakistani firms is very poor, so Chinese consumers are unaware that the Pakistani dried mango (and even orange juice) is far superior as it is 100 per cent natural. The dried mango exported by Philippines to China has sugar added to it, as their mango is not naturally as sweet as the Pakistani mango and therefore Pakistani dried mango is a superior market segment with a higher price. But, without consumer awareness, it has to compete on price with the Philippines. This is a case of poor branding and consumer awareness. Exporters who have pushed for better marketing and consumer awareness do report responsiveness of Chinese demand. However, this is a gradual process and requires considerable work.

An additional issue is that China allows re-exports from ASEAN countries. For example, Malaysia imports green raisons from the Central Asian States, and stockpiles them to sell to China as required. There are many instances where Pakistani goods such as red meat and poultry cannot directly be exported to China but are re-exported to and accepted into China through ASEAN countries such as Thailand, Indonesia and Vietnam. Clearly, this needs to be taken up with the relevant Chinese stakeholders, as this leaves Pakistan disadvantaged relative to other competitors, even with equivalent market access.

The most important issue in Pakistan brought up by citrus exporters is that they are not allowed to import new seeds, and the current seeds produce a blemished, seeded variety of kinnow which has low international demand. China requires seedless variety (as do all high-end markets in Europe and the USA as well) but import of seeds only takes place at the level of government-to-government or government-to-institute. Exporters have been asking the government to import new seeds for years without success, with seeds from the 1950s still being used in the kinnow sector. Meanwhile, there are 20-25 seedless and blemish-free varieties in the world, with early/late varieties that could allow exporters to supply for 8-9 months. Currently, Pakistan only has a 3-month window in which oversupply leads to lower values in the market. Government institutes such as the Citrus Research Centre are dormant.

Finally, there is little marketing and promotion of Pakistani exports. TDAP needs to be more active and ensure Pakistan is represented in Chinese exhibitions and they are well informed

about the fairs. Every Pakistani exhibition is full of Chinese exporters, but this is not reciprocal. It is expensive to do this privately. Exporters are keen to increase the visibility of their product and create demand even at the cost of incurring short-run losses. Exporters claim that this type of collective action has worked at the association level for other countries. With China it is more difficult as the state-owned enterprises and government are not interested in imports, and the smaller importers are difficult to access. Exporters insist that TDAP should fulfill a matchmaker role to promote their sectors in wholesale markets and big supermarkets of China. But TDAP claims they have no funds to provide this kind of support.

There is also need for better representation in China. Stakeholders interviewed claimed that India, Malaysia and Thailand have commercial departments that are separate from the embassy. They maintain that India, for example, has a commercial consulate with independent staff of 30 people to study the Chinese market. On the other hand, Pakistan has only one commercial councilor to deal with delegations and Chinese ministries. The Chamber of Commerce and TDAP need to engage in public private partnerships for this purpose.

Finally, there is little logistical advantage compared to competitors at the moment. Most exporters confirm that consignments are sent mostly by air due to the nature of goods. This will continue unless CPEC offers significant cost savings through multimodal transportation—only when road, rail or sea connectivity becomes quicker and cheaper will Pakistan have a proximity advantage with China relative to its competitors.

To address the concerns highlighted by the relevant stakeholders, section 6 summarizes impediments in exporting to China to propose a way forward.

6 Way forward: Policy recommendations to harness export potential

As outlined in section 5, the feedback received from exporters who have or are planning to export to China is that the biggest challenge lies in information gaps at the pre-production, production, distribution and marketing stages, as well as unsatisfactory support from both the commercial/trade missions in China and TDAP in Pakistan. In some sectors, there are outright bans on exports. Other issues such as low competitiveness are a function of broader macroeconomic and trade policies, underdeveloped domestic supply chains and poor production practices. These create a perverse economic environment for exporters and also raise production costs relative to competitors in China. Broadly, these impediments can be categorized into demand-side issues in China and supply-side constraints in Pakistan. The key priorities for the consideration of all relevant stakeholders that can help address these two main sets of impediments in exporting to China are given below.

6.1 Addressing demand-side issues faced in China

Section 5 has shown that Pakistani exporters face behind-the-border constraints in China pertaining to demand. These include informational gaps as well as bans on imports from Pakistan in the red meat and poultry sectors. For exporters of citrus and seafood, the main impediments on the demand-side are lack of consumer awareness and technical barriers to trade (TBT) such as higher (but not Pakistan-specific) sanitary and phytosanitary (SPS) requirements compared to other export markets. There is also a lack of mutual recognition of standards and certificates, and a testing process in China that is considered unnecessarily time-consuming and complex.

For all exporters, regardless of sector, the largest entry barrier is lack of information. This is dealt with first, as it is the most binding constraint for the whole spectrum of export sectors.

Information

Information gaps exist at three levels. There is limited information for

i. Pakistani exporters about market demand and preferences in China
ii. Chinese manufacturers/exporters looking to outsource production to Pakistan
iii. Pakistani exporters looking for reliable import partners to access marketing and distribution networks in China

Stakeholders unanimously agreed that their understanding of the Chinese market is limited and is worsened by the language barrier. In addition, they find it difficult to find reliable partners in China. Both these challenges can be met by strengthening the role of Pakistan's commercial councilors and trade missions in China and the capacity of TDAP in Pakistan. This requires:

1. Market research on China
    a. The Pakistani commercial consulate in China must be separated from the embassy with a dedicated and independent staff to facilitate research on the Chinese market
    b. The three trade missions in Shanghai, Guangzhou and Chengdu must be staffed with experts catering to each of Pakistan's highest export sectors
    c. TDAP must revamp the China Focus Cell it created in 2013 into a one-stop information portal, by export sector
    d. Trade associations must take initiative and jointly commission market research on China to develop project pipelines and feasibilities by product.
2. Matching Chinese partners with Pakistani exporters through specific, not generic, support:
    a. Commercial councilors need to facilitate Pakistani exporters by identifying genuine & relevant buyers and new opportunities in China. Finding suitable Chinese partners who already understand Chinese demand and have distribution networks is the quickest way to enter the Chinese market.
    b. TDAP must sponsor business-to-business fora/meetings and delegations of Pakistani exporters with big Chinese buying houses
    c. The Pakistan-China Joint Business Council can play an enhanced role in providing matchmaking, branding and promotion services for Pakistan's exporters to China.
3. TDAP support in compiling Chinese and Pakistani compliances, by product in a joint information portal
4. Banking channels with local presence in both countries to encourage exporters as language is a strong barrier in China

The second set of issues pertain to helping Chinese firms outsource their production to Pakistan and can be overcome by mobilizing existing platforms:

1. TDAP, relevant ministries and sector associations must launch a strong publicity and awareness drive aimed at Chinese/global sourcing companies and original brand manufacturers located in China. All companies/buying houses need to be told that Pakistan now has access that is equivalent or better than its competitors in China.
2. The Board of Investment (BoI) can play a stronger role in facilitating Chinese firms looking to outsource to Pakistan suppliers. A dedicated and visible desk at the BoI can connect Chinese/global businesses with Pakistani manufacturers. This team should include experienced ex-commercial councilors and technocrats to take ownership of publicizing, branding & attracting, promoting, and facilitating potential global buyers and Chinese firms looking to outsource (a one-window team).
3. Make Pakistan the next sourcing destination for big global buyers by highlighting its cheaper production for cotton-based garments. Make big pitches and standardize these processes

The third set of informational challenges are faced by Pakistani exporters in marketing and distributing their exports in China. This disadvantage can be offset if:

1. TDAP holds trade fairs with translators to market Pakistani products in China: Exporters document this is the most important way of reaching Chinese businesses and buying houses. This will only help if there is repeated interaction with Chinese buyers– intermittent TDAP support sends a bad signal to the buyers about reliability of Pakistani suppliers. If this initial marketing is successful, stakeholders claim that in 9 out of 10 cases, the importer will distribute the product itself
2. Sector associations, trade missions in China and TDAP can raise image of Pakistani products: build awareness of the features of Pakistani products to give them a quality edge over competitors
3. Uses the export development surcharge collected from exporters for marketing through investor fora and roadshows

In addition, the database that was generated for this report can be developed into a software that enables potential exporters to access the consolidated information for specific product lines. This includes not just the tariffs offered to Pakistan, but also an identification of the top exporting country for each product line in China, the tariffs offered to that country, and the average tariff offered to the top five exporters to China. It also consolidates in one place values and growth rates of Chinese imports, which are critical for sizing the market.

Bans, consumer awareness and technical barriers to trade

Recommendations to address the remaining demand-side impediments in exporting to China are given below. In the agro-processing sector, Pakistan's critical impediment is a ban on red meat and poultry, despite better tariff access on paper.

1. The highest priority of the government must be to negotiate lifting of the ban on red meat and poultry and on assisting Pakistani producers to meet higher veterinary standards. Pakistani goods are being sent to China indirectly through Vietnam and Thailand, costing Pakistan export earnings despite better market access in China

Consumer awareness was a repeated concern of the agro-processing sector, especially in dried fruit and juices sectors. Many exporters feel they cannot compete on price in China because their product is of superior quality (e.g. Pakistani mango is naturally sweet, enabling the dried

mango to be 100 per cent organic as opposed to the dried mango China currently imports from the Philippines which has added sugar).

2. TDAP must have a budget to facilitate proper branding and marketing to educate consumers about the high quality of Pakistan's products. Chinese customers have become more discerning in terms of quality over time, and Pakistan should exploit this to access higher end markets in China. TDAP and sector associations must market the products that are natural and organic to fetch higher prices in China. This will help Pakistan get an edge over low quality cheaper competitor products with similar market access.

Finally, impediments pertaining to NTMs are not Pakistan-specific but are enforced more strictly on Pakistani consignments. To address these concerns:

1. Pakistan government should lobby for mutual recognition of standards to limit scope for stricter enforcement on Pakistani shipments
2. Customs officials must use non-invasive methods of checking such as sniffer dogs and scanners to clear packages without opening. This is especially important for agro-processed goods, which must visually be up to the mark.
3. The Pakistan government should work with China to create testing facilities at the land border with China. This would reduce the burden on individual exporters to get tested for multiplicity of quality, technical and safety standards.

The remaining impediments to trade identified by stakeholders consisted of issues on this side of the border and ranged from issues of poor competitiveness and manufacturing practices that hinder sustained exports, to more concrete difficulties in arranging a reliable internal supply of inputs. Recommendations to address these challenges are discussed below.

6.2 Addressing supply side issues faced in Pakistan

On the supply-side, creating sustainable exports to China requires better access to inputs, trade and customs facilitation, better production techniques and practices, and technical support in meeting Chinese compliances. Based on section 5, the following are key priorities for the consideration of government and relevant stakeholders to maximize benefits under the better market access provided to Pakistan in CPFTA2.

Improving access to raw materials

The domestic supply chain in Pakistan is quite weak— raw materials are of low quality while most inputs required for value-added production are not readily available domestically. Exporters rely on imported inputs and face weak trade policies that makes exporting costly. This problem is common to both the agro-processing and garments sectors. Specific measures that could be taken to facilitate exporters from these sectors are discussed below.

1. Pakistan mostly imports synthetic blends of fabric as domestic production is inadequate. Customs clearance must be expedited through bonded warehouses and low or zero tariffs on imports of synthetic fabric:
    a. Bonded warehouse facility for duty-free imports must be implemented in proper spirit of facilitation, or Pakistan will lose any tariff edge it has gained under CPFTA2

   b. Government already offers a DTRE scheme to import fabric duty-free (exporters can claim refunds on imported inputs used in exports). But only larger exporters can avail such schemes and refunds are delayed. To allow exporters to diversify and establish a presence in China, government can consider temporarily including synthetic fabric in SRO 492 (pertaining to exemption from customs duty and sales taxes). Expansion in exports could offset any losses in tax revenue
   c. Monitor leakage of this imported synthetic Chinese fabric into domestic markets by using import and export growth to keep a check (as is already done for DTRE)
   d. Remove the distinction between commercial and manufacturer importers to further remove any perverse incentives for rent-seeking or arbitrage

2. To encourage outsourcing in the initial years:
   a. China needs to be facilitated in production of non-cotton garments through duty-free import of Chinese fabric for jointly owned companies in Pakistan.
   b. Pakistan should expedite development of rail and road links on its side to facilitate the movement of inputs and finished between the two countries

3. Input-output tables based on 2014 values, must be updated by sector to reflect true import costs and export earnings

Development of supply chain

At the same time, to discourage reliance on imported inputs, the local supply chain must be strengthened through back-end policy support. This can include the following measures for the garments sector:

1. Provide incentives and a long-term plan for China to relocate its synthetic fabric manufacturing to Pakistan on priority basis. A matching desk at BoI, Ministry of Commerce and Industries (MoC&I) can ensure that potential buyers are matched with suppliers in Pakistan.
2. Government should negotiate FTAs with Turkey and South Korea to have access to a wider supply of synthetic fabric. With China forced to compete with South Korea and Turkey in Pakistan's fabric market, Pakistani exporters could benefit from lower prices of blended fabrics. This could catapult Pakistan into the high-end segment of global garments trade

For the agro-processing sector, there also critical gaps in the local supply chain. These arise from poor production practices that lower the quality and sustainability of Pakistani exports. The following measures must be implemented to reap the benefits of competitive market access under CPFTA2.

1. FBR can give tax incentives to expedite/develop JVs with Vietnam/Thailand for aquaculture and hatcheries, respectively.
2. R&D support, in the form of tax-deductible expenses, should be considered to promote sustainable fishing practices: this allows exporters to predict the size of the fish supply ahead of the season and market & plan distribution accordingly in China

3. Seek technical assistance from China to develop Karachi harbor so that it promotes sustainable and eco-friendly fishing practices: This will prevent Pakistan's exports from being banned in countries that require environmentally sustainable practices.
4. Encourage investment to improve overall fishing practices and equipment: For e.g., ribbon and tuna fish stock needs to be built up to meet demand in China. This could be done by providing information on efficient and sustainable fishing practices, appropriate regulation, and facilitation and support for collective action by private actors
5. For citrus, the government needs to either import itself or allow relevant associations to import seeds of seedless, blemish-free, and early/late varieties. Pakistan's current supply of kinnow is seeded and blemished, and also not suitable for juices— therefore it has low demand and fetches a low price.

Trade facilitation

Weaknesses on this front include ill-informed and under-qualified trade departments, lack of coordination by sector associations to put in strong marketing pitches as well as ill-defined jurisdiction of government departments over issues of trade and quality. Addressing these challenges is more urgent in the agro-processing sector, due to the nature of the products, and requires the following steps:

1. For the seafood sector, the Marine Fisheries Department in Pakistan needs to strengthen its capacity to liaise with counterpart departments in China such as the CNCA.
2. The Marine Fisheries Department needs to increase its technical capacity so that it can promote Pakistan's interests. Having market access will be useless if Pakistan's relevant departments cannot lobby its case in China. For example, India has succeeded in registering its exporters for the scientific name and HS code of topshell, while Pakistan has not. As the season has started, this will lead to a wastage of around 500 containers that cannot be exported to China in 2019
3. Improve coordination between the federal and provincial marine departments. For example, quality is a federal issue post-18th amendment but exporters continue to deal with provincial departments. This leads to unnecessary delays in processing requests— as shown by the case of CNCA, around 200-250 exporters were unable to send shipments for over a year
4. At the federal level, there should be one-window trade facilitation to deal with quality and trade-related issues

Technical barriers to trade

Apart from a few (e.g. on chromium products) there do not appear to be a substantial issue of TBTs that China applies only to Pakistan. There does, however, appear to be a lack of awareness amongst Pakistani exporters. Therefore, information desks at the top trade bodies and within the sector-level associations could be created, where exporters can educate themselves about the technical specifications of China as well as paperwork that must be done. Additional suggestions are as given below:

1. Develop a portal to consolidate SPS and other import requirements of China, by tariff line
2. To reduce the need for testing in China, local accreditation must move towards becoming internationally accepted.

3. In the meantime, the government must ensure that domestic certification bodies offer metrology, testing and accreditation services to smaller exporters who face difficulties in getting international laboratory tests.
4. Pre-shipment inspection in Pakistan must be done using better technology for efficient cargo handling. This could include laser scanners to clear time-sensitive agro-processing sector goods quickly.
5. Behavior by law enforcement agencies (such as anti-narcotics force) in Pakistan must be held accountable to procedure, so that unnecessary physical inspection of export orders is prevented. Many exporters have complained that shipments are so badly mishandled that their customers do not accept them.

6.3 Way forward

In an ideal world, the business environment should be improved for all products, and information and trade facilitation must be provided across the board. In the interim period, however, a realistic strategy would be to focus on specific products that now have competitive access under CPFTA2 with high export potential, and to relieve constraints for and facilitate these product lines first. This work can continue to be extended by consolidating the experiences of exporters that try to export to China. Experiences reveal non-tariff barriers in real time and help build capacity to address these barriers in both Pakistan (such as meeting standards and SPS requirements) and in China, by negotiating the removal of unnecessarily burdensome requirements and mutual recognition of international standards.

The way forward is to implement these key priorities for trade facilitation, while being vigilant to ensure that Pakistan's preference margins are not eroded vis-à-vis its competitors. The government should constantly monitor other FTAs that China signs, or any special re-export facilities China offers to other countries. Government capacity to actively negotiate and revise the terms of the CPFTA2 with China if such erosions occur will be critical to ensure that Pakistan continues to face market access at par with its competitors in China.

Equally importantly, Pakistan must also negotiate FTAs with Turkey, Japan and South Korea to help its exporters secure better access to other countries. By successfully negotiating relatively better tariffs with all its trade partners, Pakistan can become part of a regional trading network instead of exclusively relying on China.

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