

# **Challenges and opportunities for Pakistan under SAFTA**

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## **Abstract**

South Asian countries have been slowly moving towards a South Asia Free Trade Area (SAFTA) in recent years. The South Asia Free Trade Agreement (SAFTA) is being considered a key to success to trade liberalization, welfare gains, and economic growth for the seven countries in the South Asia region. It is still debatable that whether SAFTA will achieve its objectives or not? It is correct that potential gains from SAFTA exist but successful implementation and large welfare gains are therefore unlikely to be achieved under this agreement. There are many obstacles in the implementation and enforcement of SAFTA. Unresolved political tensions and low income groups are likely to derail much of the progress of the agreement. Countries of the region are encouraging unilateral and bilateral liberalizations which may be more effective and efficient ways to achieve economic growth and development among member countries. Paper in hand identified the challenges and opportunities faced by Pakistan under SAFTA.

**Key words:** SAFTA, economic growth, trade liberalization, opportunities and challenges

## **Introduction**

The South Asia Free Trade Area (SAFTA) Agreement was signed on January 6, 2004 at the 12th SAARC Summit held in Islamabad. The treaty has come into force on January 1, 2006 and will be fully implemented by December 31, 2015. SAFTA is intended to strengthen intra-SAARC economic cooperation and maximize the region's economic and social potential through various instruments of trade liberalization. The agreement binds all contracting states to reduce tariffs to 0-5 per cent by December 31, 2015 (Krueger, et al, 2004).

The primary objective of SAFTA is to benefit the small economies of countries like Bhutan, Maldives and Bangladesh. It is still debatable that whether SAFTA will achieve

its objectives or not? It is correct that potential gains from SAFTA exist but successful implementation and large welfare gains are unlikely to be achieved under this agreement. There are many obstacles in the implementation and enforcement of SAFTA. Unresolved political tensions and low income groups are likely to derail much of the progress of the agreement.

The SAFTA agreement's stated objective is to "strengthen intra-SAARC economic cooperation to maximize the realization of the region's potential for trade and the development of their people." The agreement calls for eliminating barriers to trade and facilitating the cross-border movement of goods between contracting states; promoting conditions for fair competition; and establishing a framework for further regional cooperation. Governed by the principles of the World Trade Organization (WTO), reciprocity, and an awareness of the needs of least-developed SAFTA countries (Bangladesh, Nepal, Bhutan, Maldives), the agreement targets the elimination of tariffs, paratariffs, and nontariff barriers (USAID, 2005).

SAFTA is being considered a key to success to trade liberalization, welfare gains, and economic growth for seven countries in the South Asian region. Establishment of free trade areas stems from the belief that trade liberalization improves the economic efficiency of any country. But this efficiency depends on the theory of comparative advantage, which advocates that free trade eventually results in producing and trading only those items for which they have a comparative advantage. Successful trade liberalization results in an expansion of exports and contraction of imports. The World Trade Organization (WTO) was established in order to institutionalize this principle of

free trade. Overall, free trade areas are considered to be the engine of growth and progress (PILDAT, 2004).

Intra-regional trade has increased significantly in the last decade, mostly through imports by all countries in the region, except Pakistan, from India. While South Asia is a fast growing destination for Indian exports, it remains marginal as a source of India's imports. The principal export destination of all South Asian countries remains North America and the European Union (EU). Thus, trade liberalisation within South Asia has largely served to stimulate Indian exports within the region but with low levels of reciprocal export growth to India. This owes in some measure to India's relatively more restrictive import regime compared to its neighbours, but it also reflects the structural rigidities in the smaller economies which have relatively little to export to India. Thus, a primary goal of trade cooperation in South Asia has been to encourage India to open up its import regime to imports from its neighbours through significant trade concessions and to help the smaller countries to enhance as well as diversify their production and export capacity to exploit emerging market opportunities in India (Sobhan, 2005).

## **Objectives**

The objective of the present study is to

1. To identify the challenges and opportunities for Pakistan under the SAFTA
2. To Compare Unilateral and bilateral liberalization with SAFTA.

## **Review of Literature**

According to a study conducted by Pigato et al. (1997), the creation of SAFTA "would be highly desirable" and "economic gains would be significant, especially for the smaller

countries". The study also concluded that SAFTA would reduce political tensions and have a positive impact on regional integration.

According to Panagariya (1999) SAFTA would prevent South Asia from pursuing a more beneficial, non-discriminatory liberalisation policy, consequently leading to higher tariffs in relation to nonmember countries. The empirical results, thus, provide mixed results regarding the potential gains of regional trade liberalisation for SAARC members. However, most studies arrive at the common conclusion that SAFTA will facilitate economic gains for all member countries through trade.

On the other hand, Studies by Srinivasan and Canonero (1995) and Srinivasan (1994) indicate that although potential gains from regional trade liberalisation are substantial, they are larger for smaller economies. Srinivasan also argues that South Asia stands to gain more by dealing with other regional arrangements as a group rather than individually.

## **Challenges**

It is argued that SAFTA will expand Pakistan's trade with member countries, decrease cost of production for the local industry due to availability of cheaper raw materials, intermediate and capital goods, increase industrial competitiveness and efficiency, provide greater market access to local producers, and lead to lower consumer prices and higher disposable incomes(Scheik, 2004).

While SAFTA is a useful vehicle for increased trade, it also faces many challenges. The critical factor in determining whether SAFTA would raise or lower the real incomes of the SAARC countries depends on whether it will be predominantly trade creating or trade diverting.

1. When countries are allowed to choose sectors that can be excluded from tariff preference of free trade, domestic lobbies make sure that the sectors in which they may not withstand competition from the union partner are the ones that get excluded. On the other hand, lobbies go along with free trade in the sectors in which they are competitive and the preference will threaten the imports from outside countries. In the same vein, lobbies tend to go for tight rules of origin or outright quantitative restrictions in precisely those sectors in which they fear the competition from the partner most. On the other hand, when the threat is mainly to the imports from outside countries, they are willing to accept greater liberalization.

2. The "behind-the border" restrictions are another challenge SAFTA must overcome. Cross-border trade can not succeed without improved trade facilitation in South Asia. Transport costs of regional trade are high in South Asia because of high inland transport cost, inefficiencies at ports and shipping, and restrictive transport and security procedures. Trade costs are high because of customs procedures, other trade procedures (health, agriculture), banking and payment procedures, and standards. It takes more than 10 days to get customs clearance on a container in South Asia compared to less than 5 days in East Asia. New transit routes are needed to better connect the South Asia region with Central Asia, China, and India (USAID, 2005).

4. The region of South Asia has blessed with many rich resources. The people are also very industrious. The missing point is proper guidance and training. It is expected that India will gain more as compared to other South Asian countries due to low cost, better quality and efficiency.

5. The big threat to trade with India is that Pakistan's exports are unlikely to find a market in India. It is feared that India on the other hand will be able to capture the Pakistani market of industrial raw materials, engineering goods, consumer goods and agricultural products, in all of which India has an exportable surplus. Pakistan's consumer and light engineering goods are uncompetitive due to high costs, poor quality, bad management practices, and unscientific market research. It is also feared that free trade will allow Multinationals to relocate their manufacturing to lower cost areas, resulting in huge employment and revenue losses for Pakistan (PILDAT, 2004).

6. It is important to note that although India currently has a comparative advantage in many industries, increased competition can serve as a stimulant to either increase Pakistan's competitiveness in these sectors or reorient the structure of the domestic industry in favour of more efficient segments. However, if we assume that increased competition will phase out uncompetitive sectors and lead to more specialised and efficient production, we need to be prepared for the effects of sectoral unemployment (even if it is temporary), especially in the face of rising poverty and lack of social safety nets.

7. There are many unresolved issues like Kashmir which are main obstacles in the way of trade with India and Pakistan. In fact this is a big threat to the failure of successful implementation of SAFTA. It is expected that once the Kashmir issue is resolved the entire SAARC region will witness considerable growth in intra-regional cooperation. In SAARC region India has geographical advantage bordering with all SAARC Countries while Pakistan is only bordering with India. If both countries resolve Kashmir issue not only the intra-regional trade will improve but also gain a major share in the world trade.

8. The region of South Asia is low income as compared to other regions of world. The people have low purchasing power. Therefore, trade among this region will not bring prosperity and economic development. But trade with countries like Canada, USA and Australia can bring more foreign investment and more reserves.

Since the trade between the two countries is confined to limited sectors it is difficult to identify the vast potential areas. However Pakistan's textile has an edge while India has advantage in industrial sector because of cheap labour and mass production. It is therefore suggested that the business community of the two countries should have the liberty to make joint ventures and explore the potential of third country.

### **Opportunities**

Although South Asia has the potential of becoming the world's largest free trade area through economic integration as envisaged by SAFTA, it continues to be considered as the world's least integrated region. This fact conveys a message to the relatively developed as well as the developing economies of the region to work sincerely towards the implementation of the SAFTA and taking it out from the underdevelopment.

Pakistan can enjoy lot of benefits in the context of SAFTA because of its geo-strategic importance in the region. Since 'energy security' commands the greatest importance for the development of any economy in present times, Pakistan, at this place, can capitalize on the basis of its proximity to the countries which have abundant energy resources. Given its vast natural resources, Pakistan can be a success story in regional settings of the free trade agreement. All of its natural resources -land, labor, rivers etc- are supportive of agriculture sector and in the atmosphere of free trade and fair competition, can

significantly boost up the agricultural sector and the overall economic profile of the country.

One of the major concerns for Pakistan in present economic situation is the sustainability of its economic growth. SAFTA serves as an instrument for ensuring its sustainability by expansion of the markets and making the industries and other sectors more competitive globally. Pakistan can take leverage of the increased competition and the economic potential of the member countries.

Since India and Pakistan are the major developed countries of the region, both can reap tremendous benefits of the region's potential of free trade. The most important aspect of the free trade arrangement is the possible prospect of dispute settlement and conflict resolution. Pakistan can take advantage of the 'trust built-up' during and after the SAFTA implementation in the region in connection with 'Kashmir dispute settlement', 'Sir-Creak', and 'Sia-Chin' conflict resolution. All of this development would go a long way in bringing peace and stability in the region and Pakistan in particular, which ultimately would result in the better economic conditions of the people in the country. A related development in the country after the 'disputes settlement' would be the cut in the defense expenditure and diversion of the resources to more productive sectors of the economy. This development is bound to create better economic and income generating activities for the people.

Greater economic integration as envisaged by SAFTA has a direct bearing on the region's total population that stands above 1.5 billion. The ultimate aim of the SAFTA is to create a 'South Asian Economic Union'. At the moment it seems like a 'dream' that can only be transformed into reality if all the member countries are willing to live up to

their commitments. Pakistan, being the major partner in the free trade agreement, would definitely enjoy the benefits through better investment opportunities because of its comparative advantages in several goods.

### **Comparison of Unilateral and Bilateral liberalization with SAFTA**

After a long way to implement WTO, need of regionalization was felt and it was considered indispensable to exploit the resources of Intra-SAARC countries and to promote the social and economic cooperation among member countries. It was also considered that discovering and exploring the potential for trade among the member countries could only be prove a tool for the development of the people in the region and this could only be achieved by liberalizing the trade by removing barriers to tradable goods and encouraging to create an environment for competition and establishing a theoretical and practical framework to encourage unilateral and bilateral relationships among member countries. Keeping in view the regional development SAARC countries agreed to think over commonalities among member countries and to establish a forum under which dream of free trade could be changed into reality and finally South Asia Free Trade Area (SAFTA) was signed in Jan. 2004 to promote unilateral and bi-lateral cooperation.

Economic integration in South Asia through Uni.-Bilateral ties could give energy to grow for mutual benefits. It was also necessary to redefine comparative advantages and to give chance to every country to emerge in the field in which she is specialized like Pakistan could emerge as textile and sport and Bhutan could grow as forest bases industries. The aims of SAFTA could give boom to regional investment, transfer of technology, human resource development. The economic interdependence and prosperity that it will generate

also has the potential of fostering lasting peace in the region (Kumar, 2005). It is estimated that the implementation of SAFTA would raise the current level of intra-regional trade from \$6 billion to \$14 billion (Sheikh, 2004). Recent World Bank studies show that developing countries that have embraced open-market strategies and thus take advantage of market synergies in the past decade have grown much faster than those that have not. As the textile is the largest industrial sector in Pakistan it will have a major role to play within the framework of SAFTA. All Pakistan Textile Mills Association (APTMA) has welcomed the ratification of SAFTA by Pakistan.

South Asia remains one of the least integrated regions in the world. Intra-regional trade as a percentage of GDP for South Asia is less than 2 percent of GDP, compared to more than 20 percent for East Asia. Regional trade in South Asia now accounts for less than 6 per cent of total trade, compared to 22 per cent within the ASEAN Free Trade Area, and 65 per cent within the European Union. Moreover, the SAARC countries have not fared well in attracting foreign investment. In 2002, the foreign direct investment (FDI) of the region amounted to only 0.5% of the global FDI flow. SAFTA carries the great promise of sustainable regional economic growth and development in the South Asian region. It has the potential to make South Asia as one of the fastest growing economic blocs in the world (SAFTA, 2004).

Moreover, the countries of this region would have to have a clean break from the past and build a different kind of relationship in the future. Keeping this strand of reasoning in mind, it is highly plausible that South Asian cooperation can become a norm for the future, provided an environment for peace and security can be created between India and Pakistan (Shah, 2003). However, even if certain bilateral trade agreements, such as between India and Sri Lanka, provide a good precedent to follow, they cannot substitute a

more balancing regional economic arrangement that can simultaneously address the interests of more and less developed or big and small countries in maximizing the benefits from the economies of scale and relative advantages while benefiting from globalization (Alam, 2004).

### **Policy options**

1. In order to compete in this region Govt. should devise such policies which can help the farmers and industrialists in reducing their cost of production, increase industrial competitiveness and efficiency.
2. Pakistan should export keeping in view the comparative advantage to all these South Asian countries.
3. Domestic farmers should be given appropriate information and updated knowledge for the better production and export methods.
4. Govt. of Pakistan should try utmost to resolve all the issues with their neighbor countries especially India to promote more trade opportunities.
5. Measures to improve the likelihood of welfare gains and economic growth associated with SAFTA should include harmonizing standards, professionalizing foreign trade management, creating specialized institutions and joint collaborative marketing efforts
6. Last but not the least, Pakistan needs to concentrate on developing policies to diversify and upgrade its export base, and creating a favourable climate for private investment. Trade liberalisation with SAARC countries may encourage policy makers as well as the private sector to increase their efforts to strengthen

Pakistan's international competitiveness. However, this depends on how well Pakistan responds to the pressures of liberalization.

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