

**STRENGTHENING TRADE BETWEEN PAKISTAN AND CHINA; A CASE STUDY  
OF FREE TRADE AGREEMENT**

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**Abstract**

The paper attempts to explore the potential benefits obtained by Pakistan and China, since they signed a free trade agreement and the importance of bilateral trade in improving friendship between the two countries. There is a more increase in Pakistan's imports from China and decrease in Pakistan's exports to China since FTA is concluded. Despite, major increase in imports from China, maximum profit had been achieved since it was signed. This also attempts to explore the impact of China Pakistan Economic Corridor (CPEC) signed under the FTA. CPEC is a multi-billion dollar project a part of One Belt One Road (OBOR) initiative initially, is carried out for the purpose of infrastructure development and the development of roads railways and gas pipelines to connect Gwadar port with Kashgar in China and facilitate trade. But there is still some negative impacts on Pakistan's economy after signing CPEC. The paper will also discuss the negative impacts of CPEC and will try to find the possible solutions to the problems.

**Key words:** CPFTA, CPEC, Agreements, import, exports, trade, regional connectivity

**1.1 Introduction:**

Initially a military assistance was formed between the two countries in 1966, a strategic alliance between them began in 1972 and economic cooperation began in 1979. In 2001 several memorandums of Understanding for trade have been signed between Pakistan

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and China (*Wikipedia, 2001*), then preferential trade agreement was signed and later in 2006 Free trade agreement was signed to bolster economic cooperation between the two countries. The research focuses on the preferential free trade agreement between Pakistan and China which was concluded in 2006 and entered into effect 2007 and the second phase of the free trade agreement which is also known as free trade agreement. China is Pakistan's biggest arms supplier and largest trading partner. Due to this agreement the economic conditions of Pakistan are improved up to some extent. Maximum profit had been achieved Pakistan in economic sphere due to this agreement.

With the Chinese help, Pakistan has got much importance not only in the region but the entire world. In recent years, both China and Pakistan are struggling to connect Kashgar region of China with Gwadar port, in order to revive old Silk Road and get easier access to Central Asian Republics, through CPEC, which is flagship project of BRI, previously known as OBOR. This can bring maximum benefits for both countries. It will facilitate trade and both countries can get duty free access for trading. So, both can achieve maximum advantages from free trade agreement through CPEC. Chines also intended to build a naval base for security at Gawadar port, so this will also help to promote traade.

## **1.2 Literature review:**

Siegfried in his book argued that CPEC has obtained much importance as an tool to promote economy and sustainable development. The main reason behind this was the so-called One Belt One road initiative or New Silk road project proposed by Chinese president Xi Jinping, so as to promote cooperation between Asia and Europe other regions as well. PBC report is also important regarding significant changes in phase one of the free trade agreement. Ministry of commerce of Pakistan as well as China has a major contribution in the Free trade agreement.

### **1.3 Objectives of research:**

- To find role of CPEC for the development of economic conditions.
- To analyze the first and second phase of free trade agreements.
- To examine major improvements in trade and economic conditions of Pakistan.

### **1.4 Research Questions:**

- To what extent economic conditions has been improved after signing free trade agreements?
- What role will be played by CPEC in improving economic conditions of Pakistan?

### **1.5 Research Methodology:**

It refers to the method of conducting research. This research is based on collection of qualitative data as well as quantitative. Data is collected from different sources like newspapers, journals, websites which are primary as well as secondary.

### **1.6 Significance of research:**

From analysis of different sources, major contributions of different organizations have been found. It was also found that there is a major increase in collaboration between Pakistan and China after signing CPFTA 2 and CPEC.

## **CHINA-PAKISTAN FREE TRADE AGREEMENT**

### **2.1 Historical background:**

International trade plays an important role in improving the economy of a country because maximum benefits has been achieved by countries from each other by granting concessions on certain priority products and making investments in different projects, that is why

Memorandum of Understanding on several projects were signed between and later in 2002, cooperation for the development of deep sea Gwadar port was carried out on the Arabian sea to facilitate transport of goods coming from western through Pakistan. A preferential free trade agreement was signed between Pakistan and China in 2003 later in 2005, additional Memorandum of Understandings (MOUs) were signed between them, covering other areas like, infrastructure, education and energy etc. (Chaudhry, 2016). When World Trade Organization (WTO) introduced a trade agreement, an FTA was signed in 2006 between both countries which was phased over a period of five years. A trade and development Authority department was also established in Ministry of commerce and textile industry in order to facilitate trade. General agreement on tariff and trade covers international trade in goods whose members are representatives of WTO and both China and Pakistan are the members of both organizations.

On 20<sup>th</sup> April 2015, both countries entered into agreement of CPEC. Efficient work is carried out after signing CPEC project to improve through development of railways, roads, gas pipelines, energy and infrastructure coal-fired power and development of Gwadar seaport power to connect the Kashgar region of China to Arabian sea through it. Work is also under way through CPEC for the construction of Special Economic zones to improve the economy of both Pakistan and China.

## **2.2 Phase 1:**

The first trade agreement between Pakistan and China was Preferential Trade agreement in 2003 and later free trade was signed between Pakistan and China on 24<sup>th</sup> Nov, 2006 and entered into effect in July, 2007. This agreement was signed between the commerce ministers of both parties and overseen by Chinese president Hu Jintao and his Pakistani counterpart general Pervez Musharraf (Ministry of Commerce, Pakistan, 2006). Under this

agreement Pakistan provided 5 percent concessions to Chinese goods on 386 items while China gave free-tariff access to Pakistan on 787 items (Shabir & Kazmi, 2007).

It consists of the following parts:

1. Agreement
2. Annex 1, 2, and 3

Agreement:

Agreement consists of articles related to the aims and objectives.

Annex 1

Annex is related to the modality for elimination of import custom duties and consists of two phases of 5 years:

- a) Phase 1

It consists of 5 categories of products and modality for the elimination of tariff on certain tariff lines for Chinese goods.

- b) Phase

It consists of categories of products and modality for the reduction of tariffs on particular tariff lines for Pakistani goods (Mofa, China, 2019).

**Tariff concession:**

Pakistan provided concessions to China on 6,803 tariff lines. In these tariff lines, zero tariff was granted on electric appliances, machinery, chemicals and other raw materials important for Pakistani industries.

China gave concessions to Pakistan on 7,550 tariffs lines. In which 35 percent products were included in zero-rated category while only 15 percent were excluded from tariff concession list.

### **3 Trade in Services:**

On February 21, 2009, Chinese councilor Bingao and Pakistani president have concluded the agreement of trade in services of CPFTA1 (Ministry of commerce China, n.d.). This agreement was signed in order to promote and facilitate trade between both countries.

#### **2.4 Custom duties:**

In article 8 of CPFTA1 it was mentioned that according to the annex agreement both countries will remove their import duties on goods originating in the region of another state (*“China-Pakistan Free Trade Agreement,”* 2006, p. 4).

#### **2.5 Second phase:**

The second phase was negotiated in 2019 and implemented from 1<sup>st</sup> January 2020. Its time period is 2019-2024. This agreement is of major significance because certain important provisions has been made in the first phase and both sides tried to grant maximum concession to each other in order to ease trade. In this phase Pakistan got zero percent tariff on 313 product lines (CPFTA 2, 2019). In this agreement China and Pakistan are trying to provide concession to each other on 75 percent tariff lines as compared to 35 percent of the previous phase in a period of 10 years for China and 15 years for Pakistan. Both countries are also trying to reduce 20 percent tariff which includes 5 percent of the products. This phase is also known as amending protocol and aims to improve liberalization of trade, electronic data exchange, bilateral trade, safeguarding measures for industry, and to facilitate balance of payments (Briefing, 2020). Under this phase both countries are struggling hard to reduce tariff in less than ten years on 90 percent of products.

CPFTA 2 provides a details tariff levied by Chinese on 8238 product lines at the 8-digit level (PBC, n.d.). In this agreement tax of about 20 percent on 412 lines will be lowered in less than 5 years. HS is a harmonized system for classifying goods, which is a six-digit code system. Important provisions has been made in this agreement.

Under this agreement:

- 1.China will extended free access to Pakistan on extra tariff lines.
- 2.Pakistan can levy additional duties in the face of balance-of-payment crises.
- 3.Immediate exchange of electronic information is also included, so as to avoid misreporting and any other type of inconvenience.

China primary focus is on manufacturing sector to boost the economy which comprises about 94.3% of its total exports. Its secondary focus is on agricultural sector which forms 3.2% of total exports. (Abbas & Ali, 2018)

According to the research, new phase would allow the Pakistani manufacturers and traders to export around 313 new products to the Chinese market on zero duty like ASEAN countries (*2nd Phase of CPFTA*, 2020). It is only 2 percent less than the total imports of both countries.

Pakistan is now offered with zero duty market access on about 1000 products as compared to CPFTA 1 in which there was zero market 724 products.

The Amending Protocol, also known as Phase 2 of the CPFTA aims to increase relations between China and Pakistan through increasing liberalization of trade in goods, safeguarding

mechanisms for its domestic industry, and facilitating inter-country balance of payments and electronic data exchange (*Briefing, 2020*).

Under CPFTA 2 Pakistan experienced a major rise of 70 percent in exports to China as compared to the first phase

### **Major imports:**

Major imports from Pakistan to China have been increased under CPFTA1 which can be seen in HS-2 level data. The list largely consists of electrical instruments, machinery, nuclear reactors

### **Priority products:**

These are the high priority products for which there is a well established market in China for export from Pakistan at the HS-8 level. So, due to these products, Pakistan can maximum its exports to China. These products are divided into three categories:

#### Priority 1 products

This category consists of 401 product lines. These are the top-level products which China import from Pakistan. Out of these product lines 93 percent have is expected to have duty free access to China. In CPFTA 2, 44 percent of the product lines is having low tariff as compared to phase 1. Some of these export products have duty-free access to China. This list has the greatest possibility of maximizing exports from Pakistan to China.

#### Priority 2 products

This list contains 1436 products lines. These are the products lines in which 70 percent of products have duty free access to China. This list shows 575 product lines rise under CPFTA



2 than CPFTA 1. So, in the second phase there of a surge of about 47 percent in tariff lines. This group consists of major products at the H-2 level i.e. machinery, mechanical appliances, nuclear reactors. There is a major rise in ten exports to China products at H-2 level.

1. Priority 3

This category includes 5872 product lines, at H-8 level. In these products 80 percent or 4701 product lines are having duty free access to China. There is a great increase of about 34 percent duty free access to China on exports than previous phase.

3.1 One Road One Belt (OBOR) Scheme:

This scheme is a Chinese flagship presented by Chinese President Xi Jinping in 2015, is noteworthy and beneficial project, focusing on regional connectivity also known as Belt and road initiative, signed by many countries with China, consists of three regions i.e. northern, southern and central. The southern corridor starts from southern city Guangzhou city of China and moves toward the western Kashgar region of China, which aims to connect with Gwadar in Pakistan (Essays, n.d.).

There are six corridors in One Road One Belt initiative:

1. New Eurasia land bridge
2. China Mongolia Russia Corridor
3. China central Asia west Asia Corridor
4. China Indo China peninsula Corridor
5. Bangladesh China India Myanmar Corridor
6. China Pakistan Corridor

One road one belt initiative focuses on the main cooperation areas among involved countries:

1. Collaboration in policies and strategies
2. Cooperation in strengthening connectivity and infrastructure
3. Promote trade and investment
4. Maximizing financial cooperation

CPEC is the most important project for strengthening economic ties between China and Pakistan. It connects western China to Arabian sea through Pakistan.

### **3.2 China Pakistan Economic Corridor (CPEC):**

It is a part of BRI and is a flagship project and signed between former Pakistani prime minister Nawaz Sharif and Chinese president Xi Jinping on 20<sup>th</sup> April, 2015. It is 3000 km network of pipelines, railways, roads for the transport of oil and other energy resources for the improvement of bilateral trade relations and regional connectivity from Gwadar to Kashgar, Xinjiang, Uighur, Province of China. Its main focus is on energy and transport infrastructure. It was proposed that his project links China strategy to develop its western region with Pakistan focus on boosting its economy. Through this project, China aims to connect get cheaper, easier and direct link to Europe, Central Asian Republics, Middle East and Gulf countries through CPEC, which intends to connect western region of China through Strait of Malacca to Arabian sea near Gwadar in Southern region of Pakistan.

### **3.3 Role of CPEC**

CPEC is a conceptual plan and is a collection of projects for connectivity and which not only benefit Pakistan and China but also have positive impact on India, Iran, Afghan relations with Pakistan. It is a game changer project which will transform the fate of Pakistan and help it modernize and overcome the energy crisis and develop infrastructure to facilitate trade (Essays, 2020). During the first phase of CPEC 600 Pakistani's will get jobs and during the second phase 1000 will get employment. According to the research first phase of CPEC is

successfully completed and first steel mill at Rashakai Economic zone is established with the help of Chinese company Century Steel with an investment of about \$240 million which would produce steel of about 1.5 million tonnes. According to the Chinese consul in Karachi due to the concerted efforts of PTI government economy of Pakistan has been successfully improved despite the Covid 19 crisis (*Dawn, 2021*). It will facilitate trade and will also help both Pakistan and China to get maximum relief on tariff and get easier access to Central Asian Republics and other Gulf countries. It is an platform of multiple cooperation and Pakistan can get benefit of increasing its exports through small enterprises, if linked with special economic zones for increasing productivity.

About 28 billion dollars is set for early harvest projects in which 10 billion USD is for transport infrastructure and 18 USD for power and energy projects ( Hussain, 2017). Due to this project, China will not only get cheaper access and facilities trade with other countries but Pakistan will also have an advantage of earning from world second largest economy by providing transit services.

### **3.4 Gwadar:**

Gwadar is port city situated on Arabian sea in Baluchistan province opposite to Oman. It was purchased by Pakistan from Oman on 8<sup>th</sup> December, 1958 (*Wikipedia, n.d.*). Through Gwadar China intends to revive the historic silk road and connect the Western Kashgar region of China with Gwadar which is in the southern region of Pakistan under CPEC.

### **3.5 Special zones (SEZs):**

There are nine Special economic zones of CPEC in Pakistan, which are the following:

1. Rashakai economic zone, M1

2. Dhabeji Special Economic Zone
3. Boston industrial zone
4. Allama Iqbal industrial city, Faisalabad
5. ICT Model Industrial Zone, Islamabad
6. Industrial park Pakistan Steel Mills, Port Qasim
7. Mirpur Industrial Zone, AJK
8. Mohmand Marble City
9. Moqpondass SEZ Gilgit-Baltistan (*CPEC Special Zones*, n.d.).

The establishment of special economic zones under CPEC is hoped to promote trade and development of small and medium sized enterprises, due which export will be increased (Kamal & Malik, 2017). Under CPFTA 2 Pakistan offers concession to the Chinese companies managing Gwadar and special economic zones and concessions will also be provided to the companies settling in more than one industrial zone. These zones will also help Pakistan to attract foreign though stable economy.

### **3.6 Connectivity with Afghanistan:**

Afghanistan is one of the major trading partner of Pakistan and there is great scope of collaboration between Pakistan and Afghanistan in the context of CPEC. Because this project can be extended to Afghanistan and due to this bilateral trade relations and inter-regional connectivity can be enhanced. Due to the inter-regional connectivity between Afghanistan and Pakistan both can be benefited (Wolf, 2019, p.143). According to joint declaration by Pakistan and China both countries will advance key cooperation projects.

### **3.7 Balance of power:**

According to the research the Corridor will create balance of power will not only enhance the strategic cooperation between Pakistan and China Pakistan sees CPEC as not merely as an

investment aimed at improving its economy but a strategic balance of power against Indian military and economic might. which will not only benefit but the entire region (Amir, 2016).

### **3.8 Security Challenges:**

Challenges in the way of CPEC in Pakistan:

#### a) Domestic Challenges:

The first is the absence of law and order.

Second challenge is the political instability in Pakistan.

Third is the institutional imbalance Pakistan, which is of military rule and insecurity for politics.

Fourth is the inter-provincial grievances because Punjab province has a lion's share in CPEC as compared to other provinces in Pakistan.

Fifth is the ongoing insurgency in Baluchistan because Gwadar port is located in Baluchistan. Due to CPEC there is growing unrest in Baluchistan and according to foreign rivals are trying to create problems in Baluchistan for the failure of CPEC.

#### b) International challenges:

First challenge is the India's belligerent attitude towards Pakistan.

Second is the Indo-Afghan nexus which showed that Afghanistan remained unruly for Pakistan.

Third is the implementation of Chabahar port, which is the result of the cooperation between Iran and India to halt CPEC.

Fourth is the involvement of big powers i.e. America and Japan. Because US considers rising of China as a major threat to its global dominance and making different policies to contain China (*CSS Forums*, n.d.).

China's economic clout is paving way for the realignments in the Middle East. After signing FTA and BRI With China Pakistan is naturally aligned with China due to which other Muslim countries like Saudi Arabia and Iran were not and pushed Pakistan to stay away from the project (*Tribune*, 2021)

#### **CONCLUSION:**

China, as a trading partner, contributing much to the economy of Pakistan. Since CPFTA is signed much progress has been shown by Pakistan's economy but there is also considerable decline in Pakistan's exports and increase its imports but still maximum benefit has been obtained by Pakistan due to the Chinese concessions and reduction of tariffs or customs duties on each other imports. Phase one did not meet the requirements of the businesses in Pakistan, and many complaints had been received, so that is why it was revised after several negotiations and signed in 2019 while implemented on 1<sup>st</sup> January 2020. Under this agreement major concessions were granted by both Pakistan and China on imports.

CPEC intends to improve strategic links between both countries, and is an important framework. Through this project, China and Pakistan can trade easily and can improve their economy by obtaining the maximum benefit from FTA through CPEC from special economic zones. Establishment of special economic zones will also help in developing foreign direct

investments and will also increase Pakistani exports to China by getting by providing support for industrial sector through joint cooperation between Pakistan and China.

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