

ASEAN TRADE EFFECT ON PAKISTAN'S ECONOMIC DEVELOPMENT*

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Abstract

Pakistan began to increase its focus on trade relations with ASEAN member countries in 1990s. The first ASEAN-Pakistan Joint Business Council Meeting held in Karachi in 2000 was an effort to seek measures to enhance trade between Pakistan and ASEAN. This paper examines the possibility that Pakistan's bilateral trade relationships with ASEAN countries help contribute to its economic development. The analysis covers a period from 1976 to 2005. It uses a panel data on Pakistan's gross domestic product (GDP) indices (in relative terms) and total trade with each founding member country of ASEAN: namely, Indonesia, Malaysia, Philippines, Singapore and Thailand. Results indicate a positive relationship between the bilateral trade relationships and Pakistan's economic development. The significance of ASEAN trade effect is better seen in a long-term perspective. It should be realized indirectly through increasing national market size, technology improvements, increase in productivity in economic sectors, growth and expansion of local firms and other economic progresses in Pakistan.

Keywords: Pakistan, ASEAN, trade, economic development.

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1. Background

Pakistan has four provinces: Punjab, Sindh, the North-West Frontier and Baluchistan. The federal capital of Pakistan is Islamabad. It covers an area of 500,000 square miles. The total population of this country is nearly 160 million in 2006. Pakistan continues to reconstruct its policies to meet the requirements of sustainable development in the era of globalization.

Pakistan has established trade relationships with most of the countries of the world since its independence in 1947. Pakistan's major trading partners for exports are the United States, Hong Kong S.A.R., Germany, United Kingdom (UK), Japan and United Arab Emirates. The major exports are cotton clothing, thread and textiles; raw cotton and rice; petroleum, leather, and fish products. Pakistan's imports are mainly from the United States, Japan, Kuwait, Saudi Arabia, United Arab Emirates, UK and China. Of all the major trading partners of Pakistan, the five-year average share of the United States, UK, Japan and Germany has the range of 31-39 percent during 1980-1995. The four countries accounted for an average 53-68 percent of the Pakistan's total trade deficit during the period (Akhtar & Malik, 2000).

Pakistan trades products with countries outside South Asia region, which are also exported by its neighbor countries. Pakistan's exports had been declining throughout the fiscal year 1998-1999. Its exports were amounted to only 13.2 percent of gross domestic product (GDP) while its imports were at 16.1 percent of GDP in 1998. Its protectionist policies and weak foreign direct investment policies were among the major causes of the low trade shares (Williamson, 1999). In regional arrangements, Pakistan's trade policies have been based on the principles of multilateralism and non-discrimination. Its involvement in preferential and regional trade arrangements has thus been limited (WTO, 2002).

The development of globalization has pushed Pakistan to construct a more open trade policy. In the 2005/06 trade policy, the country has reduced the ad valorem tariff rate from 50 percent in 1995 to 15 percent in 2005. There is also an extension of the positive list from 40 items in 1983 to 768 items in 2006 that may be legally imported from India. The signing of the South Asia Free Trade Agreement (SAFTA) in January 2004 reduces tariff at the level of intra-regional trade in South Asia.

Pakistan must expand its trade relations with various countries that have potential to increase its economic performance. Trade with the member countries of the Association of Southeast Asian Nations (ASEAN) is one of the country's efforts to achieve this goal.

2. Economic Development in Pakistan

After independence in 1947, Pakistan experienced numerous economic, social and political difficulties. In an attempt to bring economic development to the country, a basic framework of economic development was adopted with the Five-Year Plans. Agriculture was the main economic activity with some large industries at that time. After its implementation, the economy experienced an average annual growth rate of 6.8 percent during the 1960s. The manufacturing and agriculture sectors grew at 9.9 percent and 5.1 percent of GDP, respectively. There were also a low inflation rate, 3.8 percent, and a high

growth rate of employment, 72.7 percent, in major labor-absorbing sectors (agriculture and manufacturing). The unemployment rate was very low, 1.43 percent, during the same period (Nadeem, Ghazanfar & Ahmad, 2001).

During 1972-77, Pakistan's macroeconomic conditions were unstable. The annual growth rate of about 5 percent was mainly contributed by the growth of the service sector, especially defense and public administration. The annual growth rates of manufacturing and agriculture sectors fell significantly to 5 and 2 percent, respectively. There were a high rate of inflation and large budget and current account deficits. Massive public sector investment and other public expenditures created by the elected government with a populist and economic agenda were not able to reduce the deficits. The balance of payments problems were due to large trade deficit. In order to fill the wide gap between exports and imports, the government increased foreign loans but it led to increased debt burden on the economy (Khan, 2002). The debt burden added to debt-servicing expenditure further enlarged high fiscal deficit (Fatima & Ahmed, 2002). In 1999, Pakistan launched an economic revival program to ameliorate the critical economic juncture. Among the main objectives developed were to stabilize and reinvigorate the economy's productive and institutional capacity and to reduce national debt burden (Qayyum, 2001).

Pakistan had far more favorable economic growth in the 1980s than in the 1970s. The military government that replaced the elected government regulated the economy in a way that its long-term efficiency would be improved. The role of private sector in the country was expanded (Khan, 2002). Table 1 further exhibits some economic indicators of Pakistan from 1985 to 2006. The GDP per capita grew by 10.5 percent from 1990 to 1995. It doubled by 21.6 percent from 2000 to 2006. Pakistan's economic growth is almost evenly contributed by commodity sectors (agriculture and industry) and services.

Table 2 shows continuous increase of Pakistan's total trade from 1985 to 2006. It grew by 348 percent from 1985 to 1995 and 371 percent from 1995 to 2006. Although Pakistan's total imports were larger than its total exports, its exports of manufactured goods increased remarkably from 1985 to 2006. Its size of imports of consumer goods was even much smaller than its size of exports of manufactured goods. Pakistan's imports are particularly capital goods and industrial raw materials for production of consumer goods. Rising per capita incomes has been accompanied by a corresponding rise in private consumption in Pakistan. On this basis, there is an increase in imported goods, which is to fulfill high capital demands of Pakistan's economic development.

TABLE 1 Population, Employment and Selected GDP Indicators for Pakistan,
1985-2006 (fiscal year ending 30 June)

Item	1985	1990	1995	2000	2006
Population (<i>million</i>)	95.67	109.71	124.49	139.76	156.77
Labor force (<i>million</i>)	28.07	31.63	34.18	40.49	50.50
Employed (<i>million</i>)	27.03	30.65	32.35	37.32	47.37
<i>Agriculture</i>	13.66	15.68	15.14	18.07	20.55
<i>Manufacturing</i>	3.68	3.93	3.40	4.31	6.56
Unemployment rate, (%)	3.7	3.1	5.4	7.8	6.2
GDP/capita ¹ <i>Rupees</i>	4,041	4,321	4,775	27,376	33,295
Sectoral share in GDP ² (%)					
Agriculture	<u>27.4</u>	<u>25.8</u>	<u>24.9</u>	<u>26.0</u>	<u>21.3</u>
Industry	<u>23.4</u>	<u>25.6</u>	<u>25.8</u>	<u>23.3</u>	<u>25.9</u>
<i>Manufacturing</i>	<u>16.5</u>	<u>17.6</u>	<u>17.3</u>	<u>14.7</u>	<u>18.9</u>
<i>Mining</i>	0.4	0.5	0.5	2.3	2.6
<i>Construction</i>	4.1	4.1	4.0	2.5	2.1
<i>Electricity, gas & water</i>	2.3	3.3	4.0	3.9	2.3
Services	<u>49.2</u>	<u>48.6</u>	<u>49.3</u>	<u>50.7</u>	<u>52.8</u>
<i>Transport & communications</i>	10.2	9.5	10.2	11.3	10.4
<i>Wholesale & retail trade</i>	16.1	16.5	16.3	17.5	19.1

Notes: ¹ At 1980/81 and 1999/2000 market prices for the 1985-1995 and 2000-2006 statistics, respectively.

² At constant factor cost.

Source: Asian Development Bank and Federal Bureau of Statistics, Pakistan.

TABLE 2 Pakistan's Trade Indicators 1985-2006 (fiscal year ending 30 June)

Item	1985	1990	1995	2000	2006
Exports (<i>Million Rupees</i>)	<u>37,979</u>	<u>106,469</u>	<u>251,173</u>	<u>443,678</u>	<u>984,841</u>
<i>Primary commodities</i>	<u>10,981</u>	<u>21,641</u>	<u>28,113</u>	<u>53,833</u>	<u>112,268</u>
<i>Semi-manufactures</i>	<u>6,664</u>	<u>25,167</u>	<u>62,624</u>	<u>68,208</u>	<u>106,030</u>
<i>Manufactured goods</i>	<u>20,334</u>	<u>59,661</u>	<u>160,436</u>	<u>321,637</u>	<u>766,543</u>
Imports (<i>Million Rupees</i>)	<u>89,778</u>	<u>148,853</u>	<u>320,892</u>	<u>533,792</u>	<u>1,711,158</u>
<i>Capital goods</i>	<u>28,968</u>	<u>48,420</u>	<u>112,305</u>	<u>140,045</u>	<u>631,643</u>
<i>Industrial raw materials for</i>					
1. <i>capital goods</i>	<u>4,859</u>	<u>10,439</u>	<u>16,754</u>	<u>30,712</u>	<u>124,480</u>
2. <i>consumer goods</i>	<u>41,579</u>	<u>61,562</u>	<u>148,419</u>	<u>287,801</u>	<u>769,336</u>
<i>Consumer goods</i>	<u>14,372</u>	<u>28,432</u>	<u>43,414</u>	<u>75,234</u>	<u>185,699</u>
Trade balance (<i>Million Rupees</i>)	-51,799	-42,384	-69,719	-90,114	-726,317
Total trade (<i>Million Rupees</i>)	127,757	255,322	572,065	977,470	2,695,999
Balance of Payments (% of GDP)					
Total trade	<u>28.6</u>	<u>31.3</u>	<u>30.7</u>	<u>25.2</u>	<u>32.3</u>
<i>Exports</i>	<u>8.3</u>	<u>12.5</u>	<u>13.2</u>	<u>11.6</u>	<u>12.8</u>
<i>Imports</i>	<u>20.3</u>	<u>18.8</u>	<u>17.5</u>	<u>13.6</u>	<u>19.4</u>
Balance on goods	<u>-12.0</u>	<u>-6.3</u>	<u>-4.3</u>	<u>-2.0</u>	<u>-6.6</u>

Source: Asian Development Bank and Federal Bureau of Statistics, Pakistan.

3. Pakistan's Trade with ASEAN

Trade between Pakistan and ASEAN member countries has been increasingly important recently. In the late 1990s, Pakistan became a Sectoral Dialogue Partner of ASEAN that emphasized a closer relationship between the country and ASEAN. Pakistan has focused on market access, trade promotion initiatives and foreign direct investment in effort to enhance its trade with ASEAN.

In the first meeting of the ASEAN-Pakistan Joint Business Council and Trade Facilitation Workshop held in Karachi on 21-22 February 2000, the potentials for more economic cooperation activities between Pakistan and ASEAN had been recognized. The meeting recommended that information on trade, customs procedures and taxation

structures should be exchanged. Trade delegation visits, trade fairs and the easing of visa restriction were also recommended (ASEAN Secretariat, 2003). In the second meeting of the ASEAN-Pakistan Joint Sectoral Cooperation Committee (APJSCC) held in Islamabad on 28 February -01 March 2001, both sides agreed to reduce the trade imbalance by greater private sector interaction and exchange of information through workshops and Business Council meetings (ASEAN Secretariat, 2004). Pakistan continues its trade cooperation with ASEAN in order to gain economic benefits from the region.

Table 3 shows increasing trade of Pakistan with ASEAN after their first meeting. The total trade of Pakistan with ASEAN grew by 23.5 percent from 2001 to 2003. It further grew by 32.9 percent from 2003 to 2005. Pakistan's level of trade with Malaysia was the highest compared to its levels of trade with other ASEAN member countries. Malaysia's share of Pakistan's trade with ASEAN was 31.5 percent in 2001 and 30.2 percent in 2005. In 2001, Singapore had the second highest share of Pakistan's trade with ASEAN, 24.6 percent. It was followed by Indonesia and Thailand, 19.6 percent and 17.9 percent. Four years later, Indonesia took place as the second highest with 26.2 percent and it was followed by Thailand and Singapore with 19.9 percent and 17.5 percent.

4. Analysis

Frank (1968) explored the relation between international trade and economic development and discussed on how to make trade as an "engine of growth". Reshaping world trade policies should be in the interest of developing countries. In the present decade, the contribution of trade to economic development was viewed by Grossman and Rossi-Hansberg (2006) from the perspective of disintegration of production process and value addition in disparate locations. In this case, multinational corporations (MNCs) are responsible for cross-border flows of goods and services, technology and capital that expand national markets. In Kobrin (2007), openness to the world economy is the absolute condition of economic development.

In our analysis, the economic model is simply constructed as follows:

$$PakED = f(PakASEANTrd) \quad (1)$$

where *PakED* is Pakistan's economic development, which is proxied by the ratio of Pakistan's GDP to the ASEAN member country's GDP (in volume index) and *PakASEANTrd* is Pakistan's total trade with the ASEAN member country (in Pakistan Rupees). Total trade is the sum of exports and imports. The values of these two variables were adjusted to the based year 2000=100. GDP deflator was used to obtain the real values of *PakASEANTrd* variable. Annual data on Pakistan's GDP volume index and GDP deflator were taken from the World Development Indicators and International Monetary Fund (IMF) reports.

TABLE 3 Pakistan's Trade with ASEAN, 2001-2005 (fiscal year ending 30 June)

(Thousand Rupees)

ASEAN Country	2001	2002	2003	2004	2005
Brunei					
Exports	73,331	57,457	226,016	196,340	57,826
Imports	18,030	55,855	78,908	12,974	72,300
Cambodia					
Exports	232,038	294,482	348,495	484,099	667,151
Imports	20,095	34,868	24,175	69,215	21,828
Indonesia					
Exports	7,964,338	4,743,306	4,305,378	2,563,254	4,187,732
Imports	9,487,329	14,858,519	15,083,257	20,592,908	34,131,097
Laos					
Exports	4,175	7,423	315	6,582	4,484
Imports	3,484	866	123	19,753	10,036
Malaysia					
Exports	2,968,817	3,173,310	4,583,174	4,804,024	3,890,698
Imports	25,083,319	27,997,492	33,144,575	34,696,977	40,265,676
Myanmar					
Exports	227,554	251,134	508,852	208,800	117,996
Imports	1,134,252	977,945	608,790	767,587	1,873,884
Philippines					
Exports	1,901,035	360,697	1,506,420	1,520,518	1,955,665
Imports	488,694	470,088	468,314	621,396	1,012,502
Singapore					
Exports	2,819,265	2,755,018	5,058,447	6,738,185	3,378,604
Imports	19,074,977	19,811,468	24,935,899	28,291,558	22,172,019
Thailand					
Exports	3,735,719	3,402,410	3,495,739	3,641,878	4,578,357
Imports	12,218,183	10,898,622	13,329,226	15,498,648	24,578,720
Vietnam					
Exports	1,175,638	1,412,139	1,766,257	1,085,725	2,216,323
Imports	457,344	360,571	584,136	965,763	1,032,497
Total Exports to ASEAN	21,101,910	16,457,376	21,799,093	21,249,405	21,054,836
Total Imports from ASEAN	67,985,707	75,466,294	88,257,403	101,536,779	125,170,559
Total Trade with ASEAN	89,087,617	91,923,670	110,056,496	122,786,184	146,225,395

Source: Federal Bureau of Statistics, Pakistan.

The coefficient sign on the *PakED* variable is expected to have a positive relationship with the *PakASEANTrd* variable. Larger trade should help improve economic development in a country. Trade activities that cause market demand for goods and services to increase are important to boost investment, industrial development and value-addition.

The analysis covers *PakED* data from the year 1976 to 2005. Data on trade were obtained from various issues of Pakistan Statistical Year Book and Key Indicators of Asian Development Bank (ADB).

Initially, our aim was to use a panel data that cover all the ten ASEAN member countries. However, only five founding member countries (which are also known as ASEAN-5) have complete data for this 30-year period. The ASEAN countries covered in the *PakED-PakASEANTrd* model are Indonesia, Malaysia, Philippines, Singapore and Thailand.

A pooled lin-log model is estimated using the sample data.

$$PakED_{it} = b_0 + b_1 \ln PakASEANTrd_{it-1} + \varepsilon_{it} \quad (2)$$

where b_0 is the intercept, b_1 is the slope coefficient that measures the *PakED* responsiveness with respect to the lagged explanatory variable *PakASEANTrd*, ε is a random error term, and i and t refer to the i -th ASEAN member country in the t -th time period (cross-sectional unit of $i = 1, 2, \dots, 5$ and the time period $t = 1976, 1977, \dots, 2005$).

5. Results

Table 4 shows the estimate of the *PakASEANTrd* effect on *PakED*. The coefficient on the *PakASEANTrd* has the right sign and is significant at the one percent level of significance to explain Pakistan's economic development. Its positive sign suggests that stronger bilateral trade relationships between Pakistan and ASEAN member countries contribute to economic development in the country. From the table, the level of responsiveness to changes in *PakASEANTrd* is very low. However, it increases in long-term, which is reflected in its elasticity at means of 0.31.

TABLE 4 Estimates of the ASEAN Trade Effect on Pakistan's Economic Development

Independent variable	Estimated coefficient	Standard error	t-ratio	p-value	Elasticity at means
<i>PakASEANTrd</i> _{<i>it-1</i>}	0.04	0.005	8.057	0.000	0.3136
Constant	0.72	0.036	19.88	0.000	0.6556

Buse (1973) R-square = 0.3049. F-ratio = 64.914 (p-value = 0.000).
Sample = 150. Degrees of freedom = 148.

The model specification explains about 30 percent of the variation in Pakistan's economic development. In the overall test of significance, the calculated p-value of the F-statistic suggests a strong significant model of *PakED-PakASEANTrd*.

The results support the argument of Faizal (2004) that emphasizing economic development enhances Pakistan's linkages with the ASEAN region. The effort of Pakistan to increase bilateral ties with individual ASEAN countries is to expand its economic sectors and to provide a balanced perspective of South Asia to ASEAN member states. Currently, Pakistan is ASEAN's sectoral partner and its co-operation with

the regional economic grouping is in the eight areas namely, trade, industry, investment, science and technology, drugs and narcotics control, human resource development, environment and tourism.

In 2007, Pakistan and Malaysia signed a comprehensive Free Trade Agreement (FTA) (Daily Times, 2007). The agreement is Pakistan's initiative to secure market for its export products in Malaysia and deepen the economic and trade relationship with an important member of the region.

6. Conclusion

In this paper, a *PakED- PakASEANTrd* model is estimated. Before specifying the model, we initially sought a panel data for ten ASEAN member countries. Unfortunately, only five of them have time series data for the period from 1976 to 2005. The limited data could be one reason for the very low value of the estimated coefficient.

The results from the model estimation agree with the theoretical expectation of trade activities can promote economic development in a country. The positive effect of trade is better seen in a long-term perspective. Trade brings benefits to Pakistan, which includes increase in its market size, technology improvements, increase in economic productivity and increase in local firms' competitiveness at international level.

Pakistan's trade policies toward ASEAN member countries must be formulated in such that its size of exported goods and services to the region can be increased. On the import side, Pakistan's increasing size of imported goods from ASEAN must not worsen its trade imbalance because they contribute to better capitalization on the growth of industries.

Increasing trade relations between Pakistan and ASEAN has strengthened their cooperation in the fields of economic, science and technology. This highlights international trade as an important tool to accelerate Pakistan's economic development.

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