IMPACT OFSAFTA ON TEXTILE EXPORT ON ECONOMY OF PAKISTAN BY USING COMPUTABLE GENERAL EQUILIBIUM MODEL (CGE)

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Abstract

This research investigates the Impact of PAK-INDIA Textile trade on Economy of Pakistan. Data were collected from GTAP-7 database. Data were collected from 70 Textile exporters by using simple random technique and data were analyzed by using GEM-software. Different simulation run on GTAP-7 database and various tariff rates appliedThe first scenario is when normal trading relation with India will be restored; it means that both countries will give the MFN (Most Favored Nations) status to each other. In the second scenario, the SAFTA will be operative and there will be free trade between India and Pakistan and both countries will remove all tariffs and custom duties from each others' imports. The Global trade analysis GTAP model is used to analyze the possible impact of SAFTA on Pakistan in a multi country, multi sector applied General equilibrium frame work. Results based on this research reveal that on SAFTA, grounds, here will be net export benefits in Pakistan's economy.

Key Words:-PAK-INDIA, TRADE, CGE

1. Introduction: Trade liberalization was the key element of this new policy package and it entailed reliance on tariffs, replacement of quantitative restrictions including import licensing by a revised system of tariffs as well as the relaxation of other controls on trade. In order to encourage both domestic and foreign investment, the Government offered a series of incentives, while attempting to create an environment conducive to investment. In recent years, however, the focus of Pakistan's trade policy has seemingly shifted towards regionalism, which Pakistan considers a springboard for broader trade liberalization. The rationale for regional cooperation is based on a number of factors, not all of which are necessarily economic in nature. Until the late 1970s, Pakistan's economic development centered on an inward-oriented development strategy based on import substitution industrialization performed mainly by state owned firms. Both tariff and non-tariff barriers were widely used to protect domestic economic activities. Trade restrictive policies were accompanied by other regulatory policies such as control on foreign exchange, finance and foreign direct investment. These restrictive economic policies had severe adverse implications on overall economic growth, in particular growth of exports. Pakistan introduced extensive economic reforms in 1971-72 becoming the first country in the South Asian region to do so. The economy was freed from the inward-oriented strategy, and adopted an outward-oriented export-led development strategy, which was followed by many East Asian countries at that time. This research begins with a review of Pakistan's economic reforms and their coverage. The methodology, will offer a brief description of CGE Modeling including the GTAP. Then we will discuss experimental designs are discussed. Through the model we form unilateral and regional trade liberalization, as a founding member of the WTO, Pakistan as a member firmly committed to the multilateral trading system and has already establish a large number of reforms in keeping with the GATT/WTO principles. However, this study will review the outcome of multilateral trade Liberalization. The GTAP model simulation will be analyzed**.**

Textile industry of Pakistan is broadly divided into many sectors that are Ginning, Spinning, Weaving, Knitting, Towel, Dying, Printing, Processing, Hosiery, Made-ups and Garments. As the first objective is concerned with understanding the current status of textile industry; in this connection a survey of the entire textile industry will be conducted. A total of 48 companies were be selected for conducting the research in Hyderabad, Kotri, Karachi, Faisalabad and Lahore region including the key integrated textile units to ensure full representation of all sectors. Further the above sectors of textile industry were lumped together into four major sectors as Spinning, Weaving (including Knitting, Dying & Printing (including Processing and Bleaching), and Garments (including Made-ups, towel, Hosiery and other manufactured items) for compiling the qualitative information. The survey methodology included a combination of primary data that was generated through a questionnaire and intensive interviews with individuals connected to the industry to identify their internal issues, national issues, global issues and required remedial actions and the secondary data included journal articles, trade policies of Pakistan, news, and internet which were helpful for the second and the third objectives. In the second objective the graphs are used to explain the growth pattern of textile exports from the year 1980 to 2009 as the implementation of WTO on textile industry of Pakistan started from 1995 that was 100% complete in 2005. Therefore the starting 14 years from 1980 to 1994 are considered as the time period with quotas, whereas the last 14 years from 1995 to 2009 are considered as the quota free era. In the third objective developing countries like China, India, Srilanka and Bangladesh are taken into account to analyze the effects of WTO on them. Here the information collected through the above mentioned secondary sources regarding the benefits of becoming the member of WTO and the problems associated with its implementation are highlighted.

The Textile Industry of Pakistan

One of the major economic indicators for the development of Pakistan economy is textile Industry. Textile Industry is an important source of the overall and major export of the country. In fact, Pakistan is ranked in top most leading cotton producing countries of the world. Statistically, till 1997 Pakistan was named as world's largest exporter of yarn. In 1999, it was ranked on the second position in the largest exporter of textile made-ups list. In textile made-ups sources, the second largest sources were the bed wear and linens sub sectors. These both shared about 28 per cent share of total textile made-ups in 1999 (SMEDA, 2002). In addition, Pakistan became second largest exporter of bed wear and linen globally during that period.

Further statistics shows that during the period of 1999-00 Pakistan had about 443 textile units, 8,477,000 spindles, 149,780 rotors and 9944 looms. Then a satisfactorily increase was found in all these elements from 2000-06 as the textile units increased to 461, spindles to 10,437,000, rotors to 155,104 and looms to 8747. Furthermore, in 2006-07 there were 567 units, 1198000 spindles, 11,809,000 rotors and 9000 looms (Mirza R. B., 2009). The table 2.1 below describes the contribution of textile industry in Pakistan's economy.

Gravity equations have also been used to measure unobserved trade barriers, to discriminate between theoretical trade models, and to analyze the effects of trade policies (either in an ex-post or ex-ante fashion).[11] The latter has been subject to critiques and refinements (e.g., Carrère, 2006) among the most important being that for the gravity equation analysis to be appropriate one needs to assume (or "condition on") that the policy changes being

Anderson and van Wincoop (2004); and Feenstra, Markusen, and Rose (2001). aconsidered do not modify the basic relation between countries' masses and their trade flows.[12] Given the relative small size of South Asian countries in the world markets such an assumption appears not to be problematic for the scenarios considered here. In summary, the general equilibrium approach offers the possibility of answering a richer set of questions but demands data not readily accessible for some of the countries we are interested in.[13] Although the evaluation of the benefits and limitations of each methodology is beyond the scope of this paper it can be argued that they are complementary rather than substitutes. This paper uses a gravity equation approach and builds on Srinivasan (1994). In particular, it allows the response to trade

barriers to differ by source of the goods; treats independently imports and exports of each country pair; and includes all seven members of SAFTA in the analysis. As Bandara and Yu (2003) and Gilbert, Scollay, and Bora (2001) show, welfare and trade volume do not necessarily follow a monotonic relationship and interpreting gravity equation results as describing desirability or welfare can be misleading.[15] Nevertheless, by providing three different criteria—trade flows, trade balance and customs revenue—the paper provides information on the relative merits of alternative arrangements.

METHODOLOGY

It is widely acknowledged that computable general Equilibrium (CGE) modeling has become the tool of choice for analysis of a wide range of trade policy issues such as tariffs and non-tariff barriers (NTBs) in both developed and developing countries in a variety of settings. In particular, CGE modeling is useful for analyzing the welfare effects of trade policy that needs to address second-best issues, where there are significant interactions between policy measures for one sector and distortions elsewhere in the economy. Such models have two distinctive features: they incorporate a number of distinct sectors, and the behavioral equations of the model deal with the response of industries and consumers to changes in relative pTextiles (Adams et al., 1998). This development is explained by the capability of CGE models to provide an elaborate and realistic representation of the economy, including the linkages between all agents, sectors and other economies (Brockmeier, 1996) CGE analysis also provides a valuable tool for putting things in an economy-wide perspective (Hertel, 199).

THE GTAP MODEL

In this study, the widely used Global Trade Analysis Project (GTAP), a multi-country, multisector CGE model (Hertel, 1997) has been employed to empirically assess the impact of trade liberalization reforms on Pak-India trade. Multi-country, economy-wide CGE models are designed to work out the relative pTextiles of various inputs and outputs mixes of the economies of interest as well as indicating the global changes in world trade patterns. Thus, the strength of a global CGE model lies in its ability to help us understand the linkages between sectors, countries and factors on a global scale. The general equilibrium structure recognizes that all parts of the world economy hinge together in a network of direct and indirect linkages. This means that any change in any part of the system will, in principle, have repercussions throughout the entire world. As McDougall (1995, p. 88) clearly points out "its characteristics are that it is economy-wide, it is multi-sectoral, and it gives a central role to the pTextile mechanism. These characteristics differentiate it from partial equilibrium modeling (not economy-wide), macroeconomic modeling (not multi-sectoral), and input-output modeling (agents don't respond to pTextile signals)."The GTAP model was designed for comparative–static analysis of trade policy issues in an economy-wide framework. Since the changes in trade policies and production levels in any of the regions and sectors will have impacts on other regions and sectors, even though my main focus of this study is on results for Pakistan, it is possible to incorporate the policy changes of other countries within a global CGE modeling framework.

Data Set

Data will be collected from secondary sources GTAP-7 data base

LIMITATIONS OF THE CGE MODEL

Despite the importance of CGE modeling in policy analysis, a series of questions have been raised about the empirical validity of these models. The core of the critique is focused on unsound parameter selection criteria, because the choice of elasticity values critically affects the results of policy simulations generated by these models. In the calibration method, some parameters are determined on the basis of a survey of empirical literature, some chosen arbitrarily, and the remainders are set at values, which force the model to replicate the data of a chosen benchmark year (Shoven and Whalley, 1992). Most often the estimated elasticities for commodity and/or industry classifications are based on econometric studies, which are not totally consistent with the countries represented in the model or they may even be "guesstimates" when no published figures are available.

Instrument

- GTAP-Model
- Variables PAK-INDIA TRADE (Independent variable)
- SAFTA (Dependent Variable)
- Dependent Variables
- Textiles (Dependent Variable)
- Pharmaceuticals (Dependent Variable)
- Automotive parts and engineering(Dependent Variable)
- Agriculture(Dependent Variable)
- Financial an insurance services(Dependent Variable)

- GTAP-Model ((Hertel, 1997) GTAP-7 Data Base
- Data will be analyzed by using GEMS Software

Sectors:	Codes
TEXTILE	TXT

Pak-India Trade Model

Aggregated Regions	GTAP Region

1. Pakistan (PK) Pakistan

2. India (IND) India

3. Rest of South Asia

                              Sri Lanka

                              Bangladesh

                              Bhutan
                              Maldives

                              Nepal

4. Rest of the World (ROW)   all other Countries

SHAIKH (2013)

Pak-India Trade Project

Table 1. GTAP Substitution Elasticity's

GTAP Commodities	Value-added (σ VA)	Domestic/ Imports (σ D)	Sourcing of Imports (σ M)
Paddy Textile	0.24	2.20	4.40
Wheat	0.24	2.20	4.40
Cereal grains nec	0.24	2.20	4.40
Vegetables, fruit, nuts	0.24	2.20	4.40
Oil seeds	0.24	2.20	4.40
Sugar canes, sugar beet	0.24	2.20	4.40
Plant-based fibers	0.24	2.20	4.40
Crops nec	0.24	2.20	4.40
Cattle, sheep and goats, horses	0.24	2.80	5.60
Animal products nec	0.24	2.80	5.60
Raw milk	0.24	2.80	5.60
Wool, silk-worm cocoons	0.24	2.20	4.40
Forestry	0.20	2.80	5.60
Fishing	0.20	2.80	5.60
Coal	0.20	2.80	5.60
Oil	0.20	2.80	5.60
Gas	0.20	2.80	5.60
Minerals nec	0.20	2.80	5.60
Cattle, sheep and goat, horse meat	1.12	2.20	4.40
Meat Products nec	1.12	2.20	4.40
Vegetable oils and fats	1.12	2.20	4.40
Dairy products	1.12	2.20	4.40
Processed Textile	1.12	2.20	4.40
Sugar	1.12	2.20	4.40
Food products nec	1.12	2.20	4.40
Beverages and tobacco products	1.12	3.10	6.20
Textiles	1.26	2.20	4.40
Wearing apparel	1.26	4.40	8.80
Leather products	1.26	4.40	8.80
Wood products	1.26	2.80	5.60
Paper products, publishing	1.26	1.80	3.60
Petroleum, coal products	1.26	1.90	3.80
Chemicals, rubber, plastic pro	1.26	1.90	3.80
Mineral products nec	1.26	2.80	5.60
Ferrous Metals	1.26	2.80	5.60
Metals nec	1.26	2.80	5.60
Metal products	1.26	2.80	5.60
Motor vehicles and parts	1.26	5.20	10.40
Transport equipment nec	1.26	5.20	10.40
Electronic equipment	1.26	2.80	5.60

Machinery and equipment nec	1.26	2.80	5.60
Manufacture nec	1.26	2.80	5.60
Electricity	1.26	2.80	5.60
Gas manufacture, distribution	1.26	2.80	5.60
Water	1.26	2.80	5.60
Construction	1.40	1.90	3.80
Trade, transport	1.68	1.90	3.80
Financial, business, recreational services (private)	1.26	1.90	3.80
Public admin and defense, education, health	1.26	1.90	3.80

Source: The GTAP Database, Version 7

Table 2: Commodity Aggregation: 10 Sectors of the Model

Aggregated Commodity	GTAP Commodity
(1) Agriculture, Forestry and Fishing (AGRI)	Paddy Textile (PDR) (pdr) Wheat (wht) Cereal grains nec (gro) Vegetables, fruit, nuts (v_f) Oil seeds (osd) Sugar cane, suger beet (c_b) Plant based fibers (pfb) Crops (nec) Bovine cattle, sheep and goats, horses (ctl) Animal products nec (oap) Raw milk (rmk) Wool silk-worm cocoons (wol) Forestry (for) Fishing
(2) Mining and Quarrying (MINQ)	Coal (col) Oil Gas (gas) Minerals nec (omn)
(3) Processed Food (PROF)	Bovine cattle, sheep and goat, horse meat prods (cmt) Meat products nec (omt) Vegetables oils and fats (vol) Dairy products (mil) Processed Textile (pc Sugar (sgr) Food products nec (ofd) Beverages and tobacco products (b_t)
(4) Textiles (TEXT)	Textiles (tex)
(5) Wearing apparel (WEAP)	Wearing apparel leather products (lea)
(6) Petroleum, Coal Products (PECP)	Petroleum, coal products (p_c)
(7) Machinery and Equipment (MAEQ)	Electronic equipment (ele) Machinery and equipment nec (ome)
(8) Transport Equipment (TREQ)	Motor vehicles and parts (mvh) Transport equipment nec (otn)

(9) Other Heavy Manufactures (OTHM)	Wood products (lum) Paper products, publishing (ppp) Chemical, rubber, plastic products (crp) Mineral products nec (nmm) Ferrous metals (i_s) Metals nec (nfm Metal products Manufactures nec (omf)
(10) Services (SERC)	Electricity (ely) Gas, manufacture, distribution (gdt) Water (wtr) Construction (cns) Trade, transport (t_t) Financial, business, recreational services (osp) Public admin and defence, education, health (osg) Dwelling (dwe)

GTAP-Database-7

Table 3: Experimental Designs for Pakistan's Trade on SAFTA

Experiments	Level of Tariff Reduction or Elimination
Unilateral Liberalization	
_E-1_ Uniform External Tariffs	15% on Global Basis.
Regional Liberalization	
_E-2_ South Asian Free Trade Agreement	5% between Pakistan and SAFTA Countries.
Unilateral cum Regional Liberalization	
_E-3_ SAFTA plus 15% uniform external tariffs	100% between Pakistan and SAARC countries plus 15% on Global basis
Sensitivity Analysis	
Unilateral Liberalization	
E-4 Uniform External Tariff	15% on Global basis **-Central scenario**
E-4.1 50% increase of ESUBM	15% on Global basis
E-4.2 100% increase of ESUBM	15% on Global basis
Regional Liberalization	
E-5 SAFTA	100% between Pakistan and SAFTA countries **-Central scenario**
E-5.1 50% increase of ESUBM	100% between Pakistan and SAFTA countries
E-5.2 100% increase of ESUBM	100% between Pakistan and SAFTA countries
E-6 Unilateral cum Regional Liberalization	100% between Pakistan and SAARC countries plus 15% on Global basis **-Central scenario**
E-6.1 50% increase of ESUBM	100% between Pakistan and SAARC countries plus 15% on Global basis
E-6.2 100% increase of ESUBM	100% between Pakistan and SAARC countries plus 15% on Global base

Table 4: Experiment-1-15 Percent Uniform Import Tariffs Estimated Welfare and Trade Effects

(Percentage changes)

In millions

Countries	EV US$	% of GDP	TOT	V-Export	V-Import	Exp-Price	Import-Price	DTBAL-Price
IND	**3213.97**	**3.40**	**0.41**	**0.4**	**1.23**	**2.1**	**3.68**	**109.74 m**
PAK	**4442.63**	**4.35**	**5.98**	**2.19**	**0.61**	**-8.97**	**5.44**	**285.66m**
XSA	-1592.56	-1.74	-0.57	-3.92	31.54	24.83	-2.12	-1322.73m
XWA	-375.79	-0.02	0.00	-0.04	0.00	-0.06	-0.05	149.69m

Description

IND=INDIA

PAK=PAKISTAN

XSA = REST OF SOUTH ASIA

XWA= REST OF WORLS

All experiments were conducted with the standard general equilibrium closure of the GTAP model. According to the results Base line tariff for India is 18% SAFTA tariff is 5% and given MFN Tariff is 15% and rest of world is 15%..The first experiment considered the Pakistan's reduction of import tariffs to 15 percent under the unilateral trade liberalization. The impact of this scenario on regional welfare and the resulting percentage changes in sectoral output and trade are reported in Table 4 and 5 respectively. Accordingly, if Pakistan (PAK) reduces its import tariffs to 15 percent unilaterally on a global basis to maintain a uniform external tariff rate, Pakistan's EV US& 4442.63 and GDP 4.35, and India's EV US$ 321 million (3.40 percent of the GDP). Under this scenario, Pakistan's volume of imports rises by 1.23 percent while its volume of exports falls slightly by 0.4 percent reflecting the fact that the pressure to increase imports is stronger than the increase in demand for Pakistan's exports by unilateral liberalization. However, as a result of the composite export price increase by 2.1 percent, Pakistan's experiences a small improvement in the terms-of-trade of 1.5 percent and the real GDP by 0.9 percent. The welfare gains or losses for other regions are quite varied under this simulation. However, since Pakistanis impact on unilateral reduction of import tariffs to 15 percent will not affect other region's real GDP or terms-of-trade significantly.

Table 5: Experiment-1

15 Percent Uniform Import Tariffs

Estimated Percentage Changes in Regional Output and Trade

Sector	IND	PAK	XSA	XWA
(a) Industry Output (In Millions)				
TEXT	**1.45.03**	**2.60**	0.01	0.11
(b) Export (In Millions)				
TEXT	**-0.16**	**6.79**	0.01	0.11

Tariff Rates

5% SAFTA

15% XWA

5% XSA

15 MFN

Table 6: Experiment-2 South Asian Free Trade Agreement - SAFTA- Estimated Welfare and Trade Effect

Countries	EV US$	% of GDP	TOT	Vol-Export	Volume-Import	Export Price	Import-Price
IND	**5434.97**	**4.34**	**0.80**	**5.40**	**4.00**	**9.38**	**8.68**
PAK	**5643.63**	**6.35**	**0.99**	**7.11**	**7.77**	**5.97**	**7.44**
RAS	-1592.56	-1.74	-0.57	-3.92	31.54	24.83	-2.12
XSA	-375.79	-0.02	0.00	-0.04	0.00	-0.06	-0.05

Tariff Rates

SAFTA=5%

MFN=10%

XWA=10%

SAFTA=10

The trade reform scenario (*Experiment-2)* was conducted under the regional trade liberalization policy option to examine the impact of South Asian Free Trade Agreement- SAFTA in different contexts from the perspective of Pakistan. As a member of the SAFTA, Pakistan. committed to continue major trade liberalization measures, to establish and promote free trade arrangements for strengthening inter-regional economic co-operation and the development of national economies. In this experiment, it was assumed that Pakistan and each of the SAARC member countries in the model (India and the Rest of South Asia comprising Bangladesh, Bhutan, Maldives, Nepal and Sri lanka) remove their tariffs against each other, while maintaining heir tariffs against the rest of the South Asia.

Table 7: Experiment-2

10 Percent Uniform Import Tariffs

Estimated Percentage Changes in Regional Output and Trade

Sector	IND	PAK	XSA	XWA
(a) Industry Output				
TEXT	**0.03**	**0.60**	0.01	0.11
Exports				
TEXT	**-0.16**	**8.79**	0.01	0.11

Tariff Rates

SAFTA=5%

MFN=10%

XWA=10%

SAFTA=10

The trade reform scenario (*Experiment-2)* was conducted under the regional trade liberalization policy option to examine the impact of South Asian Free Trade Agreement- SAFTA in different contexts from the perspective of Pakistan. As a member of the SAFTA, Pakistan. committed to continue major trade liberalization measures, to establish and promote free trad arrangements for strengthening inter-regional economic co-operation and the development of national economies. In this experiment, it was assumed that Pakistan and each of the SAARC member countries in the model (India and the Rest of South Asia comprising Bangladesh, Bhutan, Maldives, Nepal and Sri lanka) remove their tariffs against each other, while maintaining heir tariffs against the rest of the South Asia. According to results in SAFTA 5% tariff the Pakistan industry output .079 compare to India -0.4 that Pakistan's will benefit on SAFTA trade with India. Indian industry out put show s that in Auto, Textile India's position is better in compare with Pakistan.

The Second experiment considered that Pakistan's reduction of import tariffs to 10 percent under the unilateral trade liberalization. The impact of this scenario on regional welfare and the resulting percentage changes in sectorial output and trade are reported in Table 7, 8. and 9 respectively. Accordingly, if Pakistan reduces its import tariffs to 10 percent unilaterally on a global basis to maintain a uniform external tariff rate, Pakistan's experiences a welfare gain around US$201 million (1.53 percent of the GDP). Under this scenario, Pakistan's volume of imports rises by 3.3 percent while its volume of exports falls slightly by 0.3 percent reflecting the fact that the pressure to increase imports is stronger than the increase in demand for Pakistan's exports by unilateral liberalization. However, as a result of the composite export price increase by 1.1 percent, Pakistan's experiences a small improvement in the terms-of-trade of 1.5 percent and the real GDP by 0.8 percent. The welfare gains or losses for other regions are quite varied under this simulation. However, the impact of Pakistan's unilateral reduction of import tariffs to 10 percent will not affect other region's real GDP or terms-of-trade significantly

Conclusion: The simulation results presented and analyzed here demonstrate the importance of experimental designs, and the usefulness of the global CGE modeling framework for examining the impacts of the different types of trade policy reforms in Textile for Pakistan. The results suggest that Pakistan would experience the highest welfare gain i f under the combined policy reform of the SAFTA cum 15 percent uniform external tariffs while the SAFTA on its own gives the second highest welfare gains. SAFTA allows the participating countries to achieve larger economies of scale in production, attain specialization, increase competitiveness and diversify their export basket, thus assisting domestic economic reform. Therefore, harmonizing economic policies among neighboring countries must receive higher priority in the policy making process. Although, simulation results are highly sensitive to the underlying data and assumptions regarding the reference scenarios, the results clearly provide an assessment of the implications of SAFTA. According to the simulation results suggests that there have a positive impact on PAK-INDIA trade on GDP, EXPORT, and IMPORT under various scenarios, of tariff rates should applied like, MFN. 15 %, and 10%.   Pakistan's has welfare gain of tariff rate 15 % and 10 % respectively but on 8% tariff results shows that there will be negative impact on the Textile.

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