Opportunities and Threats for Pakistan in the GSP plus status: A Case Study of Manufacturing Sector

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Abstract

The study attempted to analyze the impact of GSP plus status of Pakistan in the EU through a number of simulation experiments. Among the EU's system of preferences, GSP plus status is considered a vital opportunity for any economy engaged in trade with EU. The study employed standard GTAP to analyze the impact of GSP plus at the macro level. The standard GTAP examines the impact of trade policies at the macro level. The results of all simulations show opportunities for Pakistan in most of the sectors. The results further reveal that production activities of the country are concentrated towards the sectors of textiles, wearing apparel and leather products that need to be diversified with cost effective methods. The policy implications for the study are straight forward and related to trade policy which is also the main concern of the paper. Any attempt to improve competitiveness in view of increased competition after the GSP plus implementation will have to start from one basic acknowledgment: it is the firms themselves that have the key to success in their hands.

Key words: GSP Plus, European Union, GTAP, Competition.

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Biographical note: A results-driven professional with proven record of success in both domestic and international initiatives. Experience in training, teaching and research projects. Recognized as a leader with strong planning, organization, and implementation skills. Among few people in Pakistan who worked on CGE modelling. Currently teaching subjects related to economics, research and international business at both undergraduate and postgraduate levels. PhD Degree from GC University Faisalabad in 2017. Obtained M.Phil Economics degree from the University of Strathclyde, Glasgow (2008). Also qualified for M.Sc. Economics (2001) and BSc (Honors) Economics (2000) from International Islamic University Islamabad.

1. Introduction

In the desire of economic growth expansion, many developing economies have espoused external economic liberalization policies. It is based on a common fabrication that countries with less trade restrictions have fast-paced economies and vice-versa. Trade liberalization has an inherent tendency to raise employment elasticity of economic growth thereby creating a better impact. However, critics of globalization find a chance to emphasis that growth benefits might possibly be unevenly spread; as a result, the impingements of distributions could also affect the poor adversely (Krueger, 1998).

Trade liberalization can effectively be the reason of better economic growth. Benefits of total factor productivity gained by the economies of scale alongside enhanced efficiency; have a powerful potential to be transformed in to an immense raise in potential output. The studies conducted by Freund & Bolaky (2008) and Changa, Kaltanic, & Loayza, (2009) show that the growth effect of trade openness is significantly positive provided that partner countries successful in achieving regulatory reforms like business rules, financial developments, expansion in better education or rule of law, increase in employment opportunities labor market flexibility, etc. Otherwise, trade is not associated with long-run growth in such economies. In addition, due to the tendency of attracting Foreign Direct Investment (FDI) and larger access to regional markets, liberalized trade regime becomes a place of interest for foreign investment

prospects. A higher value of Foreign Direct Investment (FDI) consequently, may also pave the way for a larger-scale technology transfer (Chanda , 1997) and inter-industry linkages (Wang, 2011) as well as total factor productivity.

Pakistan is a developing country and is still struggling to enhance the economic growth. The progress of the economy for the last sixty-eight years is poor as well as inspiring. It is inspiring because despite of great population growth rate it has reached fast development rate resulting a decrease in poverty levels and an increase in per capita income. Due to structural changes, the economy has changed from an agrarian economy to a more expanded production structure economy. From country's total exports, production contributes 80 percent of it. Although country is growing in long run but inconsistant economic growth is still a problem.

2. European Union and GSP

European Union (EU) under the umbrella of General Agreement on Tariffs and Trade (GATT)[i], launched the Generalized System of Preferences (GSP) in 1971. It is a unique system of different trade agreements favorable to developing countries. The basic purpose of GSP was to promote the efficient usage of resources for production activities in developing economies. Ultimate purpose was to transfer the international resources from developed countries to developing countries by using the facilities of international trade (Dowlah, 2008).

The motive of the GSP was to help them in solving their economic problems. With this aim, the EU established preferential trade relations with the Asian and Latin American economies under the GSP scheme. Under this scheme, the EU waived customs duties on imports of the products from these developing countries (with the exception of so-called of sensitive products) and the duties on agriculture and food products were also reduced which do not compete with the ACP (Sapir & Langhammer, 1987) and (Naeem, 2006). The GSP system of the EU has the following distinctive features:

- The GSP is not a uniform world system, applied in the same way by all the developed countries; on the contrary, the EU, the USA, Japan and others have created their own systems, albeit broadly on the same principles. The EU version

of GSP is autonomously granted to a number of beneficiary countries.

The European Union (EU) is not only the largest single operating market of the world but also the biggest trading partner of Pakistan. Approximately one-third of Pakistan's total trade volume is running with EU. One should keep in mind the two remarks before trying to find out the position of Pakistan in EU (Khorana, et al., 2012). First, Pakistan is not part of EU's rationalistic approach that includes the "Lome Convention" or EU's policy towards some regions like Mashreq, Maghreb, and Meditatrian economies. Second, Pakistan appears in the front line of the EU's global approach (GSP Scheme) (Gillespie, 2013).

3. Methodology

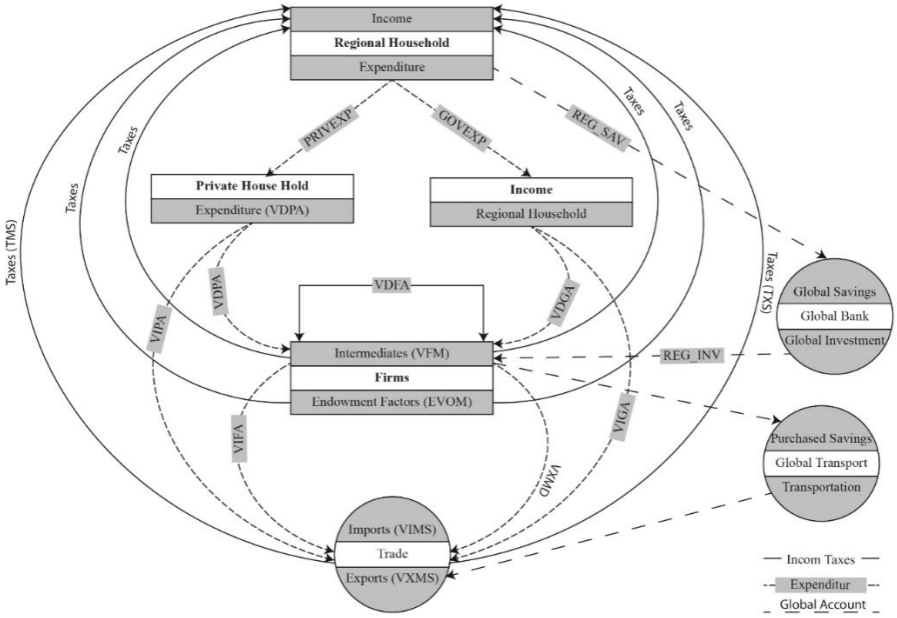
3.1. GTAP Model and Database

Any change in output or price of one commodity may bring changes in the output of other products, government revenue, and expenditures, exports, imports and employment. To understand the linkages between all sectors of the economy, Computable General Equilibrium (CGE) models are an ideal tool that has been studied in detail focusing the issues related to trade negotiations. These models link the factor and product market to the macroeconomic linkages of saving and investment (Minor & Mureverwi, 2013). A change in prices in one market can be linked to changes in other markets. Several types of CGE models are employed for this purpose: some are dynamic, emphasizing the impacts of investment and year-on-year growth rates in industry and trade (based on projections); others are static modeling investment purchases, but not the impacts of investment on productive capacity growth over time.

Multi-country or global models consist of multiple countries or the total global economy (Wobst, 2001). These models tend to have fewer sector details and are designed for analysis of proposed multi-lateral policies such as free-trade agreements. Moreover, these models do not maintain a single country model assumption of exogenising global or trading partner effects. Therefore, the implications of these effects - coming from rest of the world or other countries - have been endogenised. Any effects, transmitted to by means of various channels, of policy changes in the rest of the world, would have direct in addition to indirect influence.

These models explicitly capture this transmission mechanism. Therefore, these models can be applied in policy experiments of multilateral trade liberalization. The Global Trade Analysis Project (GTAP) model is the most widely known modeling system of multi-country models. GTAP is a multi-sector, multi-region, computable general equilibrium model[ii] with perfect competition and returns to scale (McDougall et al 1998). This model is being employed for a number of applications (international trade, agricultural analysis, labor markets, etc).

Figure 1: The Standard GTAP Model



Source: Walmsley & Minor 2013

The study used the latest database contains 140 regions with 57 sectors (version 09). For analysis purpose, the study has aggregated these into 46 different sectors and 19 regions.

3.2. Research Simulations

In order to calculate the results, the study planned three simulations using GTAP 09 (Base year 2011-12).

3.3. Simulation I:

EU28 GSP Plus status with other competitors: It allows duty-free and quota-free imports from Pakistan. What would happen by applying tariff rate on competitors in the sectors of textile, wearing apparel, beverages and leather?

3.4. Simulation II:

EU-28 GSP Plus status and quota restriction: The consequences of capping mechanism applied on Pakistan.

3.5. Simulation III:

Potential EU28-EBA status with Competitors: The potential effects of EBA (Everything But Arms) status.

4. Results of the Simulations

The study used GTAP (09) to calculate the results of simulations. The results are presented below showing a change in baseline value in million dollars value as well as in percentages.

4.1 Changes in GDP and Production of Pakistan

It is believed that trade openness and especially increases in exports, leads to increase in real GDP and economic growth. Table 1 explains the impacts of our three simulations on the real GDP of Pakistan that means. The impact of all three simulations is positive and encouraging --- showing a positive change in the baseline value.

Table1: GDP Quantity Index, Constant 2011 Prices (Percent and Millions US$)

Simulations	**Base Value (Millions US$)**	**Post Shock Effects**	**Change in GDP**	**Percentage Change**
GSP Plus status with Competitors	213686.2	213956.031	269.828	0.126
GSP Plus Status with Quota Restrictions	213686.2	213731.953	45.75	0.021
EBA Status	213686.2	213895.25	209.047	0.098

Source: Author's simulation results using GTAP 09 program

The results of the first simulation revealed maximum gains while simulation two shows minimum benefits for the GDP of Pakistan.

Changes in real output in different sectors of Pakistan are represented in table 2. The results of all three simulations revealed mixed effects on the real output of commodities. The results of the simulation when quota restriction is applied on imports from Pakistan into EU28 have more winning sectors while the simulation where Pakistan is competing with other rivals under GSP plus status have minimum winning sectors.

Table 2: Changes in Pakistan's Real Out Put (Percent and Millions US$)

Commodity	Base Value (Millions US$)	GSP Plus with Competitors		GSP Plus with EU Capping (Quota)		Potential EBA Status	
		Changes in Value	Change in Percent	Changes in Value	Change in Percent	Changes in Value	Change in Percent
Leather products	19420	0.431	0.00	0.23	0.001	0.174	0.001
Wool, silk-worm cocoons	125	3.459	2.77	-1.101	-0.881	2.49	1.992
Coal	276	-1.733	-0.63	-0.223	-0.081	-1.239	-0.449
Wearing apparel	21474	6.15	0.03	0.037	0.000	4.149	0.019
Textiles	17662	4.844	0.03	-1.044	0.001	0.299	0.001
Oil	1979	-1.248	-0.06	-0.194	0.011	0.34	0.017
Beverages and tobacco products	3209	0.817	0.03	0.147	-0.003	-1.749	-0.031
Ferrous metals	874	-5.155	-0.59	-0.819	0.000	-0.135	-0.002
Electronic equipment	4409	-1.471	-0.03	-0.1	-0.094	-4.147	-0.474
Metal products	3743	-2.34	-0.06	-0.284	-0.002	-0.717	-0.012
Light Manufactures	5719	-0.847	-0.01	-0.004	-0.015	-2.318	-0.049
Electricity	41347	0.792	0.00	0.222	-0.028	-4.413	-0.023

Source: Author's simulation results using GTAP 09 program

The case of first simulation i.e. relaxing Pakistan from tariffs as compared to competitors shows more variations in real output. On a dollar value basis, the maximum gain in real put is witnessed by the wearing apparel, with an increase

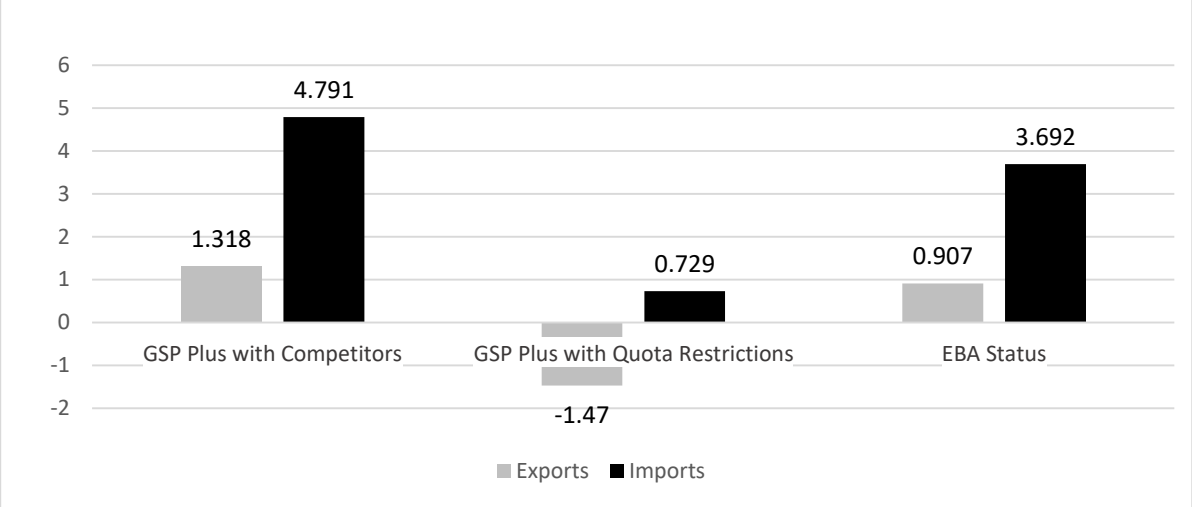
of US$ 6.15 million (an increase of 0.03 percent from baseline value) followed by textile sector with US$ 4.844 million (0.03 percent from baseline).

In the case of second simulation i.e. applying quota restrictions on imports from Pakistan to calculate the impact of capping mechanism applied by EU28 shows more winning sectors as compared to the first simulation. There are more winning sectors as compared to the first simulation. The results of the third simulation reveal that wearing apparel sector is winner acquiring the first position with a gain of US$ 4.149 million followed by textiles sector with a gain of US$ 3.593 million.

4.2. Changes in Exports and Imports of Pakistan

Trade balance always plays very important role in the process of economic growth for an economy. Exports are normally considered the goods and services for which the foreigners pay the price to domestic economy and imports are considered to be the goods and services for which domestic residents pay the price to the foreign economy (Mankiw, 2007).

Figure 2: Merchandise Exports and Imports of Pakistan¸ (Percent)



Source: Author's simulation results using GTAP 09 program

After gaining tariff free and quota-free entry into the EU28, it is expected that the exports from Pakistan may rise. Similarly, the flow of imports will also increase due to increased demand for foreign inputs and resultant higher prices of many goods. Figure 2 explains the results of all three simulations. The results of the first simulation revealed maximum gains while simulation two shows losing position of Pakistan. On the other hand, imports of Pakistan increase in all three simulations. In the first simulation, the merchandise imports of Pakistan gain 4.791 percent from the baseline value while the second simulation reveals an increase in imports by 0.729 percent. The results of the third simulation i.e. if Pakistan achieves EBA status in the EU28 also produces a positive change of 3.692 percent in merchandise imports of Pakistan.

After gaining the tariff free and quota free access in the EU28, the exports of different products of Pakistan are expected to rise. Similarly, there are equal chances of increase in prices in Pakistan that ultimately may result to increase the imports. This free access is expected to bring positive change in the production of many goods along with the enhanced availability of imported goods. Ultimately, the production of domestic goods may decrease due to the availability of imported goods at a lesser price. This change in production may differ across different sectors of the economy.

4.3. Impact on Real Investment

Real investment is the money spends to purchase the machinery rather than securities and financial instruments. The study under consideration designed three simulations using GTAP version 09 to calculate their impact on the real investment. The results of the three simulations are presented in table 3. All three simulations generated positive results. The first simulation i.e. GSP plus status of Pakistan in the EU28 while relaxing Pakistan from all tariffs and quotas as compared to its competitors, show a maximum change in real investment (US$ 2.686 million). The results of the simulation 2 i.e. GSP plus status of Pakistan when quota restrictions are applied on Pakistan to justify the capping mechanism in the EU28 show a minimum positive change in real investment (US$ 0.507 million). The results of simulation 3 i.e. if Pakistan gets the status of EBA in the EU28, are also positive and similar to simulation 1. There is a positive change of US$ 2.106 million in the real investment.

Table 3: Real Investment, Constant 2011 Prices (Percent and Millions US$)

Simulations	Base Value (Millions US$)	Post Shock Effects	Change in Real Investment
GSP Plus status with Competitors	29000	29002.686	2.686
GSP Plus Status with Quota Restrictions	29000	29000.507	0.507
EBA Status	29000	29002.106	2.106

Source: Author's simulation results using GTAP 09 program

The positive results of all simulations show that after getting the status of a duty-free and quota-free entry into the EU28, Pakistan needs to enhance the production capacity that is only possible with improved real investment. In the case of the second simulation, when the quota is applied on the imports from Pakistan in the EU28, the production capacity has been limitised that resulted in less improvement in real investment.

4.4. Change in Prices of Goods for Domestic Household

A country expects a change in the sectoral prices after sudden change in the trade balance. The results of three simulations showed an increase in the exports of Pakistan that ultimately may cause an increase in price level at the domestic market. The increase in exports not only bring a pressure on the prices of inputs that ultimately result into increased output prices but also cause an increase in the demand for imports in the neglected production sectors.

The results of the all three simulations are presented in table 4. Interestingly the results of all three simulations show a positive growth in the price of all sectors. The maximum gain in price in simulation 1 is shown in the sector of ferrous metals (3.514 percent). The results of simulation 2 i.e. GSP plus status of Pakistan in the EU28 with quota restrictions, showed a minimum increase in the price level among all three simulations. This is because the quota restrictions control

the exports in the EU28 that ultimately reduce the shortage at domestic level. The results of the simulation 3 i.e. EBA status of Pakistan in the EU28, are moderate.

Table 4: Changes in Prices of Goods in Domestic Market, Constant 2011 Prices (Percent)

Commodity	GSP Plus status with Competitors	GSP Plus Status with Quota Restrictions	EBA Status
Leather products	1.864	0.29	1.74
Coal	2.618	0.439	2.125
Wearing apparel	2.309	0.335	1.925
Textiles	2.346	0.354	1.955
Oil	2.422	0.323	1.948
Gas	2.869	0.49	2.262
Beverages and tobacco products	2.274	0.329	1.889
Petroleum, coal products	2.241	0.412	1.777
Ferrous metals	3.514	0.859	2.756
Electronic equipment	0.297	0.062	0.222
Metal products	2.152	0.346	1.736
Light Manufactures	0.332	0.059	0.253
Chemical, rubber, plastic prods	1.939	0.327	1.539
Electricity	2.329	0.412	1.81

Source: Author's simulation results using GTAP 09 program

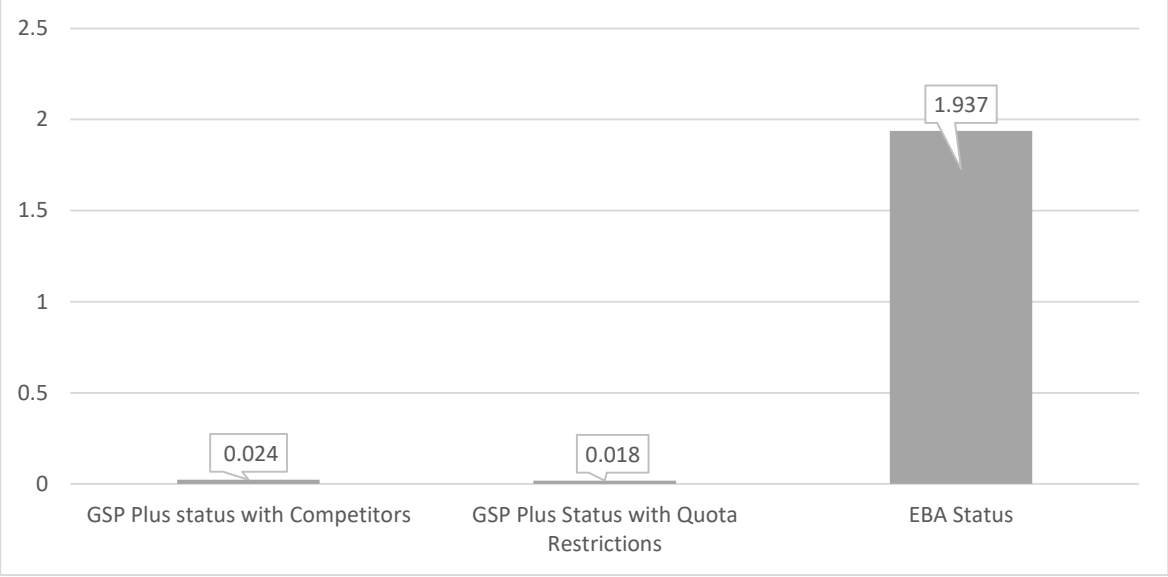
4.5. Impact on Pakistan's Terms of Trade

It is the ratio of prices that a country receives and pays in exchange for its exports and imports. It is considered important to understand the impact of changes in price on the welfare of public generally. The current study investigated the impact of three different simulations on the change in the price of imports and exports. Pakistan has already achieved the status of GSP plus in the EU28, the restriction free exports of Pakistan in the case of GSP plus and EBA may increase the export price of Pakistani products. Similarly, applying quota restriction may increase the price level at a lower rate.

Figure 3 explains the effects of different simulations performed on the Pakistan's terms-of-trade. The results of all three simulations are positive. Highest gain is seen in the results of simulation 3, assuming that if Pakistan gets the status of EBA in the EU28 just like Bangladesh. Due to this status, the exports from Pakistan may increase rapidly resulting an increase in export prices. Hence, the results of this simulation show that Pakistan would be 1.937 percent better off in terms of trade.

The results obtained by using GTAP 09 are very much similar to the previous studies that conclude that output and exports are inter-related. It is very difficult for an economy to grow without trade openness. Developing and semi-industrialized economies have to focus on the efficient use of factors of production. When exports in an economy increase, it not only increases the output level but also cause an increase in the prices at domestic level. Similarly, increased production put a pressure on the imports of related inputs in the form of capital and raw material. On the other hand, increased prices of domestic commodities due to export pressure also cause an increase in the imports of similar commodities.

Figure 3: Term of Trade (TOT) of Pakistan, Constant 2011 Prices (Percent)



Source: Author's simulation results using GTAP 09 program

The studies that support the above argument include (Esfahani, 1991), (Senguptaa & Espanab, 1994), (Ekanayake, 1999), (Jung & Marshall, 1985) and (Feasel, Kim, & Smith, 2001).

5. Conclusion

The study concludes that the GSP plus status of Pakistan in the EU28 produce positive change in the economic growth in the presence of other competitors with same or different product mix. The descriptive analysis of the results of different simulations using standard GTAP reveal that there is an overall increase in the GDP of Pakistan. The incentive to export in the EU28 will increase the production level in the Pakistan. Despite some limitations, the Global CGE model developed in this study produces plausible results that would help to shed some light on the current debate about the GSP plus effects on production, exports and household in Pakistan. The results of all simulations by using standard GTAP 09 suggest a positive change in the real GDP, real investment, merchandise imports and terms of trade of Pakistan. The merchandise exports of Pakistan increase in first and third simulation but in case of the second

simulation, it shows a decline in merchandise exports. Further, a positive change in the output of many commodities is seen in the case of all three simulations.

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Notes

1 Current WTO (World Trade Organization) is modified form of GATT.
2 There are some applications to partial equilibrium analysis