PAKISTAN'S TRADE POTENTIAL IN 'ECO' COUNTRIES: PROSPECTS AND CHALLENGES

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ABSTRACT

In this paper gravity model is used to estimate trade potential for Pakistan with Economic Cooperation Organization (ECO) countries. A cross sectional dataset of 153 countries for the year 2008 are used to estimate the trend line of world exports. The trend line is then used to estimate trade potential between Pakistan and ECO member countries at total export level. The results give trade gain and loss of the year 2008 which also verifies that Iran has a maximum trade potential. On the other hand, Pakistan over performed from its expected potential in case of Afghanistan. With countries like Kazakhstan, Iran, Azerbaijan, Uzbekistan, Kyrgyz and Tajikistan, Pakistan's trade is significant and in case of Turkey and Afghanistan, Pakistan trade is more than its expected trade.

Keywords: *ECO, Trade potential, Pakistan Exports*

1. INTRODUCTION

The globalisation upshot strongly strikes the international trade patterns and also facilitates the international trade players to gain further and encompass right of entry to new possible trade regions. Multilateral, sub-regional and bilateral trade agreements have their considerable impact and role in demarcation the international trade and backing of bilateral cooperation and deeper integration. Asia one of the leading potential area for trade also witnessed a shift in regional trade strategy because of various trade agreements e.g. APTA, AFTA, SAFTA, etc. Regional and Bilateral Trade Agreements in the recent years, have resulted in unparallel growth pattern of the trade partners, whereas majority members of WTO are now part of one or more RTAs (Mustafizur, *et al.* 2006). Pakistan has an important place in international and regional trade due to its geographical location, low-cost labour and availability of inexpensive wherewithal. Whereas Pakistan is also a member of different RTAs, FTAs and member of international trading organizations (WTO etc).

1.1 Challenges to Pakistan's Exports

According to Waheed (2008), Pakistan concentration in imports, production of less sophisticated products, exports in conventional markets, the weakening economic and political situation, war on terrorism and local demand constraints has greatly affected Pakistan's exports share in world exports. As compared to regional partners of Pakistan, the share of Pakistani exports in the total world trade is declining. According to the world trade organization the share of Pakistan exports in world exports is 0.128 percent in 2007, which is far behind than its gravitated partners i.e., India at 1.04% and China at 8.72%, whereas Asian share in world's trade stands at 29.61 %. The recent figures in strategic trade policy framework (2009-12) shows that in 2008-09 Pakistan's

total exports decreased to US$ 17.8 billion from US$ 19.1 billion in 2007-08. Whereas the identified reasons in STPF for this Pakistan's exports downturn are the global financial meltdown, high cost of finance, power outrages, worsening law & order situation and decline in foreign investment.

The objective of developing through trade can also be achieved for Pakistan, with greater trade cooperation and deeper integration with regional partners. Such trade development is also required as a countervailing measure for developing Asian countries like Pakistan to withstand the extremes of economic globalisation.

1.2 Challenges in Trade with ECO

Pakistan, Iran and Turkey had formed a group called Regional cooperation for Development (RCD) in 1964. However, it is notable that in initial years of RCD pact, the intraregional trade never exceeded in the pre-RCD level. The total volume of trade remains 2 percent of their GDPs. The RCD pact remains functional from 1964 to 1979 and was replaced by Economic Cooperation Organization (ECO) in 1985. The ECO is the inter-governmental regional organization and its charter is extracted from treaty of Izmir signed in 1977. In 1985, the ECO had offered membership to seven new countries, which include; Afghanistan, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.

1.3 Objectives for the ECO Members

The Initial objectives set for the ECO members include the following;

   i.   Sustainable economic development of member states.
   ii.   Promotion of people's living standards and quality.
   iii. Enhancing economic cooperation.
   iv.   Enhancing cooperation in social, cultural, technical and scientific fields.
   v.   Removal of trade barriers on priority basis.
   vi.   Expansion of intra-regional trade.
   vii. Development of transport and communication infrastructure in members' countries.
   viii. Human resource development of members' countries.
   ix.   Development of the agricultural resources in members' countries.
   x.   Development of industrial potential as well as human and natural resources of the region;
   xi.   Economic liberalisation and privatisation in members countries
   xii. Utilisation of region's natural resources, in particular energy resource.

The intra-regional trade in the post and pre ECO periods are not different, the factors associated with such low trade are; the security situation in Afghanistan, poor infrastructure, weak institutional implementation mechanism, poor comprehension of regional cooperation among the bureaucracies of the member countries and pathetic political will. However, among all factors the political will and the statesmanship will play an important role to save the ECO from becoming another RCD. The politician will have to save accords of TTFA, TTA and ECOTA. Apart from other reasons, some obvious and repeatedly documented reasons of declining trade are given below;

1.4 Reasons of Declining Trade

1.4.1 Political Instability

Political instability is the prospect that political forces will negatively influence the exports or the achievement of other important business intentions. The political risk addresses the alterations in the environment that are hard to expect. Political instability In Pakistan is high. The economic growth is moving in the direction of decline because of every new upcoming government, which negatively influences the exports of the Pakistan.

1.4.2. Lack of Technology

In the production of country's economy technological development plays an essential role. In the phase of hi-tech exports Pakistan is yet to enter because nearly no hi-tech objects are made for export marketplace. The majority of Pakistan's exports are with very little technical content. Since the function of technology is rising in

the world trade, Pakistan will have to plan intensive efforts to enhance technically based industrialized creation through initiation of hi-tech production in export.

1.4.3. Lack of Consistency in Economic Policies

The major requisite to succeed, so far as the export marketing strategy is concerned is to have a steady and sound macroeconomic environment which can be described by low level of inflation and sustaining economical and outer differences. The base line is that, the exchange rate policy maintains the assertiveness of the country's products. But the worth of Rupee is varying quickly against Dollar which is main determinant of irregularity in fiscal policies.

1.4.4. Low Quality Products

Pakistan has been exporting low price and low quality goods, in spite of having the ability of improving the exports by creating enhancing quality made-ups of international standards which can get a hold of high price.

1.4.5. Low Demand for Its Exports

Pakistan trade is experiencing extreme distress from huge amount of inconsistency because of low demand for its exports. There are quite a few causes like low reflection of the state, exporting poor class goods etc. Therefore it is very important for a nation to have well interaction with other states.

1.4.6. Concentration in few Markets

Pakistan exports are focused only in a small number of markets including Germany, USA, England, Japan, Dubai, Saudi Arabia and Hong Kong. Pakistan should also focus on new markets namely Mexico, Argentina, Brazil and Africa. Pakistan should concentrate in regions where the world demand is comparatively high.

1.4.7. Export and Import Bank

To deal with the severe international competition the traders have to be very steady in terms of finance. Therefore, for this reason sufficient sum of funds will be needed for exports and also for monitory assistance. We can go for a separate bank to attain this. The key function of this bank will be to offer loans /credits /finances plus other services to the exporters.

1.4.8. Agricultural Based Products

To enhance export of agricultural products government must provide infrastructure conveniences like incentives for renovation of processing industries and agro processing regions. To increase export of products like fruits, dairy, non-traditional crops, vegetables etc special consideration must be given through value addition and improved processing.

1.4.9. Joint Venture

When two or more companies work together for achieving the collective advantage and establish the business relationship is called joint venture. Many of opponents have been team up with foreign partners and are shaping joint ventures and gathering the benefits of transfer of technology, management structure, and marketing expertise. So far Pakistani companies have not taken the advantage of this opportunity. Countries with scare resources and the countries with abundance of these resources is usually form joint venture by their companies by utilizing the resources of their respective countries. Pakistan has a great opportunity to attract foreign investors for export oriented joint venture especially with China. The Trade Commissioners and the EPB will have to play a very dynamic role as individual exporters would be unable to bargain these deals with large conglomerates. Foreign partners in joint venture have to play a role in production repositioning in clothing sector through outsourcing. Brand name merchandisers and large retailers of consistent products the ones to be targeted. Foreign joint ventures can help out in marketing design, logistics, financing while the production can be handed over to the domestic firms. Japanese firms are keen to form joint venture with the south eastern countries. Thailand, India and Sri Lanka and even China succeeded in attracting Japanese investors but Pakistan was unable to attract the Japanese investors. This time Japanese considering the Pakistan as Possible destination

for investment in textiles and clothing business. This joint venture will not only bring the FDI but also initiate new technology.

1.4.10. Standards (Quality/Environment/Social)

Pakistan has to guarantee that it can tackle the environmental, quality, and social concerns of the international investors of all of its major exports. In the past Pakistan have been restricted the exports due to these factors. Exporters should get ISO 9000, IS0 14000 certification in order to assure the importers that international standards have been match up. Further we have to look into the light engineering and textiles sectors capacity to meet the required export output, and several tariff and non-tariff barriers that need to be understand and worked out. Such actions are preferred by the charter of ECO, to improve regional trade in the benefit of all the member of respective countries.

First we have to clearly understand the importance of textiles industries as a major exports driving sector. During the past last several financial years, textiles have contributed in the exports of Pakistan. It has frequently held 55%-65% of Pakistan's international exports according to the Economic survey 2010-2011. On the other side, Pakistan has historically attained only 2% to 4 % of the total ECO intra-regional exports. (Kemal, 2004). This is may be because of Pakistan and other member countries have same Comparative advantages. Therefore it becomes tricky for Pakistan's products to be of any complementary advantage to other countries of the ECO region, which is the main idea behind economic integration (Meade, 1955; Viner, 1950; Lipsey, 1957). Exports diversification would help in solving this problem. We also need to directly look into the light engineering sector of Pakistan. Pakistan has massive reserves of copper as highlighted in the inaugural speech at the 18th regional trade planning meeting (M. A. Sheikh, 2008). The federal government has already pointed out this sector as an opportunity to boost exports and a possible candidate for attractive Pakistan's comparative advantage within the ECO region (The Express Tribune, 2011).

1.4.11. Tariff barriers to Export

Tariffs refer to taxes that are related on the export on certain commodity. While ECO pointed out, its objectives, the obligation of not more than 15%. Export tax on commodities in intra-regional trade (ECOTA, 2003), and in many cases no-customs on export (PCT, 2010-2011). Much has already been done to boost intra-regional trade, a 10% tariff partiality on constitutional rates. Export tariffs have been radically reduced (Central Board of Revenue, 2010-2011); mainly due to the world wide acceptance of free trade policies, and additionally to Pakistan's need for increase in exports.

1.4.12. Non –tariff Barriers to Export

Various barriers exist which reducing the intra-regional trade capacity of Pakistan within Economic Cooperation Organization. These maybe be generally categorized as; Charges on exports, trade Difference in standardization and related requirements, Administrative entry procedures, Government interest towards, Working conditions and safety Packaging and labeling, Licensing conditions and related administrative difficulties.

2. LITERATURE REVIEW

Jahangir khan (2010), estimated a gravity model using an international dataset on bilateral trade for 137 countries in 2005, to address the subject of whether ECO (Economic Cooperation Organization) trade is too low and whether the present level of trade is accounted for by regional integration or unilateral liberalization. Results of this study verified that trade between ECO countries was lower than predicted by the equation of gravity. The result also confirmed the theory that the scale of trade at present was ascribed to regional agreements rather than unilateral liberalization. He suggested larger scope for regional cooperation among Economic Cooperation Organization (ECO) member countries.

Jahangir khan (2006) evaluated the magnitude of potential trade flows between Pakistan and the nine member countries of Economic Cooperation Organization (ECO). The main concern in this study was to explore that Intra- ECO trade had large potential for Pakistan and as compared to its potential it obtained lower share. The outcomes from the gravity model verified that Economic Cooperation Organization (ECO) had a positive and significant impact on intra-regional trade. Hence low intra-regional trade was suggested. Furthermore it was recommended that the member countries trade less with each other than what would be expected. In those

countries which had a same geographical border, the volume of trade was quite limited. The benefit of geography and the survival of trade preferences between ECO member countries could be extended to cover-up potential trade towards neighboring countries. Main hypothesis drawn from the results was that intra-regional trade had high potential for the regional countries.

Rahman et al (2006). To identify 'trade creation' and 'trade diversion' effects deriving from SAARC Preferential Trading Arrangement (SAPTA) and other nine Regional Trading Agreements (RTAs) the amplified GM was developed. Panel data approach with country 'pair specific fixed effects' and 'year specific fixed effects' was observed. To arrive at the estimates, two stages estimation method was organized. In the first stage 'Tobit Model' was applied, whereas the second stage was estimated using 'OLS'. The significant intra-bloc export creation in 'SAPTA' was found, simultaneously there was confirmation of net export diversion in the SAPTA. India, Pakistan, Bangladesh were expected to achieve from connecting the 'RTA' whereas Maldives, Sri Lanka, Nepal were expected to be affected negatively. Amongst the other RTA covered in this study NAFTA, EAC, CAN, SADC, MERCOSUR, AFTA were linked with net export diversion and intra-bloc export creation. Bangkok and European Union APTA were found to be net export diverting and intra-bloc export diverting. BIMSTEC (Bangladesh, India, Myanmar, Sri Lanka and Thailand Economic Cooperation) was found to be intra-bloc export diverting, however there was no verification of net export diversion or creation. Though none of the RTA covered in this study was found to be net export creating, more than one third of the associates of RTA were found to be affected positively by joining the RTA.

Felipe and Kumar (2010), used a GM to study the 'bilateral trade flows' and 'trade facilitation' relationship. Moreover they estimated the gains in trade resulting from enhancements in trade facilitation for the Central Asian nations. Trade facilitation was calculated through the World Bank's LPI (Logistic Performance Index). As a result of enhancing trade facilitation in Central Asian countries, their outcomes showed significant gains in trade. In the case of Azerbaijan the gains vary from 28% to as much as 63% for Tajikistan. Moreover, intraregional trade rose by 100%. Amongst the components of LPI, they found that the maximum increase in overall trade comes from advancement in infrastructure, followed by logistics and effectiveness of other border agencies and customs. The outcomes also showed that the increase in bilateral trade, due to an improvement in the exporting country's LPI(Logistic Performance Index), in high-technology, highly sophisticated and more differentiated products was greater than the increase in bilateral trade in low technology, less differentiated and less sophisticated products. For the Central Asian nations this is mostly important to lessen their reliance on exports of natural resources and expand the manufacturing base by shifting to more sophisticated goods. Beyond their borders when they take a look at markets, trade facilitation plays an essential role.

According to Zarzoso (2003), different Authors from 1980 to 1999 calculate the determinants of bilateral trade flows among forty-seven different countries. They focused on the effects of preferential agreements between various economic blocs and areas. The authors not only approximate a gravity equation which shows the effects of weight comparison on preferential agreements but also, shows the dependency of other determinants on bilateral trade flows such as geographic proximity, income levels, population, and cultural similarities. The results indicated that those variables which were traditionally involved in the gravity equation not only present the expected signs but also emphasize the role played by intra-bloc effects. According to the theory, Income Elasticities (exporter and importer) are non-negative and are approaching to unity. Exporter's income elasticity is greater than that of corresponding importer which point towards the significance of a country's production capacity in fostering exports. The predictable coefficient for the exporter population variable is negatively signed which tells about the absorption effect, the larger the size of the exporter, the lesser the exports. However, the expected coefficient analogous to the importer population is negatively signed till 1990. Beyond 1990, the sign is positive that shows the growing significance of the role played by scale economies and market-size effects in international trade models.

According to Paas, for modeling transition processes in overseas trade the benefits by means of the gravity method is the capability of gravity models to detail foreign trade patterns under the circumstances of relatively little data and for validity of theoretical background of the model processes. The results by the gravity approach to discover the global trade patterns of Estonia with a small, open, and comparatively successful transitional economy let us to conclude that economies in transition must appear for a regional slot to go into the world market. In 1990, less than 10 percent of Estonian overseas trade flows were outside the former socialist countries. In 1998, more than 50 percent of Estonian worldwide trade was with EU countries, mainly with developed countries around the Baltic Sea. These significant changes in international trade pattern also depend on reform of foreign trade and customs policies.

3. RESEARCH METHODOLOGY

3.1 Model

The standard gravity model is supposed to be used in this study. The model shows the distance, population and economic proportions of two countries. Basically the gravity model states that the trade level of any two countries raises and declines with their size and distance respectively. The gravity model variables are distance, population, GDP and dummy variables (common language and common border).

3.2 Sample

A sample data of 153 countries will be used to identify general trade pattern and trade trend line for the year 2008. This trend line will then be used to estimate the trade potentials for Pakistan with ECO members' countries at total exports level.

3.3 Model Estimation

The augmented gravity model used in the current study is:
$$Ln(Xij) = \text{ß0} + \text{ß1 } Ln(GDPi) + \text{ß2 } Ln(GDPj) + \text{ß3 } Ln(DISTij) + \text{ß4 } Ln(POPi)$$
$$+ \text{ß5 } Ln(POPj) + \text{ß6 } Dum\_Border + \text{ß7 } Dum\_Lang + \text{ß11 } Ln(\alpha)$$

Where *Xij* are the total exports of country *i* to country *j*

GDPi	is gross domestic product of country *i*.
GDPj	is gross domestic product of country *j*.
DISTij	is distance between country *i* and country *j*.
POPi	is total population of country *i*.
POPj	is total population of country *j*.
Dum_Border	is the dummy variable for common border
Dum_Lang	is the dummy variable for common language
α	is the unexplained variation in the dependent variable

4. DISUCSSION & ANALYSIS

4.1 Expected Results (Total Exports)

The year-wise betas estimated will be used as base to calculate the predicted export flows of Pakistan with the ECO member countries. This method will determine the exports potential for Pakistan with ECO member countries.
 Following equation will be used to calculate the predicted export flows for year 2008:

$$Ln(Xij) = -30.23 + 1.36Ln(GDPi) + 0.95Ln(GDPj) + [-1.29 \ Ln(DISTij)]$$
$$+ [-0.09 \ Ln \ (POPi)] + 1.05(Adj \ ij) + 1.27(Lang \ ij)$$

The actual data of GDP for the both countries in the same year, the distance between the two countries and the data of population, common border and common language will be utilized to estimate the predicted trade. The results will give an indication of potential trade loss or trade gain for the year 2008. The highest trade potential for the year 2008, is identified for Iran i.e. US $ 78 million. However, in case of Afghanistan, Pakistan over perform from its expected potential and it remains US $ 1726. The preliminary results clearly indicated that there is considerable scope for an increase in Pakistan's exports with ECO. Specifically, Pakistan is having significant trade potential with Iran, Kazakhstan, Uzbekistan, Azerbaijan, Tajikistan and Kyrgyz and Pakistan's trade with Afghanistan and Turkey is more than its expected trade.

Table-1 shows the results of the GM. The coefficient of GDPA is 1.36 shows that, when GDP increases by 1 percent, trade increases by 1.36%. For GDPB, the coefficient is 0.95, shows that, when GDP increases by 1% trade increases by 0.95%. The distance coefficient is about -1.29 specifying that when two countries distance is 1 percent higher, trade between these countries fall by 1.29 percent. The coefficient of distance is high, reflecting that in general transport amongst most countries are costly and perform as a considerable barrier. The coefficient of dummy variable for language is 1.27 and coefficient of common border is 1.057, and both have a significant impact on trade.

5. CONCLUSION

All estimation methods and models created eventually endure form problems/weaknesses. The study is empirically based and so relies strongly on the accessibility, comprehensiveness and validity of the data. The GM of trade too has its own restrictions and strengths. If countries are relatively near, having a common language and border, and also close societal associations, their trade affairs will be strong. Political interactions (clashes/stresses, coordination/friendship) are at times very influential than commercial and fiscal deliberations.

The study illustrates the trade potential of Pakistan with ECO (Economic Cooperation Organization), prospects and challenges. The results are obtained using gravity model to identify the trade gain or loss. The estimation indicates highest trade potential for Iran and Afghanistan. The results exhibit significant trade potential for Kazakhstan, Iran, Azerbaijan, Uzbekistan, Kyrgyz and Tajikistan. The trade relation of Pakistan is much more than the expected trade with Afghanistan and Turkey. There is substantial capacity for Pakistan to increase its exports with ECO countries. The trade inclination existence and the freedom of geography amongst ECO (Economic Cooperation Organization) members can be extended to cover up trade potential toward neighboring countries.

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APPENDICES

Table 1:

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Dependent Variable: EXPORTS			
Method: Least Squares			
Date: 06/10/11 Time: 12:00			
Sample (adjusted): 2 16289			
Included observations: 16288 after adjustments			
Convergence achieved after 5 iterations			
C	-30.23728	0.450573	-67.10843	0.0000
GDP_A	1.369951	0.015970	85.78478	0.0000
GDP_B	0.956178	0.013052	73.25836	0.0000
DISTANCE	-1.295135	0.026480	-48.91015	0.0000
POPULATION_A	-0.097609	0.019023	-5.131078	0.0000
POPULATION_B	0.003738	0.015304	0.244223	0.8071
COMMON_BORDER	1.057199	0.132077	8.004428	0.0000

COMMON_LANGUAGE	1.274348	0.058038	21.95723	0.0000
AR(1)	0.192707	0.007710	24.99398	0.0000
R-squared	0.634108	Mean dependent var		15.49666
Adjusted R-squared	0.633928	S.D. dependent var		4.177773
S.E. of regression	2.527713	Akaike info criterion		4.693060
Sum squared resid	104012.0	Schwarz criterion		4.697313
Log likelihood	-38211.28	F-statistic		3526.538
Durbin-Watson stat	2.049794	Prob(F-statistic)		0.000000
Inverted AR Roots	.19			

Table2:

Countries	Real Trade (In US Million $)	Expected trade (In US Million $)	Trade Potential (In US Million $)
Afghanistan	1,864.99	139.02	(1,725.97)
Azerbaijan	2.58	20.18	17.60
Iran	360.30	438.77	78.47
Kazakhstan	17.42	64.72	47.30
Kyrgyz	3.35	6.54	3.18
Tajikistan	0.83	11.40	10.57
Turkey	532.94	147.07	(385.87)
Turkmenistan	1.72	13.70	11.98
Uzbekistan	3.97	38.69	34.72