Chapter 9

International Trade

Abstract

International trade provides a lot of benefits to importing as well as exporting countries. Importing countries enjoy the benefits as they get those commodities or services that they cannot produce domestically. Likewise, from exporters side they can buy other products that they need or to get money. In this way lot of job are created in the economy. Economies of various countries also affect the world's productivity of international trade. If any nation is not working at its optimal level, then it can fulfill its needs through international. Imports are oftenly more expensive as compared to domestic products, especially when the currency of importer country is cheaper than the exporter country. In this chapter, different theories of international trade, economic basis for this trade, trade barriers, FDI and other concepts are discussed.

Keywords: Trade, imports, exports, commodity, tariff, quota

9.1. Theories of International Trade

International trade means selling, buying or exchanging of products and services among the countries (Wild and Han 2006). It includes different aspects among the countries. There are various theories related to international trade, like, comparative advantage, absolute advantage, mercantilism, factor proportion theory, new trade theory and international product life cycle.

9.1.1. Mercantilism

According to this theory, nation should rise its wealth through encouraging exports and discouraging imports. It was practiced in throughout the Europe in 1776. It is general perception that Gold, Silver and wealth is a symbol of strong nation (it was also useful when the king desired to finance a foreign war). Generally, all the trade was accompanied under the supervision of government authority and highest bidder get the trading rights. Colonization, trade surplus and government interventions were accomplished through this. All these factors worked collectively. Trade surplus was sustained with the help of colonization of less developed regions for raw material. Developed countries get raw material from there under developed countries and after manufacturing export the finished goods around the world.

9.1.2. Absolute Advantage Theory

By using the same amount of resources or fewer resources, a nation can produce goods more efficiently with respect to other nation. It refers to the ability of a party like, firm, to produce a greater quantity of a good or service than competitors, using the same amount of resources. Basic objective of this theory was to improve the living standard of the people by obtaining goods cheaply and in more quantity. This theory also measure the living standard of people to check the strength of country based on reserves that a country has.

9.1.3. Comparative Advantage

A country is said to have a comparative advantage in the production of a good (say pens) if it can produce pens at a lower opportunity cost than another country. A country should specialize and export that commodity in which he is more efficient with respect to other countries.

9.1.4. Factor Proportions Theory

This theory focuses on the quantity and cheapness of the product while other theories focuses on the specialized product. A country rich in labor can specialize in labor oriented products and a country where capital and land is cheaper can specialize in land and capital oriented products. Like a country rich in land can specializes in export of agricultural commodities, in this situation this country should import most of its capital commodities from other countries to enhance its labor efficiency for these exports.

9.1.5. National Competitive Advantage Theory

This is modern theory, which states that a country's competitiveness in certain industry rest on the country's ability of innovation and up gradation of the industry. This theory measures the resources, skills and technological abilities of the country. This theory emphasizes on improvement in technology and workers training and development. On the ground of above theories, the determinants of international trade can be observed. International trade fluctuates consistently due to different factors evolved in production process.

9.2. Economic Basis for International Trade

International trade enables nations to enhance their productivity and get specialization in their production. Sovereign countries, as individuals and territory of country might specialize goods that they can manufacture through utmost efficiency and with the help of trade their domestic production cannot work efficiently. A better answer of this question "Why do countries trade?" hinges on three facts,

First, distribution of capital, natural and human resources between the countries are uneven; nations differ with each other in endowment in economic resources. Second, for efficient production, different products need various combinations and various technologies. Third, commodities are also discriminated on the basis quality and other non-price factors. Many people give preference to imported products than that good produced domestically.

Resources, product differentiation and technology is not fixed always between the nations. When distribution varies the efficiency and success to produce and sell, products will also change. For example, in last few decades, South Korea enhances its stock of capital as well as improves the quality of its labor force. Half-century ago, South Korea export only raw material and some agricultural products (McConnel and Brue 2005). However, South Korea exports huge quantity of manufactured products now. As national economies evolve, the quality and size of labor force, the composition and volume of capital stock can move, innovation in technologies, and even the quality of land and the quantity of natural resources also varies. When such changes occur, the relative efficiency of a nation will also change.

Through free trade based on the principle of comparative advantage, the world economy can achieve a more efficient allocation of resources and a higher level of material well-being. Paul Krugman says that "If there were an Economist's Creed it would surely contain the affirmations: 'I understand the principle of comparative advantage' and 'I advocate free trade'". Showing that free trade is better than no trade is not the same thing as showing that free trade is better than sophisticated government intervention.

9.3. Trade Barriers

9.3.1. Tariffs

Excise duty imposed on imported items is called tariff. These are imposed to protect the domestic production or to collect revenue. Revenue tariffs are imposed on those goods which are not produced in the home country (Jhingan 2001). The purpose of imposition of these taxes is to get revenue for federal government. Protective tariffs are designed to give protection to the domestic producers. Even though tariffs levied on imports are not sufficient to cut off from imported items, they create difficulties for foreign manufacturer to sell product in local market.

9.3.2. Import Quota

It is the maximum amount that can be imported in a specified time period. These works more efficiently as compare to tariffs. A good may be imported in greater quantity in spite of high tariff, imports strictly prohibit imports once quota has been filled.

Box 9.1 Pakistan's trade strategy

“For the past four decades or so, many developing countries have latched onto the coat-tails of the boom in global trade and leap-frogged the development ladder by pursuing an export-led growth strategy. This strategy has more often than not been embedded in a wider "industrial policy" which has sought to fast-track industrialization. In comparison, Pakistan's exports have increased 2.7 times over this period, placing it among the low achievers on this score. Clearly, Pakistan has not fared well on this count. If anything, a visible pattern emerges when Pakistan's trade regime and performance aver the recent past is critically examined: the country's policymakers have had a distinct import-bias rather than an explicit export-bias! The most egregious example of the anti-export policy bias is from the Musharraf- Shaukat Aziz period.

The nominal exchange rate was kept stable for several years, resulting in a real appreciation of the rupee precisely at a time when almost all the successful exporter nations were actively using a weak currency as a policy tool to promote their exports. In addition, the State Bank of Pakistan (SBP) opened the monetary taps and began flooding the economy with cheap credit. A large part of this credit was used to finance import- based consumption. Furthermore, import tariffs were reduced drastically - with Pakistani negotiators signing up to lower 'bound' tariffs under the WTO than most other developing countries. And to top it all, Pakistan also went ahead and signed up to a Free Trade Agreement (FTA) with China in 2006 – only the third or so country to have done so. Because of these misplaced policies, Pakistan's imports surged, far outstripping exports, setting the stage for the biggest balance of payments crisis in the country's history.

To put this in perspective, by 2008, me country's imports had crossed US$ 40 billion, with exports financing less than 50 percent of import payments. More disastrously, the opening- up of all manner of imports stunted the country's manufacturing sector. At a time when the share of manufacturing in GDP increased for many countries in Asia, the share of Pakistan's manufacturing sector in GDP declined, as did its share in employment and new investment. While Pakistan has gone the route of whole scale opening of imports across the economy, the successful exporter nations have adopted a much more cautious liberalization of imports, restricting freer imports to the export sector via bonded warehouses and export processing zones. Pakistan should also learn from the policy experience and current practice of other countries including India and move towards greater liberalization in a phased and well planned manner”.

Source: *Sherani (2014)*

Box 9.2 Government may revisit all preferential Free Trade Agreements (FTAs)

"The government is revisiting all the FTAs and PTAs as there is a growing realization among policymakers that they had been poorly negotiated and were now causing injury to the domestic industry. Pakistan so far has signed four FTAs under South Asia Free Trade Agreement (SAFTA) with China, Sri Lanka, Malaysia and India. Besides, there are three PTAs with Iran, Mauritius and Indonesia, they added. Undoubtedly, after the signing of these FTAs and PTAs bilateral trade volume with these countries increased substantially, but mostly moved into negative as the balance of trade went in their favour. It is not only that these trade agreements are causing injury to domestic industry, they are also making some of country's imports costlier due to monopolistic tendencies created by these FTAs and PTAs against cheaper sources of supplies from other countries of the world market.

At the time of signing of SAFTA with India in 2004, volume of bilateral trade was only $375.88 million. However, in subsequent years, it rose to $2.606bn with $2.1bn imports from India and $0.5bn exports from Pakistan to India. Similarly, when FTA was signed with China in 2007, bilateral trade was at $4.109bn which subsequently increased to $12.417bn with balance of trade at $9.275bn going in favour of China. The bilateral trade with Malaysia stood at $1.637bn and after signing of FTA in 2008, it rose to $1.985bn with $1.560bn balance of trade going in their favour. Undoubtedly regional trades around the world are increasing, but it was equally important that minimum safeguards should be given to domestic industry. The European Union (EU) member states are presently doing around 50pc of their trade within the bloc and against this; the SAARC member countries are only having 5pc trade within the region. FTAs and PTAs signed by Pakistan are not properly negotiated and situation is becoming more and more difficult for domestic industry with each passing year because customs duties are being reduced and this was making our products uncompetitive. All these trade agreements have a clause which allows renegotiation in case of injury being caused to domestic industry and Pakistan can revisit all the FTAs and PTAs to safeguard its domestic industry".

Source: *Rana (2014)*

9.3.3. Nontariff Barrier (NTB)

These are licensing requirement which specify unreasonable standard related to commodity safety as well as quality or redundant bureaucratic red tape which is used to control imports. European countries and japan continuously issue licenses to the domestic importers to control the imports. United Kingdom uses this barrier to control the import of coal.

9.3.3.1. Voluntary Export Restriction (VER)

A trade restriction in which foreign companies "voluntarily" fix their export's quantity for a specific country that have the influence of import quotas, are agreed to by exporters in the hope of avoiding more stringent trade barriers. Through trade restrictions foreign firms voluntarily fix their exports to particular country that have effect of import quota, are agreed in the expectation of no more trade barriers.

9.3.3.2. Administrative obstacles

Government can erect when free trade agreements limits to the imposition of quotas and tariffs. These are known as Administrative obstacles. It includes quality control, living wage, safety standards and other standards to be encountered by foreign producer. If these standards are not followed by foreign producer, their goods are banned for sale domestically. It may include safety standards, health or environmental standards.

9.3.3.3. Subsidies

These are the payments which are made by government to producer, like state provides subsidy to farmer to decrease the cost of production. Purpose to provide this subsidy is to rise the consumption of domestically produced products with respect to foreign products.

9.3.4. Dumping

When a producer export its product to another country at a price below its domestic price level or below from its cost of production is called dumping.

Box 9.3 Elimination of Trade Barriers in Pakistan

"Pakistan has also adopted various polices of trade liberalization like many other developing countries. It leads to minimal tariff and non-tariff barriers. It includes trade liberalization programs of reduction in import tariffs, rationalization of tariff structure, abandonment of administrative control over export and import quota. The maximum rate of custom duty has been reduced to 25 percent with only 4 tariff slabs, Para-tariffs have been almost eliminated, negative import list has been drastically reduced over year and goods are abandoned only due to specific religious health and security consideration".

Source: *Yasmin and Khan (2005)*

9.4. Economic Impact of Tariffs

While looking at the supply and demand analysis, the observation of economic impacts of protective tariffs. Curves D_d and S_d in Figure 9.1, depict the supply and demand of a product in which a country, say Pakistan has a comparative advantage in DVD (Disregard curve S_d+ Q for now). Before trade the output is q and domestic price is P_d. Now, we assume that trade opens and Japan has a comparative advantage in DVD players. Japan sold these items to Pakistan. It is assumed that under free trade domestic price and world price level is same, which is denoted by P_w. At P_w, domestic production is 'a' and domestic consumption is d. The distance along x-axis in between demand and supply curve shows imports, i.e., "*ad*". Thus, similar is the case for world price in Figure 9.1.

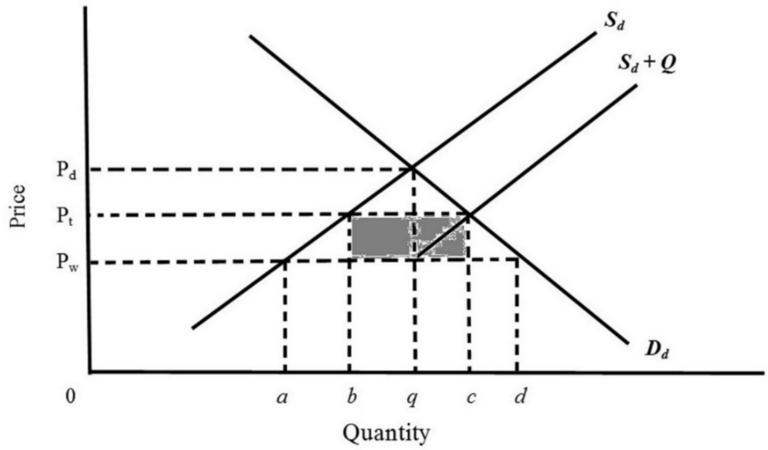

Fig. 9.1 The economic effects of a protective tariff or an import quota

A tariff that rises the price of commodity from P_w to P_t will decreases local consumption from point *d* to *c*. Domestic manufacturers will be capable to sale more output (*b* rather than *a*) at a greater price (P_t rather than P_w). Overseas exporters are impacted as they can sell less of their product now (*bc* rather than *ad*). Highlighted area shown in the figure represents an amount paid by domestic consumer through tariffs. Import quota of *bc* units shows the same effect as tariff with one exception, highlighted quantity will go to foreign producers instead of domestic government.

9.4.1. Direct Effects

Consider, Pakistan impose tariffs on import of DVD player. The tariff, will rise the price level from P_w to P_t have four effects,

9.4.1.1. Decline in Consumption

Main impact will be on consumption, the consumption of DVD player go down and consumption will decline from point *d* to *c*. Tariffs will restrict the consumer to buy few DVD players and to spend a portion on less desired substitute. Pakistan consumers will be in loss due to these tariffs, as they are now paying P_wP_t more for each of the c units they buy at price P.

9.4.1.2. Increased domestic production

Pakistani producers cannot charge a higher price P_t per unit. Because, the new price is greater than the pre-tariff world price P_w, the local DVD player industry goes up and move right side with supply curve S_d, rising domestic output from *a* to *b*.

Thus, local manufacturers enjoy greater sale volume with price level. But from a social perspective, the greater local productivity from *a* to *b* shows that the tariff permits domestic producers of players to invest abroad.

9.4.1.3. Decline in Imports

Although the price of DVD player move P_w to P_t, but the Japanese producers will also face loss. This amount goes to Pakistan's government and not the Japanese manufacturers. After tariff world price, or the per unit revenue to Japanese producers, remains at P_w but imports volume declines from ad to bc.

9.4.2. Tariff Revenue

The shady rectangle point out the revenue's volume from tariffs. Aggregate revenue with the implementation of tariffs can be determined through multiplying number of players imported, *bc* with tariff P_wP_t, per unit. This is a transfer of income from consumer towards government and does not indicate any alteration in the economic wellbeing. Thus, government gains the share that consumer pay more for DVD players.

9.4.3. Indirect Effect

Tariffs have indirect effect beyond what our supply and demand diagram can show. As Japan sold fewer DVD players to Pakistan, Japan will earn small amount of Rs. Exporting industries of Pakistan then cut its production and release resources. Due to their ability of sale products in the world's market and due to their comparative advantage, these industries are highly efficient.

Tariffs promote inefficient industries that do not have comparative advantage, they indirectly shrink the efficient industries that have comparative advantage. Put directly, resources move in wrong direction due to tariffs and that's not surprising. Trade and specialization leads to an efficient use of resources and greater output. But protective tariff works opposite to it. Therefore, tariff's also causes a decrease in the efficiency and world's output.

9.4.4. Economic Impact of Quotas

As discussed earlier that it is basically a restriction imposed on imports for a given year that a specific amount of mentioned goods can be imported. Quota also works on the same principle but a huge difference between quota and tariff is, quota transfer revenue to foreign producer and tariff transfer revenue to domestic government.

Suppose Figure 9.1, without imposing a tariff Pakistan prohibits bc units of Japan's DVD players. In simple words, import quota on DVD players is imposed on Japan. We intentionally choose the size of this quota same as imports would be under a P_wP_t

tariff, so that "equivalent" situations can be compared. Because of the quota, the supply of players is S_d + Q in the Pakistan. This supply consists of the domestic supply plus the fixed amount hr (=Q) that importers will provide at each domestic price. The supply curve S_d + Q does not extend below price P_w, because Japan cannot export these players to Pakistan at lower price, instead it would be sold to other nations at market price of P_w.

Utmost economic conclusions are identical like tariff. Prices of DVD players are higher (P_t instead of P_w) because imports have been decreased from *ad* to *bc*. Local consumption of DVD players reduces to c from d. Pakistani manufacturers enjoy all a greater price level (P_t rather than P_w) and better sales (*b* rather than *a*).

The differentiation is this, the price rise of P_wP_t paid by Pakistani buyers on imports of *bc* (the dark area) no longer goes to the Pakistan. A tariff provides revenue to government which is used to cut taxes or for financing of other public goods and services that give benefit to Pakistan. In comparison, higher price level created through quota generate additional revenue to foreign producer.

9.4.5. Net Costs of Tariffs and Quotas

F Figure 10.1 shows that tariffs and quotas impose costs on domestic consumers but provide gains to domestic producers and, in the case of tariffs, revenue to the Federal government. Consumer cost due to trade restriction can be determined by calculating the effects of restrictions on buyer's price. The price of commodity rises in three ways due to protection that are as follows;

1) Price of imported good rises
2) Due to higher price level of imported product, consumer shift towards the purchase of domestic products.
3) Price of domestic product will also rise because import competition declines.

After a lot of research, it is observed that consumer's cost substantially exceeds the gain to producer and government. Efficiency loss or sizeable net cost to economy arise due to trade security. Moreover, firms hire huge quantity of economic resources to effect assembly for clearance and maintain protectionism rules and regulations. Because, these rent-seeking efforts turn away resources from more socially desirable purposes, trade constraints levy that cost on economy. So, from the above discussion it is concluded, gain that Pakistan generate to protect industries come at the expense of too much higher loss for the whole industry. That creates inefficiency in the economy.

Box 9.4 Pakistan-FDI

"According to the World Bank report published in 2012 foreign direct investment, net inflows (percent of GDP) in Pakistan was 1.14 as of 2010. Its highest value over the past 40 years was 3.90 in 2007, while its lowest value was -0.06 in 1973. And net outflows (percent of GDP) in Pakistan were 0.03 as of 2010. Its highest value over the past 26 years was 0.11 in 1989, while its lowest value was -0.04 in 1997. The latest value for Foreign direct investment, net (BoP, current US$) in Pakistan was $1,975,000,000 as of 2010. Over the past 34 years, the value for this indicator has fluctuated between $5,492,000,000 in 2007 and $8,220,530 in 1976.
Foreign direct investment (FDI) increased by 29.7 percent during Jul-April FY13, in contrast to a decline of 36.7 percent during the same period last year. During Jul-April, FY13 inflows of FDI remained at $1,893.6 million against $1,723.3 million showing an increase of 9.9 percent".

Source: *Wasti and Ahmad (2013)*

9.5. Foreign Direct Investment (FDI)

Investment that is made by one entity or organization of one country to company entity of another country. FDI is substantially different from indirect investment. In foreign direct investment, entities influence and control over the company in which investment is made. Open economies that have high growth rate and skilled labor force attract more foreign direct investment with respect to close and highly regulated economies. A company can make overseas investment in different ways either by making a subsidiary office or company in foreign country through joint venture or by taking shares of overseas company. Threshold accepted for FDI according to OECD is 10%. Therefore, investor must purchase at least 10 percent stock or shares of the company in which he invests. Like, American companies' takes majority of stakes in Chinese companies.

9.5.1. Factors Effecting FDI for Developing Countries

FDI plays an important role in development for the countries having deficiency in capital. As it is consistent source for capital inflow and it is as very helpful in technological transfers and create employment opportunities (Mottaleb and Kalirajan 2010). For the developing nations, it provides a viable way to increase savings and to attain economic growth. However, it may vary from country to country. As many developing nations, getting success to fascinate the FDI. Why is this so? Why have some nations get success converging foreign direct investment while other nations have not? This study is an effort to answer these questions. Specifically, features of a country are likely to be a magnet for multinational companies and for promotion of foreign capital inflow what policies are discussed here.

Potential markets of goods and services are a big source of FDI. This is because, investor think it would be cost effective to produce and sale in the same market without any transportation cost or imposing tariff on commodities. The other rationale is the region of natural input resources, where they can start their production without any transportation cost. The other relevant determinants are global integration, market size, and business friendly environment of investee country. For measurement of purchasing power and market size, GDP per capita is used, average tariff is also used as a proxy of global integration. Regarding business friendly environment, different indicators such as inflation rate for macroeconomic environment, secondary school enrolment rate for availability of skilled labor and M_2 to GDP ratio for financial sector depth are also considered (Hussain and Kimuli 2012).

9.6. Economic Integration

It is the association of economic policies among various nations with individual or complete eradication of tariff and non-tariff barriers on trade happening between them prior to their integration. It will leads to lower price level for consumer and producers with the objective to rise the economic efficiency of the country. Arrangement of different regions for decline or removal of trade restrictions is the regional integration. The principle objective of integration is to decrease the cost for producer and consumer and to increase trade level among countries.

9.6.1. Types of Economic Integration

The trade stimulation effects intended by means of economic integration are part of the contemporary economic this theory. One of best option is free trade, with free competition and no trade barriers. It is treated as best option, and although realized within certain developed states, it has been thought of as the second-best option for global trade where barriers to full free trade exist.

9.6.1.1. Preferential Trade Agreement (PTA)

It is the weakest form of integration. In a PTA, nation's offer reductions in tariff on some commodities. But higher tariffs imposed on commodities will remains same other than that products.

9.6.1.2. Free Trade Area (FTA)

It is a type of tariff in which nations agrees to finish the tariff among themselves but it is to be maintained for the rest of world. The best example of free trade area is North American Free Trade Area (NAFTA). Its rules and regulations are designed to protect products imported from FTA member countries at cheaper tariff and exported to other countries at higher tariffs.

9.6.1.3. Customs Union

When different countries agree to diminish tariff between themselves and impose tariff for the rest of the world. European Union (EU) is the best example of this. EU avoids from creating complex rules but introduce a problem of policy coordination.

9.6.1.4. Common Market

Common market establishes same tariff rate between member countries and allows the free mobility of labor and capital among nations. In today, European citizen can work or invest throughout the European countries without any restriction.

9.6.1.5. Economic Union

An economic union usually will develop a free trade in products and services, set permit free, mobility of labor and capital, set same tariff among nations, and will also relegate some fiscal spending responsibilities to a supra-national agency.

9.6.1.6. Monetary Union

The Monetary union generates collective exchange between the cluster of nations. For this purpose, a combined monitory authority is formed that determine the monetary policy for whole group.

Box 9.5 India-Pakistan Trade: A Roadmap for Enhancing Economic Relations

"With new governments in both India and Pakistan, there is once again a window of opportunity to improve economic ties. While the measures for reducing trade barriers generally have the support of businessmen on both sides of the border, it is critical to build constituencies in each country for greater bilateral trade liberalization. The success of the "confidence building" short-term measures and the resulting growth in trade would give a major impetus to the creation of vested interests that would support more far-reaching liberalization of trade between the two countries.

Only then will the political and bureaucratic opposition to increased India-Pakistan trade be diminished. Trade will of course not solve all the problems between the two countries, but it could be an important catalyst in the lowering of tensions. It is clearly in the interest of both countries, and the world for that matter, to find a political resolution to the India-Pakistan problem, and increased trade can well be the starting point for this objective. In the case of India-Pakistan trade relations, good fences do not make good neighbors."

Source: *Khan (2009)*

9.7. South Asian Free Trade Area (SAFTA) - An Example of Economic Integration

As it is time of globalization and regional collaboration is compulsory in the recent era and it happens in all areas, more important is trade. Regional Trade Agreements (RTAs) are very supportive in this respect. SAFTA is a treaty reached on 6 January 2004 at the 12th SAARC summit meeting in Islamabad, Pakistan. It formed a FTA of 1.6 billion individuals in Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. The seven overseas ministers of the territories signed a framework agreement on SAFTA to decrease customs duties on traded items up to zero to the year 2016. This agreement was enforced on January 2006 and follow the sanction of the agreement by the seven governments. It was required from developing nations to come down their tariffs to 20 percent in the next two year phase up to 2007. It was agreed that at the end of 2012, duty will be declined to zero in a series of annual cuts. The least developed countries in South Asia have an extra three years to diminish tariffs to zero. India and Pakistan approved the treaty in 2009, whereas Afghanistan as the 8th member state of the SAARC ratified the SAFTA protocol on the May 2011.

9.7.1. Objectives

The basic aim of this commitment is to encourage competition into the zone and every member country get fair benefits from trade. other objective is to help the individuals of the nations by bringing transparency and integrity between the countries. SAFTA was established to raise the level of trade and economic collaboration between the SAARC states by decreasing the tariff and barriers and also to provide special preference to the Least Developed Countries (LDCs) among the SAARC nations.

9.7.2. Principles

1) Overall reciprocity of advantages to benefit equitably all Contracting States, taking into account their respective level of economic and industrial development.
2) Negotiation of tariff reform that is improved and extended in successive stages through periodic reviews;
3) Recognition of the special needs of the least developed contracting states and agreement on concrete preferential measures in their favour;
4) Inclusion of all products, manufactures and commodities in their raw, semi-processed and processed forms.

9.8. World Trade Organization (WTO) and its Implications for Pakistan

WTO is an association that intends to liberalize and supervise international trade. This organization officially come into existence on January 1, 1995 under Marrakesh Agreement. General Agreement of trade and tariff (GATT) has been replaced with WTO. It supervises and provides market access to different states regarding their goods and services, and create friendly policies for investment and the trade. It also makes policies to protect domestic industry from overseas goods and services, using illegal practices like transfer price mechanism and dumping. It provides rules regarding legal framework, government regulations, environmental aspects and labor standards. (Nasir 2012). It is important to understand how its rules affect the developing countries such as Pakistan.

In 1930, after the Second World War and Great depression, countries promote mutual trade, based on some specific rules. The Great Depression had deep effects on people and countries. Some additions in the form of voluntary membership agreements were made in 1948 and continue their efforts to decrease tariffs in a series of "trade rounds" till the inauguration of WTO on January, 1995 in the 8th round at Uruguay.

WTO is an association of broader constitutional and legal elements that standardize the global integration. Its basic motive is to initiate an open trading system in which enterprises of respective states can trade in a fair way. It also tries to create a competitive environment to improve the standard of living, create employment opportunities and enhance production volume. It helps in administration, implementation and other multilateral and trilateral trade agreements. It works as a medium for negotiations between its member countries and deal with their multilateral trade agreements. It also deals with a frame work to implement the results of negotiation. It protects the domestic industry though quota and tariff. It forbids Quantitative restrictions use except in few number of situations. The member countries are insisted to abolish the production of domestic industry by decreasing tariffs and eliminating the barriers on multilateral trade negotiations.

This rule laid down based on non-discrimination between the member countries. Tariffs and other rules must be applied on exports and imports without any discrimination. Exceptions of the rules are regional arrangements subjected to free trade agreements or preferential. When a developed nation apply duty free rates on imports from developing nations are known as Generalized System of Preferences.

The rule forbids member states from discrimination among domestically produced products and imports in case of internal tax or internal regulations.

9.8.1. Pakistan and WTO

Pakistan joined the WTO, when this organization came into existence in 1995. As a developing nation, Pakistan enjoyed the extra time given for planning to follow the Agreements of WTO up to 2005. The world's political and economic systems are reshaping and rules of engagement are changing. WTO is knocking at the door of every country. Whether, we like it or not but we have to play this game. In order to play this, game properly; first of all, we have to learn the rules of the game. If we can do this then in the long run maybe we shall become an important player of the game and then rewrite the rules according to our own liking.

Box 9.6 MFN Status to India

India and Pakistan, the two largest economies in South Asia, share a common border, culture and history. In 2011, trade with Pakistan accounted for less than half a percent of India's total trade, whereas Pakistan's trade with India was 5.4 percent of its total trade. India had granted Pakistan MFN status in 1996, but Pakistan is yet to grant MFN status to India according to World Trade Organization (WTO) norms, and missed the deadline date December 31, 2012 for approving India for MFN status, member countries are required to provide this status on a reciprocal basis. Both the countries have mutual trade volume of more than 1.6 billion dollar.

- Any member of WTO is required to give MFN status to all members of MFN. This is not a favor that can be granted or withheld. Pakistan is in noncompliance with WTO rules and India could seek action but has chosen not to do so.
- Pakistan requested India to waive its objection in WTO to EU duty concessions for Pakistan. In return it promised to give India MFN status. This was in Sept 2011. When India did its part, Pakistan backtracked and said they had agreed in principal but it would take then a year to implement. Eventually they said they would implement by December 2012. But they did not keep their word.

The PML-N government sprung a surprise at the recent trade talks with India by offering New Delhi the most-favored nation (MFN) status from next few months-with a condition. Pakistan sought access for 250-300 of its items at lowered duties.

Source: *Khan (2014)*

Box 9.7 Trade Related Challenges Facing Exporters in Pakistan

"In a report of United Nations Industrial Development Organization (UNIDO) a survey of 157 Pakistan exporting firms in Sindh and Punjab industrial regions was conducted. It was found that during the period 2000 to 2004, average firm export values increased. Enhanced export trade performance has become more critical to developing countries within the context of a more liberal trading system. Over the last decade, Pakistan has liberalized its trade. Total exports responded favorably rising from US$ 6.7 billion in 1992 to US$9.1 billion in 2002, but sustaining this growth is a challenge due to longstanding structural weaknesses in the industrial and exporting sectors. Thus, helping Pakistani firms develop dynamic exporting capabilities is a key policy objective. The major market for the textile and leather sectors is the European Union, while that for agro processing and fisheries is Asia. This exporting pattern underlines concerns within the sector that export growth is hampered by a range of firm and export policy related constraints. Export market diversification is correlated with firm size, where larger firms are more diversified reflecting gains from economies of scales and exporting experience. In addition, gains from such diversification are significant.

The uptake of new production and process technologies is highest in textiles and leather but very low in agro-processing and fisheries. Exporters in Pakistan, especially small and potential exporters, lack the capacity to demonstrate compliance with standards and their poor awareness of rules and standard requirements poses a major challenge. Report makes a number of recommendations aimed at the private sector, government departments and other relevant bodies. These recommendations include the following:

- Enhance government efforts at creating a better business environment to spur industrial investment, exports and growth. Consideration should be given to reforming regulatory policy in particularly tax administration, rationalizing customs procedures, anti-corruption and electricity supplies.
- Examine ways to increase public and private sector coordination to strengthen capacity in research and development and dissemination of relevant business information, which will reduce the costs of doing business.
- Strengthen the credibility of conformity assessment practices in Pakistan through attainment of international recognition of Pakistan National Accreditation Council (PNAC).

The national standards institute should develop a National Enquiry Point to provide information on standards and technical regulations. This service should be linked to the National Reference Centers established at Trade Development Authority (TDA)".

Source: *PIDE (2007)*

Pakistan has got huge potential in many different sectors especially agriculture. It's high time to start utilizing our own resources effectively rather than going towards aid programs. We need to learn from Chinese model of growth. They are following a policy of keeping a distance from international politics and hostile engagements for many decades now. At the same time, they have strengthened their internal infrastructure and are following an export oriented approach. When we say that China and Pakistan are all weather friends then these slogans should also be transformed in learning from each other. WTO will be a window of opportunity or a threat for us; it will depend upon what we do today and how we prepare for tomorrow.

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