

# Modelling welfare effects under Pakistan–China free trade agreement

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## Abstract

**Purpose** – This paper aims to empirically examine the trade creation and diversion impacts on merchandise imports of Pakistan under the Pakistan–China Free Trade Agreement (FTA). The analysis of Pakistan's preferential treatment with its largest trade partner as well as the most substantial exporter of the world will help to shape trade policy, open windows for academic research and also gives an immense contribution in literature.

**Design/methodology/approach** – A disaggregated panel data on the imports of Pakistan from China and other WTO member countries and tariff concessions at Harmonized System (HS) two-digit level used for the agreement period of 2006–2012. The empirical analysis takes care of bias through robust and panel-corrected standard errors with time, industry-specific effects and controlling for multilateral trade resistance.

**Findings** – Evidence found in support of trade creation under the Pakistan–China FTA. It means overall this agreement increased the welfare of Pakistani consumers.

**Practical implications** – Findings are in favour of negotiations and signing for the next round of this agreement and with other major trade partners like the US and Saudi Arabia.

**Originality/value** – It is worth investigating empirically the impact of preferential trade liberalization between Pakistan – a developing country – and China – the largest importer of the world – explicitly, in the form of trade creation or diversion. The empirical assessment of this FTA signed with the world's largest exporter will not only contribute immensely to the literature but also help in trade policy formulation and open windows for academic research. Another unique aspect of this study is the use of disaggregated data consisting of all goods imports along with tariff concessions at two-digit Harmonized System (HS) code.

**Keywords** China, Pakistan, Trade creation, Free trade agreement, Import demand

**Paper type** Research paper

## 1. Introduction

The debate about the effects of regional trade agreement (RTA) was started about 70 years ago when General Agreement on Tariffs and Trade (GATT) advocated liberalization as a policy variable from 1947 to 1995 till that renovated as World Trade Organization (WTO). One highly controversial and emerging aspect of trade liberalization among empirical researchers is the impact assessment of free trade agreements (FTAs). Interestingly, 625 regional trade agreements were notified globally till 1 February 2016, and 238 out of these were FTAs (WTO, 2016). That is why there has been a great debate on the assessment of FTA by two concepts trade creation and trade diversion. An FTA, economically beneficial

