

CHINA-PAKISTAN ECONOMIC RELATIONS

Atul Kumar

Research Assistant, IPCS

INTRODUCTION

In February 2006, while addressing the Pak-China Business Forum, President Pervez Musharraf of Pakistan poetically described China-Pakistan relationship as “deeper than the ocean and higher than the mountain.”¹ Hopes of progress in bilateral relationship were further consolidated by the launch of a bus service between Gilgit, in Northern Areas of Pakistan, and Kashgar, in Xinjiang province of People’s Republic of China, on 15 June 2006. However, in reality, though the military-strategic relationship between the countries is in good shape, the economic dimension is not as promising. The present report endeavors to examine the economic aspect of China-Pakistan relationship, both in the historical and the present context.

MILITARY-STRATEGIC RELATIONSHIP

Pakistan’s “all weather relationship” with China has endured a number of hiccups in the last six decades inspite of the completely different type of changes in their political system. While Pakistan has experienced a number of military regimes with democratic intervals; China has passed through a number of domestic revolutions. Pakistan was the third country to recognize the People’s Republic of China. It was also among the countries opposing the United Nations resolution recognizing China as an aggressor in the Korean War. By the end of the 1950s, both the countries expressed intentions to condone each other on minor issues. While Pakistan did not overtly react to Tibet’s occupation by China, the latter did not criticize Pakistan’s joining of the Southeast Asia Treaty Organisation (SEATO), which was meant to contain China. After the 1962 war, their relations went through an irreversible transformation. Pakistan solved the border dispute with China in 1963 and subsequently, both countries concluded the Civil Airlines Agreement. Chinese ultimatum to India during the Indo-Pakistan War of 1965, which was meant to ease the pressure on western front, further solidified this relationship. Pakistani press coverage of this event compared it with the United States’ embargo on arms trade with both belligerent states, despite Pakistan being a member of SEATO. These were the formative years when common perception in Pakistan began assuming China as its national saviour.

In the 1970s, the international situation took a definite turn. East Pakistan underwent a violent uprising and China while keeping an eye over events shaping up in South Asia, was also in a dilemma over how to sustain its relationship with Pakistan.

¹ “China-Pakistan celebrate 55th year of friendship”, <http://www.gov.cn/misc/2006-02/22/content_206699.htm>.

Chinese helplessness in supporting Pakistan during the Indo-Pakistan War of 1971, because of cold weather and the Russian buildup on its frontiers, however, did not affect the bilateral relationship. China made up for its earlier helplessness by vetoing Bangladesh's entry into the UN, an event that could take place only after Pakistan itself had recognized Bangladesh.² As a result, the popular perception of China as a trusted ally of Pakistan was solidified. By 1979, the power center had shifted in China and the Chinese economy was opening up under the new leadership of Deng Xiaoping. Deng's main plank, that economic relation precedes all other forms of relationship, changed the dynamics of Chinese foreign policy, which shifted closer to the United States. By the 1980s, China had become the most trusted ally of Pakistan. The improvement in relationship between China-Soviet Union and China-India pushed China to shift on some of the issues it supported Pakistan on. However, the core of the relationship stood firm even after the Cold War, collapse of the Soviet Union and the 9/11 attacks on the US.

ECONOMIC RELATIONSHIP

Some components of the economic relation between the two countries are bilateral trade, mutual investments (direct/portfolio or both), joint ventures and aids/loans provided to each other. Taking into account these variables, contemporary China-Pakistan economic relation appears quite underdeveloped.

Bilateral Trade
Table 1

China's Total Trade Volume with Pakistan and other countries

Year	1997	1998	1999	2000	2001	2002	2003	2004	2005
Pakistan*	1.07 (20.21)	0.915 (18.74)	0.971 (17.21)	1.09 (18.88)	1.30 (19.93)	1.80 (19.47)	2.43 (23.38)	3.1 (27.90)	4.26 (34.98)
India	1.83	1.92	1.98	2.77	3.60	4.94	7.6	13.6	18.73
SAARC	3.9	3.89	4.15	5.35	6.43	8.31	-	-	-
ASEAN	25.06	23.66	27.20	38.55	41.80	54.76	78.2	105.9	120
Japan	60.81	58.02	66.16	83.20	87.88	101.97	130	167.9	200
USA	49.03	54.99	61.49	83.30	80.61	97.31	126	169.4	211.63

(Billion Dollars)

* The figures in brackets refer to the Total External Trade Volume of Pakistan in billion dollars.

(Sources: United Nations, Statistical Yearbook for Asia and Pacific,³ IMF, Direction of Trade Statistics and various other sources⁴ and Economic Survey of Pakistan 2005-06).

² John W. Garver, "Sino Indian Rapprochement and Sino Pakistan Entente", *Political Science Quarterly*, Vol. 111, No. 2 (Summer, 1996), pp. 323-47.

³ United Nations Economic and Social Commission for Asia and the Pacific, *Statistical Yearbook for Asia and Pacific (1989, 1993, 2003)*, Bangkok.

⁴ International Monetary Fund, *Direction of Trade Statistics Yearbook 2001*, Washington.

Table 1 distinctly shows that the economic relationship between China and Pakistan has been minimal. Over the years, China's trade with Pakistan has been a fraction of its trade with other trading partners like ASEAN, Japan and the US. Even on Pakistan's side, the trade volume with China has been of little significance. As the table shows, China's share in Pakistan's external trade was less than six per cent till 2000. This share crossed ten per cent only in 2003, almost 25 years after the opening up of Chinese economy. Even in the terms of Chinese trade with South Asia, Pakistan's share was a paltry 20-25 per cent on an average before Chinese trade agreements with India came into force. Once India-China trade took-off, the percentage of Pakistani trade has gone down on even the South Asia level.

Export/Import

Table 2

China's exports to Pakistan and South Asia (in million dollars)

Year	1977	1979	1982	1985	1989	1991	1992	1993
China's Total Export (\$Bn)	7.6	13.7	22.0	27.4	52.6	72.0	85.0	91.7
Pakistan	49	122	203	185	368	597	551	752
India	1	-	101	84	169	144	158	255
Bangladesh	17	-	90	76	192	204	215	187
Sri Lanka	28	95	37	61	69	118	104	137
Nepal	-	-	21	17	27	32	35	34

Year	1994	1995	1996	1997	1998	1999	2000	2001	2002
China's Total Export (\$Bn)	121.0	148.8	151.1	182.8	183.7	194.9	249.2	266.1	325.6
Pakistan	606	789	623	692	525	581	637	718	1243
India	572	765	698	938	1016	1162	1503	1903	2673
Bangladesh	370	633	656	697	661	701	857	958	1068
Sri Lanka	146	239	192	245	292	259	391	395	338
Nepal	40	53	37	58	67	207	199	149	105

(Source: United Nations, Statistical Yearbook for Asia and Pacific⁵ and IMF, Direction of Trade Statistics⁶).

Table 3

China's import from Pakistan and South Asia
(Million Dollars)

⁵ United Nations Economic and Social Commission for Asia and the Pacific, *Statistical Yearbook for Asia and Pacific (1989, 1993, 2003)*, Bangkok.

⁶ International Monetary Fund, *Direction of Trade Statistics Yearbook 2001*, Washington, pp. 166-68.

Year	1977	1979	1982	1985	1989	1991	1992	1993
China's Total Import (\$Bn)	7.2	15.7	18.9	42.3	59.1	63.8	80.6	103.9
Pakistan	19	30	143	58	224	89	92	96
India	1	-	81	39	102	120	811	416
Bangladesh	17	-	22	12	35	9	6	8
Sri Lanka	52	62	7	13	4	5	6	6
Nepal	-	-	4	2	5	1	1	2

Year	1994	1995	1996	1997	1998	1999	2000	2001	2002
China's Total Import (\$Bn)	115.6	132.1	138.8	142.4	140.2	165.7	225.1	243.6	295.2
Pakistan	162	223	342	379	390	390	456	582	557
India	321	398	719	897	908	826	1273	1700	2274
Bangladesh	17	45	34	50	26	14	17	17	32
Sri Lanka	6	2	4	9	6	9	11	6	11
Nepal	2	0	3	10	5	8	7	5	5

(Source: United Nations, *Statistical Yearbook for Asia and Pacific*⁷ and IMF, *Direction of Trade Statistics*⁸).

China's exim relations with Pakistan are depicted in Tables 2 and 3. In the initial years, export from Pakistan was greater. During the Korean War, Pakistan's exports of cotton and jute had boomed but soon fell back to pre-War levels. Pakistan's main items of export were raw cotton, raw wool and jute, which had a huge market in China. On the other hand, Chinese products were less popular in Pakistan because of strict import control regulations and competition from western products. The main items of Chinese export to Pakistan were machinery, cement and other capital goods. The quantity, however, was not substantial. After first trade agreement was signed in the wake of border settlement treaties of 1963, where both countries accorded Most Favoured Nation (MFN) status to each other, it was resolved that they would engage in barter trade due to shortage of hard currency. However, Chinese trade suffered as a result because Pakistan used to exchange cotton, hides, wool and rice with coal, iron and steel manufactures, cement and other goods from China. The quality of Chinese finished goods was, however, starkly inferior to the goods coming from other countries and this led to a fall in their demand with suppliers in Pakistan giving minimal preference for Chinese goods. It was one of the major reasons, which stalled the growth of Chinese trade with Pakistan,⁹ and it remains true even today.

⁷ United Nations Economic and Social Commission for Asia and the Pacific, *Statistical Yearbook for Asia and Pacific (1989, 1993, 2003)*, Bangkok.

⁸ International Monetary Fund, *Direction of Trade Statistics Yearbook 2001*, Washington.

⁹ "Chinese locomotives found defective", *The Dawn*, 5 March 2005.

According to the data provided by the Economic Survey of Pakistan, the share of cotton manufactures in Pakistan's export during 2005-06 is 58.4 per cent. Since 1992, this ratio has fluctuated between 57-63 per cent. If leather is added, both constitute almost 65 per cent of total export in 2005-06, which negates all claims of diversification of Pakistan's export.¹⁰ Though the situation is better today than the early sixties, when Pakistan's major export item was raw cotton, everything still revolves around cotton. An additional problem is that China itself is a big exporter of cotton manufactures. Due to the developing nature of their economies, both countries are competing with each other in some regions of the world. The availability of Chinese textiles at lower prices leads to tough competition for Pakistan's textile manufacturers. Due to these structural and market factors China is not one of Pakistan's major export markets of Pakistan. Pakistan's biggest export markets are the US, United Kingdom, United Arab Emirates and Germany. China does not even figure in the list of top ten export destinations.¹¹

As far as imports are concerned, China has become one of the top five import sources of Pakistan after the opening of its economy. China supplies the bulk of cheap commercial goods all over the world and in the process for Pakistan as well despite a common preference for western goods in Pakistan's market. The cost of goods plays a big role in increase of imports from China. Nevertheless, for Pakistan, China matters much as an import market but for China, importance of Pakistan as a market is almost insignificant. Chinese trade with its East Asian and South-east Asian neighbours is very large in volume, by comparison. China exported \$124.2 billion worth of goods to its Six East Asian neighbours in 2003 and \$168.8 billion in 2004. In comparison, to the rest of Asia minus Japan and the Middle East, China only exported goods worth \$28.6 and \$40.4 billion dollars in 2003 and 2004 respectively.¹² This category includes many countries besides those from South Asia and where Pakistan stands, what share it gets and its subsequent importance as a market for China can be easily deduced.

Mutual Investments

The net inflow of foreign private investment from China to Pakistan is illustrated in Table 4.

Table 4
Net Foreign Private Investment from China to Pakistan
(Million Dollars)

Year	2001-02	2002-03	2003-04	2004-05
Amount	0.3	3	14.3	0.4

¹⁰ Pakistan Ministry of Finance, *Economic Survey 2005-06*, p. 130, <http://www.finance.gov.pk/survey/sur_chap_05-06/09-trade.PDF>.

¹¹ Pakistan Ministry of Finance, *Economic Survey 2005-06*, p. 131, <http://www.finance.gov.pk/survey/sur_chap_05-06/09-trade.PDF>.

¹² World Trade Organization, *International Trade Statistics 2005*, <http://www.wto.org/english/res_e/statis_e/its2005_e/its05_appendix_e.pdf>, pp. 221-22. The six East Asian neighbours are Hong Kong, Malaysia, South Korea, Singapore, Taiwan and Thailand.

(Source: State Bank of Pakistan, Statistical Bulletin¹³).

The above data shows that private entrepreneurs in China are not enthusiastic about investing in Pakistan. According to one data, out of 400,000 Chinese private investors, only 31 are still present in China.¹⁴ The rest left after the threat of destabilization became prominent following the unrest in Balochistan and Waziristan. Whatever investment comes from China to Pakistan, comes from the government of China or by government-owned Chinese companies. The rate of private investment, which was growing in Pakistan till 2003-04, is now on the decline. As far as overall foreign investment in Pakistan by China is concerned, the Board of Investment of Pakistan does not consider China as a major source of FDI. In its list, China does not figure in the top 12 countries.¹⁵ It is only when investment from Hong Kong is added with Chinese investment that the FDI figures improve.¹⁶ This is in contrast with the figures given by Pakistan's Prime Minister Shaukat Aziz, in December 2004, where he said that China has \$4 billion of investment in Pakistan.¹⁷

Most of the investment in Pakistan is either in the form of grants, loans, aid or is in the pipeline. Pakistan is one of the major beneficiaries of Chinese aid, loans and grants. Since 1970, it has remained one of the largest destinations for Chinese support. In 1979, China disbursed \$4960 million, out of which Pakistan got \$620million, which amounts to 13 per cent of the total. Even at the Donors' Conference, held in Pakistan to help October 2005 earthquake victims, China promised to pay \$814 million. The money for the development of projects like Gwadar in Pakistan is an example of Chinese grants, aid or loans to Pakistan.

Joint Ventures

Joint ventures by China and Pakistan are evident from some of the following examples. During Musharraf's visit to China in March 2006, the latter agreed to invest \$12 billion in Pakistan, apart from \$500 million, which will be used to establish a joint venture company.¹⁸ Some aspects of these joint ventures are interesting. While the Karakoram highway has been built to bear the load of tanks, the Pakistan Aeronautical Complex is producing fighter aircraft in collaboration with China and the Gwadar Sea Port has been declared a sensitive defence zone. Though joint ventures with China exist in other areas as well, like in steel, heavy engineering and motorcycles manufacturing, the bigger projects are invariably in public sector and have strategic orientations.

Public sector

¹³ State Bank of Pakistan, *Statistical Bulletin*, July 2006, p. 140,

<http://www.sbp.org.pk/reports/stat_reviews/Jul_06/Pakistan_Balance_of_Payment.pdf>.

¹⁴ Government of Pakistan Privatisation Commission, "Hafiz Sheikh assures full support to Chinese company",

<<http://www.privatisation.gov.pk/Handout/HO-AR-05/August-05/Handout%20August%202005.htm>>.

¹⁵ Government of Pakistan Board of Investment, "Investment Indicators - FDI shares by country",

<http://www.pakboi.gov.pk/Biz_Guide/investment_indicators.html>.

¹⁶ Government of Pakistan Board of Investment, "China Brief",

<http://www.pakboi.gov.pk/Country_Brief/China.pdf>.

¹⁷ "China, Pakistan to strengthen defence ties", *Dawn*, 17 December 2004,

<<http://www.dawn.com/2004/12/17/top2.htm>>.

¹⁸ "China will invest US\$12 billion in Pakistan", *Shanghai Daily*, 9 March 2006.

- Karakoram Highway.
- Pakistan Aeronautical Complex, Kamra.
- Gwadar Deep Sea Port
- Chashma Nuclear Power Plant.
- Indus Highway.
- Thar Coal Development
- Saindak Metal (Copper/Gold) Project.
- Pakistan Cycle & Industrial Cooperative, Lahore.

Private sector

- Saigols Qingqi Motors Ltd.
- Zhongxing Telecom (Pvt) Ltd.
- Sino-Pak Metal Foundry in Nooriabad
- Sehala Chemical Complex
- Pak Glass Ltd. Glass Industry
- Saif Nadeem Ltd.
- Haier Home Appliances

INDISPENSABLE PAKISTAN

Pakistan is very important for China because it is one of the mid-range powers of South Asia.¹⁹ Its geographical location puts it on the main route between China-Middle East and China-Central Asia. To maintain economic and strategic connectivity with these regions, China requires safe passage through Pakistan. This has acquired greater relevance after China became the second largest importer of oil in world.²⁰ Second, despite being one-fourth of India in size, population and resources, Pakistan has been able to keep Indian attention engaged on the western front. As a result, China has remained relatively free from any heavy pressure on its south-western border. Besides, China has also gained a moral high ground where it clubs India with Pakistan and frowns at any comparison of India with itself. Since in future, India's emergence as an undisputed power of South Asia can jeopardize the Chinese ambitions of leading Asia and ultimately posing a challenge to the US hegemony, a strong Pakistan in the Chinese camp is beneficial as it ensures that Indian claim of regional overlordship will not go unchallenged.²¹

Moreover, if China ignores Pakistan, Pakistan may completely slide into the American camp or get destabilized; both of which are not to China's advantage. In the latter case, particularly, the effects might spill over into the Chinese province of Xinjiang and create fresh problems. On the strategic front, the Chinese dream of getting a foothold in the Indian Ocean, without having an aircraft carrier, is being fulfilled with the development of Gwadar port. Given the presence of the US Navy's Fifth Fleet in the Persian Gulf, it is a big strategic feat to have a Chinese presence at

¹⁹ John W. Garver, "Sino Indian Rapprochement and Sino Pakistan Entente", *Political Science Quarterly*, Vol. 111, No. 2 (summer, 1996), pp. 323-47.

²⁰ David Zweig and Bi Jianhai, "China's Global Hunt for Energy", *Foreign Affairs*, Vol. 84, No.5, September-October 2005, p. 28. It was 50.9% in 2003 and 45.4% in 2004.

²¹ John W. Garver, "Sino Indian Rapprochement and Sino Pakistan Entente", *Political Science Quarterly*, Vol. 111, No. 2 (Summer, 1996), pp. 323-47.

Gwadar.²² Furthermore, with the growing involvement of the United States in Asia, starting with Afghanistan, air bases in some Central Asian states and strong naval presence in East and South-east Asia, China feels that it is getting encircled. The 1996-97 Taiwan Straits Crisis and the Indo-US nuclear deal further reinforced this feeling. These, individually or combined, increases the importance of Pakistan as an ally of China.

Importance of Economic Relations

It is evident from the above exposition that the nature of China-Pakistan relationship has been military-strategic for the past six decades. But international politics has changed today China has already become a major trading partner for India. Sino-Indian trade has improved and is expected to cross the \$20 billion mark soon.. This growing economic relationship has resulted in a shift in Chinese policy on some core issues. China has shifted its stand on the Kashmir issue and instead of using phrases like “self-determination” and “UN Resolutions”, it considers this as bilateral issue to be solved through peaceful negotiations.²³ On the issue of deterrent support, China switched positions, during the Kargil conflict of 1999, and refused to help Pakistan.

Having noticed these changes, Pakistan is now trying to enlarge its trade basket as well as the overall trade volume. Pakistan needs an economic foundation which will cement its relationship with China. Bilateral economic relations have gained prominence in the twenty-first century, especially after Chinese Prime Minister Zhu Rongji’s visit to Pakistan in May 2001. Zhu concluded three agreements, one of which was to develop Gwadar Port. Subsequently, China-Pakistan signed a Preferential Trade Agreement in November 2003. In 2004, bilateral trade crossed the \$3 billion mark and by April 2005, both countries were mulling a Free Trade Agreement. In 2006, the Early Harvest Program was launched to encourage bilateral trade, under which China will extend zero-rated tariffs on 767 items while Pakistan would reciprocate by extending the facility on 464 items.²⁴

CONCLUSION

It has been amply illustrated that China-Pakistan economic relations were carried on at a minimal level for the last five decades. The reasons for this low-key relationship can be summarized as follows. First, while cheap Chinese products could initially take over Pakistani market, the craze disappeared once people realized that they were of low quality, with almost no guarantee by the company. This was true for both small items, like shoes, as well as bigger items, like locomotives. Pakistani businessmen preferred to sell western goods due to the better demand for them. Since Chinese brands were not as famous as the western ones, so the competition usually went against China..

²² David Zweig and Bi Jianhai, “China’s Global Hunt for Energy”, *Foreign Affairs*, Vol. 84, No.5, September-October 2005, pp.33-35.

²³ John W. Garver, “Sino Indian Rapprochement and Sino Pakistan Entente”, *Political Science Quarterly*, Vol. 111, No. 2 (Summer, 1996), pp. 323-47.

²⁴ Zhang Lijun, “Closer ties”, *Beijing Review*, Vol. 49, No. 2, 12 January 2006, <<http://www.bjreview.com.cn/06-02-e/w-3.htm>>.

Second, despite being neighbours, there was a lack of effective means of communication between them. The Karakoram Highway, which opened in 1978, could not be used to increase the volume of trade in any substantial manner. One primary reason is that, since the highway crosses through tough geographical regions inundated by landslides and shifting of glaciers, the road remains unfinished. In particular, the road between the Khunjerab Pass and Sust, a frontier town in Northern Areas of Pakistan, is very dangerous and discourages heavy traffic. The road also remains closed on account of political reasons. During the 1990s, when Pakistan was going through Islamic extremism and religious fundamentalism, the fear of this spreading into already disturbed Xinjiang made China discourage any contact between Xinjiang and the Northern Areas of Pakistan.²⁵ A number of Pakistan's citizens were arrested and even executed in China. Thus, this road has not been able to facilitate transportation of goods. In addition, an underdeveloped shipping industry in Pakistan further limits the trade routes and discourages the growth in trade volume.

Third, political factors are also significant because unrest in Pakistan discourages investors from China. Musharraf has promised to create a Special Economic Zones for Chinese Investors, but until the political situation is stabilized, no major investments in Pakistan are likely. The present trade takes place only through the Chinese public sector. But that has limited expansion scope, since China itself is privatizing all state owned enterprises. If both countries desire to take the economic relations to a respectable level, private investment from China would be imperative.

Fourth, to improve the trade volume, the trade basket has to be enlarged. Pakistan's cotton based industry is the main pillar of its exports. Since China itself is a major textile manufacturer, trade volume will not rise if it remains based on only one commodity.

Nevertheless, the low trade volume does not mean that China-Pakistan relations are weakening. Pakistan is very significant for China for several reasons. Pakistan is China's strongest link to the Islamic world and China is not going to abandon Pakistan even if its relations with India improve. On the contrary, recent reports indicate that China-Pakistan military-strategic relations are improving in the wake of Indo-US nuclear deal. China's promise to deliver Pakistan a nuclear reactor and develop the Gwadar Port, which has the facility to berth destroyers and other naval vessels, indicate such a trend. The opening of the bus service projects the desire of extending the cultural relationship as well. However, development in Sino-Pak economic relations is necessary to buttress developments in other areas of this bilateral relationship

²⁵ Hayder Mili, "Xinjiang: An Emerging Narco-Islamist Corridor", The Jamestown Foundation, 26 April 2005, <http://www.jamestown.org/news_details.php?news_id=108>.