

TRADING & ENERGY CORRIDORS¹

Future Prospect

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I would like to analyze the topic of Trading and Energy Corridors in the larger context of Pakistan's foreign economic policy. So far we have pursued our foreign policy largely on the basis of political, security and non-economic considerations. My argument is that it is a high time that we should revisit this experience of past 67 years in the light of the emerging global, regional and national trends and see whether this policy needs to be altered and modified. I would therefore begin by briefly placing before you the current and future trends.

At the global level

- (a) We are seeing a transition from industrial economy to knowledge economy in which physical, natural and raw human resources would not count that much. It would be the skills, ingenuity and creativity that will be the drivers of growth. Technological advances and information explosion can help nation states only if they prepare themselves with the requisite absorptive capacity to assimilate and apply the technology.
- (b) There is a shift in the world's economic center of gravity from the West to Asia. China has already become world's largest exporting nation and is likely to overtake the U.S. in becoming the largest economy of the world in Purchasing Power Parity (PPP) terms by 2016/17. In less than two decades the Asian economies will surpass the U.S and Europe combined as the ascendant region in terms of share of global output, investment and population.
- (c) Integration of markets and interdependencies of economics induced by trade, global supply Chains, financial flows, worker remittances information flows, production hubs would pose many challenges but also generate enormous benefits for nation-states.

¹ A paper presented at the International Seminar on "Crossroads Asia: Dynamics of Peace and Progress" organized by the National Defence University at Islamabad on February 11, 2015.

- (d) Climate change will spawn shift from conventional carbon based energy sources, create scarcity of water resources, and make food security and availability more uncertain for the burgeoning population.
- (e) Demographic changes – ageing population and high dependence ratios in Japan and Europe while younger population in South Asia and Sub Saharan Africa would alter the composition of world labor force. How far the demand for labor emanating from the Advanced economies can be met by the supply of requisite skills available in the emerging economies remains an open question.

At the regional level

- (a) China and India would occupy the first and third places in the ranking of world economies with annual GDP approximating over \$ 200 trillion. They would have a market of more than billion middle class consumers while at the same time sourcing their raw materials, components and parts for production and exports from the rest of the world.
- (b) India is being bolstered by the leaders in the US, Japan, UK, Australia as a success story for rapid economic development under a democratic system challenging the popular paradigm that rapid growth is possible only under authoritarian and non-democratic regimes. India's self confidence in its own capabilities, the strong political leadership and a dynamic private sector are reinforcing this perception.
- (c) Afghanistan is at the junction of a road that can either lead to progress, prosperity and peace for its 25 million people or an alternative path that will perpetuate the misery, civil strife and instability that has been their fate for over past 35 years.
- (d) Iran is asserting to occupy its rightful place as a responsible member of the community of nations. The internal power struggle and external threats have not made this task easy but the people of Iran have clearly voiced their preference in favor of a break from the past.
- (e) India has repaired its bilateral relations with Bangladesh and is currently engaged in doing so with the new regime in Sri Lanka. Free Trade agreements with both these countries and electricity supply to Bangladesh are fortifying the economic links.

- (f) Central Asian Republics are exploring options to diversify their markets for energy supply and are interested in least cost trading routes and shipping lanes

Given the above global and regional trends it is obvious as to what should be the objective of our foreign economic policy. The primary objective, in my view should be to maximize the opportunities offered by globalization and regional cooperation for the benefit of the majority of Pakistan while at the same time skillfully managing the threats to Pakistani economy. It is my considered opinion that Pakistan can double its per capita income and reduce poverty levels significantly within the next 10-12 years if we are able to implement the policy aimed at attaining this objective.

This may appear as a pipe dream in the midst of all difficulties we are facing today. But let me remind you that Pakistan's own past record has been much better than what we have experienced in the last six years. Pakistan growth rate of 6 percent plus in the 1960s, 1980s, and early 2000s has been a source of envy among many developing and emerging economies. Disparate counties in East Asia such as Indonesia, Malaysia, Thailand and Viet Nam have demonstrated that international trade and regional economic cooperation can bring about a miraculous change in the living standards of hundreds of millions of impoverished people. Poverty levels in East Asia that were much higher than Pakistan are now among the lowest in the world while per capita incomes that were much lower are many times more than that of Pakistan . Our foreign economic policy should therefore be tailored to use our strategic location to our best economic advantage. So far our location has been a source of instability and worries to us as a nation.

What should be the contours of such a policy?I would like to limit my remarks this morning to this region alone and that too with the neighboring countries – India, Afghanistan, Central Asian Republics Iran and China.

First, there must be a realization that the past policy of strategic competition particularly with India hasn't worked well and perhaps there is a need to shift the gears and work on the primacy of economic cooperation – trade and energy. This does not, by any means, imply that we should give up our principled stand on Kashmir or other disputes with India but follow the example of China. Although both these countries have boundary disputes the bilateral trade between China and India has exploded to \$ 75 billion annually. We should not wait any longer and phase out the remaining items on the negative list and confer Non Discriminatory

Market Access NDMA to India as 85 percent of tradable items have already been permitted. Why drag on the feet for a paltry 15 percent? Why not win international goodwill and economic gains for the country?

Second, our Free Trade agreement with China has been lack luster as far as benefits accruing to Pakistan are concerned. We should review and revisit the agreement and build mechanisms whereby we are able to capture at least 0.5 percent of Chinese imports of over \$ 2 trillion plus.. Links to the Western provinces through China Pakistan Economic Corridor would certainly boost trade creation. Investment and technology transfer from China should be given priority for building long term capability.

Third, Afghanistan being a land locked country needs Pakistan badly for its economic sustenance and progress. The image of Pakistan has been tarnished due to the chequered history between the two countries. It is quite an opportune time with the new government in place that we should extend our full cooperation to Afghanistan through trade, investment, technical know-how etc. Our participation in their economic revival would wash away to some extent our tarnished image and help build some trust. We should seriously consider entering into a Free Trade Agreement with Afghanistan and later to form a Customs Union.

Fourth, the Iran-Pakistan gas pipeline would be good test for the sincerity and sustainability of future economic cooperation between the two countries. A lot of progress has been made and a number of obstacles have been surmounted. We should do our best to get a waiver from the U. S. for this very critical project. In addition, we should accept Iran's offer for supplying 3000 MW of electricity at prices much lower than our Furnace oil fired power plants.

Fifth, the establishment of Special Economic Zones in the border areas with India, Iran, Afghanistan and China can also help create economic activity through forward and backward linkages and thus help in reduction of unemployment and poverty. Except Wagah-Attari most of the border areas are relatively backward. These zones would also contribute towards narrowing regional economic disparities.

Pakistan's exports have stagnated around \$ 25 billion annual for last several years. It is so unbelievable that being located between two large and dynamic economies of the world that we are losing out world market share every year not only in aggregate but also in Textiles and Clothing. This is an item in which we enjoy major competitive advantage compared to Bangladesh which has now over taken us in world market share.

All studies carried out so far by international financial institutions, research institutes, academic scholars are unanimous that normalization of trade with India would multiply the volume of trade manifold. A lot of informal trade that is taking place through third countries or illegal channels would also be diverted. Consumers, producers and Government revenues would all benefit from this normalization. We are not talking of any preferential treatment but doing business with India as we do with all other countries in the world. Reasoning and rational thinking rather than emotions should guide our policies. It is a pity that India-Pakistan trade offering substantial opportunities for employment, price stability and growth has remained hostage to the primacy of bilateral political disputes.

Pakistan is facing one of the worst energy crisis for last several years that is retarding industrial output and exports, contributing to slow down of economic growth and also creating deep dissatisfaction among 20 million consumers of electricity in the country. The current system peak load of 24,000 MW is projected to rise to 30,000 MW by 2016-17 and 40,000 MW by 2021-22. Investment shortfalls, poor fuel mix, weak governance and enforcement, institutional failures and perverse incentives have created stress in the economy and society. This wide growing gap between the demand and domestic supply can be met through a combination of regional cooperation and national policy and institutional measures. What is required on the national policy and institutional front is known and discussed quite widely. I would therefore focus in this session on the scope of regional cooperation and integrated power market.

Regional power market can realize economies of scale for generation capacity additions through larger projects that exploit complementarities and comparative advantage. Such a market will result in increased access to lower cost supplies. Besides efficiency in generation, optimized transmission would increase grid stability and reliability through provision of multiple links, increased availability and access to cleaner affordable sources of supply (hydro, natural gas, LNG) and increased use of renewable sources such as solar and wind would reduce environment costs. The other advantage of such a market would be that competition in wholesale power provision would help the consumers by paying affordable price of electricity. A number of cross-border projects that are underway or at the design or planning stage should be brought to fruition sooner than later. These projects include

- (a) LNG Supplies for the newly built terminal at Port Qasim and proposed at Gwadar

- (b) Turkmenistan- Afghanistan-Pakistan-India (TAPI) gas pipeline project would have the capacity to supply 33 billion cubic meters of natural gas a year to Afghanistan, Pakistan and India over 30 years.
- (c) Iran-Pakistan pipeline would transmit 750 MMCFD gas from South Pars field of Iran line. Government of Pakistan is planning to lay down the 70km from Gwadar to Iran border followed by 700 km from Gwadar to Nawabshah for onward transmission to the northern parts of the country.
- (d) The Central Asia and South Asia (CASA) 1000 project will allow surplus hydropower from the Krygz Republic and Tajikistan to flow to Afghanistan and Pakistan by 2017-18. Some 1000 MW of clean electricity capacity would be available for Pakistan and 300 MW for Afghanistan through high voltage transmission infrastructure and systems linking the country.
- (e) India is ready to supply 1000MW to Lahore through Amritsar.
- (f) Iran has offered 3000 MW through Baluchistan.

Most of these projects are hanging on for several years and need to be finalized and implemented expeditiously. What are the barriers that need to be removed from developing a Regional electricity market?

- (a) Lack of adequate cross-border transmission links and harmonization of standards and procedures enhance costs.
- (b) Poor operational efficiency, financial performance and creditworthiness of the region's utilities and governments make the projects unattractive for investors.
- (c) Institutional and regulatory frameworks for planning and investment are weak.
- (d) Lack of transparency in setting pricing, tariffs, opaque and complex subsidies stifle competitive forces and thus adversely affect consumer welfare.
- (e) Deep mistrust between the governments in the region particularly between India and Pakistan heightens the political risk.

These barriers can be removed through investment, institutional strengthening and incentives to the private investors. They are not insurmountable but require quick decision making, problem solving and better implementation capacity on our side.

To sum up, the main argument advanced in this paper is that the imperatives of present and future trends on the global and regional level dictate that Pakistan should become an active beneficiary of globalization and regional economic cooperation. In turn, this calls for a paradigm shift in our foreign policy from the primacy of political, security and non-economic factors towards trade, investment and energy. World trade grows twice as fast as world output and every country that has grown rapidly has taken advantage of world and regional trade. Pakistan cannot afford to be marginalized in South Asia region if other countries enter, into bilateral or sub regional Free Trade and Investment Agreements.

Pakistan is facing and likely to face energy shortages. Regional electricity and gas markets can offer a solution to this problem both in the short and medium term. If cross border energy corridor in which pipelines, terminals, transmission lines, grid stations, refineries, railway wagons, road transportation are set up and allowed to operate without let on hindrance the transaction costs of supplying energy to Pakistan can be considerably reduced. Similarly, clusters of supply chain supporting goods and services, training institutes, banking channels, effective logistics management can promote trade, economic activity and employment on both sides of the border. Trade links and energy corridors can thus become pillars of strength for Pakistani economy.