

Pakistan's Trade Potential with Turkiye

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Executive Summary

Pakistan and Turkiye have been exploring new avenues to enhance their bilateral trade relations and have signed several agreements and memorandums of understanding to boost trade and investment. Despite the potential benefits, the bilateral trade volume between the two countries remains well below its potential. Pakistan and Turkey signed a Preferential Trade Agreement (PTA) on 12th August 2022 at Islamabad, Pakistan. Our analysis shows that Pakistan and Turkey have great potential for trade, given their economic sizes and geographic proximity. The results suggest that a one percent increase in Pakistan's GDP would lead to a 1.19 percent increase in Pakistan-Turkey trade while a one percent decrease in the distance between the two countries would lead to a 0.06 percent increase in trade. Similarly, one percent increase in population decrease the trade by 1.33 percent. The paper concludes that there is a significant untapped potential for trade between Pakistan and Turkey, which could be realized through the removal of trade barriers, promotion of bilateral investment, and enhanced cooperation in various sectors such as energy, agriculture, and tourism.

Introduction

Pakistan and Turkiye¹ have been historically close to each other. Their relations go back to the time of the sub-continent and Ottoman Empire when Muslims supported the preservation of the Ottoman Empire through the Khilafat Movement. Pakistan and Turkiye are considered important countries in the Muslim World. In terms of their geographical placement, both countries have prominent geo-strategic locations. Turkiye is between Asia and Europe, both politically and economically important regions. Turkiye is also a neighbor to the region known as Eurasia that has invariably remained a focus of geopolitics. Likewise, Pakistan has an important role in trade and strategic spheres within South and Central Asia. The establishment of CPEC and the pursuit of agreements on transit trade makes Pakistan vital for regional trade and connectivity. The close diplomatic, cultural, religious, and historical factors hold great potential for enhancing economic and trade relations between Turkiye and Pakistan. Therefore, the signing of the Preferential Trade Agreement (PTA) between Pakistan and Turkiye on August 12, 2022², in Islamabad is an important development.³ The PTA is expected to boost trade and further improve political and economic engagement between the two countries.

The two countries have common interests in terms of security, trade, economy, and culture. Turkiye and Pakistan have been actively working to improve trade relations between the two countries. Bilateral trade between Pakistan and Turkiye has increased significantly in recent years, and the two countries have set a target of \$5 billion in trade by 2023. Turkiye and Pakistan have sign a Preferential Trade Agreement (PTA), to improve trade relations between the two countries. The study will analyze the effects of trade flow between two countries. The study will also investigate the trade barriers hindering the growth of trade between the two countries and recommend ways to overcome these barriers.

Pakistan and Turkiye have remained on solid political and economic terms since the independence of Pakistan. Despite intense political ties, Turkiye has a different level of engagement with Pakistan's allies, like the USA and Saudi Arabia. Under these circumstances, the signing of the PTA holds a special significance. It needs closer analyses of how it will impact current and future economic and political relationships between the two.

Bilateral trade between Pakistan and Turkiye has remained steady. The figure shows the bilateral trade between Pakistan and Turkiye⁴.

¹ Wertheimer, T. (2022, June 2). Turkey wants to be called Turkiye in a rebranding move. *BBC NEWS*. <https://www.bbc.com/news/world-europe-61671913>

² <https://tribune.com.pk/story/2370762/pakistan-turkey-sign-preferential-trade-agreement>

³ Kundi, I.A. (2022, August 13). Pakistan Turkiye signs FTA to enhance trade volume. *THE NATION*. <https://www.nation.com.pk/13-Aug-2022/pakistan-turkiye-sign-FTA-to-enhance-trade-volume>

⁴ FBR/TDAS. Provided by Mr. Salahuddin, Trade Analyst, Ministry of Commerce, Islamabad.

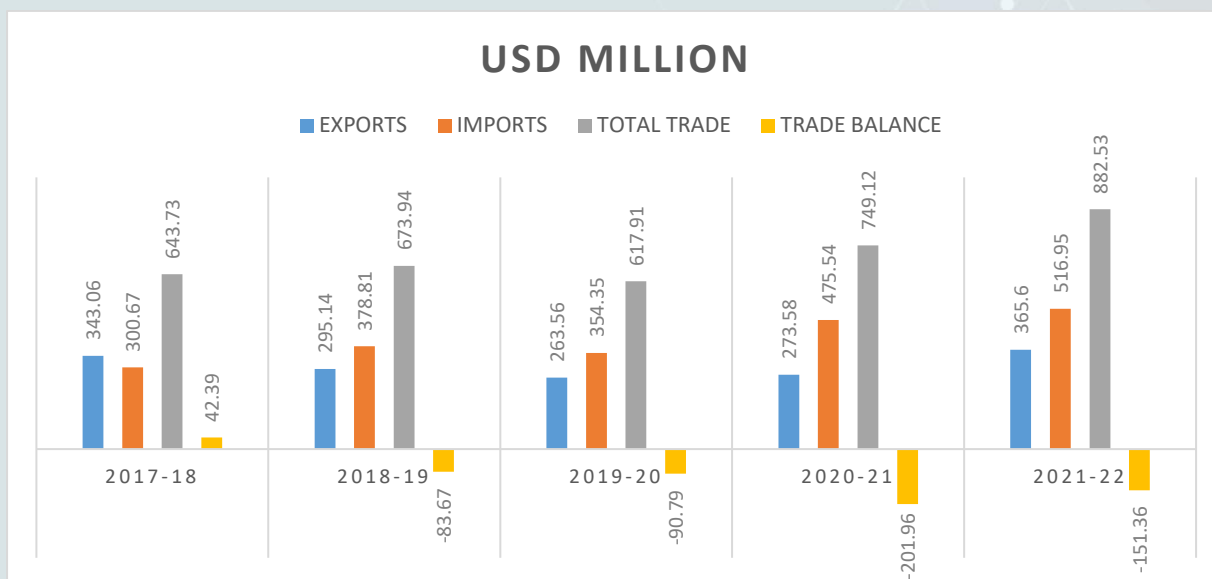


Figure 1. Bilateral Trade of Pakistan and Turkiye

Pakistan has run a trade deficit with Turkiye in the last few years. "One of the main reasons is the imposition of regulations duties to restrict import from Pakistan, especially, Textile and garments".⁵

In 2015 during the HLSCC, negotiations for Pak-Turkiye PTA were announced. Seven rounds of talks were held from October 2015 to June 2017. However, negotiations stalled afterward owing to disagreement over the inclusion of sensitive sectors for the grant of tariff concessions. The sensitive items on the Turkish side were textile, yarn, leather, and apparel. While for Pakistan, it included automobile, agriculture, milk, dairy, textile, and garments.

Under the current PTA, Turkiye has given tariff concessions on 261 Tariff Lines, while Pakistan gave concessions on 130 Tariff Lines. Considering their sensitivities, tariff concessions on textiles have yet to be provided by Turkiye. In contrast, Pakistan has excluded chemicals, HRCA (coil/sheet), dairy sector, especially whey powder, from its concession list in light of consultations held with stakeholders.

Nonetheless, Pakistan could obtain concessions on some items of its export competitiveness. These include mangoes, dates, sesame seeds, rice, surgical goods, sports goods, furniture, leather products, etc. Most importantly, concessions on some of the priority sectors reflected in STPF 2020-25⁶, including footwear, seafood (fisheries/prawns), processed food (juices, confectionaries, etc.), and light engineering goods were also obtained.

Between 2020 and 2021, Pakistan traded heavily with Turkiye. They exported \$224M worth of textiles and \$94.2M machinery cost during that period while importing the equivalent value

⁵ Mr. Bilal Pasha, ex-CG Istanbul.

⁶ STPF 2020-25. www.moc.gov.pk/

in machines, textiles, and metal products. During the same year, Turkiye also traded heavily with Pakistan, exporting \$122M worth of machinery and \$119M worth of textiles while importing \$109M worth of metal products⁷.

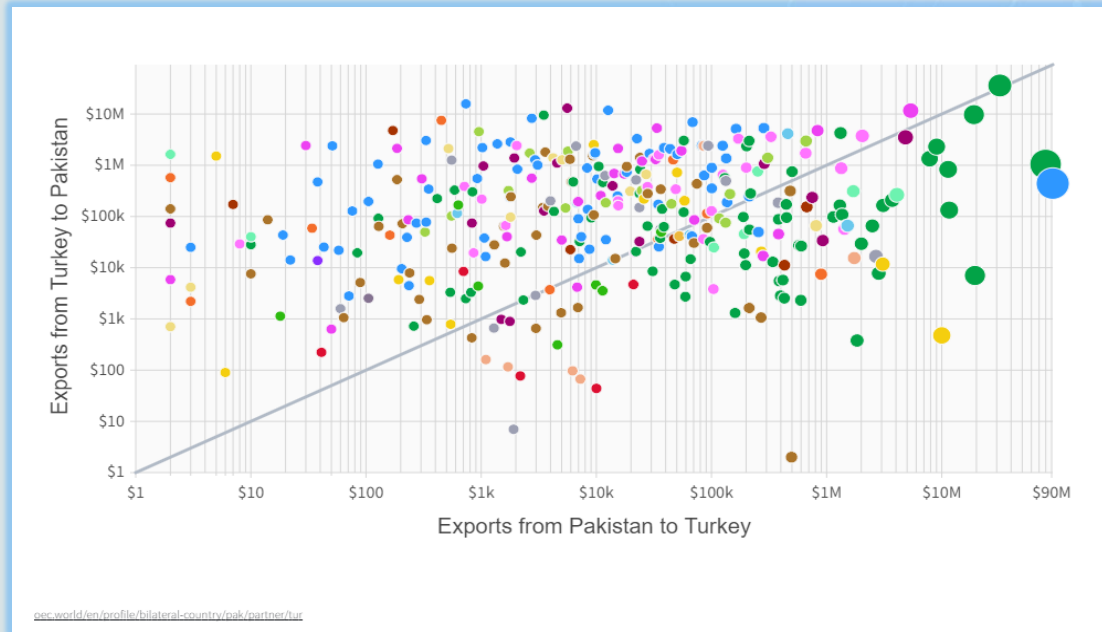


Figure 1: Exports from Pakistan to Turkiye⁸

The study contributes to the existing literature on trade relations between Pakistan and trading partners, mainly focusing on Turkiye. The study comprehensively analyzes the current state of trade relations between the two countries and identifies the key drivers of trade growth. The findings of this study will help the policymakers, trade experts, and business leaders in both countries to understand the potential of trade relations between Pakistan and Turkiye and how to further strengthen them.

⁷ http://www.cepii.fr/CEPII/en/bdd_modele/presentation.asp?id=37

⁸ OEC World

Existing Studies on Pakistan Turkiye Trade

Authors	Methodology	Key Findings
Suvankulov and Ali (2012) ⁹	Augmented gravity model	Pakistani exports to Turkiye have increased significantly since 2001, outperforming Turkish exports to Pakistan and estimates made by the augmented gravity model. Turkiye's exports to Pakistan include commodities with higher added values. Turkiye will probably gain more from the prospective free trade pact.
Ali (2017) ¹⁰	Computational general equilibrium model GTAP	Turkiye benefits more from the free trade agreement than Pakistan. Trade liberalization has an overall positive influence on both economies, but Pakistan's economy might not benefit from the deregulation of its regulated sectors, even if there is significant room for bilateral trade in the textile and chemical industries.
Khan and Khan (2013) ¹¹	Gravity model using panel data	Trade volume is positively impacted by GDP and GDP per capita, but distance and the dummy variable for cultural similarity had a negative impact. Iran, Japan, Turkiye, Malaysia, India, and Malaysia have more untapped trade effects with Pakistan.
Zaman et al. (2010) ¹²	Gravity model using panel data	Bilateral trade and per capita income were substantially connected. There is little evidence of a relationship between the distance variable and bilateral trade. Pakistan and Turkiye could benefit economically from an endeavor to enhance bilateral trade.
Khiyavi et al. (2013) ¹³	Gravity model using panel data	A nation's per capita income has a favorable and considerable impact on the amount of its agricultural trade. The expansion of the exporting and importing countries' markets affects trade in farm commodities.
Atif et al. (2019) ¹⁴	Stochastic frontier analysis on an enhanced gravity model	Import tariffs had an adverse and significant influence on chemical product exports, but devaluation had a favorable effect. All anticipated potential benefits were observed, except an insignificant effect of contiguity.

⁹ Suvankulov, F., & Ali, W. (2012). Recent trends and prospects of bilateral trade between Pakistan and Turkiye: A gravity model approach. *Journal of International and Global Economic Studies*, 5(1), 57-72.

¹⁰ Ali, A. (2017). A CGE Analysis of Pakistan-Turkiye Free Trade Agreement.

¹¹ Khan, S., & Khan, D. (2013). An Empirical Analysis of Pakistan's Bilateral Trade: A Gravity Model Approach. *Romanian Economic Journal*, 16(48).

¹² Zaman, K., Qaiser, A., Adnan, K., & Zahid, A. (2010). Empirical Evidence of Trade Integration between Pakistan and Turkiye (A Gravity Approach). *Journal of Managerial Sciences*, 4(2), 106-114.

¹³ Khiyavi, P. K., Moghaddasi, R., & Yazdani, S. (2013). Investigation of factors affecting the international trade of agricultural products in developing countries. *Life Science Journal*, 10(3), 409-414.

¹⁴ Atif, R. M., Mahmood, H., Haiyun, L., & Mao, H. (2019). Determinants and efficiency of Pakistan's chemical products' exports: An application of stochastic frontier gravity model. *PloS one*, 14(5), e0217210.

Karagoz and Saray (2022)¹⁵	Gravity model using panel data	Economic size favors trade volume between Turkiye and Asia-Pacific nations, while distance has a negative effect. The population density of the countries did not appear to have any real impact.
Gul (2014)¹⁶	Trade indices	Pakistan's trade surplus with Turkiye, significant export overlaps, and intra-industry trade would provide more potential for business efficiencies between the two nations. The planned FTA would assist Pakistan in increasing value addition and expanding the export market.
Abbas and Shujaat (2018)¹⁷	Augmented gravity models for export and import flow with panel data	SAFTA had a positive impact on Pakistan's exports, but its impact on imports was negative. Other FTAs had positive impacts on both exports and imports. Pakistan should focus on diversifying its export markets and boosting its export competitiveness.

Analysis and Discussion

Table 1 shows the results from the random effect panel gravity model. The results show that Pakistan has a positive effect on economic growth with trade from its top trading partner. It means that the 1 percent increase in GDP will increase the total trade by 1.198 percent with the rest of the trading partners. Interestingly population has adverse effects on total trade volume. It means that a 1 percent increase in population will decrease the trade volume by 1.33 percent, mainly because of the increase in domestic consumption. Lastly, remoteness is one of the important indicators showing transaction cost, as mentioned. 1 percent increase in the distance reduces the trade volume by 0.069 percent.

Table 1: Results of Random Effect Panel Gravity Model Estimations

<i>Variable</i>	<i>Coefficient</i>	<i>Std. Error</i>	<i>t-Statistics</i>	<i>Probability</i>
<i>Constant</i>	16.82575*	2.034921	8.268499	0.0000
<i>lnGDP</i>	1.198102*	0.041319	28.99614	0.0000
<i>lnPOP</i>	-1.339360*	0.163174	-8.208159	0.0000
<i>lnRemotness</i>	-0.069380*	0.010533	-6.586835	0.0000

Adj. R² = 0.9653, F-value = 668.91 [Pr.0.000], D-W = 0.697, Hausman = 0.00 [1.00]

Note: * denotes the significance level at 1%

Source: Author's own calculations

¹⁵ Karagoz, K., & Saray, M. O. (2022). Trade potential of Turkiye with Asia-Pacific countries: Evidence from panel gravity model. *International Economics Studies*, 36(1), 19-26.

¹⁶ Gul, A. (2014). Analyzing Pakistan's Trade Opportunity with Turkiye. *The Lahore Journal of Economics*, 19, 349.

¹⁷ Abbas, S. (2018). Free Trade Agreements and International Trade Flow of Pakistan: A Gravity Modelling Approach.

Pakistan's Trade Potential

The trade potential of Pakistan can be estimated after the coefficient from the gravity model estimation, as shown in Table 1. We can predict Pakistan's trade potential (FT_P) from the sample data set. To evaluate the trade potential, two approaches can be used. First is the ratio of trade potential $[\frac{FT_P}{FTA}]$, where FT_P is the trade potential, and FTA is the actual trade. After calculations, if the value is greater than one, there is a trade potential. After measures, it can be used to analyze the trade potential with respective countries. Second is the difference between trade potential and actual trade potential, i.e. ($FT_P - FTA$). A positive value indicates future possibilities, while negative values exceed Pakistan's trade potential.¹⁸

Table 1: List of countries for both classes of Pakistan's trade potential

$(FT_P / FTA) > 0$	$(FT_P / FTA) < 0$
Bangladesh, Belgium, Italy, Kenya, Malaysia, Netherlands, Poland, Portugal, Qatar, KSA, Sri Lanka, Thailand, Turkiye , UAE,	South Africa, Spain, Demark, China, Germany, Australia, Canada, France, UK, USA

Economic Complexity

The figure below is the visualization is a map of the product space. It shows products sourced from Turkiye and Pakistan, colored from blue to yellow. The closer a product is to blue, the more comparative advantage Pakistan has over Turkiye. Similarly, the closer a product is to yellow, the greater Turkiye's comparative advantage over Pakistan. This shows that there is a trade potential between Pakistan and Turkiye. Turkiye, compared to Pakistan, has a comparative advantage in many products.

¹⁸ Batra, A. (2004), India's Trade Potential: The Gravity Model Approach, Working Paper No. 151, Indian Council for Research on International Economic Relations.

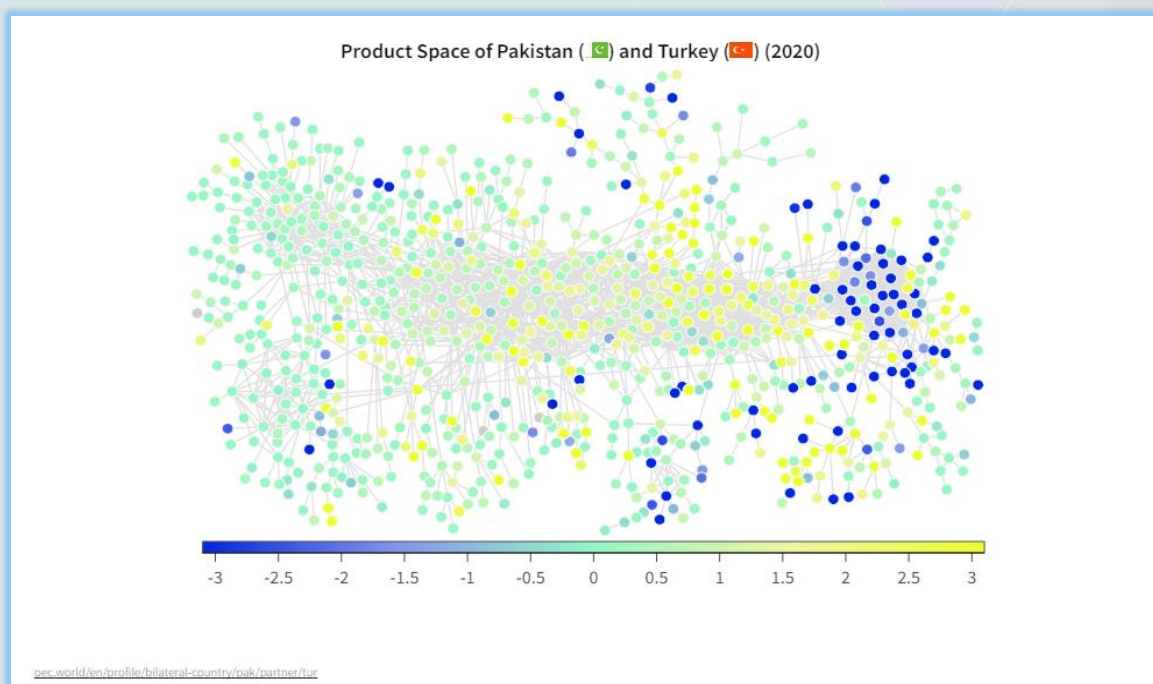


Figure 2: Economic Complexity/Product space of Pakistan and Turkiye¹⁹

Policy Recommendations

Some policy recommendations to further improve trade between Pakistan and Turkiye are:

- Simplifying trade procedures and lowering non-tariff obstacles are two areas where both governments may work together. This can be accomplished by the adoption of common standards, simplified customs processes, and the elimination of unnecessary paperwork.
- By creating a welcoming atmosphere for businesses and giving financial incentives, governments may encourage investment between the two nations.
- Only a small number of goods account for the vast majority of bilateral commerce at present. By encouraging the export of novel goods and services, governments may help diversify the trade basket.
- Developing transportation and communication infrastructure is an area that governments may put money into to ease the flow of goods and services.
- The governments may enhance economic cooperation and commerce by encouraging business partnerships between firms in both nations.

¹⁹ Source: OEC World

Conclusion

Pakistan and Turkey have a long economic relationship, however some issues must be solved in order to continue and improve the trading partnership. To begin, present commerce between the two nations is strongly skewed in favor of Turkiye, and Pakistan must minimize its trade imbalance and increase exports to Turkiye. Governments must diversify their trade baskets and encourage the export of new items and services. Second, Pakistan confronts infrastructure disadvantages, such as insufficient transportation and communication networks, which impede its capacity to engage successfully in international commerce. As a result, the government must spend in infrastructure development in order to enable trading. Third, non-tariff barriers such as customs processes and bureaucracy are substantial impediments to bilateral commerce. Governments must streamline trade procedures and eliminate non-tariff obstacles. Finally, while being a major player in the world economy, Turkiye has a small investment footprint in Pakistan. The governments must work together to promote bilateral investment by creating a favorable business climate and granting incentives to investors. Addressing these essential challenges would allow Pakistan and Turkey to strengthen their economic ties, resulting in enhanced economic growth and development in both nations.

ACTION MATRIX				
Problem	Pathways to Solutions	How to Implement Each Solution	Actors Responsible	Implementation Timeline
Trade Enhancement/Reducing Trade Deficit	<p>Facilitation in trade</p> <p>Promotion of investment</p> <p>Diversification of trade</p> <p>Expansion of infrastructure</p> <p>Encouragement of Joint Ventures</p>	<p>Simplifying trade procedures and lowering non-tariff obstacles.</p> <p>Creating a welcoming atmosphere for businesses and giving financial incentives.</p> <p>Encouraging the export of novel goods and services.</p> <p>Developing transportation and communication infrastructure</p> <p>Enhancement of economic cooperation and commerce by encouraging business partnerships between firms</p>	Mainly Ministry of Commerce, TDAP, Ministry of Finance and SBP	Medium to Long Term

About the Authors

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