

Presentation on
CPEC: Threat or Opportunity
Protecting Local Industry through
Infant Industry Theory

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CPEC: Threat or Opportunity - Protecting Local Industry through Infant Industry Theory

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 - CPEC AND PAKISTAN
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CPEC: Threat or Opportunity - Protecting Local Industry through Infant Industry Theory

- **Introduction**

- CPEC more than \$60 billion project
- It is a part of BRI or OBOR in which China is investing around \$1 trillion, connecting 60 countries with 60pc of global population, 30c of global GDP and 35pc of global trade.
- Most of the analysts believe that OBOR is the part of the imperialist design of china to expand its influence using the surplus money for infrastructure development in different countries.
- But Chinese leadership denies it by saying that OBOR is purely for infrastructure development.

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- However, if look at the structure and design of the OBOR, it has three dimension, **namely, local, regional and international.**

Local

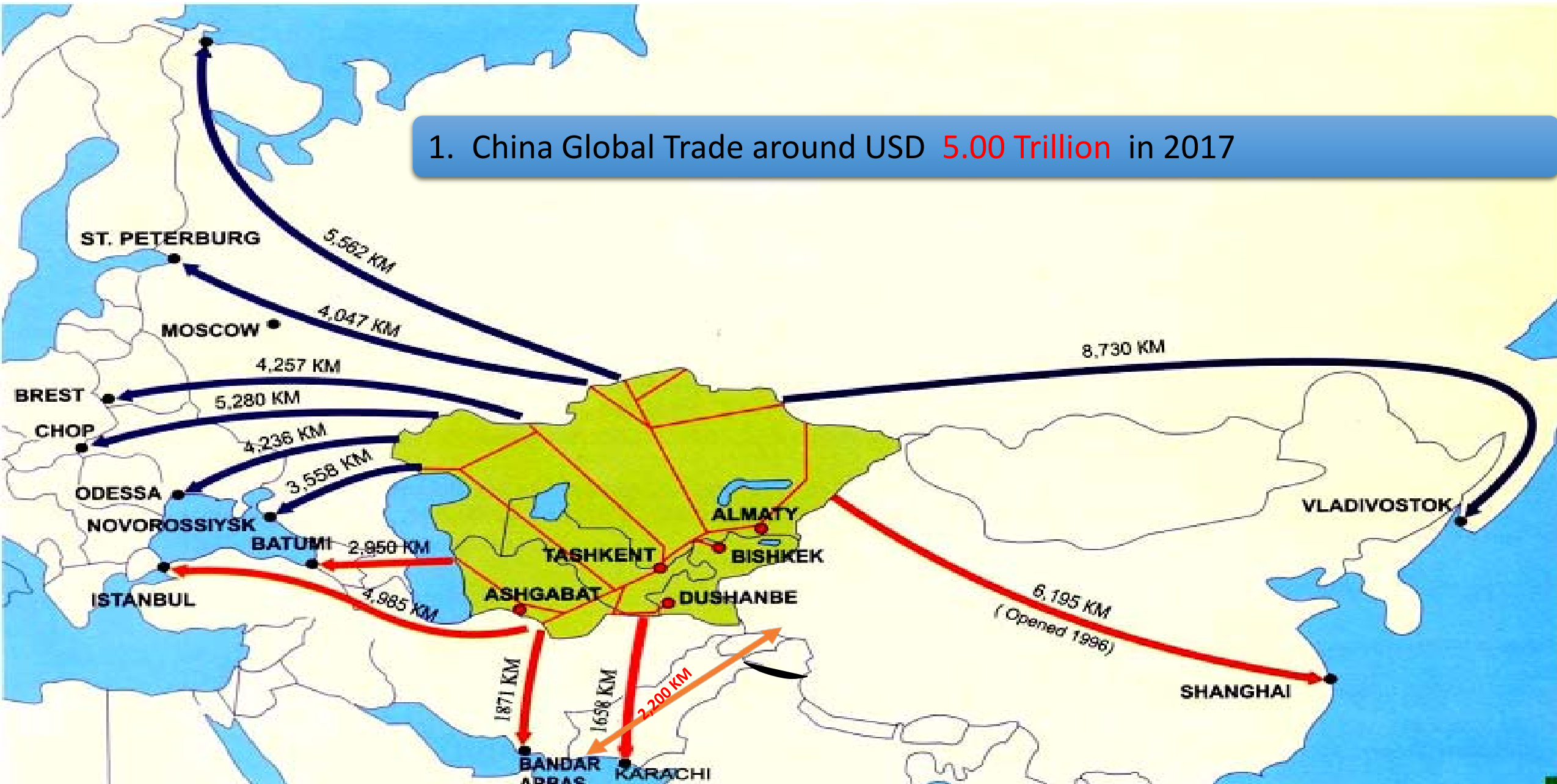


CPEC: Threat or Opportunity

Regional

Inter Regional Trade Potential

1. China Global Trade around USD **5.00 Trillion** in 2017



One belt, one road

China is pushing to revive its ancient overland and maritime silk routes to Europe. The route connects many land and sea ports over three continents.

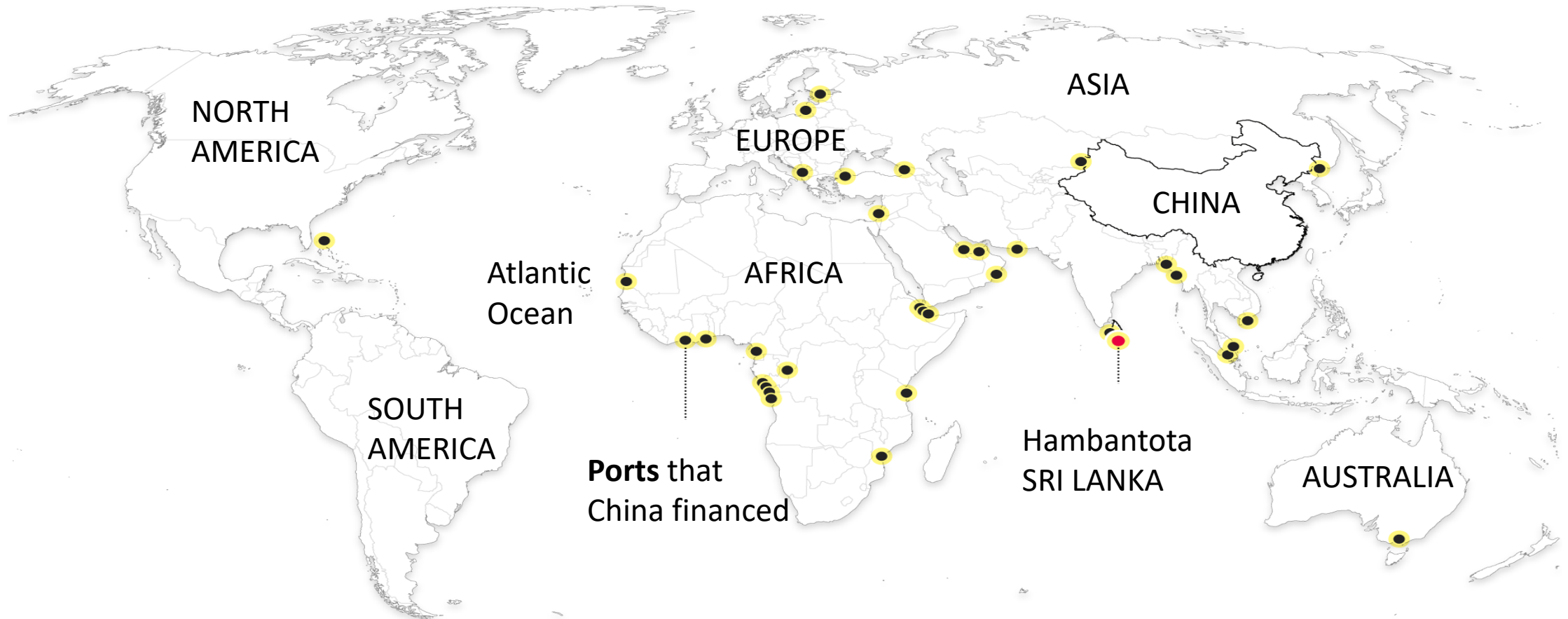


CPEC: Threat or Opportunity

International

String of Pearls Strategy

China-Backed Ports - China has helped finance at least 35 ports around the world in the past decade, according to a Times analysis of construction projects.



China's Proposed New Silk Roads



CPEC: Threat or Opportunity

- **OBOR as Debt Trap Diplomacy – Reality or Western propaganda**

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- **CPEC AND PAKISTAN**

- CPEC started in 2013 when Chinese president Xi Jinping proposed its establishment.
- **It total cost is estimated to be \$62 billion**
- \$34 billion will be invested in energy projects, \$16 billion in infrastructure (roads and railways) projects, \$793 million in Gwadar Port and nearly \$44 million in other project.
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- As these projects are located in four provinces of Pakistan, 16 in Baluchistan will have 16, KPK 8, 13 in Sindh and 12 in Punjab.
- The CPEC is expected to add 2 to 2.5 percent to the annual economic growth to Pakistan economy
- Also, it is forecasted to add 2 million direct and indirect jobs to Pakistan's economy between 2015 and 2030.

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- **Implementation**

- The implementation of CPEC projects has to be completed in four stages;
- Early Harvest 2015-2019 Most the energy related projects to be completed by 2019, adding 7000 megawatts to the national grid and helping reduce the load shedding and boosting industry and exports.
- (ii) Short term projects to be completed up to 2022. They are mainly related to roads, the development of Gwadar, fibre optic network, hydel and coal mining and power projects.
- (iii) Medium projects to be completed up to 2025. They are related to Railways and Industrial zones
- Long term projects to be completed up to 2030 that contain the Completion of Industrial zones, Agriculture, Tourism, etc.

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- **Promises and Perils**

- If we look at the structure and design of CPEC, It offers promises and perils.
- Promises in the shape of opportunities to boost dying economy
- perils in the form of threats to the local business as they lack competitive power to compete against Chinese industry in the open market.

Threats/challenges

- Threats emanate from
 1. **Institutional innovation**
 2. **Dysfunctional Institutions**
 3. **Lack of continuity**
 4. **Internal instability**
 5. **Administrative inefficiency**
 6. **No vision**
 7. **No planning**
 8. **Ineffective taxation regime**
 9. **Trust gap between state and market forces**
 10. **Lack of professionalization of management**
 11. **Lack of access to finance**
 12. **Lack of Technology**
 13. **Unskilled labour**

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- CPEC as win-win project
 - However, despite all the speculations and fears, it is hoped that CPEC would produce win-win situation for both China and Pakistan and lead to the transformation in the economic outlook of Pakistan
 - It will open up new vistas of job creation, economic growth, and increase in exports through infrastructure development once the energy and other projects under CPEC are completed.
 - It will lift all the boats from the surging waves of poverty, unemployment, illiteracy and death and disease Pakistanis are facing, especially in the underdeveloped province of Baluchistan, and distribute the investment evenly amongst all the provinces.

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- **CPEC NOT A GIFT – CHINESE PROFESSOR**

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- **FDI and Developing Country**

- Foreign Direct Investment (FDI) is an important source of investment for the developing countries and recognized as a powerful engine of growth.
- It helps capital-poor countries to build up physical capital, create employment opportunities, develop productive capacity, enhance skills of local labour through transfer of technology and managerial know-how, and help integrate the domestic economy with the global economy
- FDI is also beneficial in reducing the saving-investment gap which is a common problem for many third-world countries including Pakistan

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- CPEC could be game changer provided it is managed well to contribute towards the productivity of our industrial sector.
- Historical parallels – CPEC and Marshal Plan 1947
- CPEC and Western Investment in China 1980's

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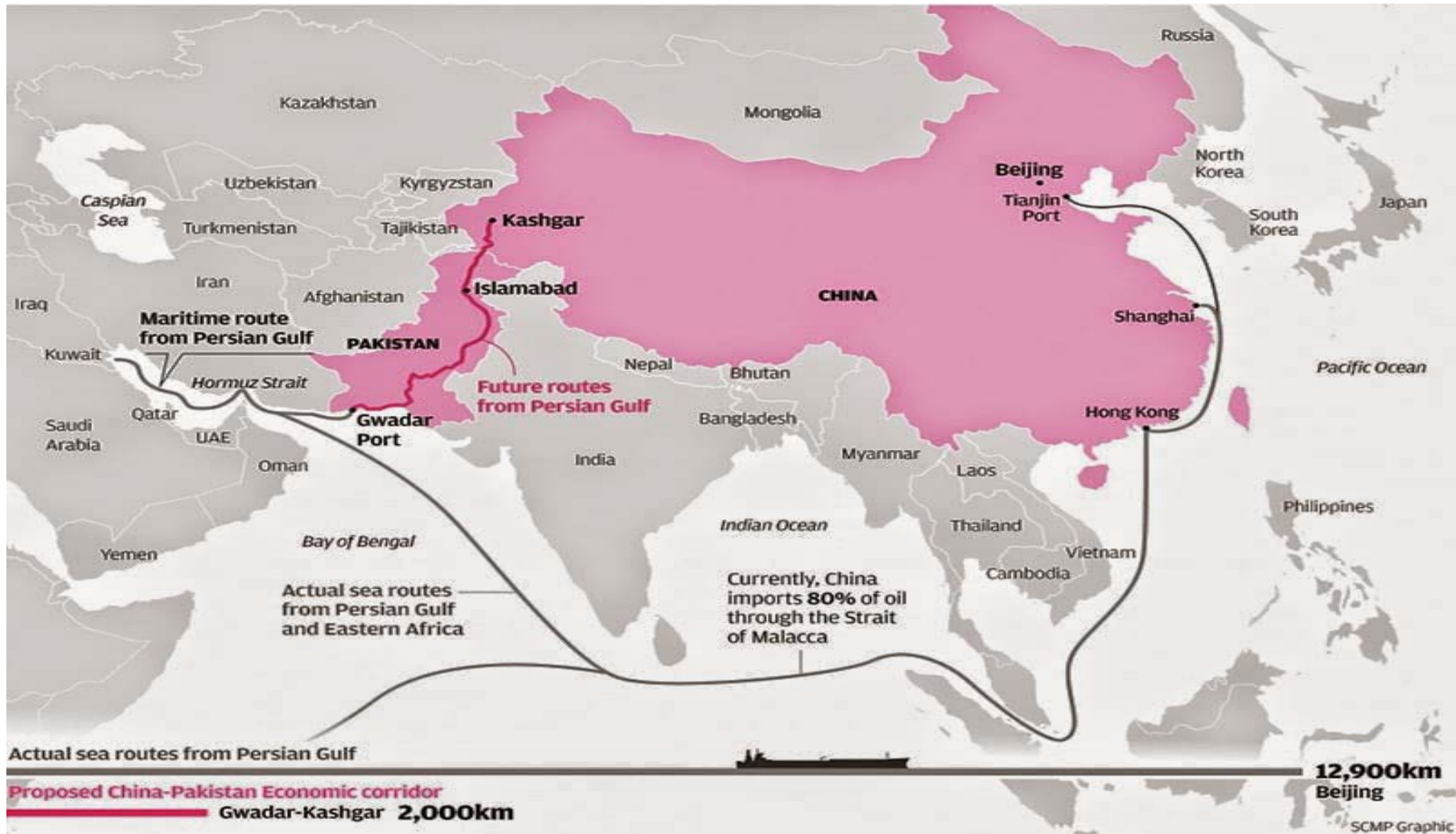
- **Theories about FDI**

- Firms always go for location-driven advantages such as locations abundant in natural resources, infrastructure, attractive business environment and availability of skilled labour.
- According to this theory, the choice of location is influenced by the behaviour or the motivation of the firm either in shape of **resource seeking, market seeking or structure asset seeking**
- Apparently the decision looks more motivated by structure asset seeking than resource seeking or market seeking in order to have access to Middle Eastern Oil.

Presently china import form **Strait of Hormuz to Arabian Sea to Strait of Malacca to South china sea.**



Apparently the decision looks more motivated by **structure asset seeking** than resource seeking or market seeking in order to have access to Middle Eastern Oil.



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- The literature also shows that institutional variables also play role in attracting FDI (Europe and US are glaring examples)
- Dunning (1973) presented two theories namely Supply-Oriented and Demand-Oriented theory.
- According to Supply theory, investment goes to the locations having low-cost production whereas Demand theory focuses on the location of market and its purchasing power.

Rugman developed impressive conceptual framework in 1980, explaining further evolution of FDI. The matrix has two axes

- *Firm Specific Advantages (FSA)* consisting of
 - competitive advantages of the firm – technological development
 - the know-how level,
 - marketing capacities
 - and managerial abilities

- *Country Specific Advantages (CSA)*, consisting of:
 - Natural resources endowment
 - Quality of labour market
 - Institutional characteristics or public policies dedicated to an attractive business environment

Benign Model and Malign Model

	Benign Model	Malign Model
FDI Inflow	Positive effect on government policy, better institutional standards, better incentives	Negative effect on government policy, promoting corruption
Income Equality Effects	Higher tax income Low price of goods and services Higher employment and wages	Tax evasion Possibility of monopolistic rents Crowding out of employment due to capital intensive techniques
Spillover Effects	Positive spillover → technological advancement, competition	Negative spillover → elimination of local firms
Trade	Higher exports → improvement in current account → trade balance	High import intensity → excessive royalty payment → worsen current account balance
Growth Effects	Additional supply of capital → lowering the return of capital → increase in labor wages → fair distribution of income → better health and education facilities	Adoption of capital intensive techniques → crowding out of local investment → employment level further declines → Poverty

Theoretical Perspective

- Competence Gap Analysis – Senghass
- Adam Smith Vs Fredrick List

Infant-Industry theory - Fredrick list

- In his book 'National Systems of Political Economy ' (1841), List maintained that protection of industry is necessary in order to achieve long term industrial development
- List was of the view that backward country cannot rely on the "natural course of things" to promote industrialization through market forces
- According to theory, protection is not aimed at protecting and promoting inefficient but nurturing them to gain more competitive power in the long run to produce low cost goods as their competitors do

THE MAIN FEATURES OF LIST'S ARGUMENT

- First, countries go through five stages in their development:
- (i) the savage stage; (ii) the pastoral stage; (iii) the agricultural stage; (iv) the agricultural and manufacturing stage; and (v) the agricultural, manufacturing and commercial[services] stage.
- Second, to progress, countries ought to industrialize, i.e. go from stage (iii) to stages (iv) and (v).
-
- Third, such transitions cannot take place automatically through the “natural course of things”, i.e. through market forces.
- Hence, to do so, infant industry protection becomes necessary for countries which are at stage (iii) if other countries are at different stages of development, i.e. “some have outdistanced others in manufacturing”.
-

THE MAIN FEATURES OF LIST'S ARGUMENT

- Fourth, protection should be temporary, i.e. confined to the infant stage and should be gradually removed as the industry matures.
- Finally, protection should be confined to the manufacturing sector; agriculture should not be protected, even though productivity growth in this sector is important for development.

Theory of Productive Power

- The productive power of a nation not only depends on factors of production and possession of natural advantages but also on the stability of institutional factors and their independence and power as nation.
- The factors of production must be accompanied by national unity, independence and a common goal and cooperation of productive forces

Kicking the ladder away

- Kicking the ladder away approach has been popularized by Chang (2002) by opposing the policy of free trade and investment supported by developed countries.
- He argues that the developed countries supported this policy when they attained the status of economies of scale otherwise they had very nationalistic and protectionist approach towards their economy.

Data Analysis – Results and Discussion

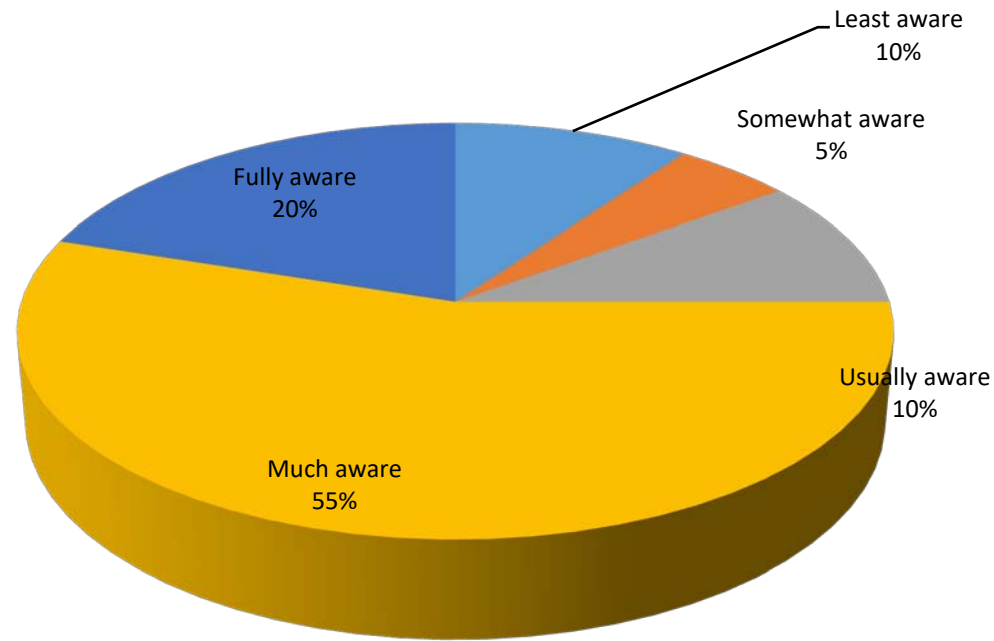
- Methodology:
 - A qualitative research methodology is employed and the data is gathered from 20 divergent and potential sector of SMEs through a close ended survey questionnaire.
 - The likert scale is used to evaluate the opinions of respondents for awareness, challenges; and threats and opportunities of CPEC.
 - **The results revealed** that SMEs owners are now more aware about the CPEC and its related details while the major challenges for producers were to cope with the low access to finance, unavailability of business and legal advisory services and difficulties in market access.

Data Analysis – Results and Discussion

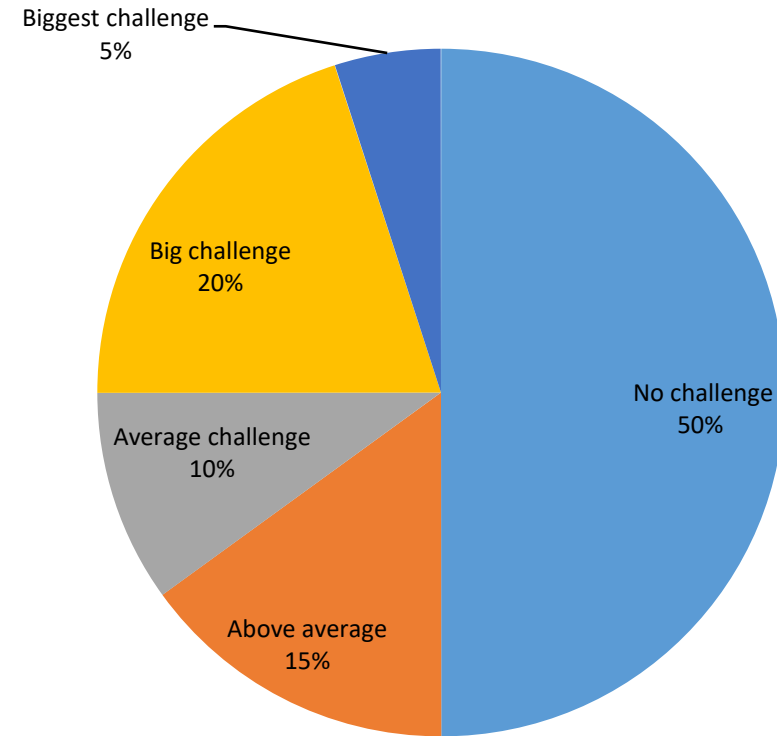
- Moreover, the majority of selected respondents consider the project of CPE as an opportunity for their businesses, industry and economy of Pakistan.

Data Analysis – Results and Discussion

Awareness of CPEC Projects and Programs



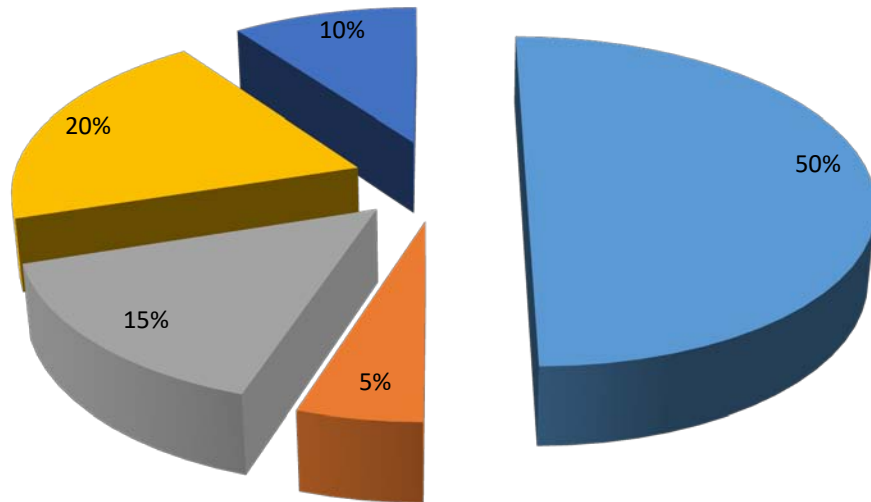
Skilled Labor



Data Analysis – Results and Discussion

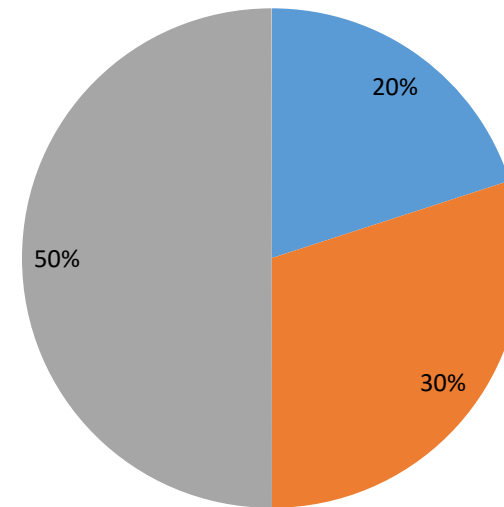
Upgrading of Machinery/Technology

■ No challenge ■ Above average ■ Average challenge
■ Big challenge ■ Biggest challenge



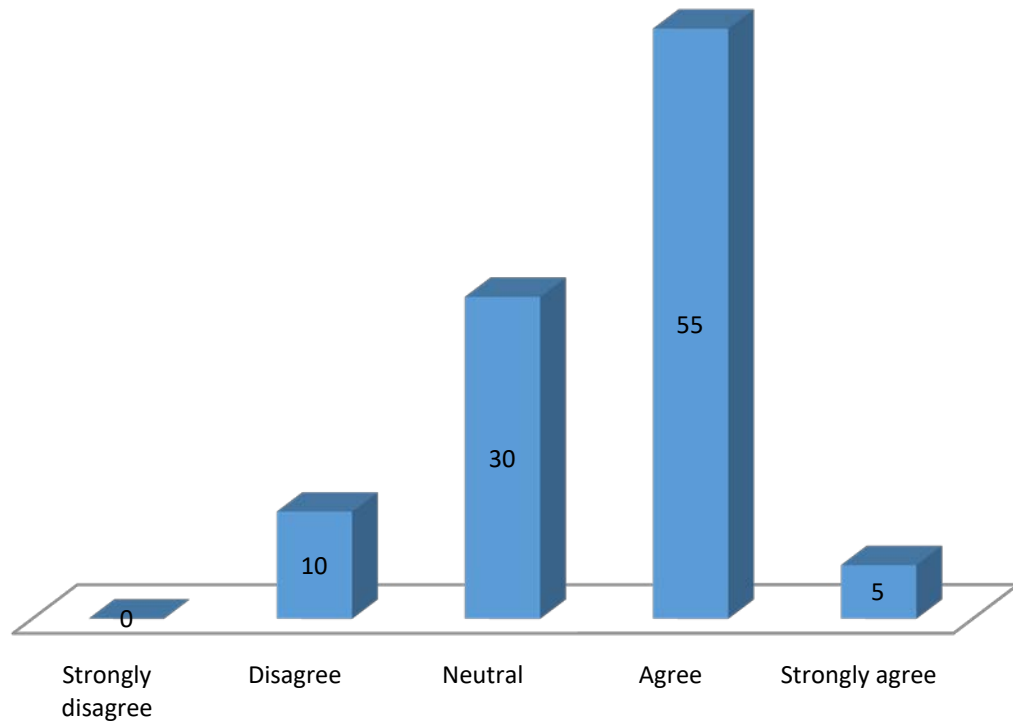
Access to finance

■ Average challenge
■ Big challenge
■ Biggest challenge



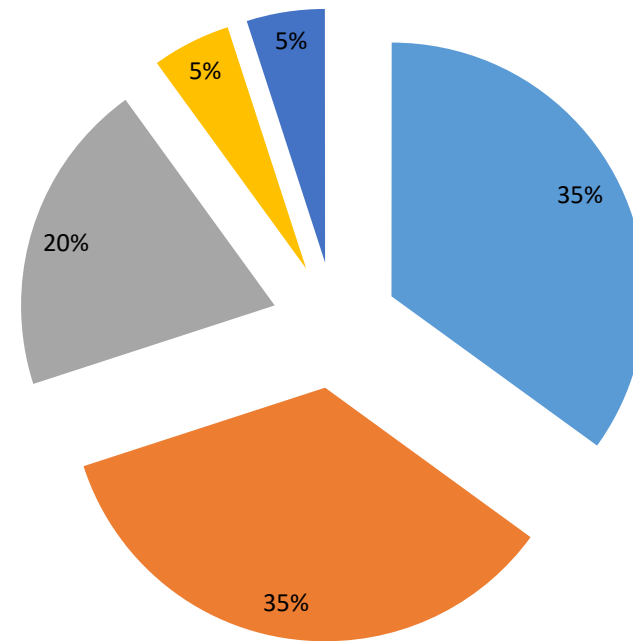
Data Analysis – Results and Discussion

CPEC as an opportunity for the Economy (%)



Consistency in Government Policy and Support

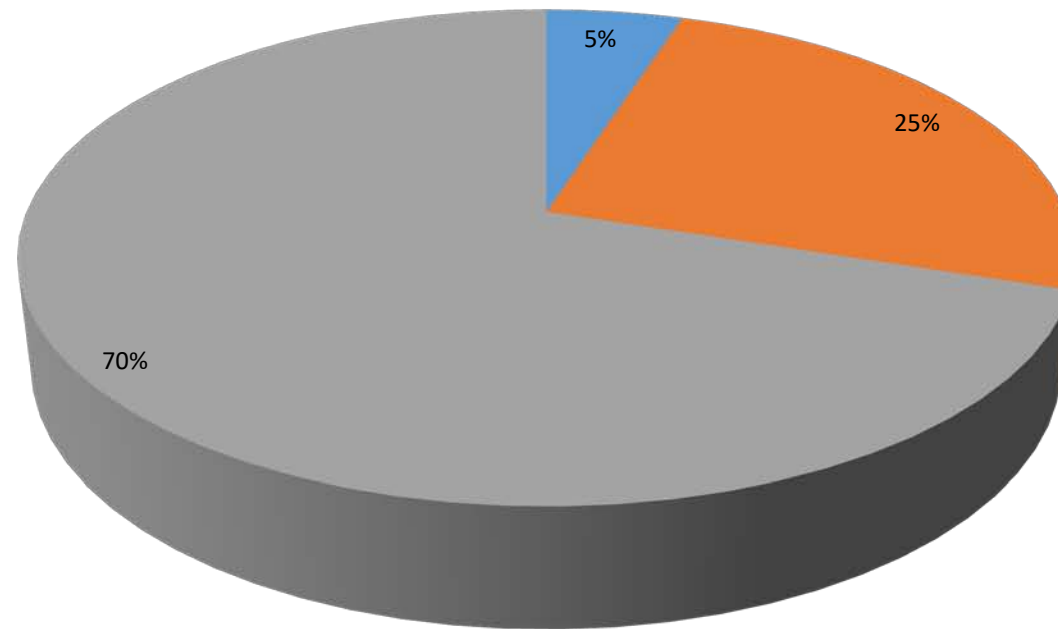
Strongly disagree Disagree Neutral Agree Strongly agree



Data Analysis – Results and Discussion

Need for Consistent Government Policy and Support

■ Neutral ■ Agree ■ Strongly agree



Recommendations

- Government must provide support to SMEs to build their capacity.
- Should announce national industrial policy with special package for SMEs in consultation with all the stake holders
- Should give priority to economic relations than strategic ones.
- Government should make it mandatory for the Chinese firms to enter into the joint ventures with local industry. In this way Pakistani firms will be able to develop their capacity.

THANK YOU