PAKISTAN AND INDIA TRADE TIES-THE UNTAPPED POTENTIAL

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EXECUTIVE SUMMARY

Recent times have seen a renewed emphasis on improving upon the economic and commercial relations between Pakistan and India. In particular, the liberalization of trade between the two countries has become a growing issue at both regional and bilateral level meetings. The global trend of regional economic cooperation which has rapidly gained importance in the last few years has remained strong and persistent because globalization and the World Trade Order (WTO) are making such changes necessary. However, when it comes to South Asia, the situation is disappointing because intra-regional trade has remained stagnant at less than 2 percent of the total trade in the last twenty-five years. Similarly, bilateral trade between Pakistan and India, the two largest economies and trading nations in the region, is also not reflective of any remarkable progress given the history of acrimony between the two countries.

This paper attempts to examine the issues concerning the move towards liberalizing trade with India and prospects for investment in Pakistan in an economic perspective. The book is structured as follows: Chapter 1 constitutes the introduction, stating an overview about the various forms and stages of regional integration. It also goes on to describe the two arguments regarding the formation and development of regional trade blocks.; Chapter 2 gives an explanation to the basic need for the two trading partners to review and enhance their trade relations. There are three key reasons why trade between India and Pakistan needs to be enhanced: First, viewed in a larger regional context, South Asia is the least integrated region and stronger economic relations between India and Pakistan is key element of regional integration in South Asia. Second, there are vast untapped trade and investment possibilities between the two countries which can be gainfully exploited with significant welfare gains for their populations. Third, as natural trading partners with a common border, trading with each other can be substantially higher as the potential is estimated to be 10 times the current level. Chapter 3 then reviews the structure of Pakistan's trade with India through various channels. In addition, Pakistan's trade policy with India, tariff and non-tariff trade barriers in both countries and the issue of granting the Most Favored Nation (MFN) status are discussed. Chapter 4 then elaborates opportunities and threats in some important sectors which are likely to emerge by the opening up of trade between the two countries are covered in Chapter 4. These sectors include Textiles and Clothing, Iron & Steel, Chemicals & Pharmaceuticals, Automobile, Small & Medium-sized Enterprises and Information Technology. Broad policy guidelines are spelt out in Chapter 5 for the two Governments enhancing the Indo-Pak trade. Chapter 6 finally gives the conclusion to the paper.

TABLE OF CONTENTS

INTRODUCTION .... Error! Bookmark not defined.

1.1 STAGES OF REGIONAL TRADING ARRANGEMENT........ ***Error! Bookmark not defined.***

1.2 MAJOR ARGUMENTS AFFECTING REGIONAL TRADE BLOCKS............ ***Error! Bookmark not defined.***

PAKISTAN-INDIA TRADE: THE NEED .... Error! Bookmark not defined.

PAKISTAN-INDIA TRADE: THE PRESENT ... Error! Bookmark not defined.

3.1 PAKISTAN'S TRADE POLICY WITH INDIA......... ***Error! Bookmark not defined.***

3.2 TARIFF AND NON-TARIFF TRADE BARRIERS.. ***Error! Bookmark not defined.***

3.3 NON-TARIFF TRADE BARRIERS IN PAKISTAN ***Error! Bookmark not defined.***

3.4 NON-TARIFF TRADE BARRIERS IN INDIA .... ***Error! Bookmark not defined.***

3.5 THE ISSUE OF MFN STATUS UNDER THE WTO ***Error! Bookmark not defined.***

PAKISTAN-INDIA TRADE: THE POTENTIAL Error! Bookmark not defined.

4.1 TEXTILES AND CLOTHING..................................... ***Error! Bookmark not defined.***

4.2 IRON AND STEEL.. ***Error! Bookmark not defined.***

4.3 CHEMICALS AND PHARMACEUTICALS............. ***Error! Bookmark not defined.***

4.4 AUTOMOBILES .... ***Error! Bookmark not defined.***

4.5 SMALL AND MEDIUM ENTERPRISES (SMES) ... ***Error! Bookmark not defined.***

4.6 INFORMATION TECHNOLOGY (IT) .... ***Error! Bookmark not defined.***

POLICY SUGGESTIONS TO ENHANCE PAKISTAN-INDIA TRADE .... Error! Bookmark not defined.

5.1 TRADE ON MFN BASIS... ***Error! Bookmark not defined.***

5.2 INFORMATION EXCHANGE.................................. ***Error! Bookmark not defined.***

5.3 TRANSPORT ROUTES .... ***Error! Bookmark not defined.***

5.3 TRANSPORT BOTTLENECKS................................. ***Error! Bookmark not defined.***

5.4 BANKING .... ***Error! Bookmark not defined.***

5.5 NON-TARIFF BARRIERS.. ***Error! Bookmark not defined.***

5.6 VISAS.. ***Error! Bookmark not defined.***

5.7 COMMUNICATION .... ***Error! Bookmark not defined.***

5.8 INVESTMENT .... ***Error! Bookmark not defined.***

IMPLICATIONS OF TRADE LIBERALIZATIONWITH INDIA Error! Bookmark not defined.

6.1 HIGHER ECONOMIC GROWTH............................ ***Error! Bookmark not defined.***

6.2 ACCESS TO LARGER MARKETS .... ***Error! Bookmark not defined.***

6.3 BENEFITS TO PAKISTANI CONSUMERS............ ***Error! Bookmark not defined.***

6.4 WELFARE GAINS FROM TRADE IN WHEAT AND SUGAR. ***Error! Bookmark not defined.***

6.5 GENERATE HIGHER CUSTOMS REVENUE......... ***Error! Bookmark not defined.***

6.6 REGIONAL PROTECTION...................................... ***Error! Bookmark not defined.***

6.7 JOINT VENTURES AND TRANSFER OF TECHNOLOGY ***Error! Bookmark not defined.***

6.8 TRANSIT TRADE .... ***Error! Bookmark not defined.***

6.9 ENHANCED EFFICIENCY .... ***Error! Bookmark not defined.***

6.10 SOCIAL BENEFITS .... ***Error! Bookmark not defined.***

6.11 SAVINGS FOREIGN EXCHANGE........................... ***Error! Bookmark not defined.***

6.12 CURB SMUGGLING... ***Error! Bookmark not defined.***

6.13 REDUCTION IN DEFENSE EXPENDITURE AND PEACE DIVIDEND...***Error! Bookmark not defined.***

6.14 PROMOTION OF TOURISM .... ***Error! Bookmark not defined.***

6.15 CULTURAL COOPERATION .... ***Error! Bookmark not defined.***

6.16 HARMONY IN POLITICAL RELATIONS .... ***Error! Bookmark not defined.***

6.17 CONCERNS AND THREATS.................................... ***Error! Bookmark not defined.***

CONCLUSION .... Error! Bookmark not defined.

CHAPTER 1
INTRODUCTION

Commerce has throughout the history been one of the main pillars of bilateral relations between countries, as well as a critical factor of the multilateral relationship for regional forums among different countries.

Even before the initiation of liberalization and free-trade, in the shape of globalization, countries formed strategic relationships, in the form of regional trade blocks. These regional trade blocks were all part of larger regional arrangements that covered a range of factors including economy (overall, sectoral and sub-sectoral level), trade, communication, international relations, strategic and geo-political environment.

With the increasing trend towards globalization, trade is becoming the most important aspect of the relationship between countries.

Major changes in this regard include the formation of international agreement on monetary standardization, "Bretton Woods, which later on gave rise to the international monetary fund (IMF). But the current wave of international trade at a multilateral level was given stimulus by the formation of General Agreement on Trade and Tariff (GAAT). This wave of internationalism of trade was simultaneously followed more abruptly by regional trading arrangements that were formed at different levels, in different shapes and covered different aspects of trade. These included bilateral trading arrangements between two countries (in the shape of granting of Most Favorite Nation status, MFN), Free Trade zones (between two or more countries) or arrangements that covered certain specific areas of interests between trading countries. Thus, these arrangements can also be described to be in the range of optimal to constrained optimal trading arrangement.

1.1 STAGES OF REGIONAL TRADING ARRANGEMENT

Theoretically, there are four stages[1] of regional trading arrangement that include;

1. Free-Trade Area
2. Customs Union
3. Common Market
4. Economic Union

[1] *Wikipedia, the free encyclopedia*

Free Trade Areas, also called **Free Trade Zones** or **Export Processing Zones (internally)**, designate either parts of a country or groups of countries that agree to eliminate tariffs, quotas and preferences on most goods between them. A pertinent example of such could be NAFTA (North American Free Trade Agreement).

A **Customs Union** is a free trade area with a common external tariff. The participant countries set up common external trade policies including, custom duties, quotas, preferences and/or other non-tariff barriers applied uniformly to all goods entering the area, regardless of their source and destination. The arrangement between Turkey and European Union, BENELUX (Belgium, Netherlands and Luxembourg) and even the United States of America are examples of Customs Union.

Common Market is a step forward towards more regionally integrated economies, in a sense, that these arrangements have common policies on product regulation, and freedom of movement of all the factors of production (goods, services, capital and labor). European Union remained the biggest example of such integration and it is now moving towards Economic Union.

The concept of **Economic Union** requires national, social, taxation and fiscal policies to be aligned and administered by a supranational institution. In this regard, association between some of the members of European Union has resulted in a monetary union called Euro.

1.2 MAJOR ARGUMENTS AFFECTING REGIONAL TRADE BLOCKS

There are two main schools of thought, regarding regional trading arrangements, one supporting the formation of these blocks whereas the other opposing such. Both these arguments are mainly based on economic rationale. The basic premise being, that countries base their decisions on international trade solely upon the prospects of enhanced economic growth.

Factors affecting decisions of forming regional trading arrangements include expanding regional markets (allowing economies of scale), increasing specialization and attracting Foreign Direct Investment (FDI). While, non-economic arguments may include management of immigration flows and promotion of regional security, an important aspect with regard to India and Pakistan.

The economic factors can be divided into two broad categories[2]:

1. Static Effects
2. Dynamic Effects

Static Effects of lowering tariff barriers among members of trade bloc, result either in increasing trade creation or in decreasing trade diversion. Trade creation occurs when some domestic production of one customs-union member is replaced by another member's lower-cost imports. The welfare of the member countries is increased by trade creation because it leads to increased production specialization based upon the principle of "Comparative Advantage"[3]. Accordingly, the resulting arrangement also results in more efficient allocation of world resources due to the respective specialization of the trading countries.

On the other hand, trade diversion occurs when imports from a low-cost supplier outside the trading arrangement are replaced by a higher-cost supplier within the trading bloc.

Dynamic Effects are those economic consequences of trading arrangement that affect the long-term growth of the member countries. These gains include economies of scale, greater competition and a stimulus of investment. The main reason for the emergence of these factors is the creation of a larger trading market. Removal of monopolistic barriers (both trade and non-trade) results in freer trade, whereas increased trade investment occurs in the shape of capital investment by non-member nations to avoid external tariff barriers.

These two schools of thought are based upon static and dynamic effects of trade blocks. According to Larry Summers, any 'ism' (bilateralism, regionalism and multilateralism) is good as long as its ultimate objective is trade liberalization. Supporters of this school of thought argue that regional arrangements promote freer trade and multilateralism in at least two ways

Firstly, trade creation has generally exceeded trade diversion, and that the RTAs contribute to both internal and international dynamics that enhance rather than reduce the prospects for global liberalization. Then internal dynamic is particularly important for developing countries: regional commitments, which can be negotiated much faster than global pacts, lock in domestic reforms against the risk that successive governments will try to reverse them. Internationally, the

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[2] *Estimated Effects of Trading Blocs, www.iie.com/publications/chapters_preview/72/5iie2024.pdf*

[3] *In economics, the theory of comparative advantage explains why it can be beneficial for two countries to trade, even though one of them may be able to produce every kind of item more cheaply than the other. What matters is not the absolute cost of production, but rather the ratio between how easily the two countries can produce different kinds of things.*

RTAs often pioneer new liberalization ideas that can subsequently be generalized in the multilateral system.

On the other hand, the school of thought led by Jagadish Bhagwati, is although in favor of multilateralism but opposes regionalism. This school of thought put forwards the argument that regionalism fragments world economy and also calls for the need to contain and shape it in ways that it becomes maximally useful and minimally damaging, and consonant with the objectives of arriving at multilateral free trade for all, which is the end of free trade in his conception. It also argues that the previously existing protectionist culture would now be transferred to a regional level[4].

With both of these views in regard, it has been observed that theoretic assumptions are not similar in all of the cases and these assumptions also vary in various conditions in different regional blocs. It is also to be observed that these regional blocs are solely based upon economic factors as mainly assumed by the theorist and in reality have a major impact from non-economic factors. The non-economic factors are especially important with regard to South-Asia (mainly India and Pakistan), as would be discussed during the later part of this paper.

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[4] The case of Boeing and Airbus (involving the two sides of Atlantic, America and Europe) is a prime example in this case, in which both sides argue that illegal trade concessions are being given by the opposing sides.

CHAPTER 2
PAKISTAN-INDIA TRADE: THE NEED

Trade between India and Pakistan is of immense importance to both countries. The interest in understanding the trade dynamics between the two countries is a recent phenomenon, particularly in India. This interest, in part, has arisen following the signing of the South Asian Free Trade Agreement in January 2004. There has also been a very visible initiative on the part of the private sector to work avidly towards furthering bilateral trade and creating awareness in each other's countries, about the potential for mutual economic engagement.

Recent times thus, have seen a renewed emphasis on improving upon the economic and commercial relations between Pakistan and India. In particular, the liberalization of trade between the two countries has become a growing issue at both regional and bilateral level meetings. The global trend of regional economic cooperation which has rapidly gained importance in the last few years has remained strong and persistent because globalization and the World Trade Order (WTO) are making such changes necessary. However, when it comes to South Asia, the situation is disappointing because intra-regional trade has remained stagnant at less than 2 percent of the total trade in the last twenty-five years. Similarly, bilateral trade between Pakistan and India, the two largest economies and trading nations in the region, is also not reflective of any remarkable progress given the history of acrimony between the two countries.

Experts believe that there are three main reasons for promoting the trade between the two neighboring countries, these being:

1. Regional Integration
2. Large Informal Trade
3. Natural Trading Partners

1. Regional Integration

Regional integration efforts in the Asian region indicate that SAFTA would ultimately lead to integration with the larger Asian community through BIMSTEC and ASEAN. The success of SAFTA in turn would depend on trade relations between India and Pakistan. It is therefore in the interest of the two countries to take necessary steps to enhance trade.

Intra SAARC trade has been quite meager. In 1991, intra-SAARC trade as a proportion of trade with the rest of the world was only 3.0 %. By 2004, the share

had increased to 4.7%. India is the largest country in the region and its share in total SAARC trade increased from 38% in 1991 to 45% in 2004[5]. South Asia remains the least integrated region compared to East Asia, Europe and Central Asia, Latin America, Middle East and North Africa, and Sub-Sahara Africa. Intra-regional trade in South Asia is only 0.8% of GDP, one eighth of Latin America's level and only a fraction of East Asia's nearly 27% of GDP[6]. Intra-SAARC trade, thus, at US $ 11.5 billion in 2004, could reach newer heights if the potential trade between India and Pakistan is tapped.

2. Large Informal Trade

One indicator of gauging the vast untapped potential trade between the two countries is the large informal trade, believed to range between US$ 250 million to US$ 2 billion between the two countries.

The informal trade between the two countries remains substantial, particularly through third countries such as Dubai. Moreover, almost every exportable item was being exported to Pakistan through third countries. This cross-border informal trade takes place through passengers traveling by train and by bus, though informal trade is much larger on the train route. The goods train through the Attari/Wagah border is also used to transport goods (through mis-invoicing and bribes to official authorities) that are not on the permissible list. Infact before 1999, informal trade was more visible along the Indo-Pak border, particularly along the Khokrapar-Munabao route. An item known to be traded the most was live animals, mainly goat and cattle. Informal trade also takes place along the Indo-Pak border, but the degree of risk in trading is much higher than on the Indo-Nepal and Indo-Bangladesh land borders. Also, in such cases, payments are almost always linked to drugs and narcotics.

Studies on informal trade are yet another indicator of trade possibilities between India and Pakistan. A study conducted by Taneja (2004) summarizes the available estimates of informal trade in the region. The value of informal trade between India and Pakistan is estimated at US $2 billion, half of which is traded through third countries (technically official trade) such as Dubai, CIS countries and Afghanistan while the other half is cross-border informal trade.

The estimate is, however, not based on any methodology. A more conservative estimate by Government of Pakistan places such estimates in the range of US $ 100 and US $ 500. The former is based on visits to various markets for smuggled goods while the latter is based on interviews with customs officials. Taking an

[5] *Calculated from Direction of Trade Statistics , IMF (2006)*
[6] *World Bank (2004)*

average of these two guesstimates, the new guesstimate places the value of smuggled Indian goods into Pakistan at US $ 250 million.

Mukherjee (2001) indicates that unofficial exports through both routes comprise of machinery, cement, tyres, tea, medicines, videotapes, alcoholic beverages, chemical products, steel utensils etc.

Informal imports from Pakistan consist of food items, synthetic fibers and some chemical products. FICCI (2001) shows that commodities being smuggled to Pakistan through third countries comprise of industrial machinery, cement, tyres, chemicals and tea. Commodities being smuggled into India are pulses, edible oils, spices and dry fruits. Based on a survey of firms ASSOCHAM (2004) indicates that items traded informally from India to Pakistan comprise of textile machinery, tannery equipment, machine tools and equipment/spares, cotton fabrics, viscose fibre, tyres, confectioneries, cashew nuts, chemical products, cosmetics, alcoholic beverages, stainless steel utensils, ayurvedic medicines, video tapes and cassettes. Items traded informally from Pakistan to India comprise of plastic goods, synthetic fibre, melamine dinner sets, textiles and clothing, woollens, and food items such as sugar, edible oil and vegetable ghee. In fact, informal exports from India cover the range from low cost mass scale produced goods to Indian branded items such as Tata's tea Tetley and products made by Dabur and Pioma Industries[7].

The Government of Pakistan (1996) study identifies the principal informal imports from India to be cattle, beetle leaves and nuts, spices, tea, tyres, tubes and pharmaceuticals. A summary showing all products traded informally is presented in **Table 2-A**.

Table 2-A Items Traded Informally Between Pakistan And India

Items exported informally from India to Pakistan	Items imported informally from Pakistan to India
Textile machinery	Pulses
Tannery equipment	Edible oils
Cement	Spices
Cattle	Dry fruits
Beetle leaves and nuts	Plastic goods
Spices	Synthetic Fibre
Tubes	Melamine dinner sets
Tyres	Textiles and clothing
Tea	Woolens
Medicines	Sugar

[7] *Economic Times (2003)*

Videotapes Alcoholic beverages Chemical products Steel utensils Machine tools and equipment Cotton fabrics Viscose Fibre Confectioneries Cashew nuts Cosmetics Ayurvedic medicines Video tapes and cassettes.	Edible oil Vegetable ghee

Source: Mukherjee (2001), ASSOCHAM (2004), FICCI (2001), GOP (1996)

3. Natural Trading Partners

Besides other factors, Pakistan and India share common border, making them but natural trading partners. This particular factor can be instrumental in substantially reducing any intermediary cost (using third country route) for the purpose of normal trading.

Moreover, ethnic links between trading partners in both countries facilitate trade, minimize risk and also serve as an important channel of information flows on quantities and commodities to be traded.

Batra (2004), in his recent study estimates the augmented gravity model[8] in which the dependent variable is bilateral trade flows between India and its trading partners and the independent variables include GNP, population, distance, adjacency, commonality of language, colonial links, landlocked areas, island countries, and the existence of preferential trade arrangement. The model thus emphasizes on the natural factors rather than on economic variables such as openness, exchange rates etc. The model estimates trade potential for India with 145 countries. The study shows that the potential for India's trade with Pakistan is the highest in the SAARC region. The model predicts that trade could expand by US $ 6.6 billion over and above the existing bilateral trade level[9].

[8] *A common application of econometrics, the gravity model predicts bilateral trade flows based on the economic size (often using GDP measurements) and the distance between two units.*
[9] *Using GNP in PPP terms (even though bilateral flows are measured at current prices) the predicted trade flow between India and Pakistan is US $ 13.1 billion.*

CHAPTER 3
PAKISTAN-INDIA TRADE: THE PRESENT

Pakistan and India are the two most populous and largest economies of the South Asian Region. However, official bilateral trade remains negligible and neither country falls in the category of top ten trading partners of each other partly due to their history of being relatively closed economies.

India's share in Pakistan's total exports remained less than one percent, whereas in total imports, it fluctuated within a narrow range of 1.36 to 2.66 percent during the last five years (FY01-06). Pakistan's share in India's total exports averaged 0.45 percent whereas in imports it constituted only 0.11 percent during FY 1999-00 to FY04. The informal trade between Pakistan and India is estimated at $1.5 to $2 billion which is being carried out through exchange of goods at the Indo-Pakistan border, the misuse of the personal baggage scheme through "green channel" facilities and Afghanistan[10]. Trade through third countries or circular trade is mainly conducted through agents operating in free ports like Dubai or Singapore and the Central Asian Republic (CAR) countries. The size of circular trade underlines the potential of flourishing bilateral trade between the two countries.

3.1 PAKISTAN'S TRADE POLICY WITH INDIA

Pakistan has adopted a conscious strategy to gradually open trade with India, particularly in sectors in which it is not so competitive. While Pakistan allows all kinds of exports to India, it had maintained a positive list of 687 items which were officially importable from India. In pursuance of the South Asian Preferential Trade Agreement (SAPTA) negotiations, the positive list of importable items was expanded by 81 items to a total of 768 items and further to 773 items in February 2007[11]. On the other hand, India does not impose equivalent formal restrictions on exports to or imports from Pakistan, but other restrictions (e.g. on travel, remittances, banking, customs clearance) are generally believed to have a similar effect, especially as regards imports[12]. In order to protect domestic industries in India, it also maintains a list of "Sensitive" consumer goods, imports of which have been regularly monitored by the Ministry of Commerce, India. Since the establishment of SAPTA, Pakistan and India have moved gradually towards liberalizing trade with each other. The total number of items on which Pakistan has so far given concession to India has been

[10] *Federal Bureau of Statistics*
[11] *Trade Services Centre, MCB Bank, Rawalpindi*
[12] *World Bank Report No 29954, September 2004.*

extended to around 463 items while India extended concessions on 262 items. Under SAPTA, Pakistan and India will scale down tariff rates from 25 percent to 20 percent within a time frame of two years, w.e.f. January 2006.

3.2 TARIFF AND NON-TARIFF TRADE BARRIERS[13]

Low volumes of trade and low trade integration in India and Pakistan have their roots in their respective trade systems, as both have relatively restrictive trade regulations. India's trade restrictiveness measures 8 (on a scale from 1 to 10), while Pakistan's index stands at 6. Comparatively high trade restrictiveness is partly a regional feature, with the average of South Asian countries at 5.9, compared to an average of all Asian countries of 4.4. India's tariff peaks are concentrated in the agricultural, automobile, and textiles and garments sectors. India's average tariff stands higher at 22.2 percent against 14.9 percent for Pakistan and a developing country median of 11.2 percent.

India started its trade liberalization process in 1991-92 and from 2002-03 the general maximum customs duty was reduced from 35 percent to 20 percent (30 percent for agricultural products) in January 2004. The agricultural tariffs at an average of 40.1 percent remain substantially higher than non-agricultural tariffs (19.7 percent). The highest rate of basic customs duty in India is 70 percent whereas some agricultural products are subject to import duties as high as 80-150 percent. In India, significant non-tariff barriers include:

- Requirement of political or security clearance,
- Sampling or customs inspection,
- Requirement of technical or standard certification,
- Labeling and marking rules,
- Packaging rules specification, etc.

Government-mandated import monopolies in the areas of agricultural and petroleum products are also in place. In addition, India maintains tariff rate quotas in the agricultural sector, and uses technical barriers to trade in the form of technical standards and regulations, administered by the Bureau of Indian Standards.

In Pakistan, trade liberalization started in 1980 and by 2002-03, the basic maximum tariff was reduced to 25 percent. Currently Pakistan operates with a relatively simple, four-rate structure, i.e. 25 percent, 20 percent, 10 percent and 5 percent. The average unweighted customs duty is 14.9 percent. Pakistan's trade liberalization has included the agricultural sector, where the unweighted average

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[13] *Pakistan-India CEO Business Forum Study, January 2005*

tariff (20.5 percent) is only moderately above the non-agricultural tariff average (13.8 percent). Pakistan's imports from India remain restricted to items covered on a positive list. Pakistan, mainly protects the edible oils and automobile industries, and also imposes high tariffs on alcoholic drinks. Despite the efforts to open up for trade, average tariffs of both countries remain relatively high. The imports in India are subject to various types of duties. Other duties include:

- Additional customs duties, which are levied on all items imported into India, and are equivalent to the excise duty payable on goods manufactured in India;
- A special duty equivalent to 5 percent of the value of goods on specific articles mentioned in the Customs Act;
- A special additional duty which is levied on all articles with varying rates;
- An additional surcharge which is levied from time to time with varying rates but for most goods equal to 1 percent;
- An educational cess of 2 percent levied on all imports in the 2004 budget.

After the goods are landed, imports are also subject to taxes by the Indian states- octroi, local sales tax and local government sales tax and toll tax, etc. India and Pakistan also employ other types of tariff-like measures. For India, this includes small-scale industry and other exemptions on domestic excise taxes. Moreover, for some products, India applies values other than actual c.i.f. prices as the base for ad valorem import duties, which is done mainly as a preventive measure against under invoicing, but may at times effectively result in higher tariffs**.** In case of specific duties it must be kept in mind that on the basis of current exchange rate, i.e. Indian Rs 100 =Pak Rs 154.521[14] the impact of duties will be more pronounced for Pakistan. By contrast, Pakistan has in the past employed "regulatory duties" imposed on top of normal customs duties, to provide extra protection to particular local industries. However, this policy is being phased out, with no new duties being imposed.

3.3 NON-TARIFF TRADE BARRIERS IN PAKISTAN

According to the World Trade Organization's (WTO) definition, non-tariff barriers (NTBs) include all measures, other than tariffs, that are used to protect domestic industry. One of the main principles of GATT is that protection to domestic industries should be through tariffs and not through the imposition of quantitative restrictions and other non-tariff measures. The WTO considers the following to be major NTBs:

- Technical regulations and standards;
- Import licensing;

[14] *Exchange rate as at 14.11.2007*

- Local content requirement/rule of origin issues;
- Import by state trading enterprises;
- Anti-dumping and countervailing measures;
- Customs, shipping and port procedures/regulations;
- Technical barriers to trade;
- Government procurement regulations.

In addition, the misuse of WTO provisions regarding domestic industry protection (e.g. laws pertaining to anti-dumping, countervailing, and safe guard measures, subsidy to agriculture and industry, etc.) also constitute very effective non-tariff barriers.

In the area of non-tariff barriers, one of the most significant obstacles to trade is Pakistan's restriction of imports from India. Although Pakistan has progressively removed all its non-tariff barriers since the 1980s, its imports from India remain restricted to items covered on a positive list. In 1986, Pakistan issued a list of 42 items that were allowed to be imported from India. This list has progressively been extended to 687 items in May 2003, 768 items in November 2004 and further to 773 items in February 2006. In addition, a 2002 Statutory Regulatory Order (SRO) permits the import from India of raw materials which are not produced locally and are required for the production of exports, including approximately an additional 1000 items.[15] The increase in permissible items for import despite, the positive list approach continues to be a crucial obstacle to imports from India. In addition, Pakistan employs health and safety-related barriers, including a ban on imports of some second-hand household machinery; used motor vehicles, and some categories of industrial machinery. Pakistan has recently institutionalized anti-dumping procedures under a new anti-dumping law.[16]

3.4 NON-TARIFF TRADE BARRIERS IN INDIA

In India, a significant number of non-tariff barriers are in place while the protection in the case of consumer goods (65 percent) is quite high relative to the average rate for the whole economy, the protection for intermediate goods (43 percent) and the capital goods (34 percent) are also quite substantial[17]. While import licensing was largely abandoned in 2001, the remaining forms of non-tariff barriers include:

- Requirement of political or security clearance,
- Sampling or customs inspection,
- Requirement of technical/standard certification,

[15] *Trade Services Centre, MCB Bank, Rawalpindi*
[16] *Anti-Dumping Duties Ordinance, 2000*
[17] *Pandey, 2004 WP No. 140 ICRIER.*

- Labeling and marking rules,
- Packaging rules specification and local content/rule of origin schemes, etc.
- Government-mandated import monopolies in the areas of agricultural and petroleum products
- Non-availability of representatives of local banks from either country in the other, LC opening is another major problem, since India allows opening of LCs only in the banks recognized by the Indian government**.**
- Visa & travel restrictions,
- Hurdles in inter-provincial movement of goods because of security checks and delays in learing consignments,
- Limited number of ports & inland custom ports for imports, etc.

In addition, India maintains tariff rate quotas in the agricultural sector, permitting the import of small quotas at moderate tariffs while applying much higher tariffs on imports in excess of the quota amounts. Besides, India uses technical barriers to trade in the form of technical standards and regulations, administered by the Bureau of Indian Standards, which operates a certification scheme for foreign exporters of products on a list of more than 100 items. To be sold in India, these products are required to be certified as meeting Indian quality standard mark. Moreover, India employs sanitary and phyto-sanitary rules in the agricultural sector, and other health and safety regulations (e.g. in pharmaceuticals), which may in part serve the purpose of discouraging trade. For instance, under health and safety concerns, India bans the import of used clothing and second hand household machinery and cars. India frequently uses the trade defense provisions to discourage imports. At present India has 133 antidumping and safeguards measures in force and reportedly about 30-35 investigations are under review/scrutiny.

Efficiency of customs operations can act as a de facto barrier to trade. As delays in clearing goods at customs effectively constitute an extra cost for traded products relative to domestically produced goods, long delays diminish the competitiveness of imports. Pakistan and India both have above average delays in customs clearance.

According to the World Bank Investment Climate Surveys, the average number of days to clear imports through Pakistani customs was 17 days (2003), while it took an average of 10 days in India (2000). These compare with an average of 4 days for developed countries, and 6 days for East Asia. In addition, some other restrictions have also hampered trade between India and Pakistan. A restrictive visa regime continues to curb travel between the two countries, thus limiting potential possibilities to engage in business contacts. Direct air travel between India and Pakistan used to be banned and was partially restored only in late 2003. Similarly, sea and land transportation between the countries is also

difficult. Ships plying between Indian and Pakistani ports are obliged to first touch a third country port before being allowed to harbor. In addition, India limits the ports and inland customs posts at which imports can be cleared for a number of products it labels as sensitive items. Moreover, the lack of coordination between the railway authorities of both countries and border closure continue to hamper land transportation. In the area of payments system, current restrictions and underdeveloped financial links act as an impediment to the efficient settlement of payments.

3.5 THE ISSUE OF MFN STATUS UNDER THE WTO

Given the improving relations between Pakistan and India in the recent past, an increased emphasis has been given to the issue of granting the Most Favored Nation (MFN) status to India. Pakistan and India are among the 25 founding members of the GATT. One of the fundamental principles of GATT is the MFN clause according to which any trade concession granted to one member of GATT must be extended to all members. Moreover, after the acceptance of the WTO Agreement, Pakistan has recommitted itself to the principles of GATT to pursue the objectives of free trade in a non-discriminatory multilateral framework. As a signatory to the Agreement, Pakistan is bound to grant MFN status to all member countries including India without any kind of discrimination. MFN is one of the instruments in use by the WTO to make member countries' trade regimes competitive and non-discriminatory. Contrary to the popular view, MFN does not mean giving special treatment to imports from another country. MFN refers to nondiscrimination among goods or services imported from other member countries and simply remove discriminatory practices in international trade. The principle requires that any favorable treatment given to one member of the WTO, such as lower tariffs or greater market access, has to be extended to import of similar products from all other member countries. For instance, following the grant of MFN status, US and China simply began to trade with each other on the same footing as with the rest of the world.

The MFN principle, however, has some exceptions. For instance, signatories to a regional trade agreement can give concession to each other's exports over and above their obligations under the MFN principle. India granted MFN status to Pakistan in 1996 but Pakistan has not yet reciprocated in the same manner. Since then India has been urging Pakistan to grant MFN treatment to India as well because such a status will ease qualitative and quantitative restrictions on the flow of goods between the two countries. Instead of granting MFN status, Pakistan has gradually increased the number of items permissible for trade with India and now maintains a 'positive list' of 768 goods which may be legally imported from India. It may be worth mentioning here that MFN status does not translate into trading 'freely' with India; it means trading with India in the same

way as Pakistan trades with the rest of the world. The trading community in Pakistan seems to be in favor of granting the MFN status to India. The Karachi Chamber of Commerce and Industry (KCCI) has already recommended to the Government to grant MFN status to India because, in their view, it is unlikely that it will cause any damage to the Pakistani industry[18]. Pakistani manufacturers, however, feel that liberalizing trade between the two countries, after granting MFN status to India, will mostly benefit India given that it possesses a substantial industrial and engineering base. By conceding MFN status, Pakistan will suddenly expose its economy to the well diversified industrial structure of a large economy enjoying a substantial transport cost advantage over all its competitions. Moreover, dumping of cheap Indian products is also likely which will pose problems for the regulators in Pakistan. With the regional integration of South Asian countries along with binding MFN rules, it is expected that both countries will find it more beneficial to trade with each other.

[18] *KCCI Report March 2004.*

CHAPTER 4
PAKISTAN-INDIA TRADE: THE POTENTIAL

The current volume of trade between India and Pakistan is not commensurate with the existing potential. Although the recorded trade between India and Pakistan is merely $415 million (5-years average), but through third country and illegal channels, it is estimated between $250 million to $2 billion annually[19]. The potential of trade between the two countries quoted by the KCCI lies within the vicinity of $5 to 10 billion[20], which can be fully explored and expanded by adopting mutually beneficial policies and joint strategies. Indian and Pakistani business leaders, during their meetings at different times, have identified various areas which have a substantial potential for cooperation
and an immense scope for bilateral trade. These include tea, spices, auto parts, consumer and light engineering goods, tires and transport equipment, entertainment, healthcare, IT and pharmaceuticals from India, and fresh and dry fruits, sugar, raw cotton, gems, fish, marbles and onyx, power and textiles from Pakistan.

Following few paragraphs will elaborate the opportunities and threats in some important sectors in Pakistan which are likely to emerge by the opening up of trade between the two countries. These sectors include: Textiles and Clothing, Iron and Steel, Chemicals and Pharmaceuticals, Automobiles, Small and Medium-sized Enterprises and Information Technology.

4.1 TEXTILES AND CLOTHING

The textile and apparel sector continues to be the driving force for economic growth in both India and Pakistan. The textile and apparel sector in these countries accounts for a significant portion of traded goods, contributing 20.6 percent in India and 61.46 percent in Pakistan, of the total value of exports in FY07[21]. Both these countries are highly dependent on the sector for creation of employment opportunities and export earnings. The dismantling of the quota regime represents both an opportunity as well as a threat: an opportunity because markets will no longer be restricted; a threat because markets will no longer be guaranteed by quotas and even the domestic market will be open to competition.

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[19] *Taneja, 2006*
[20] *KCCI Report March 2006*
[21] *Federal Bureau of Statistics*

Presently trade in textile and clothing between India and Pakistan is almost nonexistent. Pakistan's total imports of textile and clothing in FY06 stood at $65.3 million (of which 85.6 percent was raw cotton imports), while exports to India stood at a dismal $11.1 million despite the grant of MFN status to Pakistan by India. It is generally apprehended in Pakistan that Indian textile products are cheaper than Pakistani products and hence will flood the domestic market once India is granted MFN status. In both India and Pakistan, the textile and apparel sectors exhibit different degrees of specialization. While firms in Pakistan are specialized in cotton textile intermediate goods (yarn and grey fabric), as well as towels and bed linen, firms in India have developed a highly complex sector covering the entire value and production chain from fibre production to garment manufacture and packaging. Firms in these two countries generally are not vertically integrated, and are, for the most part, independent, privately owned small and medium sized firms. However, several firms in the textile sector have become vertically integrated in recent years. For example, Pakistani bed linen manufacturers are large, integrated units that continue to upgrade capacity with new machines when needed. India has inherent strengths in terms of a strong multi-fibre raw material base, low cost of labor, intellectual capital, and dynamic entrepreneurship. In a recent study published India is regarded as a major alternative source to China once quotas are removed for apparel and made-up textile products. The study further stipulates, "Retailers and apparel suppliers acknowledged that India is likely to remain competitive after quota removal because of its large, relatively low cost labor force, a large domestic supply of fabrics, and the industry's ability to manufacture a wide range of products. Retailers describe Indian firms as innovative, particularly in design functions[22]." International brands already present in the market include Benetton, Lacoste, Levi Strauss, Crocodile, Dockers, Lee, Wrangler, Nike, Reebok, Adidas, Zegna, Marks & Spencer, etc. On the other hand, Pakistan is termed as a supplier of limited range of products. However, it is considered a competitive supplier of cotton goods, particularly men's apparel, home textiles, and fabrics. It is believed that India's production costs are among the highest in the world although it has the lowest labor costs. Labor costs have declined as a percentage of production (7 to 8 percent, down from 12 percent in the 1990s) whereas power and other costs have continued to grow. According to KCCI Pakistan's industrial competitiveness and firm-level comparisons suggests that while wages in Pakistan are low by international standards, they are often significantly higher than those in Bangladesh and slightly higher than in India despite it being a low wage, labor surplus economy. It is further contended that allowing for the differences in labor and capital productivity, on average Pakistan is a higher cost location than the People's Republic of China (PRC), India or Bangladesh. An

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[22] *Tariq Rashid (2006), Implications of Liberalizing Trade and Investment with India (SBP Research and Policy Wing)*

important source of cost reduction and efficiency improvement in many countries is the use of imported intermediates that are of better quality than domestic substitutes, or at least better suited to the needs of the domestic industry. Pakistan's apparel sector has moved a long way from its traditional pattern of reliance on domestic inputs towards international sourcing of intermediate inputs. The 41 percent share of import contents in the apparel sector in Pakistan is far higher than the 6 percent share in India. Pakistan's textile sector, however, remains strongly linked to the transformation of domestic inputs (97 percent). To participate in the fully-globalize market for textiles and clothing that will emerge after the abolition of the quotas, it seems likely that Pakistan would need a greater degree of international sourcing of textile inputs.[23]

Compared to their Pakistani counterparts, Indian small scale enterprises in the textile sector are better placed due to conscious efforts by the Indian Government, which over the years has facilitated them by granting various concessions through fiscal and infrastructure development policies. SMEs in India mostly operate in clusters and enjoy tax and excise benefits. Most importantly, until 2001, the Indian Government had kept domestic woven and knitted apparel market reserved for the small scale industrial producers.

Pakistan's economy is far less diversified as compared to the Indian economy and depends heavily on the textile industry. Despite Government efforts to widen the industrial base and diversify exports, the industrial sector remains dominated by the textile sector. Unless efforts are made to rectify this situation, granting unrestricted access to Indian textiles in Pakistani domestic market may have serious repercussions for the whole economy. It is a well established fact that free trade leads to greater benefits to consumers in the form of lower prices due to increased competition. Similarly, despite facing losses in the short run, producers also ultimately gain through greater market access and improved efficiency in the long-run. Eliminating all barriers to intra-regional textiles and clothing trade would likely induce some limited specialization and trade in intermediate inputs for use in exports to high-income countries.

*4.2 IRON AND STEEL*24

Iron and Steel Industry provides basic raw material for the engineering industries and construction /infrastructure sectors. Developments in this vital sector generally reflect the overall economic growth in the country. Shortage of essential raw material (iron ore) hampered the development of this important

[23] *Ibid.*

[24] *Ibid.*

industry and the country is forced to fulfill its domestic requirements through import of iron & steel and its products. Pakistan Steel with a production capacity of 1.1 million tons of raw steel per annum, with a built-in potential to expand capacity to over 3 million tons per annum, is the first integrated iron & steel works project in Pakistan, which was established to enhance domestic availability. It produces a wide range of products including coke, pig iron, billets, hot rolled coils/sheets, cold rolled coils/sheets, and formed sections like channels, angles, galvanized sheets, etc. However, its production is largely dependent on imported raw materials, i.e. iron ore. During the last two years, India was the major source of raw material (iron ore) to this vital industry. In FY06, imports from India accounted for 69.2 percent of the total imports (iron ore concentrate and manganese ores and concentrates), compared to 40.6 percent in FY05. The other suppliers of iron ore were Australia (19.9 percent) and Iran (10.9 percent). However, the average import unit value of Indian iron ore during FY06 was slightly higher than the average import unit value of total iron ore imports, primarily due to the considerably cheaper imports from Iran. It is therefore unlikely that imports from India would be able to maintain its dominating supplier status. Moreover, there is not much room for increasing imports from India in the near future on account of the need to diversify the source of raw material for this important sector. Unlike Pakistan, India has a well-established steel industry and is a net exporter of steel and steel products. On the back of abundant raw materials, highly skilled technical manpower and competitive labor, India is the eighth largest crude steel producer in the world and largest producer of sponge iron in the world with production of 8.00 million tons in 2005-06. The total finished steel production in India stood at 36.19 million tons during 2005-06. On the basis of routes of production, the Indian steel industry can be divided into two types of producers: a)Integrated Producers that convert iron ore into steel; and b)Secondary Producers, the mini steel plants that make steel by melting scrap or sponge iron or a mixture of the two.

Pakistan's iron and steel product imports from India during FY05 and FY06 were just a small fraction of its total imports. In FY06, Pakistan imported a total of $62 million worth of iron and steel products (326 items) of which India supplied only 25 items worth $7.1 million. Out of 25 items imported from India, 13 items had lower unit value of imports compared to the unit value of the same items imported from elsewhere. These items may be identified as the potential imports of iron and steel products from India. Similarly, additional import items could also be identified by comparing Pakistan's import of iron and steel products from the rest of the World with the Indian export of iron and steel products to the rest of the world.

4.3 CHEMICALS AND PHARMACEUTICALS[25]

The chemical industry is a key contributor in the economic development of any country. Pakistan's chemical industry has by and large developed on a fragmented and ad-hoc basis, motivated by a combination of the existence of a small local market and traditionally high tariffs. As a result it suffers from the lack of economies of scale, national integration and consequent un-competitiveness. Resultantly, the country is highly dependent on imported chemicals to cater for the needs of its agriculture as well as industrial sectors. Since Pakistan is an agricultural economy, major part of the chemical industry provides agricultural inputs, i.e. fertilizer and pesticides. During FY06, the total imports of chemicals (fertilizers, insecticides, plastic materials, medicinal products, and other organic and inorganic chemicals) stood at $2.8 billion, an increase of 29.5 percent over the last year.

Sectors in which some economies of scale and integration have been achieved on the basis of a growing local market include fertilizers, pesticides and to some extent dye-stuffs and other inputs for the textile industries. The production of pesticides and dye-stuffs are primarily based on imported base materials and the domestic value addition is confined to formulations and packaging.

Chemicals are divided in two main categories from the value addition point of view. Those produced in large and bulk quantities but with lower value addition are called commodity chemicals such as fertilizers and soda ash, etc. Specialty chemicals are those produced in smaller quantities with higher value addition, i.e. dyes and pigments, pharmaceuticals and enzymes, etc. Compared to Pakistan, the Indian chemical industry is well-established and has shown impressive growth over the years contributing about 6.7 percent in the Indian GDP. The industry is a vital part of the agriculture and industrial development in India and has key linkages with several other downstream industries. In terms of volume, it is the twelfth largest in the world, and third largest in Asia. With a current turnover of about US $30.8 billion, it accounts for 14 percent of the total manufacturing output in India. During the last five years, it grew at twice the rate of growth in Asia and five times the world growth for the sector. India is becoming the laboratory of the world for the global chemical industry and leading global players like Dow Chemicals, DuPont, and General Electric have set up their own laboratory or using Indian laboratories.

The chemical industry in India comprises many sectors i.e. organic/ inorganic chemicals, dyestuffs, paints, pesticides, specialty chemicals, etc. Main individual chemical industries are caustic soda, soda ash, carbon black, phenol, acetic acid,

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[25] *Ibid.*

methanol and azo dyes. India is currently the largest manufacturer of pesticides and the second largest producer of agro chemicals in Asia. India is also the third largest fertilizer producer in the world. Besides the presence of major world manufacturers such as Unilever, ICI, Hoechst, DuPont, BASF, Bayer and Glaxo, there are thousands of large, medium and small-scale companies in the sector.

It is believed that Pakistani producers of export-oriented downstream industries, including textiles, food and beverages, soaps, vegetable oil, fertilizer, etc., would benefit under a free trade arrangement by getting cheaper caustic soda from India The pharmaceutical industry in Pakistan also plays an important role in the economic development of the country by ensuring better health to the people through supplying cheaper and quality drugs. Total local production/consumption of pharmaceuticals is presently estimated at $2.0 billion. There are about 316 pharmaceutical manufacturing companies including 30 multinationals (47 percent share), which are meeting around 80 percent of the country's requirement. Total capital investment in this sector is Rs 21.12 billion divided almost evenly between national and multinational companies. Most of the pharmaceutical manufacturing units are ISO certified. Almost 95 percent of the basic raw materials used for manufacturing of medicines are imported from China, India, Japan, United Kingdom, Germany, Netherlands and others. Other production inputs, i.e. technology, labor, packaging materials, power and raw materials are easily available and Government provides good incentives for importing raw materials and technology.
The leading categories of pharmaceutical products manufactured in Pakistan consist of systematic anti-infective, anti-rheumatic, non-steroidal and broad-spectrum penicillin. Several factors such as inconsistent and discriminatory policies, lack of funds for upgrading the plants, high duties in the formulation industry, lack of R&D facilities, unavailability of sophisticated machinery, high cost of inputs stringent price controls have affected production in the pharmaceutical industry. However, there has been a substantial increase in investment in the formulation industry to improve quality and to increase capacity. Compared to the pharmaceutical industry of India, the size of Pakistani companies is relatively small and hence uncompetitive. The Indian pharmaceutical industry has become a net exporter and is now putting up USA (FDA) approved plants and is exporting to advance economies. They have also integrated backwards and invested heavily in basic manufacturing and Research and Development to become globally competitive. In some pharmaceutical raw materials, the Indian companies are the only suppliers worldwide. The Indian pharmaceutical industry has shown tremendous progress in terms of infrastructure development, technology base creation and a wide range of production. The Indian industry now produces bulk drugs belonging to all major therapeutic groups. Strong scientific and technical manpower and pioneering work done in process development have contributed to this. The country ranks

fourth worldwide accounting for 8 percent of world's production by volume and 1.5 percent by value. India is also among the top twenty pharmaceutical exporters and among the top five manufacturers of bulk drugs in the world. The industry manufactures almost the entire range of therapeutic products and is capable of producing raw materials for manufacturing a wide range of bulk drugs from the basic stage. Over 60 percent of India's bulk drug production is exported and the balance is sold locally to other formulators. With more than 85 percent of formulation production in the country sold in the domestic market, India is largely self-sufficient in the case of formulations, even though some life-saving, new-generation, and under-patent formulations continue to be imported. It is the largest producer of Sulfamethoxole and Ethambutol (anti TB). Indian pharmaceutical Industry has the advantages of self-reliant technology for production; innovative scientific manpower; low production costs; low R&D costs; easy availability of raw materials and well-developed capital equipment. Many units are approved by regulatory authorities in USA and United Kingdom. However, it is highly fragmented with about 22,000 players; the organized sector comprises about 260 players and the top ten companies account for one-third of the market. Formulations account for about 80 percent of this market while the rest is made up of bulk drugs. Structure and dynamics of the Indian pharmaceutical industry are unique primarily on account of the following facts:

1) The process patent regime
2) Price controls
3) Exemptions to Small Scale Industries (SSIs).

Industrial licensing has been abolished except for production of recombinant DNA technology, bulk drugs requiring in-vivo use of nucleic acids as active principal and specific cell-tissue targeted drug formulations. FDI up to 100 percent is permitted on the automatic route for manufacture of drugs and pharmaceuticals (provided the activity does not attract compulsory licensing or involve use of recombinant DNA technology, and specific cell/tissue targeted formulations). Imports of drugs and pharmaceuticals are allowed freely, except those in the restricted list of import under the current Exim Policy, which can be imported under an import license. Indian pharmaceutical products are being exported to a large number of countries including USA, Canada, Germany, France and Latin American countries. Major products exported are anti-infective (including antibiotics), anti-bacterial and anti-tuberculosis drugs. During FY05 and FY06, Pakistan imported 4.3 percent and 6.8 percent of its total imports of chemical and pharmaceutical products respectively from India. Out of total imports of $2.9 billion (1105 items) in FY06, India supplied 353 items worth $196.8 million. Out of total imported chemicals and pharmaceutical products from India, 166 imported from elsewhere. These items have the potential for enhancing imports from India.

4.4 AUTOMOBILES

The automobile industry in Pakistan operates under franchise and technical cooperation agreements with leading world manufacturers and can be broadly categorized into various segments, i.e. cars and light commercial vehicles (LCVs), two and three wheelers, tractors, trucks and buses and vendor industry. The importance of auto industry in the Pakistan economy can hardly be over emphasized. The vehicle manufacturers alone employ around 10,000 workers with more than 100,000 people working in the vendor industry. Presently, the automobile Industry mainly comprises of more than a dozen manufacturers of passenger cars, commercial vehicles, motorbikes and tractors, and over 800 down stream vendors supplying various indigenous component to these Manufacturers. During the FY05-06 the automotive industry contributed over Rs 30 billion to the government exchequer in the form of duties and taxes, with a contribution of Rs 17 billion from the top four manufacturers alone. From the late 80s to the early 90s the demand for automobiles in Pakistan was on the rise, setting the stage for a decade of robust growth[26]. The demand has risen substantially after September 11, 2001, partly in the wake of the increase in home remittances which resulted in greater liquidity in the market. Consumer financing, particularly by the larger commercial banks, has played an important role in supporting the demand for automobiles. In order to meet the rising demand, the automobile industry has increased its production considerably. The industry has achieved a phenomenal growth of 50.2 percent in FY06 even over the very high base due to a 46.6 percent rise in production during FY05.[27]

Compared with Pakistan, India has a strong engineering base and has successfully created a sizable capacity for production of vehicles. It enjoys a clear edge over Pakistan in the automobile sector. Indian auto companies are highly cost competitive due to appropriate levels of automation and low cost automation and have achieved a high level of productivity by embracing Japanese concepts and best practices. India is already the second largest two wheeler manufacturer in the world, second largest tractor manufacturer in the world, and fifth largest commercial vehicle manufacturer in the world and fourth largest car market in Asia. The automobile industry in India is now gradually evolving to replicate those of developed countries. As regards auto trade with India, there is a lurking fear in Pakistan that free trade with India will adversely affect our automobile sector particularly its two wheelers, as Indians are presently marketing these items at much cheaper rates.58 Many assemblers feel that the local industry will suffer due to opening of trade with India in case the cost of doing business in Pakistan is not brought down in due course of time.

[26] *Trade between India and Pakistan Potential Items and the MFN Status.html*

[27] *ibid*

Pakistani autoparts industry is only interested in the procurement of raw materials from India instead of seeking any technical collaboration or the transfer of technology. However, Pakistan can import automotive components and spare parts from India at a lower price as presently these items are being imported from Far East at higher prices. On the other hand, India is expected to benefit from free trade due to its low raw material, electric and labor costs.

4.5 SMALL AND MEDIUM ENTERPRISES (SMES)

SME sector is an important sector in the economy of Pakistan. According to Small & Medium Enterprise Development Authority (SMEDA), more than two million small and medium enterprises (SMEs) spread across the country contribute 30 percent to GDP and generate around 25 percent of the manufacturing sector's export earnings. The SMEs constitute 90 percent of the business and are responsible for 80 percent of nonfarm based employment.[28] However, the competitiveness of the SMEs is marred by their structural weaknesses and to some extent insufficient institutional support from the government. Over 90 percent SMEs are very small in size, both in terms of investment and workforce. Consequently, they are fraught with various problems ranging from their smaller size to higher production costs, lack of access to easy and cheap finance, modern technology and capital goods, non-availability of local raw material, lower productivity, etc. Moreover, expensive labor, skill gaps and a flawed tax structure have also impeded their growth. A Small and Medium Enterprise Bank has been established to provide program loans, new credit appraisal and documentation techniques to assist the SME financing needs. Since most of the SMEs in Pakistan cannot be categorized in the documented formal economy, these units can neither have access to finance to support their production capacity nor to upgrade their technology to improve efficiency and productivity. This has resulted in higher input and production costs as well as a lack of efficiency and competition. All these problems weaken Pakistan's SMEs sector in the South Asian region.

On the other hand, India has a strong industrial base and its small-scale sector has grown phenomenally during the last three decades. Small and medium-sized enterprises
are considered to be one of the principal driving forces of economic development in India. The significant role of Small Scale Industries (SSIs) in the Indian economy is reflected by fact that presently these account for 95 percent of all industrial units in the manufactured in the small-scale sector with export share to the extent of 35 percent.

[28] *ibid*

The Government of India has always accorded priority to the Village and Small Industries Sector in its Industrial Policy Resolutions and for industrialization strategy. The State has played a progressively active role in the development as well as strengthening of small-scale industries through various measures. In this regard, a full fledged Bank namely the 'Small Industries Development Bank of India' (SIDBI) is functioning as an apex institution for promotion, financing and development of industries in the small scale sector and for coordinating the functions of other institutions engaged in similar activities. These policy measures have given thrust to the simplification of regulations and procedures, economic viability of SSI units, improving their competitive strength, export promotion, credit flow and development of integrated infrastructure for the sector.

What will happen to Pakistan's small and medium business sector once trade with India is further opened up and moves towards freer trade between the two countries? In this connection, no specific study has so far been conducted to analyze the possible implications of free trade on regional SMEs. It is, however, generally believed that India is one of the most protected economies and its industrial base is stronger than Pakistan. It would be difficult for Pakistani SMEs to compete with Indian SMEs under existing conditions. Most of the small and medium entrepreneurs are of the view that SMEs in Pakistan do not have the kind of strength that they need to compete in a free trade environment. SMEs in Pakistan are already grappling with numerous structural and institutional weaknesses and will be the most vulnerable sector if free trade starts between Pakistan and India. Some (efficient and cost-effective) SMEs would survive while others won't, which will result in plant closures and unemployment. Only those industries would be able to hold out against Indian products which are already catering to export markets. On the other hand, some entrepreneurs view the prospect of liberalization of trade as a window of opportunity to improve production quality and efficiency through greater exposure to regional competition especially with India. This idea is supported by the fact that the exporting industries of readymade garments, knitwear and hosiery have already achieved a minimum level of efficiency and are now reasonably competitive. Only those industries marketing their products domestically with no potential for exports will face the problem. In view of the foregoing, there is an urgent need to address all the issues facing the SMEs in Pakistan, and to formulate a policy framework along with a conducive regulatory environment before entering into free trade with India. The SMEs need a lot of financial and technological support from the government to sustain and compete in a free trade era. The solution lies in technology up-gradation, modernization, and emphasis on core competencies and promoting clusters/industrial estates.

4.6 INFORMATION TECHNOLOGY (IT)

Information Technology (IT) is the top priority and a sunrise industry in the global arena. The entire South Asian economy is also being propelled by the services sector, in particular by knowledge-based industries. A large number of Indian, Pakistani and Sri Lankan IT professionals are active in Europe and America. Starting from a low level of $4 million in 1980, Indian software exports have reached US $8 billion in FY05. By 2008, India's software industry is expected to cross US $87 billion, with $50 billion coming from exports.[29]

In India, the IT industry has made tremendous progress and has emerged as one of the fastest growing sectors. The Government of India has recognized IT as a priority sector for the growth and development of the country and has therefore, formulated strategic policies and provided incentives for its advancement. A large number of Indian software companies have not only acquired international quality certification but also enjoy a comparative advantage in IT-enabled services. A majority of the multinational companies operating in the area of information technology in India have either software development centers or research development centers. India's expertise in emerging technologies has actually helped the country to get new customers and the companies in Europe and Japan are directing their outsourcing to India.

In Pakistan, the IT industry is in its infancy but is growing at an enormous pace while struggling to catch up with the regional and global industry. According to Pakistan Software Houses Association (PASHA), Pakistan is currently home to around 300 IT and BPO companies, who generate around $50 million revenues annually. At present, the industry employs around 10,000 professionals. However, most of the companies are small to medium sized with a little representation of entities having full concentration in the export of software and IT-enabled services. Pakistan has lagged dangerously behind other regional countries in exploiting IT as a catalyst for economic revival. However, the significant growth of the Internet and the coming tidal wave of E-Commerce still provide immense opportunities for Pakistan to exploit their potential and use them for accelerating its economic revival. Though the software industry is growing at an accelerated pace in Pakistan, the fledging Pakistani industry is unlikely to provide serious competition to the enormous Indian industry once trade is further liberalized. However, this is one of the potential areas which could be exploited, and business-to-business links can be cultivated for mutual advantage both for Pakistan and India. There is a need to enhance business opportunities and help National Association of Software and Services

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[29] *Tariq Rashid (2006), Implications of Liberalizing Trade and Investment with India (SBP Research and Policy Wing)*

Companies (NASSCOM) and PASHA, the apex bodies representing the Indian and Pakistani IT software and service companies, to put together a framework of mutual co-operation for continuous interaction between the two countries in the IT sector. The Pakistani IT industry can look at Indian experiences and learn from them in putting up businesses in cooperation with each other. India with its wider software Industry can extend help to Pakistan to promote IT through the establishment of joint ventures. In this connection, the major players in the Indian IT sector may be approached for possible joint ventures.

CHAPTER 5
POLICY SUGGESTIONS TO ENHANCE PAKISTAN-INDIA TRADE

The paper aims to provide useful insights for policy makers. The sequencing of policy implementation should be such that as a first step trade relations between the two countries should be normalized by trading on MFN basis. As a second step, policymakers should address problems related to information exchange, trade facilitation, banking, non-tariff barriers, visas and communication. As a third step an enabling environment for investment has to be created so that India and Pakistan can enter into joint ventures. The key policy suggestions can be outlined as follows:

5.1 TRADE ON MFN BASIS

As a first step, and perhaps the most important one, India and Pakistan need to normalize trade with each other on an MFN basis. The step has already been taken by India and it remains upto Pakistan now, to respond accordingly. It is essential to move from a positive list approach to a negative list approach. Moreover, it is important for the two countries to have a common Harmonized System of codes, and greater transparency.

5.2 INFORMATION EXCHANGE

- As new firms enter into Indo-Pak trading, trade needs to be facilitated through better information exchange on commodities and quantities to be traded. Establishing web portals towards this end would perhaps be the easiest in terms of implementation.
- Information on each other's policy environments should be disseminated to traders. Such information should be made available on Government websites. Improving information flows between the two countries will also reduce the search costs for trading.

5.3 TRANSPORT ROUTES

- As there are only two operational routes, Mumbai-Karachi sea route and the Attari/Wagah rail link on the land border, new routes should be opened up.
- New rail and road links e.g. the Khokrapar-Munabao link and the Srinigar Muzaffarabad link (for goods transportation) should be opened.

5.3 TRANSPORT BOTTLENECKS

- Abandoning the positive list approach would allow goods to move freely on the direct routes thereby lowering transaction costs.
- The rail protocol should be amended such that restriction on wagon balancing is removed and wagon availability is improved.
- Measures such as simplifying border procedures and introduction of EDI (Electronic Data Interchange) facilities should be introduced at the land borders.
- The shipping protocol should be amended so that third country and non-national flagships can ply on the Mumbai-Dubai sea route. This would help in lowering shipping costs.

5.4 BANKING

- As there is evidence of anonymous transacting between trading partners, payments through formal channels assume a greater role. Currently, the payments system is formalized through the Asian Clearing Union which is inefficient as payments are often delayed. The two countries need to have an institutional arrangement so that the state, private and foreign banks can participate freely in banking transactions.
- There needs to be greater transparency to address problems related to confirmation of L/Cs and to payments.

- A more rigorous system on application of Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary Standards (SPS) by Pakistan needs to be put in place.
- India would need to address barriers related to security considerations so that transaction costs of importing from Pakistan are lowered.

5.5 VISAS

Visa restrictions should be eased by eliminating city specific visas prior to entry and police reporting on arrival.

5.6 COMMUNICATION

Uninterrupted telecommunication links between the two countries would facilitate trade between the two countries.

5.7 INVESTMENT

- Currently there are no Indo-Pak joint ventures. As several Indian companies are showing an interest in having joint ventures in Pakistan, it is important to understand the nature of such investment and provide timely facilitation.
- Governments of India and Pakistan should set up an institutional mechanism that would guarantee each other's investments.

The joint-productions in showbiz sector can surely provide the required impetus. The suggested roadmap can serve as an important tool for policymakers of the two countries.

CHAPTER 6
IMPLICATIONS OF TRADE LIBERALIZATION WITH INDIA

Pakistan and India are the two most populous and largest economies in South Asia. The current status of trade is not reflective of any remarkable progress as total volume of trade between the two countries remained at a low level during the past five years ending FY04. The liberalization of bilateral trade between the two countries would not only lend impetus to the integration of both the economies but would also be seen as a good omen by the other nations as well. With political and economic stability, India and Pakistan can expect fresh foreign investment coming into these countries. Cheaper cost of production, skilled labor, educated middle class, female literacy, booming economy, vital US and European interest in the region can change the fate of many people of the sub-continent in a span of 5/10 years' time. There is an enormous potential for increasing trade flows between India and Pakistan. As compared to the average trade flows of $415 million during FY 2000-01 to FY 2004-05, the estimates of trade potential range from $1.85 billion to $10.0 billion. However, part of such flows would certainly be the conversion of existing trade now routed through third countries into direct India-Pakistan trade, as well as the formalization of trade flows currently smuggled across the border.

6.1 HIGHER ECONOMIC GROWTH

Trade liberalization can lead to higher economic growth. Gains in total factor productivity achieved through the economies of scale and enhanced efficiency are likely to translate into higher growth of potential output. In addition, a liberalized trade regime is likely to attract FDI, as an economy with larger access to regional markets becomes more attractive to foreign investors. Higher FDI, in turn, may lead to increased technology transfer and total factor productivity. Moreover, trade liberalization can be seen as part of the broader process of regional integration, which may foster closer relations between India and Pakistan. The potential advantages of trade liberalization for Pakistan appear to be large**.** Going well beyond the immediate creation of trade flows, the advantages of dismantling tariff- and non-tariff barriers include the potential for boosting productivity and economic growth, and can also extend to promoting regional cooperation in all areas. The lowering of trade barriers can create trade flows which will increase economic efficiency, in product groups currently being produced in Pakistan. Similarly, the lowering of trade barriers will create new export opportunities for Pakistani products in other SAFTA member countries.

6.2 ACCESS TO LARGER MARKETS

Pakistani producers would lose due to falling consumer prices, but gain due to access to larger markets and possible efficiency boosts. As a main disadvantage for producers, trade liberalization is expected to lower prices of imported products, and Pakistani firms competing with those imports are likely to face decreasing profit margins. By contrast, trade integration will allow producers to access a much wider market, allowing for greater efficiency in production by exploiting economies of scale in production, thereby boosting productivity. In addition, since freer trade provides entrepreneurs with an incentive to explore new export opportunities and to compete more fiercely with imports, trade liberalization can lead to efficiency gains through learning and innovation. Finally, like consumers, producers would also benefit from increased reliability of power supply that may materialize if trade in power is liberalized.

6.3 BENEFITS TO PAKISTANI CONSUMERS

Trade liberalization will unambiguously benefit Pakistani consumers, when product prices will fall and consumer choice will increase with reduced trade barriers. Importing from India rather than from more distant locations would imply lower transportation costs. These, as well as lower tariffs, would be largely passed on to consumer prices if there is sufficient competition among suppliers. In addition, in agriculture, price volatility could decline, as at times of unforeseen shortages in local production, access to Indian production could help smooth out price spikes. Pakistani consumers could also gain from liberalized trade in power, as the reliability of power supply could increase. In textiles, lower prices would be expected to have a beneficial income distribution effect, as lower income households spend a higher share of their income on textiles. For upper income groups, access to high-quality Indian silk products would imply an increase in consumption choices. In engineering goods, consumers may benefit from lower prices for cars, motorcycles and bicycles, as well as access to Indian products.

6.4 WELFARE GAINS FROM TRADE IN WHEAT AND SUGAR

Food grain production, in general, and production of wheat, in particular, carries great significance in the agriculture sectors of Pakistan. Similarly, sugar industries have an important contribution to the GDP in both Pakistan and India. A study reveals that there is no clear comparative advantage to either India or Pakistan in wheat trade. Unlike Pakistan, India maintains huge subsidies to its

farmers. If subsidies to Indian farmers are removed, their comparative edge will disappear in favor of wheat farmers in Pakistan.

6.5 GENERATE HIGHER CUSTOMS REVENUE

The Pakistani government would gain in terms of customs revenue. Increased trade flows that stem from the lifting of import prohibitions from India and diversion from informal to formal trade would generate additional customs revenue for Pakistan. By contrast, to the extent that existing tariffs are lowered, there would be corresponding losses in customs revenue. However, as the existing trade flows are much lower than the potential for such flows, the former effect would almost certainly dominate the latter. In addition, to the extent that trade integration increases the likelihood of the construction of a gas pipeline from Iran or Afghanistan through Pakistan to India, the government could then get profit from transit fees, estimated in the order of US $500–700 million.

6.6 REGIONAL PROTECTION

Economic relations between countries are changing fast because globalization and WTO are making such changes compulsive. More and more developing countries are seeking to boost their economies through larger exports and regional trading blocs. There are too many examples in the modern world of economic cooperation and cultural exchanges between political rivals leading eventually to a political settlement. A classical example of economic cooperation and cultural exchanges overriding political disputes can be seen in the relationship between the Soviet Union and the US and the West as a whole. They traded with each other amply despite their cold war rhetoric. Later, the same pattern was witnessed between China and the US and other Western countries. In Asia, China and India, putting aside their major territorial disputes, are promoting economic and political cooperation and even having joint military exercises. Viewed against this background, initiation of a program of greater collective cooperation between the two large economies of the region could serve as an appropriate response to counter the adverse effects of emerging trading economic blocks in the industrial world. It can make SAARC a vibrant organization thus making it more competitive for other regional blocs like ASEAN, NAFTA, and the EU to ponder upon the strength and prosperity of the region. This would also enable both countries to get better bargaining position vis-à-vis other countries. Within the protective walls of regional economies, both countries can achieve specialization in various sub sectors of industry. Moreover, the strengthening of bilateral/regional trade would also provide a cushion to the economies of both countries from the financial or stock market shocks.

6.7 JOINT VENTURES AND TRANSFER OF TECHNOLOGY

India had achieved remarkable development and growth in the span of just 12 years since the advent of economic reforms. There is no denying the fact that the technological base of India is quite advanced. Pakistan, on its own part, has also made a modest progress in agricultural and industrial fields. Both countries have made a remarkable progress in their perception management strategies for the outside world. At present, joint ventures between the two countries are non-existent, and so is direct investment. While India and Pakistan compete to sell their goods in the global market, there are many areas in which both the countries can complement each other's needs and hence produce cost-effective quality goods. Both the countries, besides, promotion in trade and industry could also look forward to industrial cooperation and sharing of technology and establishment of joint ventures in some potential sectors, i.e. information technology, drug pharmaceuticals, fish processing and dairy products, chemicals, agro chemicals (pesticides), automobiles and spare parts, etc. In addition, India and Pakistan can establish joint ventures to harness and transmit the region's hydropower resources. Cooperation in water management and hydropower projects can help in increasing irrigation benefits, decreasing risks of floods, and establishing an India-Pakistan electric grid system for intra-country transmission of electricity. The infrastructure and other facilities provided in the Export Processing Zones could be utilized to establish joint ventures, which in turn would augment the transfer of technology and manpower to each other. The industry of both the countries will benefit by exchanging expertise, knowledge and technical know-how.

6.8 TRANSIT TRADE

Pakistan holds potential as a feasible and viable transit route for the international trade of land-locked Central Asian Republics, Afghanistan and Chinese provinces bordering Pakistan. Realization of this potential could mark an impressive addition to our economic capacities. Pakistan as a transit state has to look far beyond just the presently perceived Indian comparative advantage. A bulk of what Pakistan trades in the future with India will emanate in Iran, Qatar and Central Asia. Granting of transit rights will open up huge markets for India in Central Asia and for Pakistan in the South Asian countries.

6.9 ENHANCED EFFICIENCY

Since trade liberalization with India entail tariff restructuring, it is likely to bring efficiency in the domestic industries as the reduction in protection to the domestic industry would force them to restructure in the face of greater

competition. Promotion of investment by the Indians in Pakistan can add to such competition in the export oriented industries.

6.10 SOCIAL BENEFITS

Trade is an area that will have economic as well as social benefits for both countries and their people. There are about 373 million people in both India and Pakistan who are living below poverty line out of the total population of about 1.20 billion people in both countries. According to ADB's annual report, the experience of five Asian countries - China, India, Thailand, Pakistan and Vietnam - reveals that poverty is a challenge that can be overcome if states pursue "sustained pro-poor" policies. India is a huge market second to China. Free trade will provide smaller economies like Pakistan access to new market and increased demand for their products which in turn will raise output and employment levels and contribute to their prosperity. Continued strong growth in the two large low-income countries will reduce global poverty, serve as an incentive to other developing countries and benefit the world economy as a whole.

6.11 SAVINGS FOREIGN EXCHANGE

Imports from India will cost less because of low freight costs and easy accessibility of the market which could save country's foreign exchange substantially. India has a well diversified exports structure and also produces internationally reputable products in sectors like chemicals, IT and consumer electronics and transport equipment. Consumers in Pakistan can benefit from a wide variety of items in such sectors.

6.12 CURB SMUGGLING

Unofficial trade between the two is substantially higher than the official trade, which is depriving the exchequer of huge revenues. Both countries failed to achieve any significant gains as the advantage is passed on to corrupt elements and Mafia, who thrive on smuggling, illegal border trade, transit through third countries, personal baggage in connivance with customs officials, etc. at both the ends. Legalized trade, therefore, will be favorable to Pakistan mainly because it will reduce smuggling and increase government revenue besides providing us vast market across the border.

6.13 REDUCTION IN DEFENSE EXPENDITURE AND PEACE DIVIDEND

Pakistan and India have a long history of armed conflict over the Kashmir issue. Super power rivalries, regional conflicts and internal instabilities in the

developing countries including Pakistan provided a justification to increased spending on defense. India and Pakistan are heavily relying on external assistance to finance their defense expenditures. An adverse effect of the heavy expenditure in defense and debt service has been that a very small amount is left for other important sectors of the economy viz. education, medical health, etc. By diverting some part of savings from military spending to productive investment, the country could be able to raise its rate of growth substantially. More commerce between India and Pakistan will enhance the political and economic space to deal with differences. Healthy trade relations between the two nations would ultimately pave the way for the settlement of political dispute, which in turn, would facilitate a negotiated mutual reduction in military expenditures resulting in peace dividends for two impoverished countries. During 2004-05, Pakistan spent 3.1 percent to 3.5 percent of GDP, and India 1.5 to 1.7 percent of GDP, on defense.

6.14 PROMOTION OF TOURISM

Promotion of tourism is another area of mutual cooperation and benefit. Pakistan offers great untapped potential for development of tourism in its Northern and coastal areas. Besides, a lot of historical and religious places exist to attract the tourists. Tourism has been given the status of industry in Pakistan and offered fiscal and tariff incentives. This is an area where we can benefit from the experience of highly developed tourist industry in India and seek collaboration for developing tourism industry in Pakistan. But all these require liberal visa facilities for both businessmen and tourists. In this regard introduction of railway passengers booking between important cities of the two countries, extension of transit visa facilities and easing of policy in respect of reporting procedures on short visits and greater liberalization of travel facilities would not only facilitate people-to-people contact between the two countries but also generate additional foreign exchange earnings.

6.15 CULTURAL COOPERATION

On public level, relations between Indians and Pakistanis are usually very cordial and friendly. Most recently there have been frequent visits of artists, delegation of trade bodies, social scientists, academics and information media personnel between the two countries who have been extended very warm welcome. Promotion of trade and economic activities would also enhance cultural and educational exchanges, which could help in reinforcing the fabric of our bilateral relations. Both the countries have a large number of common game events and frequent visits of their teams will greatly improve social and cultural relations.

6.16 HARMONY IN POLITICAL RELATIONS

Improved trade relations with India are likely to enhance Indian interest in the region and may motivate India to agree for the gas pipeline through Pakistan. India, which is deficient in energy, has been reluctant in having the pipeline through Pakistan for various political reasons. It is likely to bring substantial improvement in political situation which in turn would bring more economic benefits to both India and Pakistan.

6.17 CONCERNS AND THREATS

The benefits of trade with India must be weighted against the costs inherent in certain apprehensions about competition from India which has been feared in the past for a number of reasons. Some studies conducted so far, have identified three potential areas of Pakistan's economy, i.e. agriculture, textiles and engineering sector that would be affected following its trade liberalization with India. Despite liberalization, India's trade regime still remains more restricted than Pakistan in terms of both tariff and non-tariff barriers. Prohibitive non-tariff barriers in India have made Pakistan's exports to India unattractive. Though some trade barrier exist in Pakistan and MFN status has not been granted to India, however, Pakistan can consider granting the MFN status in case the trade barriers particularly the non-tariff barriers imposed by India are minimized. A large part of the resistance in Pakistan comes from the country's business community who feel that the higher cost of production in a relatively smaller economy in comparison to India will make them vulnerable to tough competition. Though low transport cost from India will provide the Pakistani consumers cheaper products, however, it is also likely to reduce the natural protection of Pakistan's domestic producers. The decision to relax trading links with India should have to be in stages, only opening up sectors first where Pakistani businesses and industries do not feel threatened on a large scale. There is a general apprehension in the business community in Pakistan that the opening up of trade will adversely affect our industries particularly the textiles, automobile and some other industries in which Pakistan is not so competitive in terms of prices. The decision to liberalize the trade will need to be made keeping in view the developmental stage in different industries. For example, in case of automobile industry, we may prefer to import automotive components and spare parts from India instead of importing complete assembled cars which are much cheaper in India compared to Pakistan.

CHAPTER 7
CONCLUSION

Pakistan has recorded persistent trade imbalance with India during the last ten years. The growth in bilateral trade between Pakistan and India over the years has been dismal and quite volatile. Low volumes of trade and low trade integration between the two countries have their roots in their respective trade systems, as both India's and Pakistan's trade regulations are relatively restrictive. Despite recent reforms to open up trade, India's average tariffs remain relatively high at 22.2 percent in 2005 compared to 14.9 percent in Pakistan and a developing country median of 11.2 percent. India has the largest number of tariff peaks in South Asian Region, which are concentrated in the agricultural, automobile, and textiles and garments sectors. In addition, India's most complicated and pervasive non-tariff barriers as well as export subsidies and domestic protection have made difficult for Pakistani products to enter into Indian market.`

There is substantial scope for improving trade between the two countries. The potential of trade estimated by various reports ranges between $0.75 billion to $6.5 billion. The trade compositions of India and Pakistan reveal that there are 1181 items worth $3.9 billion which are common between Pakistan's exports and India's imports during FY06. Potential of exports is estimated at $2.5 billion for 692 items under which Pakistan's export unit values are less than that of Indian imports. Similarly, against 2646 common items of Pakistan's imports worth over $7 billion in FY06, India had exports worth over $15 billion. Potential of imports is estimated at $2.7 billion under 48.7 percent of these items, for which the unit values of Pakistan's imports are more than the unit values of India's exports**.** Even after excluding the items which are currently permissible for imports from India; about 45 percent of the items remain in the common list which could be imported from India at a lesser cost than the current cost of import from the rest of the world. It is estimated that allowing import of such items from India (i.e. expanding the current list of positive items) the average saving for Pakistan could range between $400 million to $900 million.

Pakistan's economy is far less diversified as compared to the Indian economy and depends heavily on the textile industry. Textile sector still represents 46 percent of total manufacturing and provides 65.6 percent of Pakistan's export receipts. Unless efforts are made to improve this situation, granting unrestricted access to Indian textiles in Pakistani domestic market may have serious repercussions for the whole economy.

The comparison of textiles exports of both Pakistan and India identifies 176 common items which have comparable unit values. Out of these 176 items, India has a price advantage, i.e. lower realized export unit value in 48 textile products while Pakistan has price advantage in 128 textile products. Since other factors like quality, production and design of products, etc. are also important, it is hard to conclude on the basis of just export unit value that granting of MFN status will result in a uni-directional flow of textile products, i.e. Indian products flooding the domestic market of textile products.

In the iron and steel sector, the average import unit value of Indian iron ore during FY06 was slightly higher than the average import unit value of total iron ore imports primarily due to the considerably cheaper imports from Iran. It is, therefore, unlikely that the imports from India would be able to maintain its dominating supplier status.

Under the iron and steel products, about 47 items are identified that are cheaper to import from India on the basis of lower unit value of Indian exports compared to the import unit value of Pakistan's imports from the rest of the world. Besides, the quantum of items being already imported can also be enhanced.

During FY05 and FY06, Pakistan imported 4.3 percent and 6.8 percent of its total import of chemical and pharmaceutical products respectively from India. Out of total imports of $2.9 billion (1105 items) in FY06, India supplied 353 items worth $196.8 million. Out of total imported chemicals and pharmaceutical products from India, 166 items had a lower unit value of imports compared to the unit value of the same items imported from elsewhere. These items have the potential for enhancing imports from India.

The potential advantages for Pakistan appear to be generally large, reaching from lower prices, higher choice for consumers, and increased efficiency and market access for producers to higher revenue for the government. Moreover, trade liberalization with India can foster economic growth and broaden the process of regional integration as well. Complete elimination of tariffs under SAFTA may increase the intra-regional trade by 1.6 times the existing level.

Pakistan's ability to benefit fully from bilateral trade opportunities will depend on successfully seeking greater access to the Indian market. Currently India's trade regime offers limited access to some important segments of its domestic economy, especially in agriculture, manufactured goods and consumer goods. To ensure that Pakistan's producers in the northern part of the country are not exposed to a sudden increase in competition on account of lower transport costs, most of the import trade should be initially conducted through sea-lanes. Once the interest of domestic producers has been protected, the land route can be

opened to most commodities. Restricting the land route for trade in early stages will also limit smuggling while proper customs facilities are developed at border points. In case of those imports for which India is the principle supplier, protection can be ensured to domestic producers with tariffs on MFN basis.

Granting MFN status to India is an economic issue with international repercussions. Being a signatory of WTO, Pakistan is required to open its markets for India without any discrimination. In case, Pakistan grants MFN status to India, it will have to dispense with the present importable list and ease other non-tariff barriers on items to be importable from India. At present, high tariffs and non-tariff barriers in India are one of the major obstacles to grant the MFN status to India and liberalize trade between the two countries. Pakistan can only benefit from granting MFN status to India if the latter ensures a level playing field by removing some non-tariff barriers and reduces tariff on items of interest to Pakistan**.** In order to resolve this issue and tap the potential to push the process of bilateral economic co-operation ahead for the benefit of both sides, the India-Pakistan Joint Study Group (JSG) on Trade and Economic Cooperation has been constituted.

Pakistan and India have already signed SAFTA agreement. Sri Lanka, Bhutan and Nepal have already signed bilateral free trade agreements with India. Now both the countries should prepare themselves in terms of quality and effective marketing to face the global challenges in the face of the WTO whereby there will be no barriers in global trade.

Access to Indian markets can be negotiated in a bilateral framework. Keeping in view the balance of payments concerns, Pakistan should initiate negotiations, to seek phasing out of restrictions on its exports to India. There are recent precedents of bilateral negotiations between major trading partners in response to growing trade imbalances arising due to trade restrictions, e.g. US-Japan trade negotiations.

Pakistan can also adopt a stepwise approach: initially expanding the list of importable goods to include industrial raw materials (dyes, chemicals, paper, plastic, iron ores, etc.) from India which are already being imported from other countries for Pakistani industry and more cheaply available in India. Such imports will be cheaper and save precious foreign exchange by saving the transport cost also. The list can be gradually extended in response as India offers more access to Pakistan's exports.

Meanwhile, Pakistan can expand the list of permissible imports to include all those items for which Indian tariffs and quantitative restrictions equivalents are equal or to lower than tariffs in Pakistan.

One of the major factors of Pakistan's lower exports to India is that the Pakistani goods are deficient in competitiveness. In a world of cut-throat competition, a country needs to offer high quality and cheaper products to increase its share in the export market. For increasing its exports to Indian market, local industries must be strengthened through government patronage; technical support and information back-up to improve their viability to match in quality and price with the Indian products.

The infrastructure and other facilities available in Pakistan's Export Processing Zones (EPZs) provide enormous potential for Indian investors which could be utilized to establish joint ventures between the two countries. Moreover, the establishment of Special Economic Zones at Gawader and other cities (like China and India) offering exemptions from various taxes, import and labor laws besides providing manufacturing facilities and raw materials at international competitive price may also be a good option to attract foreign direct investment. Potential sectors for joint ventures include: agricultural products, food processing, auto spare parts, minerals, chemicals, pharmaceuticals, leather, textiles, tires, information technology, telecommunication, power and natural gas pipelines projects etc. There is a need to set up an institutional mechanism in both countries to guarantee each other's investment.

And finally, with a middle-class that now numbers over 300 million people, the Indian market for many categories of goods is getting bigger all the time. While Pakistani manufacturers may not be able to compete with Indian manufacturers in some categories of goods, they can compete with them quite effectively in many other categories and beat them in their own market.

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