

Pakistan – India Trade Liberalization: *Research Brief*

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Background

The decision by the Government of Pakistan (GoP) to grant Most Favored Nation (MFN) status to India could represent a landmark in the process of normalization of trade between the two countries. Simultaneously, if India agrees to the rationalization of non-tariff barriers (NTBs) on both goods and services, some of which may be more stringently or directly applicable to Pakistan, the true potential of bilateral trade could be fully realized.

The progress in recent times on improving and strengthening trade relations between Pakistan and India has been the strongest since the Pakistan and India began talking in 2011 of more liberalized trade between the two countries. In November 2011, the Federal Cabinet of the Government of Pakistan announced the decision to grant India the MFN status. In January 2012, Pakistan announced that it would move from a positive to a negative list for items to be imported from India. The negative list of 1,209 tariff lines (products) was announced after the Cabinet approved on February 29, 2012 with the provision that it will be phased out by the end of the year. This was soon followed by an agreement between Pakistan and India on customs cooperation, mutual recognition and redress of trade grievances. The recent breakthroughs on liberalizing trade between Pakistan and India also paved way for discussions on other areas of economic cooperation.

The recent developments on normalizing trade between Pakistan and India paved way for discussions on other areas of economic cooperation and coordination that could confer significant gains to both Pakistan and India. For example, in a move that will strengthen commercial ties between India and Pakistan, Reserve Bank of India has permitted foreign direct investment from Pakistan into India which had been banned hitherto. Pakistan and India signed three agreements on customs cooperation, mutual recognition and redress of trade grievances that would help in addressing the issues related to non-tariff barriers between the two countries. Furthermore, India and Pakistan have agreed to a more liberalized visa regime of granting multiple-entry visa valid for a year, for Indian and Pakistani businessmen.

On the request of the Ministry of Commerce, Pakistan Trade Project commissioned studies to analyze the impact of trade normalization between Pakistan and India. The studies include:

- i. A Primer: Trade Relations between Pakistan and India (1947-2012);
- ii. Pakistan-India Trade Relations: The Impact of Non-Tariff Barriers,
- iii. Pakistan-India Trade Relations: A Sectoral Analysis,
- iv. Policy Options for Managing the Impact of Trade Normalization with India,
- v. Macroeconomic Impact on Pakistan of The Newly Liberalized Pakistan-India Trade.

These studies were contracted out through the Institute of Public Policy (IPP), Beaconhouse National University (BNU), led by Dr. Hafiz Pasha (Economist/Dean of School of Social Sciences BNU).

In addition to the studies commissioned to IPP, Pakistan Trade Project carried out the following additional studies:

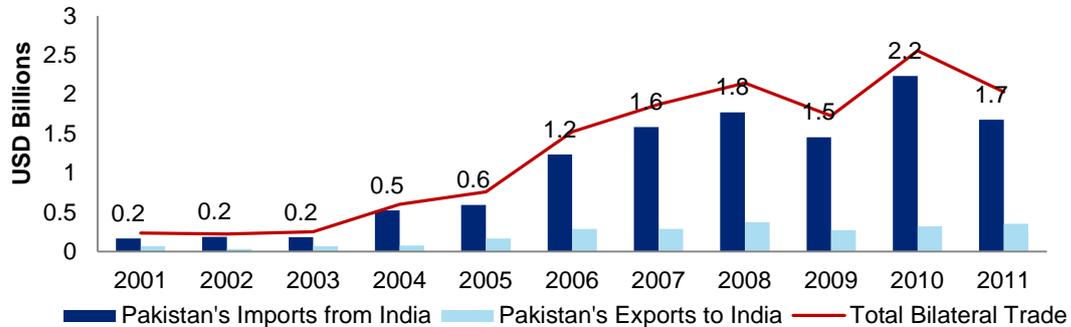
1. Assessment of potential of intra industry trade between Pakistan and India
2. Analysis of the investment policies and practices between Pakistan and India.

This research brief lists the key findings of research conducted by the Institute of Public Policy and the Pakistan Trade Project on various aspects normalization of trade between Pakistan and India.

1. Trends and Patterns in Bilateral Trade between Pakistan and India

This section briefly present data of trade between Pakistan and India since Pakistan replaced the Positive List with the Negative List. Figure 1 illustrates trends in Pakistan-India bilateral trade from 2001 – 2002.

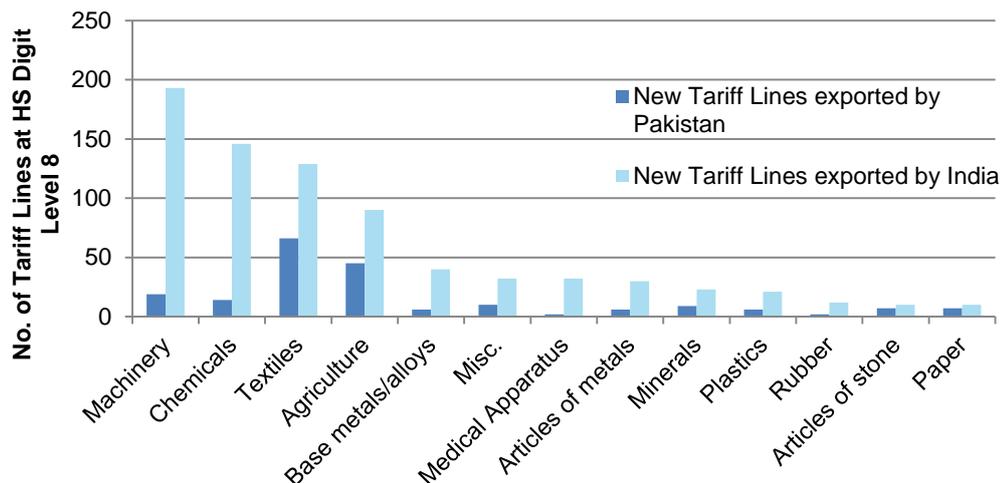
Figure 1: Pakistan-India Bilateral Trade



Since the replacement of the Positive List¹ in 2012, Pakistan's exports to India have diversified over the period of March 2012 – March 2013; with the greatest number of new tariff lines exported belonging to textiles and agriculture goods. Majority of these tariff lines from India are inputs to the local industry of Pakistan. There has been a significant increase in imports of machinery and chemicals from India following the abolition of the. These products may make the domestic industry in Pakistan more competitive globally.

Figure 1: Pakistan-India Bilateral Trade shows the trend in bilateral trade over the last decade. As a result of successive expansions in Positive List by Pakistan and liberalization of maritime and road transport protocol, there has been a strong upward trend in bilateral trade. In 2010, following the floods in Pakistan, there was a large influx of agricultural goods into Pakistan from India. Sugar imports alone amounted to US \$ 600 Million. In 2011, there was a decline in agricultural imports from India as Pakistan had a bumper crop in sugar.

Figure 2: Diversification of export basket of Pakistan and India post Positive List
March 2012 – March 2013



Following the abolition of the Positive List, imports from India increased by 794 tariff lines and exports to India grew by 214 tariff lines at HS level 8.

¹ Positive List: A list of items that were allowed by Pakistan to be imported to Pakistan from India, as per appendix G of the Pakistan Trade Policy 2009-2012. This list was abolished in 2012. The Positive List comprised of 25% of all tradable tariff lines at HS digit level 8.

2. Macro-Economic Impact of Trade Liberalization with India

This section is based on the analysis conducted by the Institute of Public Policy. For details, please refer to IPP report “*Macroeconomic Impact on Pakistan of the Newly Liberalized Pakistan-India Trade*”

The following types of technical analysis were undertaken by the Institute of Public Policy, to derive the macro-economic impact of trade liberalization with India:

1. Measurement of Revealed Comparative Advantage (RCA)– depending upon the extent to which disaggregated (in terms of the HS code) data for India and Pakistan respectively is available and for the world economy, the Balassa measure of Revealed Comparative Advantage, quantified in each product category in each country.
2. Measurement of the Trade Complementarity –a Trade Complementarity Index (TCI) to determine the scope for trade between the two countries following liberalization.

The analysis suggests a modestly favorable macro-economic impact of trade liberalization with India. Key findings are as follows:

- It is estimated that by 2014-15, the GDP of Pakistan could be 1.5% higher, implying an increase in average household income of about \$100 per annum. Given the large size of the Indian Economy, the gains in GDP terms are only about 0.5%
- The analysis shows that the number of poor will be less by 1 million. While there may be some labor displacement in import-substituting industries, the net increase in employment in the medium run is about 169,000, about 3% of the labor force.
- The consumer welfare gains are estimated at Rs 70 billion, equivalent to gains annually of Rs 2300 per household. The gains could be higher for Pakistan if India could further open up agricultural and textile markets
- The total potential diversion of India’s annual imports to Pakistan is estimated to be close to \$2.2 billion, equivalent to 9 percent of Pakistan’s annual global exports and almost eight times the actual level of exports to India.
- Of this total potential, Pakistan’s exports to India are expected to increase in the medium run (approximately 3 years) from under \$300 million in 2010-11 to just over \$1.3 billion, an increase of over 300 percent.
- There is a likely improvement in the global trade balance due to cheaper imports from India and larger exports. Research analysis shows that the global balance of trade of Pakistan could improve by \$ 240 million annually.

3. Impact of Non-Tariff Barriers (NTBs)

This section summarizes the key non-tariff barriers in India and Pakistan that affect trade between the two countries. For details please refer to IPP's report "*Pakistan-India Trade Relations: The Impact of Non-Tariff Barriers*".

One of the key assumptions behind the estimates of potential macro-economic impact of trade liberalization between Pakistan and India highlight above, and explained in detail in the IPP report titled "*Macroeconomic Impact on Pakistan of the Newly Liberalized Pakistan-India Trade*" is that bilateral trade between the countries will not be hampered by non-tariff barriers. Non-tariff barriers (NTBs) include all policy instruments, besides tariffs, that are used to protect a domestic activity or industry. They normally refer to 'government imposed' or 'government sponsored' measures.

Non-Tariff Barriers of India

India is an active user of NTBs. According to the Overall Trade Restrictive Index (OTRI)² India is the most restricted economy (as a result of a pervasive use of NTBs) in South Asia, followed by Bangladesh and then Pakistan. While India does not have NTBs explicitly specific to Pakistan, it is perceived by many exporters in Pakistan that the application of NTBs by India is more stringent towards Pakistan.

A summary of the NTBs applied by India on imports from different sources is given below:

- Sanitary and Phyto-sanitary (SPS) measures are applied on all agriculture products through a complex regulatory system. India is one of the most active users of anti-dumping measures. A number of safeguard measures have also been imposed, including quantitative restrictions.
- Quantity control measures, including quotas, are applied on 415 sensitive items e.g. marble and milk products
- Import prohibitions are applied on 51 items including livestock products
- Import licensing process is complex and is applied on 442 tariff lines, primarily live animals, vegetable and mineral products
- Price control measure are used frequently Reference prices have been established for some products, which are revised every two weeks to align with international market prices. Minimum import prices have been set for certain products including marble.
- Para tariffs are imposed as additional duties and surcharges on all goods India applies over and above tariffs increasing the average tariff rate from 12 percent to 25 percent.³
- Technical barriers to trade including quality standards, packaging and labeling requirements are complex, in particular for food products and textiles. Pre-shipment inspection is applied on metallic waste and some textiles and clothing items.
- Agriculture subsidies per hectare are three times higher in India as compared to Pakistan.

Agricultural products and textiles are of special interest Pakistani exporters to India and face the largest number of NTBs. These NTBs are applicable to textile and agriculture exports from any source country and are not specific to Pakistan.

Non-Tariff Barriers of Pakistan

The summary of NTBs applied generally by Pakistan is as follows:

- Pakistan's main trade policy instrument is its tariff regime. Industrial policy is influenced by a large number of Statutory Rules and Orders (SROs), which specify concessions/exemptions in tariffs by end use and product.
- Import prohibitions and licensing are applied for health, safety, security, religious and environmental reasons.

²World Bank Overall Trade Restrictiveness Index. 2011

³Trade Policy Review of India, WTO, 2011

- Some imports under SROs require approval by relevant ministries/agencies, like the Engineering Development Board (EDB) for the import of components and parts for the automotive sector, finished pharmaceuticals by the Ministry of Health and Ministry of Food and Agriculture for import of wheat flour.
- The National Tariff Commission (NTC) conducts anti-dumping, countervailing and safeguard investigations.
- Pakistan has 27,000 national standards, covering mainly agriculture, food, chemicals, civil and mechanical engineering and textiles.
- There are 25 notifications covering sampling and testing procedures as well as labeling, package, storage and transport of a number of food products, and pharmaceuticals, among others.
- Pakistan's SPS-related legislation is relatively outdated.

NTBs in Pakistan tend to be more focused on manufactured goods, especially with regards to customs valuation, pre-shipment inspection, import licensing by a number of Ministries/Agencies, quantitative restrictions, indigenization, anti-dumping and quality certification.

Overall, Pakistan exporters face special restrictions in trade with India including problems in transportation, financial transactions and stringent visa requirements. Also there are apprehensions that India applies NTBs more strictly on Pakistani imports, motivated partly by security considerations. Such apprehensions are difficult to validate. They reflect a trust deficit that needs to be overcome if the trade liberalization process is to proceed effectively. Hence, greater transparency in the application of NTBs and in the trade facilitation measures along with more direct interaction between Pakistani businessmen and their counterparts in India may alleviate many of the aforementioned issues and concerns over time.

4. Impact of Trade Liberalization on Pakistan's Selected Sectors

This section is based on the analysis conducted by the Institute of Public Policy. For details, please refer to IPP report titled "Pakistan-India Trade Relations: A Sectoral Analysis"

Analysis shows that Pakistan has a potential to export garments, woven cotton fabrics, woven terry fabrics, citrus fruit, animal and vegetable fats & oils by trade creation.⁴This identification is based on the application of the following criteria:

- i. RCA (Pakistan) >1
- ii. RCA (Pakistan) > RCA (India)
- iii. Global exports of Pakistan of at least \$ 100 million
- iv. Global imports of India currently are negligible (below \$ 10 million)
- v. Not in the SAFTA Sensitive List of India

Table 1: Projection of Exports of Pakistan to India (at 2010-11 base)

No	HS Code	Description	Existing Exports	Potential Exports	% increase (\$ Million)
A. Agricultural Goods			62	239	285
1	0703	Onions ^b	3	3	
2	0804	Dates	46	125	
3	0805	Citrus Fruit	-	40	
4	1006	Rice ^b	13	13	
5	2207	Ethyl Alcohol	-	58	
B. Textiles and Clothing			46	278	504
6	52	Cotton Fabrics	32	141	
7	55	Woven Fabrics	-	42	
8	57	Carpets & Floor Coverings	1	7	
9	58	Terry Fabrics	-	11	
10	60	Knitted / Crocheted Fabrics	-	25	
11	61	Wearing Apparel	1	8	
12	62	Wearing Apparel	-	11	
13	63	Other Made up Articles	12	33	
C. Non-Agricultural and Non-Textile Manufactured Goods			98	664	577
14	2523	Cement	39	217	
15	2707	Oils from Coal Tar	14	25	
16	2710	Oils from Petrol	15	235	
17	2847	Hydrogen Peroxide	4	6	
18	2917	Polycarboxylic Acid	12	83	
19	4107	Leather	8	24	
20	9018	Medical and Surgical Inst	5	62	
21	95	Sports Goods	-	12	
D. Other Goods			80	120	50
E. Total Exports of Pakistan to India			286	1301	355

Source: Derived

Table 2 depicts a summary of Level of 'Threat' in terms of increased competition to different products either being imported by Pakistan from countries other than India or being produced in Pakistan, if Pakistan is normalize trade with India by removing the Negative List. For this study a survey of a total of 75 total product groups at the 4 digit HS level, which can potentially face competition, was conducted. Results show that there is a case for reducing the sensitive list by eliminating the items with a low level of threat. Please refer to the IPP report titled "Pakistan-India Trade Liberalization: A Sectoral Analysis" for further details of this analysis.

⁴ Pakistan India Trade Relations, A sectoral Analysis, IPP, 2012

Table 2: Level of Competition Expected to be faced by Products (locally produced or imported) in Pakistan from Imports from India

'High' Threat of Marginal Competition	'Medium' Threat of Marginal Competition	'Low' Threat of Marginal Competition
Iron and Steel	Vehicles	Ceramic Products
Pharmaceuticals	Paper and paper Board	Toys, Games & Sports Goods
Man-made filaments	Rubber & Articles	Cigarettes
Machinery and Mech. App	Articles of Iron & Steel	Articles of Leather
Electrical Machinery and App	Aluminum & Articles	Glass & Glassware
	Optical & Surgical Instruments	Tools, Implements and Cutlery
		Misc. Articles of Base Metal
		Furniture, Mattress
		Footwear

5. Analysis of the Major Sectors of Pakistan

Profile of the key selected sectors of Pakistan including agriculture, textiles and clothing, chemicals and pharmaceuticals, and automobiles is presented in detail in IPP report titled "Pakistan-India Trade Relations: A Sectoral Analysis." The report emphasizes that while there is an export potential for agriculture, textiles and clothing in India, the market access to Pakistan's main export items has been limited by the continued presence these products in the SAFTA⁵ Sensitive List of India. It is suggested that Pakistan must negotiate to gain market access in high potential exports to India under the SAFTA framework.

The report also presents an analysis of revealed comparative advantage (RCA), at the 4 digit level of the HS. There are 40 product groups in which Pakistan has relative comparative advantage and India does not and accounts for significant exports of Pakistan of at least \$ 100 million, in 2010-11. Ten out of these groups are from agriculture, 22 from textiles and clothing and 8 from other mining and manufactured goods. India has RCA in 71 product groups in which Pakistan does not. Out these items 12 are from agriculture, 8 from textiles and clothing and 51 are from other manufactured goods. These are significant exports of India, in excess of \$500 million in 2010-11. India's potential exports to Pakistan include petroleum oils, jewelry, motor vehicles, iron ore, iron and steel, metal products, women garments, chemicals, medicaments, electrical equipment, and tea. Over two thirds of India's exports are competitive with respect to Pakistan.

Further, the report determines the extent of trade complementarity (the extent to which the exports of one country are the imports of the other country) between the two countries. The results show that the Trade Complementarity Index (TCI) between India's exports and Pakistan's imports is quite high at 0.580. However, the TCI between Pakistan's exports and India's imports is low at 0.230. This indicates that in the event of trade liberalization there is greater scope for diversion of existing imports of Pakistan to India than for Indian imports to Pakistan. This also explains why India also enjoys a relatively large surplus in trade with Pakistan. Pakistan's exports to India are limited by the fact that the exports are concentrated in textiles and clothing, in which the latter is one of the largest global exporters.

Following the assessment of the overall trade prospects after liberalization, largely on the basis of secondary data, in-depth sectoral case studies were proposed of some sectors. The criteria for

⁵ South Asia Free Trade Agreement

choosing those sectors is where is there maximum potential, either for increasing exports to India or where Indian exports are likely to be relatively competitive in the Pakistani market.

i. Agriculture Industry

The level and pattern of agriculture differ significantly between India and Pakistan. India produces substantially more rice on a per capita basis than Pakistan, as compared to wheat, There appears to be a relative decline in the availability of other food grains in India.

The Indian economy is somewhat less dependent on agriculture with correspondingly higher shares of industry and services. The process of structural transformation has proceeded at a relatively rapid rate in India and the share of agriculture has fallen from 23 to 17 percent over the last decade, as compared to a change from 24 to 22 percent in the case of Pakistan.

The livestock sector of Pakistan is relatively more developed. While the population ratio between India and Pakistan is close to 7:1, the ratio of milk production in 2010-11 is about 3:1 and in meat output, 2:1. Given the pre-dominantly vegetarian diet of the majority of the people of India, it is not surprising that the production of pulses and major vegetables like potatoes and tomatoes is relatively high. In fruits, Pakistan appears to have higher production per capita, especially in the case of mangoes and citrus fruit. However, banana production is vastly higher in India.

Within cash crops, the big change is in cotton. During the last decade, India has gone for bio-genetic varieties and production of cotton has more than trebled, while it has fallen somewhat in Pakistan. Consequently, the ratio has diverged from about 2:1 to over 8:1. India today enjoys a substantial exportable surplus of cotton.

It is interesting to observe the price gradient in agricultural items between cities of India and Pakistan. This reflects not only the impact of differences in per capita availability but also of trade barriers, both tariff and non-tariff. Adjusting for differences in the exchange rate, food prices appear to be generally higher in Pakistan, with the exception of atta (wheat), in Karachi as compared to Mumbai, and in some vegetables like onion and tomato. In the event of liberalization of trade in agricultural commodities, it is likely that the volume of trade in food items could expand significantly in view of the large price gradients.

The total value of production by the agricultural sector of Pakistan is Rs 4968 billion in 2011-12. It has increased annually at the rate of 3 percent in constant prices and by 22 percent in current prices since 2005-06. The share of the subsectors of crops and livestock is 42 percent and 55% respectively, with the remainder, 3%, being accounted for by forestry and fishing. The share of agriculture in the labor force of Pakistan is 45 percent in 2010-11.

The largest export is rice at \$2,132 million, followed by wheat at \$519 million, ethyl alcohol at \$ 184 million, citrus fruit at \$125 million, meat at \$114 million, fish frozen at \$113 million, vegetable fats/oils at \$ 107 million and dates at \$100 million. Other exports are below \$100 million in each case. The total value of major agricultural exports was in excess of \$4 billion in 2010-11.

In 2010-11 Pakistan's agricultural exports to India in the major products, listed in Table 5, was \$64 million, equivalent to about 12 percent of India's global imports. The only significant export to India was dates, worth \$46 million.

Table 2: Trade in Agricultural Products

Major Items* Exports of Pakistan							
HS Code	Description	Global		Exports of Pakistan from India	Presence in India's SAARC Revised Sensitive List**	Current Rate of Customs Duty of India	Trade Complementarity
		Exports of Pakistan	Imports of India				
0201	Meat	63	-	-	N	30	N
0204	Meat	114	-	-	Y	30	N
0303	Fish Frozen	113	-	-	Y	30	N
0304	Fish Fillets	46	5	-	Y	30	Y
0306	Crustaceans	36	4	-	Y	30	Y
0504	Guts, etc. of Animals	27	-	-	N	30	N
0701	Potatoes	33	-	-	Y	30	N
0703	Onions	34	7	3	Y	30	Y
0709	Other Vegetables	39	2	-	N	30	Y
0710	Vegetables Frozen	21	-	-	N	30	N
0712	Vegetables Dried	23	-	-	Y	30	N
0804	Dates, etc.	100	180	46	Y	30	Y
0805	Citrus Fruit	125	9	-	N	40	Y
1001	Wheat	519	55	-	Y	100	Y
1006	Rice	2132	-	13	Y	70 – 80	N
1101	Wheat Flour	32	-	-	Y	80	N
1301	Lac, natural gum	44	85	-	N	30	Y
1516	Animal or Vegetables Fats, Oils	107	7	-	N	30	Y
1604	Prepared Fish	62	-	-	N	30	N
1605	Crustacean Mollusks	26	-	-	N	30	N
1704	Sugar Confectionary	28	15	-	N	30 – 45	Y
1905	Bread, pastry, cakes	23	17	-	Y	30 – 45	Y
2009	Fruit juices	55	29	2	Y	30 – 45	Y
2201	Waters	25	-	-	N	30	N
2207	Ethyl Alcohol	184	76	-	Y	30 – 150	Y
2401	Tobacco & Refuse	24	10	-	Y	30	Y
TOTAL		4035	501	64			

* items in which global exports of Pakistan exceed \$20 million
Source: SBP, MOC India, SAARC

Turning to major agricultural imports of Pakistan, each exceeding \$50 million in value, there are 12 such items at the 4-digit level, aggregating to \$4.2 billion in 2010-11. The largest import is palm oil at \$1850 million, followed by cotton at \$1031 million, sugar at \$ 691 million, rape or colza seeds at \$506 million, leguminous vegetables at \$ 370 million and tea at \$ 311 million.

India is already the biggest source of import of cotton, soya bean oil cake and seeds. Currently, India supplies about 13 percent of Pakistan's requirement of agricultural products. In fact, excluding palm oil (which is imported from Malaysia and India also imports this product), India has potential of raising this share substantially. Out of the 11 major agricultural items imported by Pakistan, India will be given a tariff reduction under SAFTA in 7 items.

Pakistan's exports to India are severely constrained by the high tariffs on agricultural products. India has a customs duty of 100 percent on wheat, 70 to 80 percent on rice and 30 percent on other commodities. In addition, there are state sales tax and cesses. There does not appear to be much liberalization of agricultural exports of Pakistan and many exports remain on India's SAFTA Sensitive List, revised last in September, 2012. This includes items like wheat, rice, ethyl alcohol, dates and fruit juices. It is only in products like meat, some vegetables, citrus fruit, lac and natural gum, animal or vegetable fats & oils that some preferential access has been provided to the Indian market. But in most of these products, imports by India are currently very limited.

Turning to the tariffs on agricultural imports into Pakistan, the country appears to have moved to the other extreme of trade liberalization, in complete contrast to India. Items like onions, leguminous vegetables, rape or colza seeds and seeds are totally exempt from customs duty. On other products, the maximum rate of duty is currently 25 percent. Although the statutory rate on sugar is 25 percent, the Economic Committee of the Cabinet (ECC) has withdrawn the duty on occasions when there was a large deficit in production within the country.

The agricultural trade policy of India appears to be primarily geared to protecting the interests of farmers. Not only are import tariffs very high but there is a very large subsidy on agricultural inputs. Clearly, in the bilateral trade negotiations Pakistan must emphasize to India the need to open up its agricultural commodity markets. What matters is not the number of items in India's SAFTA Sensitive List but which items.

ii. Textile Industry

The textile sector is the largest industry of Pakistan, with strong forward and backward linkages with the rest of the economy. It accounts for almost 3 percent of the GDP, 25 percent of large-scale manufacturing and 52 percent of exports. It includes cotton yarn, man-made staple fibers, carpets, special woven fabrics, knitted/crocheted wearing apparel and other made-up articles.

The value of production by the large-scale component of the textile sector of Pakistan is estimated at Rs 1297 billion (\$ 15.3 billion) in 2010-11, with over 48 percent destined for international markets. The major contribution to value of production of 49 percent is by spinning, followed by fabrics at 29 percent. Therefore, Pakistan appears to have a comparative advantage at early stages in the value chain.

Textiles is one of the most labor-intensive industries in the country, while it accounts for about one-third of manufacturing value added, it employs more than half the number of workers. The sector is characterized by a heavy dependence on domestic materials of up to 61 percent, and minimal requirement of imported raw materials. The energy dependence is moderate, with a high of 21 percent in the case of finishing of textiles.

As highlighted above, textile industry is the largest exporter of Pakistan, at over \$13 billion in 2010-11, when international prices were favorable. Table 6 reveals that the exports of cotton and yarn fetched over \$4.7 billion, followed by knitted/crocheted apparel at \$2.7 billion and other made-up articles at \$3.2 billion. The fastest growth has been observed in man-made staple fiber and special woven fabrics.

Table 3: Exports of Textiles & Clothing

	2005-06	2010-11	Growth Rate (%) (\$ Million)
Cotton and Yarn	3598	4758	5.7
Man-made staple fibers	72	601	52.7
Carpets	257	153	-9.9
Special woven fabrics	32	295	55.9
Wearing Apparel Kn/Cr	1754	2736	9.3
Wearing Apparel not Kn/Cr	1307	1076	-3.9
Other Made-up Articles	3156	3232	0.5
Others	292	379	5.4
Total	10468	13230	4.8
% of Exports	52		
Source: SBP			

Pakistan's imports of textiles and clothing are limited to about \$ 2.5 billion, consisting primarily of cotton (\$ 1091 million), man-made filament (\$ 526 million) and man-made staple fibers (\$ 582 million) in 2010-11. The primary sources are India for cotton and China for synthetic filament yarn and fiber.

Tariffs

There has been a limited opening made by India under SAFTA. Items which will see a reduction in tariffs include woven cotton fabrics and garments. But cotton, cotton yarn, fabrics of synthetic fiber, gents' shirts, panty hose, socks, men's suits and bed linen remain in the Sensitive List, and in many cases, subject to high specific duties.

Major imports by Pakistan of textiles and clothing are either duty free or at low rate of 5 to 10 percent. They are also outside the SAFTA Sensitive List of Pakistan. Profitability is relatively low in the sector although it showed some increase in 2010-11. Therefore, out of 12 major textile exports of Pakistan, only 5 are outside the revised Sensitive List of India.

iii. Chemicals and Pharmaceutical Sector

The chemicals and pharmaceuticals industry is a major industry of Pakistan with a share of 14 percent in the value added by the large-scale manufacturing sector. Within the sector, the three sub-sectors of chemicals, pharmaceuticals and fertilizer have shares of 18, 37 and 45 percent, respectively. The fertilizer industry has developed on the back of cheap supplies of natural gas, which is now increasingly in short supply. Within chemicals, the important industries are man-made fibers and basic chemicals. Overall, this sector accounts for 3 percent of the total employment in the manufacturing sector of Pakistan. The cost structure of the major industries in the sector is presented in Table 7. The dependence on imported raw materials is the highest in the case of man-made fibers followed by basic chemicals. The energy-intensity is relatively high in the case of basic chemicals and fertilizers.

Table 4: Cost Structure of Major Industries in Chemicals and Pharmaceuticals

Industry	Cost of Domestic Raw Materials	Cost of Imported Raw Materials	Cost of Energy Inputs %
Basic Chemicals	21	17	12
Man-Made Fibers	41	24	4
Pharmaceuticals	33	11	2
Fertilizers	23	4	10
Total	33	12	6
Source: CMI			

The exports from the sector in 2010-11 were polyesters (\$ 265 million), polymers (\$ 50 million), artificial graphite (\$ 62 million) and medicaments (\$ 56 million). Exports to India were marginal. The share of competing imports in the sector is estimated at 38 percent. As shown in Table 8, imports of products, in excess of \$ 150 million, are cyclic hydrocarbons (\$ 466 billion), with India already meeting 40 percent of the requirements, polymers (\$ 896 million), acylic alcohol (\$ 328 million) and fertilizer (\$ 289 million). The total import from India of the major imported items was \$ 312 million in 2010-11.

Table 5: Chemicals and Pharmaceuticals – Exports of Pakistan

HS Code	Description	Global		Exports of Pakistan to India	Presence in the SAFTA Sensitive List of India	Current Rate of Duty (%) (\$ Million)
		Exports of Pakistan	Imports of India			
3004	Medicaments	56	764	0.2	Y	10
3801	Artificial Graphite	62	34	0.4	N	10
3901	Polymers	50	1971	0.0	N	10
3907	Polyesters	265	1025	0.0	N	10
Total		433	3794	0.6		
* Source: SBP, Ministry of Commerce, India						

The primary source of imports again is China, being the largest exporter to Pakistan in 36 percent of the items. Other important sources are Saudi Arabia and various developed countries. India is the biggest exporter to Pakistan of cyclic hydrocarbons.

There is potentially a high degree of trade complementarity between imports of Pakistan and exports of India in chemicals and pharmaceuticals, following the granting of MFN status to the latter. Over 70 percent of the requirements can be met by India. But the outcome also in the Pakistani market will depend largely on the competition between China and India.

Given their larger size, greater research capability and higher R&D spending, local availability of raw materials, and a greater export-orientation/international competitiveness, India's fast-growing, generics-focused pharmaceuticals industry is likely to pose a serious competitive threat to Pakistani producers.

Within each major import of Pakistan at the 4 digit level, there is a variation in rates of tariff at the 8 digit level. Following the implementation of SAFTA, 7 out of the 11 major imports are likely to see a decline in tariffs to 5 percent for imports from India. This will substantially improve the competitiveness of Indian chemicals and pharmaceuticals in Pakistan. Therefore, out of the 11 major imports of chemicals and pharmaceuticals by Pakistan, as many as 8 items have been kept outside its SAFTA Sensitive List. Overall, Pakistan's chemicals and pharmaceuticals industry is likely to face competition from India following the implementation of SAFTA.

iv. Automotive Industry

The automotive sector has emerged as a major industry of Pakistan during the last decade. It now has a weight of almost 7 percent in the index of production by large-scale manufacturing. The sector undertakes manufacture/assembly of tractors, buses, cars, jeeps, three-wheelers and motorcycles. The auto parts industry is also a part of the automotive sector. Production grew rapidly up to the mid-year of the last decade, but has floundered since then. Employment in the sector is difficult to estimate because a high proportion of vendors are in the small-scale/informal sector. The automotive sector is a major contributor to the national exchequer. Overall, the sector accounts for close to 5 percent of federal tax revenue, second only to the petroleum sector.

Exports from the automotive sector are limited at \$16 million in the case of tractors and \$13 million of auto parts. As opposed to this imports are sizeable and exceeded \$940 million in 2010-11, consisting of vehicles in the either completely knocked down (CKD) or in completely built unit (CBU) form and auto parts. The largest source of imports generally is Japan, with the exception of Belarus in the case of tractors. These products were not on the Positive List and, therefore, there have been no imports from India.

But India is a major exporter of vehicles and has the ability to meet a large part of Pakistan's requirements, subject, of course, to being competitive in the local market.

There is a clear cascading of the tariff structure, with the highest rates on CBU vehicles. These rates range from a low of zero percent in the case of CNG Buses to 15 percent on tractors, on large vehicles at 51-100 percent and on motor cycles at 65 percent. These rates will remain unchanged after implementation of SAFTA as products of the automotive sector are all in Pakistan's SAFTA Sensitive List. Currently, various proposals are under discussion for rationalizing the structure of duties in the automotive sector.

The basic question is whether India vehicles imported into Pakistan, at existing duty rates, will be competitive in terms of price in the domestic market. A comparison is made of the landed price of India vehicles with the domestic price in Pakistan in Table 9. It appears that cars and trucks from India will be competitive in Pakistan. This part of the automotive sector in Pakistan is more likely to face a threat after granting of MFN status to India.

Table 6: Landed Prices of "Potential" Indian Exports of Automobile Products to Pakistan Domestic Prices

	Price f.o.b. of exports from India (\$)	Price cif of imports at border* (\$)	Duty + sales tax paid price(\$)	Price in Rs (Rs) (000)	Price of Local Vehicle (with sales tax) (Rs) (000)
Tractor	8474	9321	9321	839	<i>h.c.</i>
Buses AC and for more than 13 persons	41012	45113	62727	5652	5500 ^g
Three wheeled vehicles	1447	1592	2493	224	175 ^h
Car					
< 1000cc	4855	5340	9292	836	826 ^a
1000cc - < 1500cc	7001	7701	14293	1286	1419 ^b – 1571 ^c
≥ 1500cc	9337	10270	19061	1715	1908 ^d – 1882 ^d
Goods Vehicles < 5 tons	4540	4994	9269	834	1 1106 ^e
Motorcycles					
75cc – 250cc	615	676	1295	117	114 ^f

Source: Authors' own calculations.

^aDaihatsu Cuore, ^bHonda City, ^cToyota Corolla, ^dHonda Civic, ^eHonda CG-125, ^fMaster Highland, ^gHino, ^hSazgar

* 10% is the cost of insurance and freight

** The relative competitiveness of Indian products has been enhanced by the 14.2 percent devaluation of the Indian rupee as compared to 5.7 percent in the case of the Pakistani rupee since July 1, 2011.

6. Potential of Intra Industry Trade

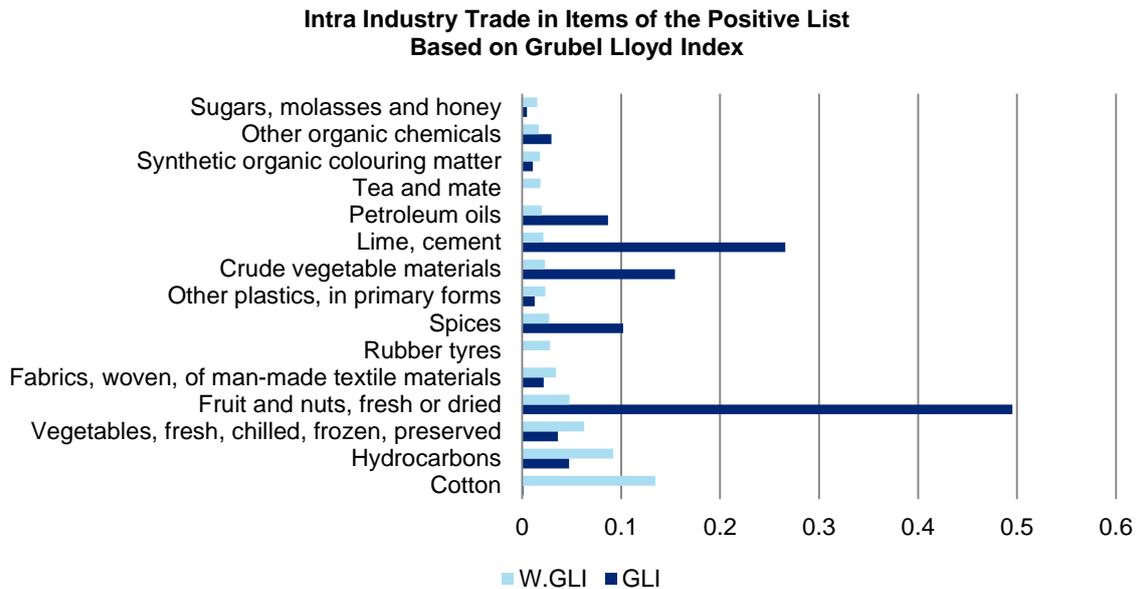
This section is based on a report conducted by the Pakistan Trade Project. For details, please refer to report “*The Potential of Intra-Industry Trade between Pakistan and India*”

As a result of the strained economic and political relations between Pakistan and India, South Asia remains one of the least integrated regions in the world. Conventional trade theories based on comparative advantages suggest that South Asian economies have limited scope for intra-regional trade as they can export similar products namely, garments, light manufacturing and agricultural products. However, empirical evidence shows that many countries simultaneously export and import of products in the same industry. This is called intra industry trade. To study the levels of intra industry trade between Pakistan and India a Grubel Lloyd Index⁶ (GLI) was constructed.

Out of tariff lines that were previously importable from India as per the Positive List⁷ regime, the highest incidence of IIT is observed in textiles (cotton and woven fabrics), agricultural products, hydrocarbons, primary plastic forms and rubber tyres. The main agricultural items that show significant levels of intra industry trade are fresh vegetables, fruit and nuts and spices. There is a notable potential in sugars, molasses and ethanol also as indicated in Figure 3.

Simple Grubel Lloyd index shows maximum IIT in fruits and nuts; however when the Grubel Lloyd Index is weighted against total bilateral trade in value terms, cotton emerges as the tariff line with the most significant level of intra industry trade.

Figure 3 Intra industry trade between Pakistan and India in Tariff Lines on the Positive List



(Source: Derived based on data at SITC Digit Level 3 from UNCOMTRADE, 2011-2012)

⁶ The Grubel-Lloyd Index (GLI) gives the ratio of intra-industry trade to total trade. IIT between country i and r can be written as:

$$IIT_{i,r} = 1 - \left(\frac{Export_{x,r} - import_{x,r}}{Export_{x,r} + import_{x,r}} \right)$$

where x is the product group and r is the trading partner and $IIT_{i,r}$ is the Grubel Lloyd Index between countries i and r . The index value is in the range, $0 \leq IIT_{i,r} \leq 1$. An index value of 1 shows pure intra-trade, the value of 0 depicts only inter-industry trade and no intra-industry trade.

⁷ Pakistan allowed imports from India of only a limited number of tariff lines that were identified as the Positive List in Appendix G, Trade Policy of Pakistan, 2012. This list was abolished in March, 2012.

In 2011, Pakistan was still trading with India under the restrictive Positive List regime; hence there was no intra industry trade in items that were not allowed to be imported from India. As a result the bilateral IIT index between India and Pakistan does not accurately capture the potential sectors where Pakistan may be able to form successful supply chain linkages with India.

For this purpose, those sectors in which Pakistan has the highest level of intra industry trade globally and India has a relatively high level of IIT to were selected to identify potential areas in which Pakistan could develop high levels of IIT with India once trade is normalized. The analysis based on global intra industry trade of Pakistan and India indicates a large potential of IIT expansion in labor intensive⁸ sectors like basic manufactures of metal, non-metallic minerals and cork and wood. At a further disaggregated level, the metal manufactures with highest IIT potential are cutlery, hand tools, sanitary ware and metallic cables. In the manufactures of minerals, the most significant items are marble, glassware and ceramics. There is also a potential of IIT in primary plastics, scientific instruments and metallic ores and scrap.

7. Cross-Border Foreign Direct Investment between Pakistan and India

This section is based a report conducted by the Pakistan Trade Project. For details, please refer to report *“Pakistan-India Trade Liberalization: An Analysis of Investment Policies and Practices”*

India is considered among the top five most attractive destinations for international investors and was ranked second, after China, in global foreign direct investments in 2010, in the United Nations Conference on Trade and Development (UNCTAD) report titled “World Investment Prospects Survey 2009-2012.” Major countries that have invested in India in the last two years (2010 – 2012) include Mauritius, UK, Singapore, Japan, Germany, Cyprus, Netherlands, USA, France and UAE.

The recent developments on liberalizing trade between Pakistan and India paved way for discussions on other areas of economic cooperation that could confer significant gains to both Pakistan and India. Under the consolidated foreign direct investment (FDI) policy, amended in April 2012, the Government of India allowed investments from Pakistan through the government route, as opposed to the automatic route, in all sectors other than defense, space, and atomic energy. While the investment regime has been liberalized, the FDI policy still remains restrictive towards Pakistan compared to investments from other countries.

⁸Measuring vertical and horizontal intra industry trade: Case for Turkey

Table 7: Sector Highlight for Foreign Direct Investment in India

Sector	% of FDI Equity Allowed	Entry Route	Entry Route for Pakistan	Other Conditions
Automobile Industry	100%	Automatic	Government	The GoI permits 200% weighted deduction on R&D expenditures. The import of technological up-gradation on the royalty payment of 5%, without any duration limit, and lump sum payment of USD 2 million is allowed under the automatic route.
Retail Industry	Single-Brand: 100% FDI >51% requires a mandatory sourcing of at least 30% from the local Indian “small industries” ⁹ Multi-Brand: Not permitted Cash & Carry/Wholesale: 100% Test Marketing: 100%	Automatic Automatic Government	Government	Single-Brand Retailing is subject to the following: <ul style="list-style-type: none"> • Products sold should be of a single brand only. • Products should be sold under the same brand internationally. • Single-brand product-retailing would cover only products that are branded during the manufacturing. • The foreign investor has to be the brand owner.
Textile Industry	100%	Automatic	Government	
Chemical Industry	100%	Automatic	Government	
Food Processing	100%	Automatic	Government	
Printing & Publishing	26%: publishing of newspaper and periodicals dealing with news and current affairs and publication of Indian editions of foreign magazines 100%: publishing and printing of scientific and technical magazines/journals/periodicals and publication of facsimile edition of foreign newspapers	Government Government	Government	
Information Technology	100%	Automatic	Government	

Pakistan’s investment policy has been formulated to create an investor-friendly environment with focus on further opening the economy and marketing the potential for Foreign Direct Investment (FDI). Pakistan has one of the most liberal investment policy regimes and public-private partnership frameworks in the entire South Asian region, under the 2012 FDI policy. The Investment Policy for 2013 and Investment Strategy 2013 – 2017 were unveiled at a meeting with the Board of Investment, in February, 2013. Unlike India’s investment policy towards Pakistan, Pakistan does not explicitly follow a discriminatory investment policy with respect to India.

⁹ Small industries defined as industries which have a total investment in plant & machinery not exceeding USD 1 million. This valuation refers to the value at the time of installation, without providing for depreciation.

The World Bank, in the world, in its 2012 annual report titled “Doing Business,” ranked Pakistan 107th, out of a total of 185 countries, in Ease of Doing Business¹⁰ and 98th in starting a business. In comparison, India ranked 132 in Ease of doing business and 173 in starting a business.

Table 8: Sector Highlight for Foreign Direct Investment in Pakistan

Sector	% of FDI Equity Allowed	Entry Route For All Countries
Food Industry	100%	Automatic
Textile Industry	100%	Automatic
Cement Industry	100%	Automatic
Chemical Industry	100%	Automatic
Leather Processing	100%	Automatic

8. Conclusions and Recommendations

Research findings indicate that India should be granted MFN status because of the potential overall improvement in the global balance of trade of Pakistan, lower inflation, employment generation and consumer welfare gains. However, Pakistan needs to revisit its negotiating strategy and convince India to open up more under SAFTA, especially in agriculture and textiles and implement agreements reached on relaxation of NTBs.

Table 9: Tariff Lines needed to be taken out of India’s Sensitive List to Improve Access for Pakistan’s Exports

No	HS Code (six digit level)*	Description	Pakistan’s Global Exports(\$ Million)
1	080450/20	Mangoes	105
2	100630	Milled rice	1892
3	110100	Wheat	352
4	520942	Woven fabrics of cotton	349
5	610510	Men’s/boy’s shirts kn/cr	350
6	610590	Men’s/boy’s shirts kn/cr	258
7	610910	T-shirts	266
8	620342	Men’s/boy’s trousers	637
9	620462	Women’s/girl’s trousers	435
10	630210	Bed linen, kn/cr	522
Total			5166

Some of the recommended short terms and long term measures that should be taken by the Government of Pakistan to maximize the benefits of trade between Pakistan and India include:

Short Term Measures:

- Negotiate with India not on the basis of the number of items in the SAFTA list but on specific items.
- Improve infrastructure e.g. Railway wagon capacity, Setup testing, warehouse and other facilities at Wagah-Atari
- Harmonize classification codes
- Launch an awareness creation campaign to inform industry
- Highlight consumer welfare gains in sectors like medicines, tea, cotton, sugar and iron and steel
- Relax visa regime
- Simplify Customs procedures
- Streamline quality control

¹⁰ The Ease of Doing Business Index is an index created by the World Bank. Higher rankings indicate better, usually simpler, regulations for businesses and stronger protections of property rights.

Medium-Term Measures:

- Launch an aggressive market development strategy in India. TDAP may organize exhibitions, fairs, delegations, information portal etc.
- Negotiate effective opening up of investment in India by removal of restrictions e.g. single brand production retail, restrictions on tourism etc
- Open more land routes
- Open bank branches
- Avoid Double Taxation
- Launch Capacity Building Measures and strengthen NTC, Customs, PSQCA
- Address power load shedding and gas shortage on priority.