GOVERNMENT OF PAKISTAN
Ministry of Commerce

Institute of Public Policy
BNU

A Primer: Trade Relations between Pakistan & India (1947-2012)

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Acronyms

APTA	Asia Pacific Trade Agreement
APTTA	Afghanistan-Pakistan Transit Trade Agreement
ASEAN	Association of Southeast Asian Nations
CECA	Comprehensive Economic Cooperation Agreement
CEPA	Comprehensive Economic Partnership Agreement
DPR	Democratic People's Republic
ECO	Economic Cooperation Organization
EHP	Early Harvest Program
EU	European Union
FPCCI	Federation of Pakistan Chambers of Commerce and Industry
FTA	Free Trade Agreement
G-20	Group of 20
GATT	General Agreement on Trade and Tariffs
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GOI	Government of India
GSTP	Global System of Trade Preferences
HC	Harmonized Code
HS	Harmonized System
HSD	High Speed Diesel
ICRIER	Indian Council for Research and International Economic Relations
LDC	Least Developed Country
MERCOSUR	Mercado Comun del Cono Sur (Southern Cone Common Market)
MFN	Most Favoured Nation
MMSCMD	Million Metric Standard Cubic Meter Per day
MNC	Multinational Company
MOC	Ministry of Commerce
MOU	Memorandum of Understanding
MQM	Muttahida Quami Movement
MW	Megawatt
NATO	North Atlantic Treaty Organization
NGO	Non-Governmental Organization
NTB	Non-Tariff Barrier
NWR	North Western Railway
PIDE	Pakistan Institute of Development Economics
POL	Petroleum, Oil and Lubricants
PPP	Pakistan People's Party
PTA	Preferential Trade Agreement
PTI	Pakistan Tehrik-i-Insaf
RP	Republic
SAARC	South Asian Association for regional cooperation
SAFTA	South Asia Free Trade Area
SAPTA	South Asian Preferential Trade Area
SATIS	Show for Audiovisual Technologies and Solutions
SBP	State Bank of Pakistan
SCOE	SAFTA Committee of Experts
SDPI	Sustainable Development Policy Institute
SMC	SAFTA Ministerial Council
SPDC	Social Policy and Development Centre
SRO	Statutory Rules and Orders
TAPI	Turkmenistan-Afghanistan-Pakistan-India

TIA	Telecommunications Industry Association
TLP	Trade Liberalization Programme
TV	Television
UAE	United Arab Emirates
UK	United Kingdom
UNCTAD	United Nations Conference for Trade and Development
US/USA	United States of America
WB	World Bank
WDI	World Development Indicators
WTO	World Trade Organization

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Chapter 0 Executive Summary

This report is the first of a series of publications aimed at unraveling the dynamics of existing and potential trade relations between Pakistan and India. This report is based on predominantly secondary research. It presents an overview of the economies and trade structure of both Pakistan and India; the existing regional agreements to support regional trade cooperation amongst South Asian countries; the trends of and restriction on Pakistan-India bilateral trade; and a chronological outline of the key developments with respect to trade relations between Pakistan and India. This report also highlights the key risks and potential outcomes with respect to Pak-India trade normalization. The remainder of the section summarizes the key analysis and discussion points in this report.

The decision by the Government of Pakistan (GoP) to move to granting 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 specific to Pakistan, the true potential of bilateral trade could be fully realized.

Overall, both economies have become considerably more oriented towards international trade with the passage of time. Today, the degree of trade openness[1] of India is 32 percent while that of Pakistan is 34 percent. In the case of Pakistan, the increase is largely due to a rise in the share of imports in the Gross Domestic Product (GDP). India has experienced a process of export-led growth. The share of exports in the GDP has increased by almost 4 percentage points over the last decade. Pakistan on the other hand is somewhat more vulnerable to external shocks due to a lower foreign exchange reserve cover of imports.

The primary destination of Pakistan's exports is the USA, followed by the United Arab Emirates (UAE) and Afghanistan. Trade with Afghanistan has developed substantially in recent years, consisting primarily of cement, petroleum, oil and lubricant (POL) products, textiles etc., while there is informal trade in cereals and other items. The largest origin of imports is UAE; followed by China. India is ranked eight among countries exporting to Pakistan.[2]

The major trading partners of India are presented in Table 7. The largest destination of the Indian exports is the UAE. This is probably due to UAE being the hub for trade to Africa. Other major destinations are USA, China and Hong Kong. Turning to imports, the biggest source is China followed by UAE, Switzerland and USA.[3]

India has a surplus in trade with USA, Netherlands and UAE. The largest deficit is with Switzerland and China. Overall, however, India has a large trade deficit, in excess of USD $48 billion.[4]

Given its vastly larger domestic market and strong economic growth performance, India has been able to conclude many more bilateral and regional trade agreements than Pakistan. This has given much greater market access to Indian exports. Trade agreements of Pakistan have primarily been with neighbors and proximate countries like China, Sri Lanka, Malaysia and Iran. India's agreements are spread across the Asia Pacific.

[1] The degree of trade openness is Trade (exports and imports) to GDP ratio. The Trade-to-GDP ratio is a basic indicator of openness to foreign trade and economic integration. It indicates the dependence of domestic producers on foreign demand (exports) and of domestic consumers and producers on foreign supply (imports), relative to the country's economic size (GDP).
[2] Trade Map 2010, International Trade Centre (ITC)
[3] Trade Map 2010, International Trade Centre
[4] Trade Map 2010, International Trade Centre

India sees better prospects for enhancing trade with major countries in world trade like China, East Asian countries and other countries in G-20. For example, the volume of trade with China has grown rapidly to reach USD $50 billion in 2010.[5]

In January 2004, the South Asian Association for Regional Cooperation (SAARC) summit meeting in Islamabad agreed to create the South Asia Free Trade Area (SAFTA) and launch it in January 2006. Under SAFTA, the member countries will implement the Trade Liberalization program (TLP) and reduce tariffs on trade among the member states on a schedule that would allow the less developed countries of the region a longer period for making adjustments.

The member states of SAFTA have been allowed to prepare sensitive lists of items which will remain excluded from the trade liberalization program (TLP) under the agreement and will, therefore, not be subject to tariff reductions. Pakistan has 936 tariff lines (at the 8 digit level of HC) in the Sensitive List of while India has a shorter list of 695 items. According to the SAFTA tariff liberalization program, the big move of tariff reduction to 0-5 percent on tariff lines outside the Sensitive List in expected in end of 2012[6] in the case of non-Least Developed Countries (LDCs), like India and Pakistan. This will effectively create a customs union and potentially have major consequences on the level and pattern of regional trade within South Asia.

Under the Trading Arrangement between Pakistan and India, Pakistan had restricted import of only those product / tariff lines included in the “Annex G” of the IPO, which was periodically expanded to allow 1870 tariff lines out of the total of 6857 lines. The transition to a full MFN status to India has led to a shift on from Positive List to a Negative List, which was approved by the Government of Pakistan on February 29, 2012. The negative list has effectively expanded the percentage of tariff lines on which import can be made from India from 27 percent to 82 percent.

As result of restrictions there is a significant volume of informal and quasi-legal trade from India to Pakistan. The main route for quasi legal trade of Indian goods in Pakistan is Dubai-Bandar Abbas-Hirat-Kabul-Jalalabad-Torkham; followed by Dubai-Bandar Abbas-Hirat-Kandahar-Chaman. The total annual volume of informal and quasi-legal trade was estimated at USD $528 million, by a 2003 study by the Sustainable Development Policy Institute of Pakistan (SDPI). This was equivalent to almost 50 percent of the formal trade with India at the time. Given the current volume of trade, informal and quasi-legal trade is likely to have approached the magnitude of over USD $1 billion by 2011.

Since 2006, the volume of formal bilateral trade has grown considerable. Indian exports to Pakistan have shown significant growth. Pakistan’s exports to India, however, have remained stagnant since then.[7] In India’s case the share of exports to Pakistan in total exports is small, at below one percent. This is, of course, the consequence of the large size of the Indian economy and of restrictions in the form of a positive list maintained by Pakistan. The share of exports to India in total exports of Pakistan is somewhat larger. While the bilateral trade does not contribute substantially to the total volume of exports of India it has acquired importance in the context of export of some individual items. A good example is that of the sugar industry of India which, in 2010 made as much as 27 percent of its global exports to Pakistan.[8] Other examples are cotton, manmade filaments, chemicals and vegetables where the shares of exports to Pakistan were significant. [9] It is expected that these sectors will develop some interest in sustaining trade with Pakistan.

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[5] Trade Map 2010, International Trade Centre (ITC)
[6] However, depending upon the interpretation of the date of coming into force of the Agreement, this could be end 2012 or end 2014.
[7] Trade Map 2010, International Trade Centre (ITC)
[8] Trade Map 2010, International Trade Centre
[9] Trade Map 2010, International Trade Centre

Overall, while there has been considerable growth in bilateral trade between Pakistan and India, most of the growth in exports to the other country appears to have accrued to the latter, despite restrictions. The existence of a larger deficit in trade of Pakistan with India does not necessarily mean that Pakistan has lost out in the process. To the extent that imports from India represent savings in the overall import bill and, consequentially, an improvement in Pakistan's global balance of trade.

The bilateral trade between India and Pakistan stood at USD $2.6 billion in 2010[10]. The ICRIER study used an augmented gravity model and quantified the trade potential at USD $6.5 billion in 2004. The State Bank of Pakistan (SBP) study of 2004 used a different methodology of assessing the extent of trade complementary between the two economies and arrived at an estimate of over USD $5 billion, with the gains being, more or less, evenly distributed. Pakistan's Secretary Commerce Zafar Mehmood has stated that the potential for formal trade could be enhanced to US $10 billion.

However, the import and export composition of both Pakistan and India suggests that the scope of diversion of Pakistan's imports to India is greater than the diversion of Indian imports to Pakistan.

Overall, it appears that, contrary to the earlier finding of the SBP [ibid], that the scope for the absolute increase in exports from India to Pakistan is significantly greater than the maximum possible increase of exports of Pakistan to India. Of course, these estimates only focus on trade diversion. The potential volume of trade could be greater if there is significant trade creation. It may be noted that greater import diversion to India may mean that Pakistan may have potentially more to gain in terms of savings in import bill and in consumer welfare due to lower prices.

At the time of independence, Pakistan and India were heavily dependent on each other. In 1948-1949, India's share of Pakistan's global exports was approximately 23.6 percent while its share of Pakistan's global imports was approximately 50.6 percent[11]. Pakistan's economic and trade relations with India, however, were fraught with challenges, the predominant of which were the various political disputes. As the disputes began to intensify in the 1950s, the trade between Pakistan and India began to become more restricted. The two countries faced a nine year hiatus from 1965, when Pakistan and India fought a war, to 1974 when the two countries signed a protocol to resume trade.

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.

There are several risks to the process of trade normalization between India and Pakistan. Risks include:

1. Restriction of trade through land route: The present decision of the Government of Pakistan to replace "Positive list" with a temporary negative list of products not open to trade has not enlarged the list of products that would be allowed to be imported from India through the land route. The opening of land routes has been made dependent on the development of the required infrastructure on both sides of the border.

[10] Trade Map 2011, International Trade Centre
[11] Ghuman, R.S. Indo-Pakistan Trade Relations (1986); Federal Bureau of Statistics, Government of Pakistan, as quoted in Ghuman, R.S. and D.K Madaan (2006)

2. Inadequate capacity of Customs border crossings: even if trade through land borders increases, the current Customs border crossings (Wagah and Khokharapar) on Pakistan and India borders do not have the infrastructure capacity to handle increased trade volumes.
3. Non-tariff barriers: the mistrust of Pakistan's private sector and policy makers / influencers regarding non-tariff barriers to trade used by India against Pakistani goods can risk the trade normalization process.
4. Pressure and interest groups: interest groups threatened by competition from Indian goods in Pakistani markets may try to reverse or slow the trade normalization process. The Government of Pakistan will likely face pressure to extend the deadline for phasing out the negative list beyond December 31, 2012.
5. Terrorist attacks in India, supported by militants in Pakistan may put significant strain on overall bilateral relations and slow / terminate the process of trade normalization.
6. Given the vast expansion of product lines importable from India, there is a possibility that some industries could suffer 'serious injury', according to the WTO terminology. The resulting losses and displacement of workers will create pressures for immediate ban on imports from India in these sectors, especially if it can be established that unfair practices are being indulged in, like export subsidies or dumping.
7. Risk of change in political vision and will to see through the trade normalization process.

There is also the problem of sequencing of the moves by Pakistan in the process of liberalization within the region. As it stands today, Pakistan is committed to give MFN status to India by end 2012 by phasing out the Negative List. Simultaneously, Pakistan may be expected to implement tariff reductions to 0-5 percent on a large number of items, outside the Sensitive List, as part of SAFTA. Pakistan has fully implemented SAFTA TLP for all members except India where the imports are subject to the Annex G of the current Import Policy Order (2009) of the Government of Pakistan (IPO). Following full implementation of SAFTA and the granting of the MFN status to India there will be a number of industries/agricultural activities which will be exposed at, more or less, the same time to opening up of trade with India and tariff reductions. Some industries may find it difficult to absorb these shocks and increase pressure to defer the moves.

Granting MFN status to India, coupled with measures for trade facilitation (like the opening of more integrated border check posts) and removal of NTBs, could confer significant gains on both sides of the border. International trade theory shows that, under some assumptions, the smaller country (in this case, Pakistan) benefits more from opening up of trade.

Potential benefits for Pakistan include:

1. Pakistani industries that can potentially benefit from access to a larger Indian market as the NTBs posed by India are removed. These industries include high quality textile products, especially cloth, ladies garments, bed wear, leather products, surgical instruments, sports goods, carpets, and cement.
2. Opening agriculture to trade with India can smooth supply shortfalls in Pakistan. The short term potential for gains in agricultural trade, however, may be limited, due to subsidies and compliance with sanitary and phytosanitary requirements.
3. In the medium-term, potential joint ventures and sharing of Research and Development (R&D) may lead to greater inter-industry specialization and, consequently, realization of greater economies of scale. The prospects for this are greater in industries like chemicals, plastic products, automobiles and auto parts.
4. The third set of economic activities that may benefit includes those sectors that will be able to access cheaper raw materials or intermediate goods from India following the opening up of trade. This will contribute to increased competitiveness of the finished products and to higher value added by Pakistani industry. Industries which could benefit include iron and steel, chemicals, pharmaceuticals and metal products.

5. An important development which could be of unambiguous benefit to Pakistan is the import of electricity and POL products, including possibly liquefied natural gas (LNG), from India. Given the high levels of power outages in the country this would contribute significantly to raising production. Initial indications are that India is willing to sell up to 500 MW of electricity to Pakistan.[12]
6. If there is a significant diversion of informal trade (from India to Pakistan) to formal channels then tax revenues could increase and the Government of Pakistan may gain additional annual revenue.
7. Consumer welfare gains from trade liberalization between Pakistan and India are likely to be substantial.

Economic sectors/activities which could face pressure following the opening of trade with India are those which were currently protected under the positive list. Down the road, an increase of 82 percent in the number of tariff lines in which trade can take place following the granting of full MFN status, indicates that a large number of activities in Pakistan could potentially be affected. For example, the automobile sector of Pakistan today enjoys high levels of effective protection with the tariff rate on completely built up (CBU) cars going up to 70 percent. This implies effective protection of up to 150 percent. Given the dominance of few Original Equipment Manufacturers (OEMs) companies enjoy near monopoly profits. Other than CBU cars, Completely Knocked Down (CKD) automotive kits, used for assembling local cars, can also be imported at competitive prices from India.

Some opponents of trade liberalization argue that the Pakistani market would be flooded with cheap Indian goods, given the more diversified production base of a substantially larger economy, leading thereby to large-scale displacement of workers. This threat would be magnified if implementation of tariff reductions under SAFTA takes place simultaneously at the end of 2012 on the large number of items which are outside the sensitive list.

An increase in the volume of imports from India is not necessarily a bad outcome for Pakistan. To the extent that this is the consequence of ‘trade diversion’ then Pakistan benefits through cheaper imports, reducing the overall import bill. Therefore, although the trade balance with respect to India may worsen there will be an improvement in the global trade balance of Pakistan. Some estimates place the annual gain at over USD $1 billion, per SBP (2005), due to cheaper imports from India which were currently from other sources. However, if Indian products penetrate enough into the Pakistani market to lead to significant ‘trade creation’ then this could lead to some short term displacement of domestic activities, while conferring some consumer welfare gains. An upcoming research by the Institute of Public Policy on the economic impact of opening trade with India with respect to key local industries of Pakistan will also focus on the possibilities of trade creation in both markets (India and Pakistan) in selected products.

[12] The Telegraph, Calcutta

Chapter 1 Introduction

The decision by the Government of Pakistan to move to granting of 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 NTBs on both goods and services, some of which may be specific to Pakistan, the true potential of bilateral trade could be fully realized.

In fact, various authors including Amit Batra (2004), Ishrat Husain (2011), A.R. Kemal (2002), Mohsin Khan (2009), Ijaz Nabi and Anjum Nasim (2001), State Bank of Pakistan (2005), Asad Sayeed (2005) and Taneja (2007) have all concluded, by the adoption of different approaches, that the potential volume of trade between the two countries is a multiple, up to five times, the current level of trade. According to Taneja (2007) the potential volume of trade could rise to above USD $11 billion.

The gains from trade could also be substantial. For Pakistan there is the prospect, first, that Pakistan can reduce the total cost of its imports as it import goods from India than from countries it is currently importing from. It is expected that the imports from India will potentially cost less not only because of savings in transport costs but also because of the relative competitiveness of Indian exports. Some estimates of the resulting saving in the annual import bill are in excess of USD $1 billion, according to the SBP (2005). The savings in the total import bills will contribute significantly in ameliorating the increasingly precarious position of the balance of payments of the country in the presence of currently falling foreign exchange reserves.

Second, subject to appropriate trade facilitation measures, and the ability of Pakistani producers to meet the Indian market and quality requirements, the vast market of over a billion Indian consumers could open up for Pakistan. Textiles, leather products, processed foods, etc. could potentially be exported in larger quantities helping to realize economies of scale. But the issue is that in the short run the margin of effective excess capacity in Pakistan is severally constrained by shortages of gas and power.

From the viewpoint of India, the granting of MFN status by Pakistan broadens the range of potential exports to Pakistan. The improvement in trade relations between the two countries, as a result of this and the reduction in mutual trust deficit may also contribute to discussions of greater South Asia-Central Asia trade and transit regional integration, whereby India may access the Central Asia and Europe cost effectively through land routes.

Pakistani sectors in which India may be able to penetrate, despite the presence of relatively high levels of tariff protection, include iron and steel, automobiles, chemicals and pharmaceuticals. Pakistani industries in these sectors may face some displacement, especially given the current supply side challenges of lack of electricity and disruptions due to law and order crises. The issue for public policy is to what extent the loss of income and employment should be traded off against consumer welfare gains and what should be the nature of policy instruments used to achieve this balance. The other policy question is to what extent existing non-competitive industries operating sub-optimally should be protected and for how long.

The above statement highlights the wide ranging and complex set of public policy issues associated with the opening of Indo-Pak trade. Therefore, there is need for proper empirical and objective research on these issues on a priority basis.

This report is the first in a series of research publications aimed at improving stakeholder awareness regarding various aspects, implications and policy options with respect to trade normalization between India and Pakistan. The aim of these publications is to:

1. Support sound policy and decision making based on reliable data and information

2. Facilitate the implementation of trade liberalization with India and support raising the awareness of the public (the private sector, media, civil society, etc.) about the benefits of opening up economic relationship with one of the fastest and largest markets in the region while highlighting the steps necessary for maximizing these benefits and minimizing any costs thereof

This report is based on predominantly secondary research. It presents an overview of the economies and trade structure of both Pakistan and India, along with the potential for bilateral trade; traces the key milestones in the trade relations between the two countries and indicates the potential risks to the process of normalization of trade relations.

Overview of the Economies of Pakistan & India

Pakistan and India are two neighboring countries which prior to Partition in 1947 were part of the same colony under the British Raj. Along with Bangladesh the three countries constitute the Indian sub-continent, which houses over 1.49 billion people, almost 22 percent of the global population. India is by far the biggest country with a population of 1.171 billion, almost seven times that of Pakistan.

The per capita income of India, as per the World Bank 2010[13] data, is estimated at USD $3,425 in purchasing power parity terms, just over 33 percent above the per capita income of Pakistan of USD $2,688 in the same period. The two countries have had a variable growth record, as highlighted in **Table 1**. In the three decades, 1960s, 1970s, and 1980s, the GDP growth rate of Pakistan exceeded that of India. But in the last two decades – the 1990s and 2000s – India has caught up and gone ahead. During the last ten years, the Indian economy grew at an average annual rate close to 8 percent, whereas the growth rate of Pakistan remained below 5 percent despite an intervening period of high growth from 2002 to 2007. Today, India is considered as one of the fastest growing economies in the world, only behind China.

Table 1: Growth Rates of the Economies of Pakistan & India (%)

	India				Pakistan			
Decade	GDP Growth Rate	Growth Rate of Agriculture	Growth Rate of Industry	Growth Rates of Services	GDP Growth Rate	Growth Rate of Agriculture	Growth Rate of Industry	Growth Rates of Services
60s	6.5	4.1	8.8	7.0	7.2	5.1	11.0	6.8
70s	3.1	1.8	4.0	4.4	4.7	2.4	6.1	4.8
80s	5.6	3.5	6.2	6.6	6.3	4.1	7.8	6.5
90s	5.5	2.8	5.6	7.3	4.6	4.4	4.8	4.6
2000s	7.7	3.1	7.9	9.3	4.6	2.7	6.2	5.1

Source: WDI

The agricultural sectors of both the economies have shown moderate growth rates of about 3 percent in the 2000s. Dynamism of the Indian economy is attributable to an over 9 percent annual growth rate in the services sector, followed by industry at close to 8 percent. In Pakistan's case, the leading sector has been industry with annual growth rate just over 6 percent.

Next, we turn to the degree of "openness" of the two economies. This is measured as the sum of exports and imports as a proportion of the GDP. Table 2 highlights the fact that Pakistan has historically been a more open economy, more inclined to trade, than India. The latter was virtually a closed economy in the 1960s following a strong strategy of import substitution, with a degree of openness of only 7 percent. At that time, the corresponding ratio for Pakistan was 12 percent. Following the process of trade liberalization in both countries since the early 1990s, the economies have become much more open. Based on the 2010 data in Table 2, the degree of openness of India is 31.6 percent while that of Pakistan is 34.2 percent. In the case of Pakistan, the increase is largely

[13] http://data.worldbank.org/indicator/NY.GDP.PCAP.PP.CD

due to a rise in the share of imports in the GDP. India has experienced a process of export-led growth and the share of exports in the GDP has increased by almost 4 percentage points over the last decade.

Contrary perhaps to expectations, **Table 2** indicates that Pakistan has a higher share in exports of manufactured goods of 74 percent, as compared to 64 percent in the case of India. The shares of exports to developing countries are comparable at 35 to 40 percent, while the share of imports from developing countries is close to 40 percent.

Table 2: Degree of "Openness" of the Economies of India & Pakistan

%

	Share of Exports in GDP	Share of Imports in GDP	Share of Manufactured Exports in Total Exports	Share of Manufactured Imports in Total Imports	Share of Exports to Developing Countries	Share of Imports from Developing Countries
INDIA						
1970	3.3	3.5	51.7	49.4	19.5	18.7
1980	4.7	8.1	58.6	38.7	17.5	28.2
1990	5.7	7.4	70.7	51.2	9.8	14.4
2000	9.2	11.2	77.8	46.7	23.1	20.9
2010	12.7	18.9	63.8	51.8	35.4	40.4
PAKISTAN						
1970	4.5	7.7	57.2	66.1	29.8	9.4
1980	11.1	22.6	48.2	54.0	37.5	16.2
1990	14.0	18.5	78.7	54.1	16.4	18.0
2000	12.2	14.7	84.7	46.8	18.8	25.0
2010	12.1	22.1	74.1	48.5	40.1	41.7

Source: WDI

What is the position of the two countries with regard to the balance of trade and level of foreign exchange reserves? This is highlighted in **Table 3**. Both countries carried large trade deficits in 2010, but the current account deficit position is much better due to the export of services in the Indian case and home remittances in the case of Pakistan. The foreign exchange reserve position of India is substantially better than that of Pakistan at 84 percent of imports, equivalent to a ten month import cover, as compared to 37 percent in the case of Pakistan.

Overall, both economies have become considerably more oriented towards international trade with the passage of time. India has had a higher GDP growth rate during the last two decades. Pakistan is somewhat more vulnerable to external shocks due to a lower foreign exchange reserve cover of imports.

Table 3: Balance of Trade & Level of Foreign Exchange Reserves (as % of GDP)

	Balance of Trade	Current Account Deficit	Foreign Exchange Reserves as % of Imports
INDIA			
1970	-0.2		35.9
1980	-3.4	-1.0	46.7
1990	-1.8	-2.2	6.5
2000	-2.0	-1.0	73.6
2010	-6.2	-3.0	84.1
PAKISTAN			
1970	-3.3		17.6
1980	-11.5	-3.7	9.3
1990	-4.5	-4.2	4.0
2000	-2.5	-0.1	13.9
2010	-10.0	-0.8	36.7

Source: WDI

Chapter 2 Global Trade Patterns of India & Pakistan

The objective of this section is, first, to see the changes in direction of trade of India and Pakistan respectively over the last few decades, second, to determine the growth of intra-regional trade in South Asia, and third, to identify the various trading arrangements with different countries and regions by the two countries. These analyses will help in determining the importance that each country will attach to bilateral trade.

Direction of Trade - Pakistan

Over the last 50 years, the direction of trade of Pakistan has primarily been with developed countries in North America and Europe in both exports and imports. However, there appears to be an increase in the share of developing economies outside the region of South Asia after 1990. This is primarily due to the intensification of the trading relationship (including entering into a free-trade agreement) with China. Trade with other economies in South Asia has remained very restricted, with some indications of an increase in 2010.

Table 4: Direction of Trade - Pakistan

(%)

	Developing Economies		Developed Economies	Total
	Within South Asia	Outside South Asia		
Exports				
1960	9.0	21.1	69.9	100.0
1970	2.6	27.3	70.1	100.0
1980	7.2	30.3	62.5	100.0
1990	4.0	12.4	83.6	100.0
2000	4.6	14.3	81.1	100.0
2010	12.3	27.8	59.9	100.0
Imports				
1960	5.5	10.6	83.9	100.0
1970	2.7	12.1	85.2	100.0
1980	3.2	15.3	81.5	100.0
1990	1.7	18.4	79.9	100.0
2000	2.7	22.3	75.0	100.0
2010	6.4	35.3	59.3	100.0

Source: WDI

Table 5 below highlights Pakistan's major trading partners.

Table 5: Pakistan's Major Trading Partners		
Country	**Value(US $ Million)**	**Ranking**
	Exports*	
USA	3,957	1
Afghanistan	2,337	2
UAE	1,808	3
China	1,634	4
Germany	1,272	5
UK	1,206	6
Bangladesh	1,015	7
Total of Above	13,229	
% of Total	(53%)	
	Imports*	
China	5,789	1
UAE	5,476	2
Saudi Arabia	4,547	3
Kuwait	3,330	4
Malaysia	2,460	5
USA	1,810	6
India	1,743	7
Japan	1,663	8
Total of Above	26,818	
% of Above	(66%)	
Source: SBP *Above USD $1 billion to the country		

The primary destination of Pakistan's exports is the USA, followed by UAE and Afghanistan[14] Trade with Afghanistan has developed substantially in recent years, consisting primarily of cement, POL products, textiles etc., while there is informal trade in cereals and other items. The largest origin of imports is UAE; followed by China. India is ranked eight among countries exporting to Pakistan.[15] Pakistan's trade with South Asian countries is given in **Box 1**.

Box 1: Trade of Pakistan with South Asian Countries

Pakistan has a surplus in its trade with countries of South Asia. The deficit in trade with India is more than balanced by surpluses in trade, especially with Afghanistan.

Historically, what was earlier East Pakistan and now Bangladesh was a major trading partner. But since 1971 its trading links have developed more with India, especially of imports.

Table: Trade of Pakistan with South Asian Countries* (2010-11) ($ Million)			
	Exports	**Imports**	**Balance**
India	287	1,445	-1,158
Sri Lanka	322	54	268
Bangladesh	908	75	833
Afghanistan	1,865	10	1,855
Total	3,382	1,584	1,798
Source: SBP * Data not available for Nepal, Bhutan and Maldives			

[14] Trade Map 2010, International Trade Centre (ITC)
[15] Trade Map 2010, International Trade Centre (ITC)

Direction of Trade - India

Table 6 gives the direction of Indian exports and the origin of imports. The share of India's trade with the other countries of South Asia is very small, especially in the case of imports. However, trade with other developing economics has trended upwards, and in 2010 exceeded 30 percent. Trade with the traditional partners in the USA and European countries, is large, although there is a visible decline in shares in 2010.

Table 6: Direction of Trade - India

(%)

	Developing Economics		Developed Economies	Total
	Within South Asia	Outside South Asia		
Exports				
1960	5.5	21.5	73.0	100.0
1970	4.6	32.3	63.1	100.0
1980	3.9	32.0	64.1	100.0
1990	3.1	23.7	73.2	100.0
2000	4.3	18.8	76.9	100.0
2010	5.0	30.4	61.0	100.0
Imports				
1960	2.2	14.2	83.6	100.0
1970	1.4	27.3	71.3	100.0
1980	1.0	36.8	62.2	100.0
1990	3.1	20.6	78.9	100.0
2000	0.9	20.0	79.1	100.0
2010	0.6	38.9	60.5	100.0

Source: WDI

The major trading partners of India are presented in **Table 7**. The largest destination of the Indian exports is the UAE. Other major destinations are USA, China and Hong Kong. Turning to imports, the biggest source is China followed by UAE, Switzerland and USA. [16]

India has a trade surplus with USA, Netherlands and UAE. The largest deficit is with Switzerland and China. Overall, however, India has a large trade deficit, in excess of USD $48 billion.[17]

Table 7: India's Major Trading Partners

Country	Value (US $ Million)	Ranking
EXPORTS*		
UAE	34,349	1
USA	25,548	2
China	19,616	3
Hong Kong	10,329	4
Singapore	10,302	5
Netherland	7,751	6
UK	7,140	7
Germany	6,758	8
Belgium	6,296	9
Indonesia	6,245	10
Saudi Arabia	5,227	11
Japan	5,191	12
France	5,068	13
Total of Above	149,820	
% of Total	(60%)	

[16] Trade Map 2010, International Trade Centre (ITC)
[17] Trade Map 2010, International Trade Centre (ITC)

Table 7: India's Major Trading Partners		
Country	Value (US $ Million)	Ranking
IMPORTS**		
China	43,479	1
UAE	32,753	2
Switzerland	24,802	3
Saudi Arabia	20,385	4
USA	20,051	5
Germany	11,891	6
Iran	10,928	7
Australia	10,789	8
Nigeria	10,788	9
Korea RP	10,475	10
Kuwait	10,314	11
Total of Above	217,130	
% of Total	(59%)	

Source: MOC,GOI
*above $5 billion for each country
**above $10 billion for each country

UNCTAD has constructed a measure of market concentration of imports and exports. These are presented for Pakistan and India respectively in **Table 8**. India has historically had a more diversified destination of exports and origin of imports. But over time while export markets have become somewhat more diversified of Pakistan they have become more concentrated in the case of India, whereas imports have become more concentrated in both countries. The latter is due to increase in share of oil imports which are available only from a few countries globally.

Table 8: Market Diversification of Trade of Pakistan & India				
	Exports		Imports	
	Number of Countries	Concentration Index*	Number of Countries	Concentration Index*
PAKISTAN				
1995	139	0.235	226	0.111
2000	167	0.215	248	0.200
2010	221	0.199	248	0.182
INDIA				
1995	250	0.138	258	0.108
2000	256	0.146	258	0.148
2010	254	0.149	257	0.245

Source: UNCTAD
*range from 0 to 1, the lower the value the more diversified are the destination/sources.

Trade Agreements of Pakistan & India

India has been able to conclude many more bilateral and regional trade agreements than Pakistan, given its vastly larger domestic market. India trade agreements are also more diverse regionally. In return, this has given much greater market access to Indian exports. Trade agreements of Pakistan have primarily been with neighbors and proximate countries like China, Sri Lanka, Malaysia and Iran. India's agreements are spread across the Asia pacific region.

India's trade with trade with major developing and developed countries in world trade like China, East Asian countries and other countries in G-20 appear to be strengthening. For example, the volume of trade with China has grown rapidly at 20 percent per annum to reach USD $63billion in 2010-11. Pakistan, a relatively smaller economy as compared to India is unlikely to get the same degree of interest in the trading partners for market access initiatives as India does. As such, along with market access opportunities available in the Indian market under SAFTA, Pakistan must continue to make inroads into the large and fast growing market in China, especially after the FTA.

Table 9 lists the FTAs and PTAs concluded by Pakistan.

Table 9: Trade Agreements by Pakistan	
Ref #	**Trade Agreement**
1	Pakistan-Sri Lanka Free Trade Agreement
2	Economic Cooperation Organization Trade Agreement (ECOTA (Pending)
3	South Asian Free Trade Agreement (SAFTA)
4	Pak – Iran Preferential Trade Agreement
5	Pakistan-China Free Trade Agreement (Goods and Investment)
6	Pakistan China Free Trade Agreement (on Services)
7	Developing-8 (D-8)- Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan and Turkey(Pending)
8	Malaysia Pakistan Comprehensive Economic Partnership Agreement (MPCEPA)
9	Pak - Mauritius Preferential Trade Agreement
10	SAARC Agreement on Trade in Services (SATIS)[18]
11	Pakistan Indonesia Preferential Trade Agreement (PTA) (Pending)
12	Unilateral Trade Preference to Afghanistan Pakistan Transit Trade Agreement (APTTA)for fresh and dry fruits

Table 10 and **Table 11** list the trade agreements that India has concluded and is in the process of negotiations, respectively.

Table 10: Trade Agreements by India	
Ref #	**Trade Agreement**
1	Agreement of Cooperation with Nepal to Control Unauthorized Trade
2	Agreement on Economic Cooperation between India and Finland
3	Agreement on South Asia Free Trade Area (SAFTA)
4	Asia Pacific Trade Agreement (APTA)
5	Comprehensive Economic Cooperation Agreement (CECA) between the Republic of India and the Republic of Singapore
6	Comprehensive Economic Cooperation Agreement (CECA) between India and Malaysia
7	India Africa Trade Agreement
8	India Chile
9	India Afghanistan Preferential Trade Agreement
10	Agreements between India and Association of Southeast Asian Nations
11	India Bhutan Trade Agreement
12	India Japan Comprehensive Economic Participation Agreement (CEPA)
13	India Korea Comprehensive Economic Participation Agreement (CEPA)
14	India MERCOSUR (Brazil, Argentina, Uruguay and Paraguay) Preferential Trade Agreement
15	India Nepal Trade Treaty
16	India Sri Lanka Free Trade Agreement
17	SAARC Agreement on Trade in Services
18	Treaty of Transit between India and Nepal

[18] Schedules and Non-Conforming measures (NCMs) are still under negotiations.

Table 11: Other Agreements under Negotiations by India	
Ref #	Trade Agreement
1	Agreement on implementation of India – Malaysia CECA
2	Framework Agreement with ASEAN
3	Framework agreement with Chile
4	Framework Agreement with GCC States
5	Framework Agreement with Thailand
6	India EU Trade and Investment Agreement (TIA)
7	India US Trade Policy Forum Joint Statement
8	India and Australia Joint Free Trade Agreement Feasibility Study
9	India Bangladesh Trade Agreement
10	India Ceylon Trade Agreement
11	India DPR Korea Trade Agreement
12	India EU Strategic Partnership Joint Action Plan
13	India Indonesia Joint Study Group Report
14	India Maldives Trade Agreement
15	India Mongolia Trade Agreement
16	India New Zealand Joint Study Report
17	India Pakistan Trading Arrangement
18	India United States Commercial Dialogue
19	Joint Communiqué for setting up the India Russia Joint Task Force
20	MOU between Establishing Border Haats across the Border between India and Bangladesh
21	MOU between India and Indonesia on the Establishment of Biennial Trade Ministers' Forum
22	MOU between India and Viet Nam on the recognition of Vietnam as a Full Market Economy

Chapter 3 Existing Mechanism for Regional Cooperation

This segment highlights the existing inter-governmental mechanisms for regional collaboration in South Asia starting with a description of the history and role of the South Asia Association for Regional Cooperation (SAARC), followed by details of the agreement on South Asian Free Trade Area (SAFTA). The authors also analyzed the list of items in the Sensitive Lists of Pakistan and India. A Sensitive list is a list of products of special interest to the individual member country that are exempt from low SAFTA tariffs. There is an understanding to gradually reduce the number of tariff lines and eventually phase it out.

South Asian Association for Regional Cooperation (SAARC)

The SAARC is an organization of South Asian nations, founded in December 1985. Its seven founding members are Sri Lanka, Bhutan, India, Maldives, Nepal, Pakistan, and Bangladesh. Afghanistan joined the organization in 2005.

The SAARC declaration identified a number of areas for cooperation, including biotechnology, communications, energy, environment, economy and trade finance, funding mechanisms, human resources development, poverty alleviation, people to people contacts, security, social development, science and technology and tourism. Over time the various summits have set up working groups in these areas to promote cooperation among the member states. This is an ambitious agenda. However, the emphasis has been on economic and social issues. Political issues have been kept out of the scope of the agreement.

The Secretariat is located at Kathmandu, Nepal. It is headed by a Secretary General appointed for a period of three years, rotated among member states in alphabetical order. The current Secretary General is Mr. Ahmed Saleem, is from Maldives.

SAARC's creation did not lead to an increase in regional trade within a regional framework. **Box 2** gives the magnitude of trade within South Asia. There was some increase in trade among some of the countries facilitated by bilateral trading arrangements. Most of these were trade arrangements with Sri Lanka.

Box 2: Trade within South Asia

The overall share of trade which is regional in character is low at 6 percent, in the case of exports, and 4 percent in imports. But there are large differences among the SAARC member countries. Regional trade links are very low in the case of India and Pakistan.

As opposed to this, dependence on other countries, especially India, for exports and imports are high in the case of LDCs. This dependence rises with Bangladesh and reaches a peak in the case of Nepal and Bhutan. Trade links of Sri Lanka have also increased following the signing of FTAs.

Table: Trade within South Asia Region

	2010	
	% of Exports	**% of Imports**
India	5	1
Pakistan	12	6
Bangladesh	3	16
Sri Lanka	7	26
Nepal	64	57
Bhutan	-	-
Maldives	36	15
Afghanistan	51	29
South Asia	6	4

Source: WDI

In 1993, the SAARC members negotiated the South Asia Preferential Trading Arrangement (SAPTA) with the aim of providing member states preference of up to 20 per cent on their trade. However, SAPTA made little difference to the volume of intra-regional trade.

In January 2004, the SAARC summit meeting in Islamabad agreed to create the SAFTA and launch it in January 2006. Under SAFTA, the member countries will implement the Trade Liberalization program (TLP) and reduce tariffs on trade among the member states on a schedule that would allow the less developed countries of the region a longer period for making adjustments. Pakistan was the last country to ratify the SAFTA agreement, among other reasons Pakistan was possibly hoping to use the promised ratification as leverage to gain concessions from India on issues such as Kashmir.

It may be noted from **Box 3** that trade among countries in South Asia is relatively less as compared to trade in different regions.

Box 3: Trade within Regions

The table below shows the trade among developing countries belonging to different regions of the world. The highest level is observed among developing countries of East Asia and Pacific, some of which are members of ASEAN. Over one-fourths of the trade is regional in character. This reflects not only differences in factor endowments but also greater intra-industry specialization. It has grown rapidly from only about 6 percent in 1990. Perhaps this experience can be replicated by the South Asia region.

In fact, regional trade in South Asia is currently among the lowest, only marginally higher than in the Arab world. Regional trade is also relatively high in the regions of Latin America and Caribbean and Europe and Central Asia.

Table: TRADE AMONG DEVELOPING COUNTRIES WITHIN REGION
(% of Total Merchandise Exports/Imports)

Region Name	1990		2000		2010	
	Exports	Imports	Exports	Imports	Exports	Imports
Arab World	2.0	2.6	1.6	3.0	2.8	4.3
East Asia & Pacific (All income levels)	11.5	14.4	17.6	23.5	25.9	26.3
East Asia & Pacific (developing only)	5.7	6.2	8.9	11.7	13.2	16.7
Europe & central Asia (developing only)	-	-	24.7	31.3	20.8	25.2
Latin America & Caribbean (developing only)	13.9	16.8	15.4	15.2	19.1	18.7
Middle East & North Africa (developing only)	4.0	3.7	3.9	5.1	7.5	7.7
Sub-Saharan Africa (developing only)	8.1	2.2	10.5	4.3	12.5	4.1
South Asia	5.8	11.9	4.6	12.0	3.5	13.0

Source: WDI

The Sensitive Lists under SAFTA

The member states of SAFTA have been allowed to prepare sensitive lists of items which will remain excluded from the trade liberalization program (TLP) under the agreement and will, therefore, not be subject to tariff reductions. However, there is an understanding of gradual reduction in the sensitive list with a hope to phase it out eventually. On January 1, 2012 NDLCs reduced the list by 20 percent. India has announced to reduce it by 30 percent after Pakistan converts positive list to negative list.

Pakistan has 936 tariff lines[19] (at the 8 digit level of HC) in the Sensitive List of while India has a shorter list[20] of 868 items which is further expected to be reduced by 30 percent. The Sensitive list of Pakistan is concentrated in Chapters 39, 55, 61, 62, 84, 85 and 87. India's list is focused on chapters 7, 39, 61 and 72. As such, there are basic differences in the coverage of the Sensitive List between the two countries.

The differences in the Sensitive list are analyzed in **Table 12** by categories of products. The conclusions which emerge are as follows:

1. India has provided more protection to its agriculture sector. Over 23 percent of the Sensitive List is in agricultural items as compared to nearly 6 percent in the case of Pakistan. For items outside the Sensitive list, India has decided to reduce the tariff for LDCs to zero percent.
2. Pakistan has provided more protection to industry. While both countries have largely excluded textiles from the coverage of SAFTA, more so in the case of India, Pakistan has included tariff lines related to machinery and appliances, and automobiles.

[19] With effect from January 1, 2012.
[20] At the time of this analysis the sensitive list of India had not been revised which is expected to be reduced by 30 percent. The list referred to above is the original unreduced sensitive list of India.

According to the provisions of SAFTA, the big move of tariff reduction to 0-5 percent in times outside the Sensitive List is expected in end 2012[21] in the case of non-LDCs, like India and Pakistan. This will effectively create a customs union and potentially have major consequences on the level and pattern of regional trade within South Asia.

Table 12: Product Categories Wise Classification of the SAFTA Sensitive List of India & Pakistan

		Number of Tariff Lines in Sensitive List			
		Pakistan	**%**	**India**	**%**
A	Agriculture	55	5.9%	207	23.8%
	1-15*: Unprocessed Agriculture	40	4.3%	140	16.1%
	16-24: Processed Foods	15	1.6%	67	7.7%
B	Minerals	3	0.3%	8	0.9%
	25-26: Minerals	0	0.0%	5	0.6%
	27: Fuel & Energy	3	0.3%	3	0.3%
C	Industry (28-97)	878	93.8%	653	75.2%
	28-38: Chemicals	65	6.9%	30	3.5%
	50-63: Textiles	224	23.9%	311	35.8%
	72-80: Iron and Steel and Metal Products	100	10.7%	59	6.8%
	84-85: Machinery & Appliances	179	19.1%	23	2.6%
	86-89: Transport Equipment	70	7.5%	4	0.5%
	Others[a]	240	25.6%	226	26.0%
D	Total	936	100.0%	868	100.0%

[21] However, depending upon the interpretation of the date of coming into force of the Agreement, this could be end 2012 or end 2014.

Chapter 4 Pakistan's Restrictions on Trade with India

Given the fact that Pakistan had earlier not granted MFN status to India, it is important to identify the nature and extent of restrictions on import from India. As such, we first analyze the **Positive List** of imports which were permissible from India until the Positive List was replaced with a Negative List, expanding the tariff lines importable by Pakistan from India. The subsequent section looks at the **Negative List**, which has been approved recently by the Federal government as a prelude to the granting of full MFN status to India. This list is expected to be phased out by the end of December 2012. The tentative implications of full trade liberalization with India are brought out.

The last subsection highlights the nature and quantum of flows of goods through informal channel from India in the presence of restrictions. Re-exports from other countries of goods originating in India are also examined. This analysis enables the quantification of the potential increase in formal trade following the liberalization.

The Positive List

This list was initially finalized under a Trading Arrangement between India and Pakistan. It was periodically been expanded and the latest list consisted of 1870 tariff lines out of the total of 6857 lines.

Items included in the Positive List included basic food items; raw materials (especially these which are not produced in Pakistan); and intermediate and capital goods (especially those which are not produced in Pakistan). [22]

Items excluded from the Positive List were generally higher value added goods posing potential competition to local Pakistani industry. Therefore, the approach towards determining the Positive List was based on the desire to insulate value adding Pakistani industries from competition by imports from India. Good examples of such cases are footwear, ceramic and glass products, paper products, value added textiles, metallic products and the automotive produces. Therefore, trade with India has hitherto been managed in such a way as to exert minimum competitive pressure on existing major Pakistani industries.

The positive list by section of the HC is given below in **Table 13.**

Table 13: Positive List of items by Section of the Harmonized Code (HC)

Section of HC	Description	Total Tariff Lines	Lines in Positive List	% of the Corresponding Tariff Line
I	Live Animals, Animal Products	248	33	13
II	Vegetables& Products	311	157	50
III	Animal, Vegetable Fats/oils	53	2	-
IV	Prepared Food stuffs	228	11	5
V	Mineral Products	195	74	38
VI	Chemicals or Allied Ind	1149	574	50
VII	Plastics and Articles	300	93	31
VIII	Hides& Skins; Leather Goods	92	45	49
IX	Wood& Articles	106	52	49
X	Paper& Paper Board	182	37	20
XI	Textiles& Articles	929	104	11
XII	Footwear& Personal Articles	59	2	3
XIII	Ceramic& Glass Products	189	28	15
XIV	Jewelry	55	5	9
XV	Metals& Articles	744	156	21

[22] Milk powder, potatoes, tomatoes, onions and other vegetables; coffee and tea; betel leaves; sugar; Coal, HSD, fuel oil; chemicals; medicines; fertilizers; newsprint and books; cotton; yarn; boilers and mechanical machinery; locomotives

Table 13: Positive List of items by Section of the Harmonized Code (HC)				
Section of HC	Description	Total Tariff Lines	Lines in Positive List	% of the Corresponding Tariff Line
XVI	Machinery	1193	353	30
XVII	Vehicles& Transport Equipment	245	15	6
XVIII	Optical& Precision Inst.	269	103	38
XIX	Arms& Ammunition	52	-	0
XX	Miscellaneous	186	5	3
XXI	Works of Art	72	1	1
	TOTAL	**6,857**	**1,870**	**27**

[1] It may be not the case that the percentage of tariff lines corresponds with the percentage of imports.

The sections where a higher share of tariff lines were included in the Positive List are vegetables and products (50 percent), animal and vegetables fats and oils (42 percent), mineral products (38 percent), chemicals (50 percent), hides, skins and leather goods (49 percent), wood and articles (49 percent) and optical and precision instruments (38 percent).

As opposed to this, sections from which only a small percentage of tariff lines were included in the Positive List are prepared food stuffs (5 percent), textiles and articles (11 percent), footwear and personal articles (3 percent), ceramic and glass products (15 percent), Jewelry (9 percent), vehicles and transport equipment (6 percent), arms and ammunition (zero percent), miscellaneous (3 percent) and works (1 percent).

The Negative List (2012)

The transition to a full MFN status to India has led to a shift on from Positive List to a Negative List, which was approved by the Government of Pakistan on February 29, 2012. The negative list has effectively expanded the percentage of tariff lines on which import can be made from India from 27 percent to 82 percent. However, as shown in **Table 14**, industries which will continue to receive protection till the negative list is phased out (expectedly by December 31, 2012) include chemicals, plastic products, paper products, value added textiles, ceramic and glass products, metallic products, machinery, vehicles and transport equipment. These industries are likely to lobby in the next few months for continuation of the negative list for the next few years.

The major development is the, more or less, complete liberalization of trade with India in agricultural products, both processed and unprocessed. It will be interesting to see how Pakistani agriculture and agro-based industry stands up to competition from across the border.

Table 14: Negative List			
Section of HC	Description	Number of Tariff Lines	Lines in Negative List
I	Live Animals, Animal Products	248	2
II	Vegetables & Products	311	-
III	Animal, Vegetable Fats/Oils	53	4
IV	Prepared Food stuffs	228	10
V	Mineral Products	195	-
VI	Chemicals or Allied Ind	1149	89
VII	Plastics & Articles	300	130
VIII	Hides & Skins; Leather Goods	82	19
IX	Wood & Articles	106	4
X	Paper & Paper Board	182	95
XI	Textile & Articles	929	78
XII	Footwear & Personal Art	59	7
XIII	Ceramic & Glass Prod	189	65
XIV	Jewelry	55	3
XV	Metals & Articles	744	203
XVI	Machinery	1193	206

Table 14: Negative List			
Section of HC	Description	Number of Tariff Lines	Lines in Negative List
XVII	Vehicles & Trans Equip	245	198
XVIII	Optical & Precision Inst	269	31
XIX	Arms & Ammunition	52	-
XX	Miscellaneous	186	91
XXI	Works of Art	72	-
		6857	1235

Informal & Quasi-Legal Trade

As result of restrictions there is a significant volume of informal and quasi-legal trade from India to Pakistan. According to the Sustainable Development Policy Institute (SDPI) study published in 2005, the main routes for illegal imports of India goods are:

1. Dubai-Bandar Abbas-Hirat-Kabul-Jalalabad-Torkham
2. Dubai-Bandar Abbas-Hirat-Kandahar-Chaman
3. Sind-Gujarat Cross Border
4. India-Dubai-Karachi
5. Lahore Border

Table 14 highlights the volumes and types of Indian goods imported through re-routing of trade. The main route for quasi-legal trade of Indian goods in Pakistan is Dubai-Torkham followed by Dubai-Chaman. The total annual volume of informal and quasi-legal trade was estimated at USD $528 million in 2003, equivalent to almost 50 percent of the formal trade with India at the time. Given the current volume of trade, informal and quasi-legal trade is likely to have approached the magnitude of over USD $1 billion by 2011.

Table 15 gives the major items which feature in informal trade. These include medicines, cosmetics, tires, cloth, silver, spices, ladies fabrics, acetic anhydrite and liquor and betel leaf. There is the likelihood that high-value, low-volume items, especially those with high duties, will continue to be smuggled in even after the liberalization of trade. This includes items like cosmetics, jewelry and medicines. Other items could enter formal trade and increase customs duty revenues to the government of Pakistan.

Table 15: Quantum of Informal & Quasi-legal Trade (2003) (US $ Million)		
Route	Items	Total Estimated Value in 2005
Through Torkham Route	Cosmetics, Cloth, Spices	157
Through Chaman Route	Tyres, medicines, Bidis, Elaichi	119
Through Karachi (Khepias Route and from Dubai)	Cosmetics, Jewellery, Blankets	91
Quasi-Legal Trade	Medicines, electroplating chemicals	98
Sindh border	Livestock, medicines	56
Lahore border	Betel leaf, cloth	7
	Total	528
Source: SDPI [2005]		

Chapter 5 Size & Growth of Bilateral Trade

This section focuses on the trends in trade between India and Pakistan over the last decade in terms of the volume of trade and the major trading products.

Volume of Trade

Table 16 presents the magnitude of India exports to Pakistan and that of Pakistan to India. Over the last ten years, the volume of bilateral trade has grown considerable. Indian exports to Pakistan have shown steady growth of 22 percent. Pakistan's exports to India grew till 2006-07 but have, more or less, stagnated since then.

The balance of trade has been in favor of India throughout the period. In 2010-11, according to the statistics of the State Bank of Pakistan, India enjoyed a trade surplus with respect to Pakistan of almost USD $1.5 billion.

Table 16: Trade between India & Pakistan (2000/2001 - 2010/2011) ($ Million)

	Indian Exports to Pakistan (MOC, India)	Pakistan's Imports from India(SBP, Pakistan)	Indian Imports from Pakistan (MOC, India)	Pakistan's Exports to India (SBP, Pakistan)	Balance of trade of Pakistan or According to MOC India	Balance of Trade of Pakistan According to SBP
2000-01	187	238	64	56	-123	-182
2001-02	144	187	65	49	-79	-138
2002-03	206	167	45	71	-161	-96
2003-04	287	382	58	94	-229	-288
2004-05	521	547	95	289	-426	-258
2005-06	689	803	180	293	-509	-510
2006-07	1,350	1,236	324	344	-1,026	-892
2007-08	1,950	1,700	288	253	-1,662	-1,465
2008-09	1,439	1,195	370	311	-1,069	-884
2009-10	1,573	1,226	276	268	-1,297	-958
2010-11	2,334	1,734	333	264	-2,001	-1,479

Sources: Ministry of Commerce (MOC),India
State Bank of Pakistan (SBP)

Table 17: Share of Indo-Pak Bilateral Trade in Total Exports of India & Pakistan Respectively

(%)

	Indian Exports to Pakistan (MOC, Govt of India)	Pakistan's Exports to India (SBP)
2000-01	0.4	0.8
2001-02	0.3	0.7
2002-03	0.4	0.8
2003-04	0.4	1.0
2004-05	0.6	2.6
2005-06	0.7	2.3
2006-07	1.1	2.6
2007-08	1.1	1.8
2008-09	0.8	2.4
2009-10	0.9	1.9
2010-11	0.9	1.0

During our research we have observed a discrepancy. A comparison of figures on exports to Pakistan of the Ministry of Commerce of the Government of India and figures on imports by Pakistan form India with the State Bank of Pakistan reveal significant differences. There are, of course some reasons why they may be different. First, the financial years differ between the two countries. For India it is April-March and for Pakistan July-June. Second, export figures are FOB while import figures are CIF. Third, SBP's data is based on realization of funds, rather than the movement of goods being imported or exported.

The figures appear to be, more or less, consistent up to 2005-06. But the value of exports reported by the Indian Ministry of Commerce start differing from 2006-07 reaching a peak of as much as USD $591 million in 2010-11.

Table 18: Share of Pakistan-India Bilateral trade in Total Imports (%)		
	Indian Imports from Pakistan (MOC, Govt of India)	**Pakistan's Imports from India (SBP)**
2000-01	0.1	2.7
2001-02	0.1	2.1
2002-03	0.1	1.5
2003-04	0.1	2.8
2004-05	0.1	3.2
2005-06	0.1	3.3
2006-07	0.2	5.1
2007-08	0.1	5.3
2008-09	0.1	4.2
2009-10	0.1	4.2
2010-11	0.1	4.9

The contribution of bilateral trade to exports of each country is given in **Table 17** and **Table 18.** In India's case the share of exports to Pakistan in total exports is small, at below of one percent. This is, of course, the consequence of the large size of the Indian economy and of restrictions in the form of a positive list maintained by Pakistan. The share of exports to India in total exports of Pakistan is somewhat larger. It reached a peak close to three percent in 2006-07 but has since fallen to about one percent.

Table 17 also highlights that the importance of the other country as source of imports is marginal for India, but significant for Pakistan.

While the bilateral trade does not contribute substantially to the total volume of exports of India it has acquired importance in the context of export of some individual items. An example is that of the sugar industry of India which, in 2010-11, made as much as 26 percent of its global exports to Pakistan. Other examples are cotton, manmade filaments and vegetables where the shares of exports to Pakistan were 6, 14 and 8 percent respectively. It is expected that these sectors will develop some interest in sustaining trade with Pakistan.

Composition of Trade

The analysis of the commodity composition of trade between India and Pakistan is conducted at the two-digit level of the HS. The source of data is the Ministry of Commerce, Government of India. Data for the last ten years in the desired format was not available with SBP.

Table 19 gives the product category wise breakup of exports of India to Pakistan. We focus on major exports, which in any one year between 2000-01 and 2010-11 exceeded USD $20 million. These exports fall in 18 chapters out of the 99 chapters in the HC.

Table 19 clearly highlights the growth of exports by India to Pakistan. In 2000-01, there were only two commodities-sugar and organic chemicals-with significant volumes. By 2010-11 exports had diversified beyond these two items to include cotton, man-made filaments, vegetables, tea, spices, rubber products, other chemical, etc.
The big increase in exports by India to Pakistan in 2010-11 is due to the increased volumes of sugar and cotton sent to Pakistan. India has made a spectacular breakthrough in cotton yields by adoption of genetically modified seed varieties and has emerged globally as a major exporter of cotton of close

to USD $7 billion.[23] Meanwhile, production of cotton in Pakistan has stagnated. Also, in 2010-11, Pakistan had a poor sugar cane crop and there was a large shortage of sugar in the country.

The question is, has the comparative advantage between the two countries fundamentally altered? At the time of partition, as highlighted in Chapter II, Pakistan was a major net exporter of agricultural products to India. But now, 64 years later, India is exporting large volumes of cotton, sugar and vegetables to Pakistan. It may, of course, be argued that we do not see the full comparative advantage of India because of the current trade restrictions and that once MFN status is granted India will also start exporting a range of value-added industrial products to Pakistan.

Turning next to imports of India from Pakistan, we focus on chapters in which imports exceeded USD $10 million at any time during the last ten years. This is the case in only 11 out of the 99 chapters and highlights the limited range of exports of Pakistan to India. It is, of course, not clear at this stage what the role of non- tariff barriers have been in restricting Pakistan exports.

Table 19: Major Products Exported by India to Pakistan (2000/2001 - 2010/2011)

(Major Exports > $ 20 million in any year)

($ Million)

HS Chapter	Description	2000-01	2005-06	2009-10	2010-11
7	Edible vegetables	1	30	60	74
9	Coffee, tea and spices	0	12	37	70
12	Oil seeds, fodder, etc	3	14	36	49
17	Sugar	57	31	1	654
23	Residues & waste, prepared fodder	18	54	88	51
26	Ores, Slag and Ash	4	20	-	-
27	Mineral fuel	0	22	14	40
29	Organic Chemicals	36	205	308	274
32	Tanning or dyeing extracts	9	21	37	40
38	Miscellaneous Chemical Products	1	5	30	47
39	Plastics and articles	14	45	38	32
40	Rubber and articles	9	43	42	55
52	Cotton	0	58	243	402
54	Man-made filaments	0	0	420	234
72	Iron and Steel	2	33	32	32
73	Articles of Iron & Steel	1	5	9	27
84	Boilers and Machinery	2	6	25	34
99	Miscellaneous Goods	1	2	2	27
	Total of Above	158	606	1,422	2,142
	Share (%)	(84%)	(88%)	(90%)	(92%)
	Total Exports	187	689	1,573	2,334
	Share of:				
	Top 3 chapter	59%	46%	62%	57%
	Top 5 chapter	72%	59%	71%	70%

Source: MOC, Government of India.

Table 20 shows that significant imports of India from Pakistan include fruits, cement, mineral fuels and some organic chemicals. The presence of some intra-industry trade between the two countries is indicated in Chapters 7, 27, 29, and 52.

Overall, while there has been considerable growth in bilateral trade between Pakistan and India, most of the growth in exports to the other country appears to have accrued to the latter, despite restrictions. The question is, has Pakistan's inability to benefit more substantially by the opening up of trade with India reflect the existence of NTBs in India or an indication of limited comparative advantage with respect to a larger and somewhat more developed economy?

[23] Trade Map 2010, International Trade Centre (ITC)

It needs to be emphasized, however, that the existence of a larger deficit in trade of Pakistan with India does not necessarily mean that Pakistan has lost out in the process. To the extent that imports from India represent 'trade diversion' due to closer access and lower costs, then there has been a saving in the overall import bill and, consequentially, an improvement in Pakistan's global balance of trade.

Table 20: Major Products Imported by India from Pakistan (Major imports > $10 million in any year) ($ Million)					
HS Code	**Description**	**2000-01**	**2005-06**	**2009-10**	**2010-11**
7	Vegetables	4	68	6	7
8	Fruits	26	26	46	63
25	Cement, etc.	-	1	43	40
27	Mineral Fuels	20	-	10	57
28	Isotopes	-	-	-	12
29	Organic Chemical	-	24	47	33
39	Plastic and Articles	-	2	7	12
41	Raw Hides and Skins	-	2	8	13
51	Wool	-	28	4	9
52	Cotton	1	-	39	22
78	Lead and articles	-	2	16	21
	Total of Above	51	153	226	289
	% of Total Imports	(80%)	(85%)	(82%)	(87%)
	Total Imports	64	180	276	333
Share of:					
	Top 3 Imports	73%	68%	49%	48%
Source: MOC, Government of India.					

Estimates of Potential Increase in Bilateral Trade

The bilateral trade between India and Pakistan stood at USD $2.6 billion in 2010[24]. The ICRIER study used an augmented gravity model and quantified the trade potential at USD $6.5 billion in 2004. The State Bank of Pakistan (SBP) study of 2004 used a different methodology of assessing the extent of trade complementary between the two economies and arrived at an estimate of over USD $5 billion, with the gains being, more or less, evenly distributed. Pakistan's Secretary Commerce Zafar Mahmood has stated that that the potential for formal trade could be enhanced to USD $10 billion.

As an initial attempt, we have used the trade complementarity approach to arrive at the latest estimate of the trade potential. This approach is essentially static in nature and focuses primarily on trade diversion given the level and pattern of exports and imports of each country. For proper estimation of the actual extent of trade diversion it is essential to make a comparison of the landed prices of imports from India with domestic prices. India will, of course, have lower transport costs than other countries exporting to Pakistan, especially after expansion of capacity for trade on land routes. A more dynamic approach would also allow for 'trade creation', which is difficult to quantify at this stage of the analysis.

Table 21 and **22** highlight the major imports and exports of India and Pakistan respectively.

1. **Major Exports (By Chapter Number) Common to Both Countries**
   27 Mineral Fuels
   52 Cotton & Yarn
   62 Other Apparel
   87 Vehicles & Parts

2. **Major Imports (By Chapter Number)Common to Both Countries**

[24] Trade Map 2011, International Trade Centre (ITC)
[25] A chapter may enter more than one classification because of differences at the 8 digit level of the HC.

27 Mineral Fuels
29 Organic Chemicals
31 Fertilizers
72 Iron & Steel
84 Boilers & Machinery
85 Electrical Machinery

3. Major Indian Exports and Major Pakistani Imports (By Chapter Number)

27 Mineral Fuels
29 Organic Chemicals
30 Pharmaceuticals
52 Cotton & Yarn
72 Iron & Steel
84 Boilers & Machinery
85 Electrical Machinery
87 Vehicles & Parts

4. Major Pakistani Exports and Major Indian Imports (By Chapter Number)

27 Mineral Fuels
39 Plastic & Articles
90 Optical & Other Instruments

5. Major Exports of India which are not Major Imports of Pakistan

26 Ores, Slag & Ash
52 Cotton & Yarn
62 Articles of Apparel
71 Jewelry
73 Articles of Iron & Steel
74 Copper & Articles
89 Ships & Boats

6. Major Pakistani Exports which are not Major Indian Imports

10 Cereals
35 Cement
41 Raw Hides & Skins
42 Articles of Leather
55 Man-made Staple Fibers
61 Apparel
62 Other Apparel
63 Made up Textiles
87 Vehicles & Parts

The extent of trade complementarity includes chapters of the HS which satisfy the following criteria:
(Group 3 above) – major Indian Exports and simultaneously major Pakistani Imports
(Group 4 above) – major Indian Imports and simultaneously major Pakistani Exports

Group 3 includes eight chapters – No 27, 29, 30, 52, 72, 84, 85 and 87, while Group 4 includes three chapters – 27, 39, 90. Since Chapters are at the two digit level, a more disaggregated analysis will be required, possibly at the six or eight digit level to identify the specialization of each country within individual chapters. This will be done in a subsequent research scheduled in mid-2012, by the authors of this paper.

However, the import and export composition of both Pakistan and India suggests that the scope of diversion of Pakistan's imports to India is greater than the diversion of Indian imports to Pakistan. The maximum trade diversion potential of Pakistani imports to India is close to USD $10 billion, if there is full diversion of imports currently to India and also if India starts exporting POL products to Pakistan. As opposed to this, the maximum potential of diversion of Indian imports to Pakistan is limited at below USD $1 billion.

Overall, it appears that, contrary to the earlier finding of the SBP [ibid], the scope for the absolute increase in exports from India to Pakistan is significantly greater than the maximum possible increase of exports of Pakistan to India. Of course, these estimates only focus on trade diversion. The potential volume of trade could be greater if there is significant trade creation. It may be noted that greater import diversion to India may mean that Pakistan may have potentially more to gain in terms of savings in import bill and in consumer welfare due to lower prices.

Overall, the potential for bilateral trade between India and Pakistan is sizeable. But the potential will only be realized if there is a sustained commitment to the opening of trade between the two countries and any emergent risks are handled well.

Table 21: India's Major Exports & Imports
($ Billion)

		2000-01 (> 1 $ Billion)				2010-11 (> 5 $ Billion)			
HS Code	**Chapter**	**Exports**	**%Share**	**Imports**	**%Share**	**Exports**	**%Share**	**Imports**	**%Share**
3	FISH AND CRUSTACEANS, MOLLUSCS AND OTHER AQUATIC INVERTABRATES.	1.4	3.1	-	-	-	-	-	-
15	ANIMAL OR VEGETABLE FATS AND OILS AND THEIR CLEAVAGE PRODUCTS; PRE. EDIBLE FATS; ANIMAL OR VEGETABLE WAXEX.	-	-	1.4	2.8	-	-	6.6	1.8
26	ORES, SLAG AND ASH.	-	-	-	-	5.8	2.3	5.5	1.5
27	MINERAL FUELS, MINERAL OILS AND PRODUCTS OF THEIR DISTILLATION; BITUMINOUS SUBSTANCES; MINERAL WAXES.	1.9	4.3	17.5	34.7	42.5	16.9	115.9	31.3
28	INORGANIC CHEMICALS; ORGANIC OR INORGANIC COMPOUNDS OF PRECIOUS METALS, OF RARE-EARTH METALS, OR RADI. ELEM. OR OF ISOTOPES.	-	-	1.1	2.2	-	-	-	-
29	ORGANIC CHEMICALS	1.7	3.8	1.6	3.2	9.1	3.6	12.6	3.4
30	PHARMACEUTICAL PRODUCTS	-	-	-	-	6.5	2.6	-	-
31	FERTILISERS.	-	-	-	-	-	-	6.2	1.7
39	PLASTIC AND ARTICLES THEREOF.	-	-	-	-	-	-	7.6	2.1
42	ARTICLES OF LEATHER, SADDLERY AND HARNESS; TRAVEL GOODS, HANDBAGS AND SIMILAR CONT.ARTICLES OF ANIMAL GUT(OTHR THN SILK-WRM) GUT.	1	2.3	-	-	-	-	-	-
52	COTTON.	2.4	5.4	-	-	6.7	2.7	-	-
61	ARTICLES OF APPAREL AND CLOTHING ACCESSORIES, KNITTED OR CORCHETED.	1.8	4	-	-	-	-	-	-
62	ARTICLES OF APPAREL AND CLOTHING ACCESSORIES, NOT KNITTED OR CROCHETED.	3.8	8.5	-	-	6.4	2.5	-	-
63	OTHER MADE UP TEXTILE ARTICLES; SETS; WORN CLOTHING AND WORN TEXTILE ARTICLES; RAGS	1.2	2.7	-	-	-	-	-	-
71	NATURAL OR CULTURED PEARLS,PRECIOUS OR SEMIPRECIOUS STONES,PRE.METALS,CLAD WITH PRE.METAL AND ARTCLS THEREOF;IMIT.JEWLRY;COIN.	7.4	16.6	9.7	19.2	40.1	16	77.1	20.9
72	IRON AND STEEL	1.1	2.5	-	-	9.5	3.8	11	3
73	ARTICLES OF IRON OR STEEL	1	2.3	-	-	7.7	3.1	-	-
74	COPPER AND ARTICLES THEREOF.	-	-	-	-	8.1	3.2	-	-
84	NUCLEAR REACTORS, BOILERS, MACHINERY AND MECHANICAL APPLIANCES; PARTS THEREOF.	1.4	3.1	4.2	8.3	9	3.6	29	7.8
85	ELECTRICAL MACHINERY AND EQUIPMENT AND PARTS THEREOF; SOUND RECORDERS AND REPRODUCERS, TELEVISION IMAGE AND SOUND RECORDERS AND REPRODUCERS,AND PARTS.	1.3	2.9	2.7	5.3	10.8	4.3	27.2	7.4
87	VEHICLES OTHER THAN RAILWAY OR TRAMWAY ROLLING STOCK, AND PARTS AND ACCESSORIES THEREOF.	-	-	-	-	11.3	4.5	-	-
89	SHIPS, BOATS AND FLOATING STRUCTURES.	-	-	-	-	5.3	2.1	-	-
90	OPTICAL, PHOTOGRAPHIC CINEMATOGRAPHIC MEASURING, CHECKING PRECISION, MEDICAL OR SURGICAL INST. AND APPARATUS PARTS AND ACCESSORIES THEREOF;	-	-	-	-	-	-	5.3	1.4
98	PROJECT GOODS; SOME SPECIAL USES.	-	-	-	-	-	-	6.2	1.7
TOTAL		**27.4**	**61.5**	**38.2**	**75.6**	**178.8**	**71.2**	**310.2**	**83.9**
OVERALL		**44.6**		**50.5**		**251.1**		**369.8**	

Source: Ministry of Commerce and Industry, India.

Table 21: Pakistan's Major Exports & Imports ($ Million)									
		2006-07 (> 200 $Million)				(> 250 $million)			
						2009-10		2008-09	
HS Code	Chapter	Exports	% Share	Imports	% Share	Exports	% Share	Imports	% Share
7	Vegetables	-	-	277	1.0	-	-	286	0.9
9	Coffee, tea and spices	-	-	226	0.8	-	-	255	0.8
10	Cereals	521	3.0	-	-	2173	11.0	949	3.0
12	Oil seeds, etc.	-	-	390	1.4	-	-	368	1.2
15	Animal or vegetable fats/oils	-	-	674	2.5	-	-	-	-
17	Sugar and confectionary	-	-	366	1.4	-	-	-	-
25	Salt, limo, cement, etc.	-	-	-	-	582	3.0	-	-
27	Mineral fuels, etc.	888	5.1	3518	13.0	1192	6.1	11230	35.4
28	Inorganic Chemicals	-	-	250	0.9	-	-	568	1.8
29	Organic Chemicals	-	-	1390	5.2	-	-	1557	4.9
30	Pharmaceuticals	-	-	227	0.8	-	-	275	0.9
31	Fertilizers	-	-	409	1.5	-	-	451	1.4
32	Tanning or Dyes	-	-	223	0.8	-	-	260	0.8
38	Chemical pond n.e.s.	-	-	323	1.2	-	-	404	1.3
39	Plastics & Articles	-	-	1035	3.8	358	1.8	1091	3.4
40	Rubber & Articles	-	-	276	1.0	-	-	-	-
41	Raw hides & skins	505	2.9	-	-	479	2.4	-	-
42	Articles of Leather	383	2.2	-	-	368	1.9	-	-
48	Paper & Paper Board	-	-	334	1.2	-	-	323	1.0
52	Cotton & Cotton Yarn	3401	19.7	680	2.5	3255	16.5	646	2.0
54	Man-made filaments	207	1.2	246	0.9	-	-	266	0.8
55	Man-made staple fibers	313	1.8	231	0.9	395	2.0	316	1.0
57	Carpets	260	1.5	-	-	-	-	-	-
58	Woven Fabrics	531	3.1	-	-	-	-	-	-
61	Apparel	2121	12.3	-	-	2139	10.9	-	-
62	Other Apparel	1081	6.3	-	-	931	4.7	-	-
63	Made up Textile Art.	773	4.5	-	-	2568	13.1	-	-
72	Iron & Steel	-	-	1134	4.2	-	-	1428	4.5
84	Boilers & machinery appliances	-	-	302	1.1	-	-	2620	8.3
85	Electrical Machinery & equip.	-	-	2763	10.2	-	-	2044	6.4
86	Railway rolling stock etc.	-	-	2078	7.7	-	-	751	2.4
87	Vehicles and Parts	-	-	1180	4.4	267	1.4	407	1.3
90	Optical & other instruments	230	1.3	365	1.4	317	1.6	-	-
95	Toys, sports & games	356	2.1	-	-	-	-	924	2.9
99	Special Provisions	-	-	1074	4.0	-	-	-	-
	TOTAL	11570	67.0	19971	74.0	15024	76.4	27419	86.4
	OVERALL	17278		26,989		19673		31747	

Source: SBP

Chapter 6 Trade Relations between Pakistan & India (1947-2012)

This segment of the report describes the trade interdependency between India and Pakistan at the time of the partition in 1947 and the key milestones in the trade relations between the two countries since then.

Initial Economic Interdependencies between Pakistan & India

Both London and New Delhi administrations were deeply concerned by the recurrent famines in the late 19th and the early 20th centuries. They took heavy human and economic tolls in the northeastern parts of the Indian sub-continent. The reactions of these administrations to the crises would deeply affect the areas that were to become parts of Pakistan. According to one account, "in the 120 years of British rule there have been 34 famines in India, compared with only seventeen recorded in the previous two millennia." Still shaken by the Great Indian Mutiny of 1857, the British colonial rulers were anxious to avoid any development that could pose a challenge to their rule over in India. The famines had caused great human suffering and could become the cause that would reunite India once again against the British rule. The British were still recovering from what they began to call the Indian Mutiny of 1857 and were anxious to avoid any developments that would once again excite and unite the citizenry against their rule.

A number of Royal Famine Commissions were set up to advise the colonial government on how to stop the recurrence of the famines that visited India's northeast at regular intervals. Ultimately the decision was taken to increase the amount of food India itself produced[26]. To increase the production of food grain in India, the Government decided to introduce surface irrigation to the vast virgin lands in the Indus Basin plain. As a part of this policy the British invested heavily in developing irrigation in central and south Punjab and in north Sindh. Investment in the system of irrigation was accompanied by a number of other initiatives by the colonial administration to ensure that the surplus food that would get produced would be transported to the deficit areas. The British laid down an elaborate system of roads and railways to connect Punjab and Sindh with the northeastern parts of British India. In building the road system they focused on further developing the fabled Grand Trunk Road built in the middle of the 16th century.

The railway system was an entirely new development. India was divided into several railway regions. The North Western Railway (NWR), one of the largest in the system, served the Punjab, Delhi and the northern parts of India. It had two purposes: to transport food surplus from Punjab and Sindh to Bihar, Bengal and Orissa, the perennially food deficit areas of British India. The system also ensured that the colonial administration could quickly move troops to the restive north. In the north, now the Pakistani province of Khyber Pakhtunkhwa, the British were deeply engaged in pacifying the unruly tribes that lived in these areas. The north was also the gateway to Afghanistan, the country the British wished to bring under their control.

The colonial government's response to the famines in India, therefore, had profound impact on the structure of the economy and the administrative system of the areas that were to become parts of Pakistan. These areas were to become fully integrated with the larger Indian economy, turning not only into the granary of British India but also into the supplier of raw cotton to the textile mills in Bombay and Gujarat. At the time of the partition of British India in 1947, India was by far the most important trading partner for the new state of Pakistan, picking up the bulk of its exports and providing it with most of its imports. The impressive inheritance of a developed system of surface irrigation along with an equally well built road and railway systems was, therefore, the direct consequences of a crisis – repeated famines in northeast British India – and the public policy response to them. What became Pakistan in 1947 (the country founded in 1947 split into two in 1971) came to be well

[26] This approach was adopted long before the Nobel Prize winning economist Amartya Sen offered a different explanation for famines. In his study of the 1943 Bengal famine, Sen concluded that famines were caused by the collapse of the earning capacity of the affected population, not necessarily by a short –term fall in production.

integrated economically and physically as a result of the way the British chose to deal with the repeated shortages of food in some of the areas under their control from 1857 to 1947. This close economic relationship between India and Pakistan would have continued had not a series of other crises intervened.

At the time of independence Pakistan inherited an economy dominated by the state regulated agriculture sector that was developed to serve the strategic interests of the colonial rulers. Agriculture was well integrated into several other sectors of the economy, in particular transport and communication. Large surpluses generated by the sector were sent as food to the food-deficit areas in northeast India and as raw materials for the manufacturing sector in the country's western parts.

India-Pakistan Trade Relations since 1947

At the time of independence, Pakistan and India were heavily dependent on each other. In 1948-1949, India's share of Pakistan's global exports was approximately 23.6 percent while its share of Pakistan's global imports was approximately 50.6 percent[27].

The bilateral and economic relations between Pakistan and India should have been a matter of mutual gains given the proximity and size of the markets and the initial structural interdependence. On March 11, 1949 the then Indian Commerce Minister, Mr. K.C. Neogy, said in Parliament that it was "supremely necessary" to have a joint economic policy between India and Pakistan and disclosed that the Government of India, in a "very informal way" had started investigations for a customs union between the two dominions.

Pakistan's economic and trade relations with India, however, were fraught with challenges, the predominant of which were the various political disputes between the two countries with respect to their boundaries with each other; the financial and asset related settlements arising from the partition; the rights on Indus water usage; and the currency exchange rates that were initially pegged with the UK Sterling.

As the disputes began to intensify in the 1950s, trade between Pakistan and India become more restricted. The two countries faced a nine year hiatus from 1965, when Pakistan and India fought a war, to 1974 when the two countries signed a protocol to resume trade.

Box 4 highlights the declining share of India in Pakistan's global trade.

Box 4: Declining Share of India in Pakistan's Global Trade (1951 - 2000)

Following the disruption of trade with India soon after partition, the share of exports of Pakistan to India declined sharply and virtually ceased. After the war of 1965 there was virtually no trade for many years. Even after resumption of trade the share of trade with India remained very low up to 1999-2000.

Table: Volume of Pakistan's Trade with India

	% share of Exports	% share of Imports
1951-52	19	0
1959-60	5	3
1964-65	9	2
1969-70	0	0
1974-75	0	0
1979-80	2	0.3
1984-85	1	0.3
1989-90	1	0.5
1994-95	1	0.6
1999-2000	1	1.6

Source: Pakistan Bureau of Statistics, 50 Years of Pakistan in Statistics

[27] Ghuman, R.S. Indo-Pakistan Trade Relations (1986); Federal Bureau of Statistics, Government of Pakistan, as quoted in Ghuman, R.S. and D.K Madaan (2006)

At the time of the partition, most of what was consumed in Pakistan, in terms of simple manufactures, came from India. Of particular importance were items such as cotton fabrics (*latha* in particular), vegetable oil (*Dalda* in particular), washing soap (*Lifebuoy* in particular) and bicycles. Pakistan had practically no manufacturing capacity of its own to produce these and dozens of other goods of immediate consumption.

As the political disputes between Pakistan and India began to put increasing strain on bilateral trade, Pakistan began to pursue rapid industrialization and diversification of its trading partners. Over time, the USA was to become Pakistan's largest trading partner while a very small proportion of total trade formally crossed the border with India.

The following timeline in **Box 5** shows the milestones in the economic and trade relationships between Pakistan and India, from 1947 to date.

Box 5: Chronology of Milestones in Indo-Pak Trade Relations (1947 - 2012)

1948	**Feb -** Government of India declared Pakistan to be a foreign country for the purposes of levying customs, import and export duties with effect from March 1, 1948. **June -** In London, a discussion about the balance of Sterling was started among the delegates of India, Pakistan and U.K. **Aug -** The Government of Pakistan had announced that a license would be necessary for the export of raw jute to India during the current shipping period ending December 31, 1948. **Sept -** An agreement had been arrived at between the Governments of India and Pakistan with regard to exemption from Import and Export control regulations, of certain classes of goods imported from or exported to Pakistan. **Nov -** According to press note it was stated that an agreement was signed between India and Pakistan for the supply of the latter of 5 million bales of raw jute during the year ending June 30, 1949.
1949	**March -** India's Commerce Minister, Mr. K.C. Neogy, said in Parliament that it was "supreme Necessary" to have a joint economic policy between India and Pakistan and disclosed that the Government of India, in a "very informal way" had started investigations for a customs union between the two dominions. **Aug -** Pakistan businessmen decided to boycott Indian made goods as counter measure against Indian Evacuee Property Ordinance. **October -** Finance Minister Ghulam Mohammad announced in Karachi that some of the articles "imported from India had been removed from the exemption lists for import duty." **December -** India's Commerce Minister Mr. K.C. Neogy announced in Parliament that India's decision to suspend temporarily dispatches of coal to Pakistan, "because Pakistan had deliberately detained enormous quantities of jute purchases paid by India nationals." **Dec -** The concern of the Government of Pakistan over the Inter-dominion impasse arising out of the non-acceptance of the Pakistan exchange rates by India was expressed in the Parliament by Pakistan's Finance Minister, Mr. Ghulam Mohammad. **Dec -** East Pakistan's Minister for Food and Civil Supplies, Mr. S.M. Afzal, charged India with contravening the Barcelona Convention in so far as it had stopped the movement of food grains in transit from West Pakistan to East Pakistan
1950	**Apr -** India and Pakistan trade delegations signed a hundred days agreement in Karachi between the two countries, resulting in the reopening of trade in a defined sphere, as a first step towards the survival of normal trade. **Apr** - Trade agreement signed by India and Pakistan in Karachi on April 21, had been ratified by both the governments. **May -** Pakistan and Indian Government's railway officials reached an agreement on resumption of freight traffic between the two countries.
1951	**Feb** - A Trade Agreement between India and Pakistan was signed in Karachi.
1952	**Aug** - Indo-Pak Trade Agreement was signed in Karachi. **Oct** - The Government of Pakistan have decided stop import of Indian films into West Pakistan with immediate effect. **Feb -** Pakistan and India agreed to continue consultation regarding India's complaint against the Pakistan export fee and duty on raw jute exported to India. **March** - Pakistan-India Trade Conference was concluded with the signing of a 3-Year Trade Agreement between the two countries.
1965	India—Pakistan War Pak-India rail link suspended in 1965 war
1974	Pakistan India sign a protocol on the resumption of trade

1975	The bilateral trade Arrangement binds them to grant MFN treatment on a reciprocal Basis as per GATT provisions (Article 4)
1985	First SAARC Summit held in Dhaka on 7-8 December
1986	The Government of Pakistan permits the import of 41 items from India. The list was expanded to 249 items in 1987
1990s	The volume of trade between Pakistan and India begins to improve again when exports doubled. During the same period the increase in imports is also manifold
1996	India grants MFN status to Pakistan as per the WTO provisions
1995	South Asia Preferential Trade Arrangement (SAPTA)
1999	India-Pakistan Kargil War
2000	The Government of India imposes a ban on import of raw cotton from Pakistan on grounds that it contains exotic strains of destructive bacterial, viral and fungal disease which is virulent under Indian climate conditions
2003	India announces resumption of Delhi-Lahore bus service
2004	**Jan** - Signing of the South Asian Free Trade Area (SAFTA), effective from January 2006 **Aug** - Pakistan refuses to grant India most favored nation (MFN) status until there is progress on the Kashmir dispute and other political issue and removal of NTBs **Sept -** Composite Dialogue process initiated between Pakistan and India
2006	**Jan** - Pakistan and India sign an agreement to re-launch a cross-border train service that was halted in 1965 **Feb** - The positive list of importable items expanded by 81 items to a Total of 768 items and further to 773 **Dec** - Revised India-Pakistan shipping protocol signed
2007	**Jan** - Officials from India, Pakistan, and Iran reportedly agree on a pricing formula for Iranian natural gas, thus potentially clearing a major obstacle to the planned construction of a pipeline to deliver such gas to India via Pakistan. **Sept** - A cross-truck Transportation Agreement signed allowing 100 trucks daily from each side of the Wagah/Attari check post
2008	**Apr** - India joins and signs a framework agreement with Turkmenistan. Afghanistan and Pakistan on a $ 7.6 billion gas pipeline project. The line will be 1,689-km Turkmenistan-Afghanistan-Pakistan-India (TAPI), with supply of 3.2 billion cubic feet per day (90 MMSCMD).Gas flows are expected from 2015. Pakistan and India agree to share equally in the gas volume.
2011	**Jan** - Government of Pakistan bans export of onions to India via land route in an attempt to stabilize prices **Sept** - Railway officials of India and Pakistan hold a meeting at the joint Check Post at the Attari-Wagah border to enhance trade through rail between the neighboring countries. **Sept 29** - The commerce ministers of India and Pakistan agree to ease restrictions on trade between the two countries and commit to doubling bilateral trade to $6 billion over 3 years **Oct 1 -** India and Pakistan's trade promotion organizations sign a memorandum of understanding to explore avenues for increasing mutual trade **Oct 14** - A two-day meeting of joint Working Group of Pakistan and India concludes with agreement on firming up of a draft bilateral visa agreement that will liberalize travel between that two countries **Dec 8** - Pakistan says that process of giving India Most Favored Nation status to boost bilateral trade is expected to be completed by October next year, 2012 **Nov 2** - Federal Cabinet, Government of Pakistan, approves in principle granting of MFN status to India **Nov 7**– Indian government formally withdraws its opposition to an EU trade concessions package at the World Trade Organization. **Nov 14** - Commerce Secretaries of India and Pakistan meet to set a time table for trade normalization
2012	**Feb 29** – The Federal Cabinet, Government of Pakistan unanimously approved replacing the positive list of goods importable from India to allow the imports of all goods except for 1209 tariff line products constituting a negative list expected to be phased out by December 2012. **April 12** - 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. **May 18 -** India's Home Ministry and Pakistan's Interior Ministry have arrived at a 'broad agreement' on a liberalized visa regime for Indian and Pakistani businessmen. For prominent businessmen, the two sides will grant multiple-entry visas valid for a year.

The South Asia Association for Regional Cooperation (SAARC) was established in 1985. In 1995, South Asia Preferential Treatment Agreement (SAPTA) was initiated followed by the implementation of SAFTA in 2006. The latter should contribute significant to the growth of regional trade in South Asia.

Since the initiation of the composite dialogue in 2004, there has been some impetus provided to development of bilateral trade, although this process was interrupted by the Mumbai attacks of 26-29 November, 2008.

> *"We have turned the corner. We are talking of complete normalization roadmap", declared Zafar Mahmood, Pakistan's Commerce Secretary after the conclusion of the meeting between the Commerce Secretaries of India and Pakistan.*
>
> *"The political leadership on both sides decided that the two sides should also work on enhancing preferential trading arrangements as part of the shared vision to significantly expand bilateral trade"*
>
> ***Joint statement of the Commerce Secretaries of India and Pakistan, November 2011***

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. The Federal Cabinet gave the Ministry of Commerce "the mandate to take the process of normalization forward, which would culminate in the observance of the MFN principle in its true spirit. In the same month, India removed its objection placed at the WTO on EU's trade package for the import of selected Pakistani goods tariff free. The Commerce Secretaries from the two countries discussed the schedule to move towards the normalization of trade relations. The secretaries reached an agreement after two days of meeting in New Delhi on November 14 and 15.

In January 2012, Pakistan announced that it would move from a positive to negative list for items imported from India. The negative list of 1,209 tariff lines (products) was announced after 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. Both governments have begun discussing import by Pakistan of electricity and petroleum products from India. A broad understanding has been reached on possible grid connectivity between Amritsar and Lahore to trade up to 500 MW of power.[28] In March 2012, senior officials from the two sides met in New Delhi to work out of the details while a joint working group has been set up to study the prospects for trade in petroleum products.

Discussions on liberalizing investment from Pakistan in India have also begun. The two countries have also arrived at a broad agreement on a liberalized visa regime for Indian and Pakistani businessmen. For prominent businessmen, the two sides will grant multiple-entry visas valid for a year.

Risks to the Process of the Normalization of Trade Relations

There are several risks to the process of trade normalization between India and Pakistan. Some of the risks arise from the political and security-related concerns / perceptions of right wing constituencies in both countries. Pressure by these constituencies may hinder trade prospects. This will be especially the case if either of the countries decide to make trade relations or dialogue on trade relations normalization dependent on the outstanding bilateral disputes (for example on Indus river water and Kashmir).

Elections are forthcoming in 2013 in Pakistan. The present ruling coalition, led by Pakistan People's Party (PPP), is well-disposed to a thaw in economic relations with India. But if after the election, the configuration of the government in Islamabad changes, then the future of relations with India may be

[28] The Telegraph, Calcutta

affected. Of course, if Pakistan Muslim League - Nawaz (PML-N) wins a simple majority then the policy direction towards trade with India will likely remain progressive. But if a coalition is to be formed, including the religious parties, then the future looks more uncertain.

It also needs to be recognized that the United Democratic Front (UDF) government in India, headed by the Congress Party, has been considerably weakened by the outcomes of the recent by-elections and a spate of corruption scandals. Consequently, the government of Mr. Manmohan Singh may not be in a position to make concessions either in the Composite Dialogue or in Trade Talks with Pakistan, under the pressure of fundamentalist and nationalist groups in the country.

Beyond the political risks, there is the overhang of a variable security situation in Pakistan arising from acts of terrorism by militants and extremists. A repeat of the Mumbai attacks (November 26-29, 2008) can put back the rapprochement process by years, as it did last time. Already, the issue of Hafiz Saeed's capture, a Pakistani national and one of the key suspects declared by the Government of India in relation to the Mumbai Bombings, has increased tensions. Alternatively, in an effort to sabotage trade with India, convoys of trucks or check posts could be targeted.

Turning to the more conventional risks, the issue is the extent to which India will reciprocate Pakistan's gesture of granting MFN status. Initial indications are positive. India has supported Pakistan's case for getting some trade concessions from the European Union and membership to a non-permanent seat in the Security Council of the UN. Recently, there has been a high profile joint inauguration of India's Integrated Check Post at the Attari-Wagah border coupled with the announcement that investment by Pakistanis in India will liberalized.

The period till December 2012 is very crucial. If there are no major moves on the NTB front by India then there will be strong lobbying for backtracking on the granting of full MFN status by end of 2012. There will inevitably be pressure to continue with the Negative List for the next few years, effectively negating the granting of MFN status. Such pressure is likely to be there anyway from powerful vested interests, including foreign investors operating in Pakistan in import-substitution based, protected industries.

Even in the favorable scenario when full MFN status is granted, there are risks down the road. Given the vast expansion of product lines importable from India, there is a possibility that some industries/sectors could suffer 'serious injury,' according to the WTO terminology. The resulting losses and displacement of workers will create pressures for immediate ban on imports from India in these sectors, especially if it can be established that unfair practices are being indulged in, like export subsidies or dumping. It will be crucial for Pakistan to be able to manage these risks by developing 'safeguards' through the requisite institutional capacity (like strengthening of National Tariff Commission) and appropriate laws, which are consistent with WTO provisions.

There is also the problem of sequencing of the moves by Pakistan in the process of liberalization within the region. As it stands today, Pakistan is committed to give MFN status to India by end 2012 by withdrawing the Negative List. Simultaneously, Pakistan may be expected to implement tariff reduction to 0-5 percent on a large number of items, outside the Sensitive List, as part of SAFTA. Pakistan has fully implemented SAFTA Trade Liberalization Program (TLP) for all members except India where the imports are subject to the Annex G of the current Import Policy Order (2009) of the Government of Pakistan (IPO). Following full implementation of SAFTA and the granting of the MFN status to India there will be a number of industries/agricultural sectors which will be exposed at, more or less, the same time to opening up of trade with India and tariff reductions. Some industries may find it difficult to absorb these shocks and increase pressure to defer the moves.

Other risks include:

1. Restriction of trade through land route: The present decision of the Government of Pakistan to replace "Positive list" with a temporary negative list of products not open to trade has not enlarged the list of products that would be allowed to be imported from India through land routes. At present only 135 items are being allowed through Wagha-Attari land route. The opening of land routes has been made dependent on the development of the required infrastructure on both sides of the border.
2. Inadequate capacity of Customs border crossings: even if trade through land borders increases, the current Customs border crossings (Wagah-Attari and Khokharapar-Munnabao) on Pakistan and India borders do not have the infrastructure capacity to handle increased trade volumes.
3. Non-tariff barriers: the mistrust of Pakistan's private sector and policy makers / influencers regarding non-tariff barriers to trade used by India against Pakistani goods can risk the trade normalization process.
4. Pressure and interest groups: interest groups threatened by competition from Indian goods in Pakistani markets may try to reverse or slow the trade normalization process. The Government of Pakistan will likely face pressure to extend the deadline for phasing out the negative list beyond December 31, 2012.

Overall, the future of expanded Indo-Pak trade has a number of risks which are diverse in nature. It is important that the process of Composite Dialogue makes progress and there is a perception that the process of liberalization is conferring gains to both countries.

Potential Beneficiaries in Pakistan MFN Status to India

The granting of MFN status to India, coupled with measures for trade facilitation, like the opening of more integrated check posts at the border and removal of NTBs, could confer significant gains on both sides of the border. International trade theory shows that, under some assumptions, the smaller country (in this case, Pakistan) benefits more from opening up of trade.

There is, in fact, a view in Pakistan that since the country has fallen seriously behind India in the rate of growth, the only way to reduce the gap is to 'jump on to the bandwagon'. Some proponents of trade liberalization with India have even argued that this will raise the growth rate of the Pakistan's economy by one to two percentage points.

Which types of economic activities are likely to benefit? Subject, of course, to trade facilitation by India, export oriented sectors of Pakistan will get access to a much larger market. Husain (2011) says that 'India has a middle class of 300 million people with rising purchasing power while Pakistan's middle class is about 30 million with more or less stagnant real incomes. A ten percent penetration into the Indian middle class market can double the market size for Pakistani companies and businesses.

Prime candidate industries which could benefit from access to a large market are, first, high quality textile products, especially cloth, ladies garments, bed wear, etc. Second, other export products which could witness a jump in sales are leather products, surgical instruments, sports goods, carpets, and cement. If, in fact, outlets for franchise of Pakistani products are given permission to operate in India then this will greatly facilitate the development of markets, resulting in greater economies of scale in production More recently, there has been an agreement, in principle, by India to allow Pakistani investment in India.

What are the prospects for agricultural commodities? At the time of partition, as identified earlier, Pakistan's exports to India consisted primarily of agricultural products. But over the last six decades, Indian agriculture has significantly developed higher yields in crops like cotton and wheat than Pakistan. For example, the yield of wheat in the Indian Punjab is 68 percent higher than the yield of wheat in Punjab, Pakistan. In fact, Pakistan imported large quantities of cotton and sugar from India in 2010 due to shortfalls in domestic production. Opening agriculture to trade with India can smooth supply shortfalls in Pakistan.

It is more likely products like fruits, vegetables, livestock products, flowers, processed foods, etc. will find a receptive market among Indian consumers. Needless to say, these products will have to satisfy the quality control standards and the process of regulation in India.

The short term potential for gains in agricultural trade, however, may be limited, due to subsidies and compliance with standards and certifications in agriculture.

Second, in the medium-term, potential joint ventures and sharing of R&D may lead to greater inter-industry specialization and, consequently, realization of greater economies of scale. The prospects for this are greater in industries like chemicals, plastic products, automobiles and auto parts. For example, tractors and motorcycles in India have higher horse power (hp) than those manufactured in Pakistan. India also produces a high proportion of tractors with capacity in excess of 50 hp while Pakistan's production is concentrated in tractors up to 50hp. Similarly, India produces a large number of motorcycles with capacity of more than 75cc while Pakistan mostly produces motor cycles with capacity of up to 75cc. As such, Pakistan could specialize in smaller tractors and motorcycles. The establishment of joint ventures would facilitate the process of specialization.

The third set of economic activities that may benefit includes those sectors that will have access to cheaper raw materials or intermediate goods from India following the opening up of trade. This will contribute to increased competitiveness of the finished products and to higher value added by Pakistani industry. Industries which could benefit include iron and steel, chemicals, pharmaceuticals and metal products. India has complete polymer chain as they have Napthe Cracker by reliance Industries. Petrochemicals have immense potential.

An important development which could be of unambiguous benefit to Pakistan is the import of electricity and POL products, including possibly LNG, from India. Given the high levels of power load shedding in the country this would contribute significantly to raising production. Initial indications are that India is willing to sell up to 500 MW of electricity.[29]

Of the stakeholder groups likely to be affected, the Government of Pakistan is one. If there is a significant diversion of informal trade (from India to Pakistan) to formal channels then tax revenues could increase. Conservative estimates suggest that the annual volume of informal trade that may be formalized upon liberalization of trade between India and Pakistan is about USD $1 billion (PKR 90 billion), as estimated by SDPI (2005) and adjusted for the increase in volume of trade over the last six years. This suggests that the additional annual revenue to the Government of Pakistan may be approximately USD $0.4 billion (Rs 37 billion) or so, approaching 0.2 percent of the GDP. This includes additional revenue from import duty, sales tax on imports and the presumptive income tax on imports, as obtained from the average import tariff from the database of FBR.

Consumer welfare gains are likely to be substantial. This will arise directly from cheaper Indian products available in the domestic markets and by price reductions by Pakistani manufacturers in the face of more intense competition. Good examples were consumers could benefit significantly are medicines, cosmetics, processed foods, items for personal care, cars, motorcycles, electrical appliances. An ongoing (2012) study "Cost of Economic Non-Cooperation to Consumers in South Asia" by India based CUTS International and Sustainable Development Policy Institute of Pakistan and other institutions from the SAARC countries studies the impact of trade liberalization under the SAFTA in terms of consumer welfare gains. The study outcomes suggests that the expected annual

[29] The Telegraph, Calcutta

welfare gains to Indian consumers by diverting import of certain products from the rest of the world to Pakistan are approximately USD $4 billion (USD $3.00 per Indian consumer). The expected annual total welfare gains to Pakistani consumers from diverting imports of certain goods to India are approximately USD $280 million (USD $16.00 per Pakistani consumer)[30].

Economic sectors/activities which could face pressure following the opening of trade with India are those which were currently protected under the positive list. Down the road, an increase of 82 percent in the number of tariff lines in which trade can take place following the granting of full MFN status, indicates that a large number of activities in Pakistan could potentially be affected. For example, the automobile sector of Pakistan today enjoys high levels of effective protection with the tariff rate on CBU cars going up to 70 percent. This implies effective protection of up to 150 percent. Given the dominance of few Original Equipment Manufacturers (OEMs) companies enjoy near monopoly profits. The prospect of competition from India could put pressure on achieving greater efficiency and reducing prices, thereby conferring some consumer welfare gains.

This has led some opponents of trade liberalization to argue that the Pakistani market would be flooded with cheap Indian goods, given the more diversified production base of a substantially larger economy, leading to a large-scale displacement of workers. This threat would be magnified if implementation of tariff reductions under SAFTA takes place simultaneously, at the end of 2012, on the large number of items outside the sensitive list.

These concerns are magnified by, first, the fact that the Indian rupee has, recently, devalued significantly against the US dollar. This raises the relative competitiveness of Indian exports. Second, the cost of electricity is significantly lower in India. Third, subsidies to Indian farmers are significantly larger. For example, farmers in India are given electricity more or less free, heavily subsidized fertilizer and extremely low prices for irrigation water. This reduces the price of products from the sector. Fourth, transport costs are lower from India.

There is, of course, a fairly high level of import tariffs on industrial products in Pakistan and this provides a level of protection to domestic industry. Also, it has been argued that Pakistan has been able to withstand the onslaught of Chinese products following the signing of the FTA. China is not only five times larger exporter of manufactured goods but also more competitive than India. Therefore, Pakistan should also be able to stand up to India.

An increase in the volume of imports from India is not necessarily a bad outcome for Pakistan. To the extent that this the consequence of ‘trade diversion’ then Pakistan benefits through cheaper imports reducing thereby the overall import bill. Therefore, although the trade balance with respect to Indian may worsen there will be an improvement in the global trade balance of Pakistan. Some estimates place the annual gain at over USD $1 billion, as per SBP (2005), due to cheaper imports from India of imports which were currently from other sources. However, if Indian products penetrate enough into the Pakistani market to lead to significant ‘trade creation’ then this could lead to some displacement of domestic activities, while conferring some consumer welfare gains. An upcoming research by the Institute of Public Policy, on the economic impact of opening trade with India with respect to key local industries of Pakistan will also focus on the possibilities of trade creation in both markets (India and Pakistan) in selected products.

[30] Mehta. Pakistan Institute of Legislative Development and Transparency. January 2012. “Trade Relations between Pakistan and India”.

Pressure Groups & Lobbies with Vested Interests

It is the role of strong lobbies and vested interests has, in part, prevented the process of the normalization and liberalization of trade between Pakistan and India. The view that has been put forward is that there should be first a resolution dispute mechanism with India, especially Kashmir. That is, there should be peace first and trade later. In fact, it has been argued that Pakistan will lose whatever leverage it has with India if it gives trade concessions first. More recently, however, with India emerging as a future economic power with high rates of growth, the power structure of Pakistan has developed a more pragmatic and less ideological approach with respect to relations with India.

How do the various political parties in Pakistan see the process of normalization of trade with India? At one extreme, the Pakistan Defence Council, a conglomerate of religious parties, aggressively champions the cause of liberation of Kashmir and has been organizing large public rallies against the US and the granting of MFN status to India. At the other extreme, the ruling party, PPP, has pursued a policy of rapprochement with India, ever since the days of Mr. ZA Bhutto and Simla Agreement (1974). Recently, a visit, albeit private, was made on April 8, 2012 by the President of Pakistan to India after a gap of seven years.

The Muslim League-Nawaz (PML-N) is also keen on opening up of trade with India. The support of PML-N can be traced to its vote bank in the trading community, which will benefit from expansion of trade with India. Also, Lahore, which is close to the Indian border, is likely to see a boom in real estate values and increased economic activity, following the granting of MFN status to India. Beyond the two large parties, regional parties, like the Mohajir Qaumi Movement (MQM), have also been supportive of trade with India.

How does the business community see trade with India? The Federation of Pakistan Chambers of Commerce and Industry (FPCCI), the apex body, has generally supported the process of opening up of trade with India. But it has voiced its concerns about NTBs of India including visa restrictions, absence of proper banking channels and limitations on the opening of franchising outlets.

A very optimistic view has been expressed by Mr. Mian Mansha, one of the key industrialist of Pakistan and one of the largest exporters. In a recent interview in April 2012 in the newspaper, The News, of Pakistan and The Financial Times of UK, he says:

'India offers more business opportunities than China'

This is presumably based on the view that there is a similarity of culture and tastes on both sides of the border.

A less visible, but powerful, lobby are those direct foreign investors that entered Pakistan mostly in the area of import substitution behind high tariff walls. The prospect of increased competition from India naturally worries foreign investors, especially in sectors like automobiles, pharmaceuticals, cosmetics and personal care items, and electrical appliances. It is likely that such foreign investors will lobby for extension of the Negative List on these items beyond December 2012.

What are the views of public intellectuals, especially economists, and civil society organizations? NGOs in Pakistan are focused more on social and human rights issues and less on economic issues. Also, the consumer rights movement is very underdeveloped in Pakistan and there has not been enough projection of consumer welfare gains arising from the availability of cheaper grade form India especially for the lower quintiles of the population.

As far as economists are concerned, the profession has generally highlighted gains from trade with India. In fact, the case for granting MFN status voiced by the Advisory Panel of Economists to the Planning Commission, headed by Dr. Hafiz A Pasha (a former commerce Minister) in 2008.

More recently, Dr. Mohsin Khan, of the Peterson Institute of International Economics, has said in a recent seminar at PIDE, that trade potential between India and Pakistan is as high as USD $40 billion. He has also said that Pakistan could gain access to markets in Nepal and Bangladesh, while India would gain access via land routes to Central Asia, Iran and Afghanistan. Other leading economists like Dr. Ishrat Husain (Dean off the Institute of Business Administration, Karachi and the former Governor of the State Bank of Pakistan); Dr. Rashid Amjad of PIDE and Dr. Akmal Husain of BNU/FCU have spoken or written in favor of the process. There is also a lot of research underway on the implications of Indo-Pak trade, including this study.

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