Pakistan-India Trade:

What Needs To Be Done? What Does It Matter?

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Managing India-Pakistan Trade Relations

ISHRAT HUSAIN

Economic historians and analysts have been faced with a conundrum for quite some time. They found it hard to comprehend that South Asia, which was a single large market until a few decades ago with goods, services, capital investment, and skilled labor flowing freely and the newly independent countries inheriting a common historical, legal, cultural, and administrative background and a very well-linked infrastructure, was the least integrated region in the world. East Asia, on the other hand, with countries having diverse backgrounds and very little in common historically, had become the second most integrated region, after the European Union. Moreover, there was almost a consensus among academic economists in both Pakistan and India, the region's two largest countries, that the normalization of trade relations would bring substantial economic benefits evenly. Among the many reasons for this puzzle, the political tension and rivalry between India and Pakistan stands out as the main explanatory variable.

Over the past year there have been some healthy developments in relaxing this constraint and resuming better trading relations. Academic consensus has now spilled over to the business community, and a majority of the businessmen on both sides of the border appear convinced that liberalization of bilateral trade would be in their mutual interest. Finally, the policymakers, for a variety of internal and exogenous explanations, seem to have overcome their reservations, and momentum has been built up over the last several months to move the process forward.

The breakthrough came in the form of Pakistan's November 2011 decision to grant Most Favored Nation (MFN) status to India and to move away from a highly restrictive positive list of items that could be

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imported from India to a negative list. The negative list was to be phased out by December 2012, at which time there would be no restriction on tradable items. Out of 8000 items, only 15 percent or 1209 items are on Pakistan's negative list. The remaining 6800 can now be imported from India, while the previous positive list had only 2000 items. This is a significant change, since 85 percent of tradable goods can now be procured from India, compared to 25 percent previously. The South Asian Preferential Trade Agreement (SAPTA), which came into force in 1995 and which both India and Pakistan have signed, will gradually phase out all tariffs on traded goods by 2016.

Annex 1 at the conclusion of this essay provides the sectorial details of the negative list. Somewhat more than 50 percent of the goods on the negative list belong to the automobile, iron and steel, and paper and board industries, which were relatively more vociferous in their opposition to movement from the positive to negative list.

It may be useful to recall that despite many hurdles and obstacles, India-Pakistan trade recorded an almost tenfold increase between 2001 and 2011, reaching a level of $2 billion. Unofficial trade, including that through third countries, is estimated at almost the same amount. Estimates based on different assumptions and models indicate a jump ranging between fivefold and tenfold from current levels if all the barriers—tariff and non-tariff—are dismantled.

Table 1: Official India-Pakistan Trade ($ Millions)

Year	Pakistan's Exports to India	India's Exports to Pakistan	Total Trade Flows
2004–05	288	547	835
2005–06	293	802	1,095
2006–07	343	1,235	1,578
2007–08	255	1,701	1,956
2008–09	320	1,914	2,234

Source: Federal Bureau of Statistics, Pakistan; Reserve Bank of India.

Table 2: India's Trade with Pakistan and the Rest of the World 2008–09 ($ Millions)

Exports to Pakistan	1,914
India's Total Exports	189,000
Percentage Share to Pakistan	1.01%
Imports from Pakistan	320
India's Total Imports	257,600
Percentage Share from Pakistan	0.12%
Total Trade with Pakistan	2,234
India's Total Trade	446,600
Percentage Share with Pakistan	0.50%

Source: Economic Survey of India.

Table 3: Pakistan's Trade with India and the Rest of the World 2008–09 ($ Millions)

Exports to India	320
Pakistan's Total Exports	19,121
Percentage Share to India	1.7%
Imports from India	1,914
Pakistan's Total Imports	31,747
Percentage Share from India	6.0%
Total Trade with India	2,234
Pakistan's Total Trade	50,868
Percentage Share with India	4.39%

Source: Federal Bureau of Statistics, Government of Pakistan.

Most studies calculate that because of low transport costs, the dismantling of tariff and non-tariff barriers, the granting of MFN status to India by Pakistan, and the improvement of logistics arrangements, the total volume of bilateral trade should be able to rise to approximately

$8 to $10 billion annually. Today Pakistan and India together ship $300 billion worth of goods to all parts of the world. This increased bilateral volume would still account for only about 3 percent of the two countries' trade volume. Therefore, the expectations at least in the short run should be tempered with a sense of realism on both sides. The full-scale realization of the potential of trade will take some time. Like a newly planted sapling, it will require tender care in nurturing and protecting it from strong winds and other extraneous influences that would otherwise uproot this weak plant.

This essay presents the reactions of Pakistani business groups to the granting of MFN status to India, identifies major risks to the growth of India-Pakistan trade, and concludes by arguing for careful management of this relationship by the two sides as it remains fragile.

Pakistan realizes that the liberalization of bilateral trade between Pakistan and India would not only lend impetus to both economies in a beneficial way, but also remove the barriers to regional integration within South Asia. The potential advantage for Pakistan from broader regional economic integration appears to be large. Going well beyond the immediate creation of trade flows, capital investment, and joint economic ventures, cooperation in the fields of IT, science and technology, and research and development would, in all likelihood, boost productivity of domestic industries and stimulate economic growth.

Major political parties and other influential stakeholders have realized that the Pakistani economy is lagging behind other countries and Pakistan has not taken advantage of its strategic location between two of the world's most populous and high-performance economies—China and India. With the signing of the free trade agreement with China in 2006, Pakistani markets and producers have already adjusted to relatively cheaper imports from China. They no longer consider that the threat of Indian products flooding Pakistani markets and displacing domestic industries carries much substance. In some areas such as fashion wear, bed wear, home textiles, and cement, Pakistan would be able to do much better and penetrate a much larger market. The overwhelming support from Pakistani businessmen for MFN status to India is partly a reflection of this sense of confidence. Traders and importers in Pakistan are anticipating much larger business volumes, and thus profits, for themselves from this opening up. Trade liberalization will unambiguously benefit Pakistani consumers, since product prices should fall and consumer choice expand when trade barriers are reduced or removed. Increased trade flow that stems from the lifting of import prohibitions for items coming from India would lead to additional customs revenue for Pakistan.

The overwhelming evidence of the advantages of bilateral trade liberalization has tilted the balance within Pakistan in favor of the proponents of increased trade with India. But there are still significant detractors who would be losers in the bargain. Some of them are vocal, articulate, and powerful. They cannot simply be ignored, as their nuisance value in retarding or reversing this new bonhomie is not trivial.

VOICES OF PAKISTANI BUSINESSMEN

Focus group consultations with businessmen engaged in the automobile, chemicals, pharmaceuticals, and textiles sectors held in Karachi and Lahore during early 2012 revealed strong reservations about the non-tariff barriers imposed by India. According to these business leaders, technical barriers to trade (TBT) and sanitary and phytosanitary measures (SPS) are acting as powerful detriments to the exchange of goods. Unless these obstacles are rationalized and simplified, the smooth flow and desired level of exports from Pakistan will be hindered. Indian non-tariff barriers Pakistani exporters have identified include:

- Sanitary and phytosanitary measures
- Technical barriers to trade
- Quotas and import licenses on 600 items
- Aggressive use of safeguard and anti-dumping measures
- Frequent invocation of countervailing duties
- Stringent license requirements from the Bureau of Indian Standards
- Multiple custom clearance requirements
- Non-standard custom valuation methodology

- Stringent and lengthy certification requirements
- Restrictions on rail movement of goods
- Complicated and restrictive visa requirements
- Long dwell times at ports and border points
- Transit restrictions
- Absence of testing labs at border crossing points
- State governments' restrictions on the use, sale, and consumption of certain goods
- Uncertainty about movement of goods between Indian states
- Non-acceptance of letters of credit issued by Pakistani banks

In addition to the general reservations expressed about the above NTBs, there were also sector-specific grievances that are briefly summarized in the following paragraphs. Other sectors such as textiles were, on the contrary, quite upbeat about the prospects of their industry.

The pharmaceutical industry's main concern was that India enjoys the advantage of having a reservoir of essential raw materials and large economies of scale that will squeeze out Pakistani products due to lower costs of production and distribution of competing products from across the border. Laxity in enforcement of standards would also bring in drugs of dubious quality at low prices, edging out some of the local substitutes. Quality control measures in Pakistan are not too stringent; it was argued that arrangements have to be put in place to apply the same quality standards effectively to Indian products as India has for Pakistani products.

The agriculture sector was concerned about many kinds of hidden and implicit subsidies granted by several state governments in India, such as on electricity for tubewells. These subsidies would not provide a level playing field for Pakistani agriculture producers to compete. Agricultural representatives also pointed out that the May 2006 notification of Super Basmati (a variety of expensive rice with a special aroma popular in the Middle East) by the Indian Ministry of Commerce was challenged by Pakistani exporters in 2008, and that the case is still pending before the court despite a passage of four years. Others worried that barriers to the movement of trucks across state boundaries and the consequential delays would damage perishable commodities.

In the automotive sector, there is a clear difference of opinion. Some of the Japanese companies favor the opening of trade, since they can import components and parts at much cheaper rates from India compared to Japan. The manufacturers of auto parts are opposed to reduced trade barriers, because they believe that Indian auto parts will flood the Pakistani market and decimate the local industry. Efficient and low-cost Pakistani exports would still be at a disadvantage as Indian assemblers have a tendency to prefer locally manufactured parts and have entered into long-term agreements with local firms. The question of switching from their present partners to other suppliers, however competitive they may be, does not arise.

The chemicals and synthetic fiber sector argued that India possessed a surplus of fiber which was equal to 80 percent of the local demand in Pakistan. Indian suppliers could simply dump their excess in the Pakistani market as the enforcement regime of anti-dumping laws was quite weak. The domestic fiber industry, which has recently invested hundreds of millions of dollars in expansion of capacity, would suffer financially.

Textile manufactures were largely optimistic that on price and quality, they could capture a significant share of the Indian market, provided the Indian textile industry does not thwart their inroads by using different kinds of administrative and restrictive practices or non-tariff barriers. Some of the cotton lawn, home textiles, and bed wear manufacturers were already exploring opportunities for joint ventures with Indian partners to open retail outlets for selling those products that are in high demand. Imports of textile machinery from India will be cost-efficient as compared to importing such items from other parts of the world. Some of the garment and knitwear and other value-added manufacturers, on the other hand, expressed concern that their Indian competitors were receiving various hidden subsidies and the playing field was not even.

While it was explained that the non-tariff barriers were not Pakistan-specific and were applicable across the board, the opponents of trade liberalization narrated their actual experience with cross-border trade in the past, which had not been too pleasant. Anecdotes of delay by the customs authorities, testing laboratories, Bureau of Indian Standards, and railways, causing losses to Pakistani exporters, were cited at these meetings. When it was pointed out that bureaucratic indifference and inertia and hassle formed part of the administrative culture in the two countries that had inherited the common civil service, it was asserted that the difference in the attitude toward Pakistani exporters was quite stark.

MAJOR RISKS TO TRADE RELATIONS

What are the major risks that can derail this process? There are many, but at least eight need to be highlighted and steps taken to mitigate them.

First, there exists a huge trust deficit between the two countries for reasons that are well known. This deficit dominates the populist thinking on both sides. The bridging of this deficit is not easy, will take some time, and will depend upon a series of positively reinforcing measures taken unilaterally by both sides in a consistent manner. There is a palpable fear in Pakistan of collective punishment and sanctions on trade against Pakistan if something goes wrong on the security or political fronts. Any unforeseen or unplanned contingency can trigger a strong adverse reaction on either side. So far the two countries have behaved responsibly in military terms in the post-1998 era, but there is no guarantee that the axe of such a triggering episode may not fall on trade—with trade flows disrupted. Both the dialogue process and trade relations should continue "uninterrupted and uninterruptible," as the Indian diplomat and politician Mani Shankar Aiyar has argued. At times of crises, the policy of engagement rather than abrupt withdrawal could prove to be effective in defusing the situation and finding an amicable resolution to the problem.

The possibilities of a knee-jerk reaction of suspending trade or imposing tough retaliatory measures in the future cannot be ruled out. This stop-and-go policy would act as a powerful deterrent to the establishment of long-term relationships across the borders as it creates uncertainty, fear, and unpredictability about the trade regime. This tendency has to be curbed if businessmen are to take advantage of the liberal trade regime.

Second, South Asian political parties when in opposition behave quite differently and diametrically opposed to their policies when in power. Scoring points and discrediting the ruling party are their main objectives. They may easily join the ranks of the extremist elements, who are the biggest detractors of normalizing relations between the two countries. The trigger point for such a coalition could be the persistence or expansion of trade imbalances in favor of India. Such bilateral imbalances are to be expected, as India is a much larger and more diversified economy. The political backlash caused by this imbalance could put undue pressure on anyone in government in Pakistan who might choose to sacrifice trade in order to survive. This myopic action, which may win some relief for the ruling party, will do enormous damage to the promotion of trade in the long run. Fickle-minded populist actions are counterproductive for durable relationships to take shape.

Third, there is always a risk from the possible ascendency of the losers lobby. It must be realized that in the short run, opening up trade will produce some losers and some winners. While traders and importers in both countries would be happy to see their business expanding, inefficient manufacturing firms will be losers from this liberalization. They may lobby the government and political parties by making noises that the onslaught of cheaper imports from the other country is destroying domestic industry and jobs. Depending on the power and influence of the lobby, it is quite conceivable that some retaliatory measures could be taken that would kick off a spate of countervailing measures. The consequential dilatory tactics would once again widen the trust deficit and hamper growing trade relations.

Fourth, the media and civil society in both India and Pakistan have become quite powerful. In case small and medium enterprises (SMEs) suffer disproportionately from trade liberalization, the media could take up their cause and create such venom that trade flows could be set back. Another possibility is that integration through trade and capital flows may amplify the contagion effect. A negative shock to the Indian economy may be transmitted to the Pakistani economy, which may slow down as a result, depending upon the trade intensity. The media in Pakistan may use such occasions to put pressure on the government to take some protectionist measures. If, as a consequence, tariffs, quantitative restrictions, non-tariff barriers, or capital controls are introduced, the credibility of the liberalization process will be damaged, setting back the evolution of relations. It is in the interest of everyone that the media should have enough positive stories to tell that generate goodwill. Frequent exchanges between representatives of the media and the holding of seminars, meetings, and roundtables of civil society organizations can help clear the mental fog and obdurate obfuscation. The businesses in the two countries will be well advised to advertise through the other country's media.

Fifth, there would be a constant need for the validation of the new popular narrative that the proponents of India–Pakistan trade are espousing. Consumers should feel that the procurement of certain goods from the other side has really benefitted them, while the producers should be able to testify that the sourcing of raw materials, machinery, or components has in fact lowered their costs. Such human interest stories should be disseminated widely through the popular as well as social media. The validation of the new narrative can become one of the contributory factors in bridging the trust deficit.

Sixth, the "composite dialogue" on outstanding political issues should continue with seriousness, commitment, and a constructive attitude. If such a dialogue does not proceed forward, those who are opposed to normalizing economic relations would be able to gain ground by asserting that Pakistan's principled stand and core issues have been abandoned for the sake of paltry material gains. This can set the ball rolling for a larger movement that would blame trade as the major impediment in the way of resolving political issues. The political leaderships of the two countries are very much committed to the peaceful resolution of the issues confronting them, and the momentum on the dialogue should not be lost.

Seventh, other areas of economic cooperation such as subcontracting by Indian IT firms to Pakistani companies, tourist packages, and collaboration in higher education, agriculture, health, and research and development between the two countries would be highly beneficial. India has developed many first-rate hospital facilities at much lower costs than Western countries. There is no reason why branches or subsidiary hospitals cannot be set up in Pakistan as they have been done in Bangladesh. Indian IT firms are market leaders in business process outsourcing, but are faced with increasing labor costs. They can sub-contract some of the work to Pakistani firms at rates that are relatively cheaper than what they pay in India and thus maintain their market share.

Eighth, there should not be any iota of doubt that disputes will arise in the course of business and grievances of all kinds will emerge. It is imperative that a dispute resolution/grievance redressal mechanism is put in place right from the beginning. This mechanism should be expeditious, inexpensive, and equitable. In place of the governments, the

Confederation of Indian Industries (CII)/ Federation of Indian Chambers of Commerce and Industry (FICCI) and the Pakistan Business Council (PBC)/ Federation of Pakistan Chambers of Commerce and Industry (FPCCI) should be involved in setting up and operating this mechanism.

To overcome these concerns and anxieties of Pakistani businesses, India—a much bigger economy accounting for more than 80 precent of gross regional product, and imbued with self-confidence and aspirations to become an economic power—could demonstrate a greater degree of generosity by removing tariff and non-tariff barriers unilaterally without risking much in return. A wider offer to its neighbouring countries in terms of opening up markets and trade and removing barriers to mobility would ultimately benefit India, reducing hostility and favoring its exporting and importing industries, as well as benefiting Indian consumers with lower prices for goods imported from Pakistan. It would be in India's long-term interest to establish asymmetric relationships with its neighbors and provide more concessions to them, initially expecting less from them in return. This posture would be helpful in generating wider economic benefits for India itself, and for its trading partners in South Asia in the long run.

Given the large and growing size of its effective market, the economic losses to India of such an approach would be minuscule, while political goodwill and returns would be substantial over time. Pakistan, Bangladesh, and Sri Lanka would be much better off economically if they were able to penetrate the buoyant Indian market. Friendly, peaceful, and irritant-free neighbors would aid rather than hinder India in moving toward its long-term goals, enunciated periodically by its leaders. South Asia, a region with the highest number of people living below the poverty line, would surge ahead.

POLICY RECOMMENDATIONS

As the Pakistan-India relationship is likely to remain fragile due to past historical experience, proactive management of the policies and processes and a vigilant eye on their implementation will be required for some time on both sides. It is therefore proposed that the following policy recommendations be put in place and monitored regularly, and that remedial actions be taken to move the process forward.

- Managing the transition from the positive to negative lists is quite critical to the future evolution of the relationship. If too abrupt large-scale, visible, and one-sided changes take place, then the lobbying efforts of those adversely affected will intensify. India, being the large economy, has to pay particular attention that its export expansion is mainly substituting for more expensive machinery, equipment, raw material, components, and intermediate goods from third countries, which will help Pakistani manufacturers in lowering their costs of production. The export of technology from India will be highly welcomed. The phasing, sequencing, timing, quantum, and composition will have to be monitored carefully to keep disruptive forces from surfacing. Although the transaction will take place mostly between private sector parties, the ministries of commerce in the two countries will have to use some moral suasion in the transition phase. Voluntary export restraints by India for a limited period may also be considered as a policy option if it is found that certain imports are exceeding their threshold value and are hurting Pakistani industries, particularly small and medium enterprises. After all, the volume of Indian exports to Pakistan will remain miniscule—2 percent of India's total at best. Any news stories that Indian goods have risen by 100 percent in one year would prove disastrous. Large bilateral trade imbalances should be kept to a minimum, and promotional activities to allow Pakistani exporters access to Indian markets would help a great deal.

- It will be necessary to rationalize and simplify the technical barriers to trade and the sanitary and phytosanitary measures which are, in fact, acting as powerful deterrents to the exchange of goods. These are, in effect, NTBs that hinder the flow of goods.

- Visa restrictions on businessmen should be eased so that they can have long-duration multiple-entry visas that allow them visits to any number of cities without reporting to the police. Businessmen have to travel frequently to different places at short notice. The present visa regime is cumbersome and time-consuming and discourages exchange. India and Pakistan have been negotiating a simpler and more streamlined process of visa application and approval for quite some time. No discrimination between large and small businessmen should be allowed in granting visas. This new visa regime should be put into effect immediately; otherwise the other efforts to liberalize trade will prove ineffective.

- Both countries should reactivate the South Asian Free Trade Area (SAFTA) and agree on a phasing-out of the sensitive list (of items that each country deems important for its economy) over the next few years. A restrictive list would nullify all the potential gains of preferential trade access.

- Financial and banking services play a catalyst role in promoting international trade. In 2005, Governor Y. Venugopal Reddy of the Reserve Bank of India and the author (then the governor of the State Bank of Pakistan) signed an agreement to open branches of two Indian banks in Pakistan, and two Pakistani banks in India. This agreement has not yet been implemented, as procedural difficulties have been allowed to overwhelm the substance of the agreement. Without banking services, the opening of letters of credit, and cross-border fund transactions, trade cannot flourish.

- One of the major problems impeding larger India-Pakistan trade flows is the poor state of logistics. The World Bank Logistics Performance Index that measures the efficiency of the customs clearance process, quality of trade and transport-related infrastructure, ease of arranging competitively priced shipments, competence and quality of logistics services, ability to track and trace consignments, and frequency with which shipments reach the consignee within the scheduled or expected time, places both countries quite low. Although the new integrated border check at Wagah-Attari would allow 10 times more trucks to cross, other logistics snags have to be dealt with quickly. Special task forces with adequate powers should be formed for at least the first year to solve the problems and facilitate flows of goods and people.

- India, as the largest economy in the region, has to pursue a more vigorous process of dismantling "behind the border barriers" if it is to realize its potential. The maze of byzantine regulations and rules and the business processes for cross-border exchange have to be simplified and streamlined. For a country that has some of the most progressive entrepreneurs, eminent intellectuals, scientists, and innovators, and globally competitive human resources, it is not comprehensible why it cannot carry out these needed reforms that will help to realize its potential.

- Businessmen on both sides have outlined the requirement for opening new border points for trade with spacious loading zones for ease of truck and rail movement, modernization of rail transportation, a new shipping protocol, and deregulation of air services. While both countries have very high mobile phone penetration, they are not allowed to avail the roaming facility when visiting the other country. The 2006 composite dialogue between India and Pakistan had on its agenda the resumption of rail services between Khokrapar and Monabao; bus service between Srinagar and Muzaffarabad; religious visits to Lahore and Nankana Sahib; a new shipping protocol; the deregulation of air services; and joint registration of basmati rice. This agenda should be revived and agreements reached to implement these measures.

CONCLUSION

The future growth, disruption, or slow death of India-Pakistan trade will depend upon whether a proactive, sensible system is put in place to manage trade relations. It is in the mutual interest of the two countries to strive for an enduring, uninterruptible, long-term relationship that is not prone to sudden disruptions, abrupt retaliations, and knee-jerk reactions. There is no guarantee that this will be an easy or smooth process. Nonetheless, at least there is one change that can make some difference. The usual South Asian bureaucracy-driven approach that is reactive, slow, and ponderous can sooner or later act as the kiss of death. A more private sector-led, problem-solving, and getting-on-with-the-job approach has a far better chance of avoiding some of the pitfalls and producing the expected results.

Annex 1: Sectorial Composition of Negative List (number of items)

Automobile	385
Iron and Steel	137
Paper and Board	92
Plastic	83
Textile	74
Electric Appliances and Machinery	57
Pharmaceuticals	49
Machinery	37
Chemicals	33
Sports Goods	32
Ceramics	28
Cutlery	22
Glass	22
Miscellaneous Manufacturing	22
Leather goods	19
Rubber goods	19
Agriculture	16
Furniture	16
Aluminum products	12
Surgical goods	10
Footwear	7
Soap and Toiletry	7
Meters	6
Metal Products	5
Prefab Building	5
Stone and Marble	5
Wood	4
Gems and Jewelry	3
Optical Fibre	2
	1209

Annex 2: India's Major Trading Partners, 2009–2010 (percentage share)

Country	Exports	Country	Imports
UAE	13.4	China	15.0
USA	10.9	UAE	11.4
Japan	9.2	Switzerland	8.6
Germany	7.1	S. Arabia	7.1
UK	6.4	USA	7.0
Total ($ Billions)	**178**	**Total ($ Billions)**	**287**

Source: Department of Commerce, government of India.

Annex 3: Pakistan's Major Trading Partners, 2009–2010 (percentage share)

Country	Exports	Country	Imports
USA	17.4	UAE	14.5
UAE	8.9	Saudi Arabia	9.7
Afghanistan	8.1	Kuwait	6.9
UK	4.9	Malaysia	5.0
Germany	4.3	USA	4.6
Hong Kong	2.2	Japan	4.4
		Germany	3.4
		UK	1.7
Total ($ Billions)	**19.3**	**Total ($ Billions)**	**34.7**

Source: Federal Bureau of Statistics, government of Pakistan.