

GRANTING MFN STATUS TO INDIA BY PAKISTAN PROSPECTS OF LIBERALIZATION OF BILATERAL TRADE

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Abstract

Pakistan government's recent announcement that it had decided to grant MFN status to India which has yet to take place has received mixed response from think tanks, stakeholders and members of civil society. Those who favour the according of MFN status to India, are of the opinion that a quick way of revival of Pakistan's economy is to enhance its economic growth rate by increasing its trade with India, a close neighbour and a large market. Those who are skeptical about enhancing trade with India say that liberalization of mutual trade will enable Indian goods to flood Pakistani market and severely damage less competitive segments of its industry. On the other hand, Pakistani exports to India will continue to suffer due to its heavy tariff and non-tariff trade barriers. There are also apprehensions about the success of bilateral trade process due to India's inflexible policy on resolving bilateral disputes. Under this scenario, this paper discusses the potential and prospects of enlarging Pak-India trade after granting MFN status to India. Looking through past experience of trade with India and its very restrictive trade regime the paper focuses on likely impact of MFN on Pak-India trade. The paper also examines the possibility of sustaining the mutual trade process in the light of tensions on outstanding disputes. Finally the paper concludes by offering recommendations for making bilateral trade a win-win situation.

Key Words: MFN, Bilateral Trade, Non-tariff, Trade barrier

Introduction

Pakistan needs to enhance its economic growth to address its current and lingering challenges of budget deficit, heavy debt burden, rising inflation, trade imbalance, energy crises and unemployment. Similarly, attracting foreign direct investments (FDIs)

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and remittances from the Pakistani Diaspora could be of greater help for addressing energy shortages, increasing Pakistan's foreign exchange reserves and caring for other economic and development issues. In this context, increasing trade and joint economic ventures with immediate neighbours, like India and other regional countries and with other states can prove to be beneficial for enhancing and sustaining economic growth. Currently Pakistan's share of global trade is only 0.14 percent. Even a 0.5 share in the global export market implies that its exports could rise from the current \$ 25 billion to 60 billion creating millions of jobs.¹ In this regard, enhancing trade with India, being nearer and a major market, is being considered by the functionaries of Pakistan government an attractive opportunity for increasing Pakistan's economic growth. It is being appreciated that as close neighbours, both Pakistan and India would enjoy lesser transportation cost and time for trade to earn mutual benefits. Apart from this, trade volumes will also increase because of acceptance of goods on both sides due to common cultural traits and similar tastes. Also, due to increased demand of Pakistani goods in India's large market, Pakistan's industry will be able to achieve economy of scale benefits in production. Analysts believe that advancement of mutual trade can bring another major advantage to Pakistan and India in a way of improving bilateral relations which can largely help in enlarging trade within the SAARC region by facilitating quick implementation of South Asian Free Trade Area (SAFTA). Not only that, meaningful progress in Pak-India trade relations can further benefit both countries and other SAARC states by opening up the mineral and energy resources of Afghanistan, Iran and Central Asian states in the west and energy reserves of Nepal, Bhutan and Myanmar in the east. Good trade relations between Pakistan and India can also create better environment for resolution of outstanding bilateral disputes.

In the past, due to lingering bilateral tensions because of 1965 War over Kashmir and 1971 Indian aggression which dismembered Pakistan, the required level of mutual trust could not develop between Pakistan and India. Nonetheless, composite bilateral dialogue was initiated in 2004; agreement for ceasefire across LOC materialized and Wagha-Attari and Srinagar-Muzaffarabad land routes were opened up for trade and visit. Ironically, volume of official trade between Pakistan and India still has remained quite low. Number of reasons which mainly include: 1) a long negative list of trade items being maintained by both the countries under SAFTA, 2) infrastructural and procedural problems on the borders, and 3) imposition of heavy tariff and non-tariff barriers by India and

¹ Ishrat Husain, "Prospects and Challenges for Increasing India-Pakistan Trade," Atlantic Council, November 2011, 1, accessed on January 5, 2013, http://ishrathusain.iba.edu.pk/speeches/New/Atlantic_Council_Issue_brief_IndiaPakistanTrade.pdf

tensions on borders due to Kashmir issue. In this realm, main hindrance in the way of healthy Pak-India economic relations is India's heavy non-tariff trade barriers, though India had granted MFN status to Pakistan in 1996. However, due to such restrictive conditions unofficial/illegal trade through smuggling and via other countries such as Dubai, Singapore and Thailand continues to happen.

To liberalize trade with India, after resumption of composite dialogue, as a consequence of long parleys held with India during 2011-2012, Pakistan government decided in principle to grant MFN status to India. In this context Pakistan's cabinet has already approved Commerce Ministry's proposal to grant MFN status to India. Although, except Pakistani business community and two main political parties who have largely favoured government decision of granting MFN to India, other opinion makers in Pakistan such as some economists, think tanks, industrialists, members of civil society and Ministry of Industries have shown mixed reaction to the decision.²

The MFN status implies that as members of World Trade Organization (WTO) both countries are obliged to adopt nondiscrimination principles of MFN which require each WTO member to extend similar trade concessions to all other members.³ In this context, granting of MFN status by Pakistan to India would mean that restrictions on imports from India would have to be eliminated and same tariff rates would apply to Indian imports as are imposed by Pakistan to imports from other countries.⁴ In this context WTO rules also allow members to impose safeguards restricting imports in case of serious injury to domestic manufacturing industry due to trading under MFN obligations.⁵ In the light of granting MFN to India both countries are seeing mutual benefits to be obtained by opening up their borders for trade.⁶ It is being estimated that after granting MFN status to India mutual trade volume

² "16 Years on.... Pakistan finally reciprocates granting MFN status to India," *Express Tribune* (Islamabad), November 3, 2011, accessed on January 3, 2013, <http://tribune.com.pk/story/286925/16-years-on-pakistan-finally-reciprocates-granting-mfn-status-to-india/>

³ "Trade Relations between Pakistan and India," PILDAT, January 2012, accessed on January 21, 2013, http://www.pildat.org/publications/publication/FP/TradeRelationsbetweenPakistanAndIndia_IndianPerspective_Jan2012.pdf

⁴ Mohsin Khan, "Indian-Pakistan Trade Relations," New American Foundation, January 2013, 2, accessed on February 12, 2013, http://www.indiapakistantrade.org/resources/Khan_India-PakistanTrade_NAF2.pdf (accessed February 12, 2013).

⁵ Ibid. PILDAT, "Trade Relations between Pakistan and India," 16-17.

⁶ Ibid., Ishrat Husain, "Prospects and Challenges for Increasing India-Pakistan Trade."

will increase from existing value of \$2 billion a year to \$ 6 billion in the initial about 5 years and later it could multiply to even higher figures.⁷

However despite such pragmatic estimates, in view of past experience of tenuous political relations between Pakistan and India, due to India's heavy tariff and non-tariff barriers and its negative list which restricts Pakistani exports, success and sustainability of this bilateral process seems to be a difficult task. To search possibilities of success of evolving liberalization of trade between Pakistan and India there is a need to find answers to some questions such as: How will MFN status to India impact Pakistani exports to India and Indian exports will impact Pakistan's industry and other related sectors in the light of previous experience of mutual trade and under India's still existing high tariff and non-tariff barriers? How the negatives of provision of MFN status should be offset by Pakistan to make its trade beneficial? And will the evolving process be sustainable in view of India's non flexible policy on resolution of outstanding disputes and resultant tensions on the Line of Control (LOC)?

This paper discusses the potential and prospects of enlarging Pak-India trade after grant of MFN status to India. Keeping in view the past experience of trade with India and its very restrictive trade regime, the paper focuses on the likely impact of MFN on Pak-India trade in the form of relative advantages and disadvantages to Pakistan and overall potential and prospects of trade expansion with India. The paper also examines the possibility of sustaining the mutual trade process and concludes by offering recommendations for making a positive sum situation in trade with India.

An Overview of Past Trade Relations with India

Soon after getting independence in 1947 both Pakistan and India became members of General Agreement on Tariff and Trade (GATT) and in line with the rules of this agreement granted in-principle Most Favoured Nation (MFN) status to each other in 1957 through a bilateral agreement but it was short lived.⁸ It is according to the fundamental principle of GATT that all its members are bound to grant MFN status to all other member states with respect to trade in goods. This implies reduction of tariffs and other barriers to trade for member countries without any discriminatory treatment in international commerce.⁹ After independence both Pakistan and India were close partners in trade. Till

⁷ Ibid., 1.

⁸ Ibid., PILDAT, "Trade Relations between Pakistan and India," 16.

⁹ Waqas Bin Najib, et al., "Implications of Trade Liberalization between Pakistan & India," Punjab Board of Investment & Trade, May 3, 2012, accessed on January 6, 2012, http://www.pbit.gop.pk/uploaded/projects/file/Working_Paper_PAK%20INDIA.pdf

1950s volume of bilateral trade between two countries remained satisfactory. Pakistan's exports to India in 1948-49 were 23.6 percent of its total exports and its imports from India amounted to 50.6 percent of its total imports which declined to 1.3 percent and 0.06 percent respectively in 1975-76. Pakistan's share in India's global exports and imports was 2.2 percent and 1.1 percent respectively in 1951-52 which gradually got down to 0.7 percent and 0.13 percent in 2005-06.¹⁰ After 1965 War followed by Indian aggression in 1971 which dismembered Pakistan, despite having signed 14 trade facilitation agreements till 1964 the trade came to stand still till the time composite dialogue was started in 2004. Even after 1996 when India accorded MFN status to Pakistan mutual trade did not pick up due to disturbed political relations because of Kashmir dispute, non-opening of all traditional land routes for trade and application of heavy tariff and non-tariff trade barriers by India. However, mutual trade gradually improved from 2004 onwards although it still remained much below the expected level.

In 2001, India's exports to Pakistan were equal to US \$ 164.6 million, which went up to US \$ 2235.8 million in 2010. The imported value of goods from Pakistan was US \$ 69.9 million in 2001 which increased to US \$ 248.4 million in 2010. As is evident from data given below the trade balance from 2001 to 2010 has been strongly in favour of India.¹¹

Table: India's Trade Balance with Pakistan (US \$ Million)

Year	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Exports	164.61	18707	183.6	522.1	593.1	1235.0	1584.3	1772.8	1455.8	2235.8
Imports	69.6	33.9	68.1	79.1	165.9	286.5	286.7	372.0	272.1	248.47
Trade Balance	94.70	153.8	115.5	442.9	427.1	948.6	1297.6	1400.8	1183.7	1987.4

Source: Trade Map, International Trade Center, Geneva & also see PILDAT, "Trade Relations between Pakistan and India"

The above data indicates that two countries have not been able to realize full potential of their trade. India's trade balance with Pakistan which was US \$ 94.7 million in 2001 increased to US \$ 948.6 million in 2006 and US \$ 1987.4 million in 2010. On the other hand Pakistan's imports from India in its global imports have increased from 4 percent in

¹⁰ Ibid, PILDAT, "Trade Relations between Pakistan and India," 12.

¹¹ Ibid.

2008 to 6 percent in 2010 where as India's imports from Pakistan remained nominal.¹² From 2001 to 2010 Pakistan's main imports from India have been sugar and sugar confectionary, cotton, man-made filaments, organic chemicals, residues, waste of food industry, animal fodder, edible vegetables, coffee, tea, spices, rubber, oil seed, fruits, grain, seed and miscellaneous chemical products. Whereas Pakistan's main exports to India from 2001 to 2010 have been edible fruit, nuts, peel of citrus fruit, melons, mineral fuels, oils, distillation products, organic chemicals, salt, sulphur, earth stone, plaster, lime, cement, cotton, lead articles, raw hides and skins, plastics and plastic articles, inorganic chemicals, precious metal compounds, wool, animal hair and fabric.¹³ The main reason for low levels of Pakistani exports to India is high tariff and non-tariff barriers imposed by India. In the opinion of Pakistani as well as Indian observers, Indian non-tariff barriers are a significant hurdle to Pakistani exports to India.¹⁴

India's Restrictive Trade Regime

Although India accorded MFN status to Pakistan in 1996, it is otherwise maintaining the most restrictive tariff and non-tariff regime in the SAARC region due to which Pakistan has not been able to draw the benefits linked with the MFN status. The toughest part of India's trade regime is high tariffs on import of textile and agriculture goods which are of Pakistan's export interest and non-tariff barriers. Although non-tariff barriers are not Pakistan specific, due to India's Free Trade Agreements (FTAs) with Nepal, Bhutan and Sri Lanka and its Preferential Trade Agreement (PTA) with Afghanistan, Pakistan is the most affected country because these countries get concessions on non-tariff barriers based on these trade agreements. Bangladesh being a Least Developed Country (LDC) in South Asia under SAFTA obligations, also gets deeper preferential treatment from Non LDCs of South Asia including India.¹⁵ Therefore after getting MFN status tariff facilities from Pakistan, while India will be able to enhance its exports because of Pakistan's otherwise relaxed tariff regime, Pakistan will only be able to draw real benefits out of MFN status if tariffs and non-tariff barriers negatively impacting Pakistan's exports to India are relaxed. For this purpose Pakistan will

¹² Ibid.

¹³ Ibid.

¹⁴ Asad Sayed, "Gains from Trade and Structural Impediments to India-Pakistan Trade," in *International Relations Theory and South Asian Regional Cooperation*, Vol. II, ed., E. Sridharan, (Delhi: Oxford University Press, 2011), 9.

¹⁵ Dr. Manzoor Ahmad et al., "Normalization of Trade with India: Opportunities and Challenges for Pakistan," Trade Development Authority of Pakistan, June 1, 2012, 4, accessed on February 3, 2013, http://www.tdap.gov.pk/word/Report_040712%20rev.pdf

have to successfully negotiate an agreement on removal of related tariff and non-tariff barriers. Failing that it might have to sign an FTA with India. India's current major tariff and non-tariff trade barriers are discussed below.

India's MFN Tariffs and Para Tariffs

India has been reducing its tariffs for the last many years. Although India's average applied MFN tariff currently stands at 12 percent, its tariff regime is still complex. In sectors of Pakistan's export interest like textiles and agriculture import taxes are still high. Then the situation is further complicated by para-tariffs levied by India since these tariffs further increase the effective applied duty rates. Whereas the average MFN customs duty rate is 12 percent, with para-tariffs it becomes 25.6 percent on the average. Actually the rates increase two fold for textile and clothing and three fold for chemicals and cement from average applied MFN rates.¹⁶

India's tariff regime also protects agriculture. Average tariff protection for agricultural products in 2010-2011 was as high as 32.2 percent in comparison to manufactured products at 8.9 percent. Almost 57 percent of agricultural goods bear tariffs of 30 percent. This state of tariffs acts as an impediment to trade of agricultural goods with India. Rice and sugar are also affected by these taxes.¹⁷ Therefore Pakistan's agriculture can only benefit by increasing its exports to India if it is given a level playing field by India.¹⁸

India's tariffs for semi manufactured goods are lower as compared to processed goods. This provides an opportunity for manufacturing industry in India to get cheaper material for further processing. Therefore it provides a potential area for Pakistani exports. However, local manufacturers of automotive parts and surgical equipment sectors in Pakistan suggest that the exports of intermediate goods be regulated in order to support the local manufacturing industry.¹⁹ India imposes para-tariff measures like Countervailing Duty (CVD) and education cess also. This considerably raises the effective tariff rate. These para-tariffs are levied in lieu of domestic taxes on imports to provide a level playing field to local producers in India.²⁰

India's sensitive list (allowed under SAFTA to restrict import of some goods to protect domestic industries) protects a wide range of textile and agriculture products. About 30 percent of the items on India's

¹⁶ Ibid., 3.

¹⁷ Ibid.

¹⁸ Ibid., Mohsin Khan, "Indian-Pakistan Trade Relations," 3.

¹⁹ Ibid., Dr. Manzoor Ahmad et al., "Normalization of Trade with India: Opportunities and Challenges for Pakistan," 3.

²⁰ Ibid., 4.

sensitive list are agricultural, whereas 34 percent are industrial products. On the other hand, Pakistan's sensitive list contains 4 percent agricultural and 24 percent textile products.²¹ According to South Asian Free Trade Area (SAFTA) signed in 2004 and enforced in 2006 India will reduce tariffs to zero from 5 percent on all products except those on the sensitive list by 2013 as per its commitment as a Non-LDC member of SAFTA.²² But its impact on Pakistan will be limited because India's agriculture and textiles are protected by the sensitive list.²³

India's Non-Tariff Barriers (NTBs)

While India's NTBs may not be country specific, they are reported to be extensive in sectors of high export potential for Pakistan, namely textiles, agriculture, marble and cement. These NTBs range from specific tariffs, and para-tariff measures to complicated labelling requirements, licensing regimes, custom procedures, multiple standards, internal state taxes, subsidies and sales taxes.²⁴ Also non-tariff barriers due to infrastructural constraints at land ports and restrictive bilateral transport protocols act as an impediment to trade, especially between India and Pakistan.²⁵ India's extensive non-tariff barriers are:

- The import licensing and permit regimes are complex, varying according to product or user.²⁶
- India is one of the most active users of anti-dumping measures. A number of safeguard measures have also been imposed including quantitative restrictions. Reference prices have also been established for some products, which are revised every two weeks to align with international market prices.²⁷
- Lack of harmonization and acceptance of standards particularly for agricultural and textile products is a major barrier from Indian side. The mutual recognition

²¹ Ibid., 3.

²² FaizSobhan, "SAFTA: Today and Tomorrow," in *SAARC towards Meaningful Cooperation*, ed., TomislavDelinic&Nishchal N. Pandey (Kathmandu: Centre for South Asian Studies, 2012), 45.

²³ Ibid., Dr. Manzoor Ahmad et al., "Normalization of Trade with India: Opportunities and Challenges for Pakistan," 3.

²⁴ Ibid., Mohsin Khan, "Indian-Pakistan Trade Relations," 3.

²⁵ Ibid., Dr. Manzoor Ahmad et al., "Normalization of Trade with India: Opportunities and Challenges for Pakistan," 18.

²⁶ Hafiz A. Pasha and Muhammad Imran, "The Prospects for Indo-Pakistan Trade," *The Lahore Journal of Economics*, vol.. 17, (September 2012): 306.

²⁷ Dr. Kamal Monnoo, unpublished paper, "Most Favoured Nation (MFN) and Trade Liberalization between Pakistan & India," 3.

agreement which has been recently signed by two countries for harmonization of standards for the time being only covers one item, which is cement.²⁸

- Many Pakistani traders feel that Indian NTBs are Pakistan-specific. Denying this allegation India says that it discriminates equally against all trading partners. Apparently it appears that NTBs imposed by India are not specific to Pakistan, but to help India. In the true sense, however, these barriers hurt Pakistan the most in South Asia because India has FTAs almost with all other South Asian countries under which these NTBS have been done away with. Also, in some cases NTBs are levied on Pakistan on ad-hoc basis.²⁹
- There are arbitrary customs procedures such as application of minimum custom values, compulsory pre-shipment inspections for certain items, import permits and original SPS certificates for agricultural products, checking by multiple agencies and bureaucratic hurdles are also a problem.³⁰
- India has also imposed some technical barriers to trade such as sanitary and phyto sanitary (plant and plant product safety) measures.³¹

While on one hand, India is widely propagating its efforts to gradually removing “official” trade hurdles, on the other hand, to maintain status quo, it is adding other barriers, particularly in sectors where its interests are most threatened by Pakistani exporters, such as cement and gypsum. In 2012, India has passed a regulation which prohibits the trucking of goods in vehicles with more than 10 wheels and also those over 40 tons capacity. Pakistan’s cement Industry has been badly hit by this Indian regulation.³²

Impact of Granting MFN Status to India on Pakistan’s Trade with India

While most of the economists, government officials, various stake holders and think tanks in Pakistan and India have generally given positive response to Pakistan's decision of granting MFN status to India,

²⁸ Ibid., Dr. Manzoor Ahmad et al., “Normalization of Trade with India: Opportunities and Challenges for Pakistan,” 4.

²⁹ Ibid., Mohsin Khan, “Indian-Pakistan Trade Relations,” 7.

³⁰ Ibid., Dr. Manzoor Ahmad et al., “Normalization of Trade with India: Opportunities and Challenges for Pakistan,” 4.

³¹ Ibid., Mohsin Khan, “Indian-Pakistan Trade Relations,” 7.

³² Ibid.

there are some who are criticising this government decision also. Those who are in favour say that granting MFN status to India will enhance mutual trade and bring many advantages to both the countries. Those who have opposed the government decision of liberalization of trade with India have cautioned against greater expectation of any spectacular increase in Pakistani exports to India because of its strict tariff and non-tariff trade regime, they have also expressed concerns that after attaining MFN status, due to Pakistan's softer tariff and non-tariff regime India's exports might flood Pakistani market thus harming its industry. Some stake holders have also expressed apprehensions about adverse implications on various specific sectors of Pakistan's industry such as textiles and agriculture due to India's additional tariffs and subsidies and some other industrial sectors which are not yet competitive. In the same line of action, few Pakistani industrialists have also requested the government for protecting interest of their industry.

While the above mentioned viewpoints have indicated various advantages and disadvantages of granting MFN status and liberalization of trade with India, they have also suggested some positive measures to make the trade liberalization process a win-win situation for both sides.

Likely Advantages of Liberalization of Trade with India

Various studies reveal that granting MFN status to India and increased bilateral trade will benefit both countries in the long run. However, since some sectors of Pakistani industry are less competitive, initially imports from India might partially harm those sectors (like automobiles and pharmaceuticals) but ultimately it will be able to compete with the Indian industry and its increased production as a result will bring dividends.³³ Also a meaningful increase in Pakistan's exports to India will only happen if India reduces and removes its tariff and non-tariff barriers and also eliminates its negative list.³⁴ If these restrictions are relaxed by India, then after giving MFN to India, Pakistan will gain access to huge Indian market and will be able to gain a number of advantages such as: Using advantage of less freight due to short distances as compared with exporting to distant countries outside the region Pakistan could market its goods in northern India at highly competitive rates.³⁵ Likewise Pakistan will be able to import raw materials for its industry from India at lesser price instead of importing from far off developed countries at higher price. Pakistan will also benefit by

³³ Majid Ali Wajid, "Trade with India in Pakistan's Interest," *Nation*(Islamabad), August 25, 2003.

³⁴ Ibid., Mohsin Khan, "Indian-Pakistan Trade Relations," 7.

³⁵ Ibid., Majid Ali Wajid, "Trade with India in Pakistan's interest."

regularizing the informal trade (US \$ 1.5 in 2004) between the two countries through smuggling on borders and through third countries.³⁶

Dr. Ishrat Hussain comments that Pak-India trade is a win-win situation. According to him, India has a middle class of approximately 300 million people with rising purchasing power which matches that of the South Eastern Europe. While Pakistan's middle class is about 30 million, even 10 percent share of the Indian middle class can double the market size of Pakistani companies and businesses.³⁷

Pakistan's automobile industry has progressed well, is producing all types of vehicles under franchise and is almost contributing over 30 billion rupees to the government exchequer annually in the form of duties and taxes. However, Indian automobile industry with strong engineering base and large capacity for production of vehicles enjoys a clear edge over Pakistan. Therefore, if Pakistan imports vehicles from India, it will benefit its consumers being much cheaper but Pakistan's industry will initially suffer till it becomes competitive. However, it will be beneficial to import automotive components and spare parts from India at a lower price than Thailand. Joint ventures between producing units of both countries located near borders will also be profitable as it will lower the unit cost of production and distribution.³⁸

In India, IT industry has made tremendous progress. It is now the fastest growing sector in India earning about US \$ 62 billion annually and employing almost 125,000 workers. A majority of the multinational IT companies operating in India have software and research development centers. Pakistan's IT industry is growing at a faster pace. As per WTO made formula, the size of IT industry in Pakistan is presently in the range of US \$ 2.8 to US \$ 3 billion and IT related exports are around US \$ 1.6 billion. To use IT industry as a catalyst for its economic revival Pakistan can draw benefit out of India's software industry. It can further promote IT through joint ventures with India in Pakistan since it can provide skilled professionals of comparable quality at lower wages than India. It will benefit both countries.³⁹ If liberalization of trade between Pakistan and India succeeds it can act as a major trust building measure which can ultimately lead to resolution of Kashmir and other disputes. A meaningful progress on resolution of Kashmir dispute can also help India in getting transit route through Pakistan to Afghanistan and Central Asia. This will facilitate India to transport iron ore from Afghanistan and energy from

³⁶ Ibid.

³⁷ Ibid., Ishrat Husain, "Prospects and Challenges for Increasing India-Pakistan Trade," 1.

³⁸ Ibid., Ishrat Husain, "Prospects and Challenges for Increasing India-Pakistan Trade," 6.

³⁹ Ibid.,

Iran and Central Asian states through Pakistan. If this happens both countries will get substantial economic benefits and this opening will also help in making the new Silk Road a success story.⁴⁰

The Pakistani industries that would benefit from liberalization of trade with India are; fish, rice, dry fruits, sugar, cotton, wool, cement, leather, yarn, cotton fabrics, clothing, cutlery, surgical instruments and sports goods.⁴¹

In iron and steel industry, India is the eighth largest crude-steel producer and largest producer of sponge iron in the world. Pakistan's iron and steel product imports from India account for just a small fraction of its total imports. In 2004, Pakistan imported US \$ 62 million worth of iron and steel products (326 items) of which India supplied only 25 items, worth 7.1 million. Another 46 are identified as import items which are cheaper to import from India than from the rest of the world. Hence these items can be imported from India.⁴²

Pakistan's chemical industry has developed on ad-hoc basis because of small local market and high tariffs. Hence the country is dependent on imported chemicals to cater to the needs of its agriculture and industrial sectors. During 2004, Pakistan's imports of chemicals were worth US \$ 2.8 billion. Indian chemical industry is the 12th largest in the world and third largest in Asia (volume wise).⁴³ Therefore, import of chemical products from India instead of importing from far off countries will be very beneficial.

Pakistan's pharmaceutical industry with 316 manufacturing companies and 30 multinationals (47 percent share), producing pharmaceuticals worth US \$ 2 billion and meeting 80 percent of country's demand plays a significant role in economic development of the country. About 95 percent of the basic raw materials are imported from China, India, Japan, UK, Germany and Netherlands. Being much smaller Pakistan's industry is less competitive than Indian industry. India is the fourth largest producer of pharmaceuticals in the world production by volume, and it is among the top 20 pharmaceutical exporters. During year 2003 and 2004, Pakistan imported 4.3 percent and 6.8 percent of its total imports of chemical and pharmaceutical products respectively from India comprising 353 items. Out of Pakistan's total imports of 1105 items in 2004, India supplied 353 items. There are still 166 items of chemical and

⁴⁰ Ibid., Raza Rumi, "Trade with India is a Rational Policy Choice."

⁴¹ Dr. ZafarMahood, "Benefits and Impediments to Trade Cooperation: A Case of Pak-India Trade," at IPRI Seminar on Pakistan-India Trade Cooperation: Challenges and Opportunities, January 30, 2013.

⁴² Ibid., Ishrat Husain, "Prospects and Challenges for Increasing India-Pakistan Trade," 5.

⁴³ Ibid.

pharmaceutical products which can be imported from India at lower unit value compared to the unit value of same items from elsewhere.⁴⁴

Pakistani consumers will benefit from cheaper Indian medicines if imported to Pakistan. For example medicines like zinetac-Galaxo cost 10 tablets for Rs. 7.20 in India whereas the same 10 tablets made in Pakistan would cost the consumer Rs. 80. So while import of medicines from India will benefit Pakistani consumers Pakistan's industry will also become more competitive although initially it will have to be provided the limited protection.⁴⁵ Import of cheaper raw material from India will also help Pakistan industry to become more competitive with Indian industry. A recent permission by the government for importing raw materials of medicines had helped in reducing price of some medicines.⁴⁶

Pakistan has a well-developed and famous sports goods and surgical instruments industry. In addition to these products Pakistan can also export light engineering products to India given its well-developed industrial clusters in Gujranwala, Gujrat and Sialkot.⁴⁷

In societal terms, increased trade would mean increased business to business and people to people connectivity which will not only help in turning SAFTA to be a successful agreement but will also help trust building on people to people level. This would create a demand at the grass roots for resolution of bilateral disputes through dialogue.⁴⁸ This will also encourage intra-regional trade, investments and joint ventures which will attract regional investments to Pakistan as well.⁴⁹

In the overall context, analysts have the perception that after grant of MFN to India and removal of tariff and non-tariff trade barriers by India, Pakistan will be able to largely benefit from trade liberalization with India. Increased trade flows from India as a result of MFN status will provide additional customs revenues to Pakistan provided corruption can be avoided in the collection of custom duties. Since reduction or elimination of trade barriers will enable product prices to reduce and increase in choices for consumers because of trade liberalization will benefit Pakistani consumers also. Immediate trade flows will also help in enhancement of economic growth of Pakistan.

⁴⁴ Ibid.

⁴⁵ Ibid., Majid Ali Wajid, "Trade with India in Pakistan's interest."

⁴⁶ Ibid.

⁴⁷ Ibid., Waqas Bin Najib, et al., "Implications of Trade Liberalization between Pakistan & India."

⁴⁸ Dr. AbidQaiyum Suleri, "Renewed Hopes for South Asia," Sustainable Development Policy Institute, June 30, 2012, accessed on February 3, 2013, http://www.sdpi.org/sdc/news_details.php?event_id=&news_id=719

⁴⁹ Muhammad Hanif, "Regional Economic Integration in South Asia: Progress and Prospects," *IPRI Journal*, vol. XII, no. 2 (Summer 2012): 118.

However, despite strong reservations among some economists and scholars regarding success of the trade process without resolving Kashmir and other disputes, they are still hopeful in view of some examples where despite serious bilateral disputes among states mutual trade has flourished in large volumes. These examples are China-India, US-China, China-Taiwan and Malaysia-Singapore. Therefore it is being hoped that as a result of increased mutual trade stake holders in Pakistan and India might ultimately help in building opinion in favour of resolution of disputes.⁵⁰

Disadvantages of Granting MFN Status to India

Due to India's high tariffs on textiles and clothing and agriculture goods, to the tune of 25 percent on the average and 36 percent on chemicals and cement, and inclusion of textiles and agriculture products in the sensitive list, Pakistan's exports of these commodities to India will continue to suffer till India agrees to remove additional tariffs other than MFN rate (12 percent) and to eliminate these commodities from the sensitive list. India's sensitive list protects a wide range of textile and agriculture products. About 30 percent of the items on India's sensitive list are agricultural, whereas 34 percent are industrial products. On the other hand, Pakistan's sensitive list contains 4 percent agricultural and 24 percent textile products.⁵¹

India also heavily subsidizes into agricultural production including fertilizers, electricity and irrigation. Indian subsidies on agriculture are almost three times higher in comparison to Pakistan. India also supports its farmers by providing modern machinery on cheaper prices and allocating more governmental budget for agriculture sector. It is also creating water issues for Pakistan by construction of water reservoirs in Indian held Kashmir (IHK) on rivers in Pakistan's share. This puts Pakistan's agriculture at disadvantage for imports as well as exports.⁵² As a result of granting MFN to India, Pakistan's automobile and automotive parts industries are likely to suffer more losses than what they will earn as profits on account of achieving economy of scale advantages due to access to India's large market and to markets of other South Asian countries through India's land routes.⁵³

Some industrialists are also of the view that after granting MFN to India, because of Pakistan's less restrictive trade barriers as compared

⁵⁰ Ibid., Ishrat Husain, "Prospects and Challenges for Increasing India-Pakistan Trade," 8.

⁵¹ Ibid., Dr. Manzoor Ahmad et al., "Normalization of Trade with India: Opportunities and Challenges for Pakistan," 3.

⁵² Dr. Kamal Monnoo presented his Concluding Remarks in *IPRI* Seminar titled "Pakistan-India Trade Cooperation: Challenges and Opportunities," January 30, 2013.

⁵³ Ibid., Mohsin Khan, "Indian-Pakistan Trade Relations," 6.

with India, Indian goods will flood Pakistani market and less competitive industries of Pakistan will either suffer losses till they become competitive or they will be eliminated in the process. In this context Pakistan's pharmaceutical and automobile industries which are contributing to Pakistan's GDP in a major way will be most affected. The exports of textiles and agriculture goods will also suffer till India agrees for reduction of unnecessary additional tariffs, removal of textiles and agriculture goods from its sensitive list and elimination of related non-tariff barriers.⁵⁴

It is also being commented that overall volume of Pakistan-India trade will also suffer till removal of India's extensive non-tariff barriers. NishaTaneja working for *Indian Council for Research on International Economic Relations* indicates towards existing non-tariff barriers which is limiting quick rise in Pak-India trade. Some of these are cumbersome procedures, non-transparent regulations and infrastructure bottlenecks which hinder smooth flow of trade across borders.⁵⁵

Businessmen involved in chemical and synthetic fiber sectors say that India had a surplus of fiber which was equal to 80 percent of the demand in Pakistan. Therefore Indians could dump this surplus in the Pakistani market since the enforcement regime of anti-dumping laws is quite weak in Pakistan. If that happens, the flourishing domestic fiber industry would badly suffer financially.⁵⁶

Some stakeholders have stated that in the past, losses to Pakistani exporters had occurred because of delays by India's customs authorities, testing laboratories and the Bureau of Indian Standards and railways.⁵⁷

Potential and Prospects of Pakistan's Trade with India after MFN

In view of the above analysis it can be well comprehended that Pakistan's economy can quickly pick up growth if it liberalizes its trade with India (provided India also relaxes its very restrictive tariff and non-tariff regime which is negatively impacting Pakistani exports to India). Mutual trade relations which are based on spirit of creating win-win situation for both sides will also provide impetus to economic integration in South Asia which would further benefit Pakistan in a major way.⁵⁸ According to

⁵⁴ Ibid., Majid Ali Wajid, "Trade with India in Pakistan's interest."

⁵⁵ Pakistan-India Trade: What needs to be Done? What does it Matter? Wilson Center, April 23, 2012, accessed on January 21, 2013, <http://www.wilsoncenter.org/event/pakistan-india-trade-what-needs-to-be-done-what-does-it-matter>

⁵⁶ Ibid., Ishrat Husain, "Managing India-Pakistan Trade Relations," 6.

⁵⁷ Ibid., 6.

⁵⁸ Ibid., Dr. ZafarMahmood, "Benefits and Impediments to trade Cooperation: A Case of Pak-India Trade."

some economists, due to restricted access of Pakistani goods in the international markets Pakistan has been facing the dilemma of getting marginal diminishing returns from the potential export items. By penetrating India's large and growing market, Pakistan can tap the potential of industrial hubs in south and west (Balochistan coastline and Karachi in Sindh), in the central belt (Multan, Lahore, Faisalabad, Gujranwala, Sialkot and Gujrat in Punjab) and in the north (Peshawar in Khyber Pakhtunkhwa).⁵⁹

Between 2001 and 2011 trade between India and Pakistan had recorded almost a tenfold increase reaching a level of US \$2 billion. Unofficial trade is also almost equal to US \$2 billion. Estimates by the economists based on different assumptions and models show a likely jump of trade from current levels to between 5 and 10 fold if all tariff and non-tariff barriers are removed by India.⁶⁰

IjazNabi and AnjumNasim have estimated that trade between Pakistan and India could increase three fold if Pakistan accorded MFN status to India.⁶¹ A State Bank of Pakistan report has concluded that bilateral trade between Pakistan and India could increase fivefold if MFN status is granted to India and non-tariff barriers were removed by both countries.⁶²

Most studies indicate that because of low transport costs, dismantling of tariff and non-tariff barriers, Pakistan's granting of MFN status to India and improvements in logistic arrangements will increase the trade volumes to approximately US \$8 to 10 billion annually.⁶³

In a recent study, Mohsin Khan has predicted that trade between Pakistan and India could increase by 20 times than its current level of US \$2.5 billion to the US \$50 billion after granting MFN status to India and while conducting normal trade relations. According to consensus estimates of the government, academics and business people in Pakistan a trade volume up to US \$6 to \$10 billion can be attained within next five years thereby raising GDP and domestic income in both countries.⁶⁴

It is being estimated that although full scale realization of the potential of trade after granting MFN status to India will take some time but a beneficial process will start which will have to be carefully managed by both India and Pakistan due to their fragile political relations.⁶⁵

⁵⁹ Ibid.

⁶⁰ Ibid., Ishrat Husain, "Managing India-Pakistan Trade Relations," 2.

⁶¹ Ibid., Ishrat Husain, "Prospects and Challenges for Increasing India-Pakistan Trade," 2.

⁶² Ibid., 3.

⁶³ Ishrat Husain, "Managing India-Pakistan Trade Relations," 2.

⁶⁴ Ibid., Mohsin Khan, "Indian-Pakistan Trade Relations," 2.

⁶⁵ Ibid., Ishrat Husain, "Managing India-Pakistan Trade Relations," 2.

With the removal of tariff and non-tariff barriers and elimination of essential exportable goods of Pakistan from its sensitive list by India, the bilateral trade if made politically sustainable is expected to bring many benefits to Pakistan such as immediate creation of trade flows, capital investment and joint economic ventures, cooperation in the field of IT, science and technology and research and development which will help in boosting the productivity of domestic industries and enhancing the economic growth.⁶⁶

Sustainability of Pakistan-India Trade Process

Considering India's rigid policy of non-removal of its tariff and non-tariff barriers, restriction of items of Pakistan's export interest through sensitive list and its long standing strategy of delaying resolution of outstanding Kashmir and other disputes creating tensions on the LOC, it is difficult to say with full confidence that Pakistan can earn desired benefits from liberalizing its trade with India. Also, there are many apprehensions regarding sustainability of bilateral trade process unless and until India shows flexibility in facilitating Pakistani exports and a definite progress is seen in resolving the bilateral disputes. It is also being perceived that the situation can be further compounded if India's game playing with Pakistan over Kashmir and Afghanistan aimed at its isolation and encirclement continues.⁶⁷ In the context of sustainability of the evolving trade process views of some analysts are:

- There is a realistic fear of collective punishments and sanctions against Pakistan if something goes wrong on the security and political fronts. Both countries' political parties and extremist groups on both sides will exploit trade imbalance being in favour of India which could put undue pressure on the Pakistan's government that may chose to sacrifice trade in order to survive.
- While traders and importers in both countries would be happy to see their business expanding, inefficient manufacturing firms in Pakistan being losers from trade liberalization may lobby the government and political parties that cheaper imports from India are destroying Pakistan's domestic industry and jobs if affected industry is not protected.
- If the Composite Dialogue doesn't proceed forward with positive results then opponents of normalizing economic relations in Pakistan would pressurize the government

⁶⁶ Ibid., 3.

⁶⁷ Ibid., Dr. Kamal Monnoo, "Most Favoured Nation (MFN) and Trade Liberalization between Pakistan & India," 7.

that trade was a major impediment to resolution of political disputes.⁶⁸

However Dr. Ishrat Hussain opines that increased trade and related socio-economic benefits can build constituencies in both countries in favour of building and maintaining good bilateral relations, ultimately contributing to progress on core political and security issues.⁶⁹ But he also states some of the factors that risk derailing of Pak-India trade regime. *Firstly*, a terrorist attack on India linked to Pakistan could prompt New Delhi by ceasing trade. *Secondly*, opposition political parties in both countries could take anti-trade positions on trade imbalance. *Thirdly*, powerful industrialists in both countries could compel governments to impose retaliatory measures on trade. *Finally*, powerful media in both countries could support the cause of smaller industries that suffer from trade liberalization. In his view trade liberalization can be sustainable and beneficial only if trade relations are managed carefully and maturely by both sides.⁷⁰

Most of the analysts in South Asia suggest that mutual trade can be made sustainable if both India and Pakistan focus on welfare of their people by removing their poverty and providing them employment opportunities by increasing volumes of their bilateral trade and enhancing economic growth. This will become much easy if India as a bigger country takes the initiative for eliminating mutual tensions by resolving Kashmir and other disputes with Pakistan in a just manner and with a larger heart. This is the only way that bilateral trade can give real dividends and can lead to major advantages to both countries in the form of wider trade with Central Asia, West Asia and ASEAN and success of the proposed new Silk Road.

In the light of the above analysis and opinions expressed by various policy makers, economic-analysts, think tanks and stake holders, main findings and recommendations of the study are summarized below.

Conclusion and Recommendations

The trade normalization process between India and Pakistan would be facilitated by granting MFN status to India by Pakistan. Liberalization of bilateral trade would be beneficial for Pakistan, provided India gets serious on suitably addressing its tariff and non-tariff barriers and removal of Pakistan's exportable goods from its negative list and both countries also address infrastructural bottlenecks on borders. As allowed under WTO rules Pakistan also needs to protect its less competitive

⁶⁸ Ibid., Ishrat Husain, "Managing India-Pakistan Trade Relations," 7-8.

⁶⁹ Ibid., Wilson Center, "Pakistan-India Trade: What needs to be done? What does it Matter?"

⁷⁰ Ibid.

industry from flooding of its market by Indian goods. To make the trade process sustainable both countries should try to achieve progress on resolution of outstanding disputes so that these do not act as an impediment to bilateral trade and South Asian economic integration. However, while Pakistan can carry out exercise of enhancing trade with India by according MFN status and using skillful diplomacy with India on removal of trade barriers and achievement of parallel progress on resolution of disputes, it may have to link provision of transit trade facility to India to Afghanistan and beyond with the achievement of a definite progress on resolution of Kashmir dispute. In any case after India is given MFN status both countries should make joint efforts to make the bilateral trade process mutually beneficial through cooperation.

To succeed in liberalization of bilateral trade, achieving an early economic integration in South Asia and initiating a process of trading with west through Pakistan and with east through India following recommendations are offered:

- Before finally according MFN status to India Pakistan should negotiate and sign an agreement with India for removal of at least critical tariff and non-tariff barriers which restrict Pakistani exports to India. The agreement should also include removal of textiles and agriculture goods from India's sensitive list. After according MFN to India, Pakistan should provide limited protection under WTO rules to those industries which are not yet competitive.
- To mobilize opinion of people of Kashmir in favour of Pak-India trade, India should also agree to open additional land routes for trade for the people of Jammu and Kashmir, such as Jammu-Sialkot and Jammu-Mirpur-Mangla routes.
- In case India continues to show inflexibility on removal of remaining tariff and non-tariff trade barriers, Pakistan should negotiate with India to sign an FTA to make the trade process beneficial.
- Pakistan should also negotiate with India for reduction of its sensitive list for key exports of Pakistan including agriculture goods, textiles and knit wear, light engineering products like fans, refrigerators, washing machines, tractors, foot wear, plastic ware and light petroleum distillates.
- Pakistan should continue with the composite dialogue to achieve simultaneous progress on resolution of all disputes and India should show flexibility on resolution of Kashmir and other disputes. Till there is a definite progress on resolution of Kashmir dispute, Pakistan should not grant transit trade facility to India to Afghanistan and beyond.

- Both countries should rationalize and simplify the technical barriers to trade and India should remove sanitary and phyto-sanitary measures which are a powerful barrier to trade.
- Banking and financial services are pivotal for international trade. Both countries should open bank branches in each other's commercial centers.
- Both India and Pakistan should also negotiate an agreement for including services and investment in each other's country as part of mutual trade.
- Domestic tax, tariff and subsidy policies that distort incentive for production and trade in both countries should be removed.
- Trade should be facilitated through quick border crossings, streamlining of documentation procedures, coordination of border agencies, opening of new border crossings, quick customs clearance, improvement of electronic data interchange, telecommunication and transport links, creation of new shipping protocols and increasing railway, air and road connections between the two countries.

Both Pakistan and India should upgrade infrastructure including covered sheds, automated handling, cold storage, weight bridges and fork lifters etc. at all ports.

