



MISPERCEPTIONS ABOUT INDIA-PAKISTAN TRADE BEYOND POLITICS

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ABOUT THE REPORT

This report makes the case for working within existing protocols to enhance trade and cooperation between India and Pakistan rather than attempting to address chronic bilateral political issues directly. Drawn on numerous published studies and in-country interviews, the report argues that trade between the two countries could play an important role in addressing prospects for peace in South Asia. The report was commissioned by the South Asia program of the United States Institute of Peace given the Institute's long-standing and wide-ranging commitment to strengthening peacebuilding in the region.

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[Economic and trade cooperation offers a clear way toward greater stability and peace between both India and Pakistan—and across South Asia as a whole.]

Summary

- India and Pakistan have a troubled past that includes four wars and countless skirmishes. Even when some form of peace and tranquility has prevailed, conditions have been far from conducive for economic and trade relations.
- Despite these tensions, bilateral trade has grown many times and is officially reported to be around \$2.2 billion today. Unofficial estimates suggest that it is twice this amount, and that the potential for trade is many times what is currently traded.
- Politics aside, the reasons for limited India-Pakistan trade are rooted in managerial, bureaucratic, transportation, and other local issues.
- High-profile political initiatives often incur resistance from lobbies and powerful groups, both economic and political, that are opposed to India and Pakistan improving their trade, economic, and political relations.
- Restricted exportable items, poor rail and road connectivity, logistics, and facilitation are key impediments to expanding trade.
- Streamlining some of these logistical issues would benefit trade significantly. Not only would trade increase, but welfare gains to the industry and to the consumers would also be substantial in both countries.
- Peacebuilding and peacemaking will always be subject to the larger political issues between India and Pakistan, but economic and trade cooperation offers a clear way toward greater stability and peace between both countries and across South Asia as a whole.

Introduction

Consensus among policymakers, political actors, and the lay public holds that neighboring India and Pakistan do not trade to the extent that their potential would otherwise allow because of the larger unresolved and continuing political issues between them since Partition in 1947. Problems such as the unresolved status of Kashmir, cross-border terrorism, and contests over regional hegemony are often cited as enough reasons. Both countries have prominent and powerful domestic political actors, constituencies, and state institutions that favor neither peace nor trade with the other. This said, trade between the two countries has in fact grown many times in two decades, to some \$2.2 billion in 2015–16.¹ Yet studies have estimated that the amount ought to be anywhere between twice and an extraordinary eighteen times that amount.² Clearly a large potential for trade is going unfulfilled.

Persistent political tensions between India and Pakistan over the decades have left the South Asian region bereft of much-needed economic cooperation or integration. Despite the existence of regional entities such as the South Asian Association for Regional Cooperation, trade between these two neighbors is limited, largely on account of unresolved political issues, and the South Asian Association for Regional Cooperation remains the least integrated economic regional entity in the world today. International relations theory and economic evidence both cite the need for and benefits from trade between neighboring countries.

Arguments have been made on the basis of historical evidence that greater trade and economic cooperation between countries that face outstanding political issues, even based on border conflicts and hostility, could lower political tensions if trade and economic cooperation were increased. Interlocking markets, the emergence of new trade and economic groups working to protect newfound interests, and benefits to government in the form of enhanced revenue are often outcomes of such cooperation.

Although peacebuilding and peacemaking will always be subject to the larger political issues that India and Pakistan confront, both within domestic constituencies and between the two governments, increasing economic and trade cooperation offers a clear way toward greater stability and peace between both countries—and across South Asia as a whole.

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India-Pakistan Trade Today

In a radical departure from the dominant narrative, this report argues that though politics matters, the reasons for the limited trade between India and Pakistan are equally rooted in managerial, bureaucratic, local, and transportation issues. Research has shown, in fact, that even after the extraordinary Mumbai attacks in November 2008, in which 164 people were killed, trade continued between the two countries.³

Although politics has without question an overwhelming impact, trade's own problems are a major impediment—so resolving these is crucial regardless of politics. In Pakistan, and probably also India, the decision to not open key sectors to trade is an excuse to protect an inefficient domestic industry. Consumers lose out as a result. Interest groups that would be exposed to greater competition were trade to increase have diverted the debate from the core issue of their own inefficiencies. Trade between any countries cannot, of course, be separated from politics, but some trade, logistical, and regulatory issues between India and Pakistan are “beyond” politics—and require careful examination if barriers are to be reduced.

This report supplements the significant existing literature on India-Pakistan trade with face-to-face interviews and discussions with a wide variety of relevant officials, traders, for-

warders, academics, and representatives of special interest groups in both India and Pakistan. A key argument is that, given current protocols and parameters, trade facilitation—including greater access to markets, improved visa regimes, more open communications, and better road and transport facilities—is the main constraint to enhanced India-Pakistan trade.

Protocols, Trends, Numbers

Despite four wars between the two countries in the last seventy years and numerous other diplomatic and political upheavals, trade between India and Pakistan came to a complete halt only between 1965 and 1974. Not only have the countries traded with each other, but India was also Pakistan's largest trading partner in its early years following independence. Trade between the two gained a stronger footing in the late 1970s and has continued to improve in each decade since; a few notable policy interventions have also been made to increase trade, especially since the early 2000s. But despite these incremental increases, the volume is still a mere fraction of what each trades with other countries in the region.

Pakistan's exports to India are only 1 percent of its total exports, and India's to Pakistan just less than that at 0.9 percent. Thus the potential for further trade between the two countries is substantial. Some projections are as high as \$19.8 billion, ten times larger than the current volume, Pakistan's at \$3.8 billion, and India's at \$16 billion. Fifty-eight percent of India's export potential involved products either on Pakistan's negative list for India or on Pakistan's sensitive list for India under the South Asian Free Trade Area (SAFTA) agreement. Thirty-two percent of India's import potential from Pakistan involves items on the sensitive list for Pakistan applicable under SAFTA.⁴

Until India granted most favored nation (MFN) status to Pakistan in 1996, when both joined the World Trade Organization, the two countries had a restrictive trade agreement based on a *positive list*, according to which only designated items were traded. In 2011, an attempt was made to normalize trade. India allowed the export of all goods—barring some tariff restrictions. Pakistan moved from the positive list to a negative one of 1,209 items in March 2012: items not included on this list were thenceforth allowed in trade.⁵

In addition to having bilateral trade protocols, India and Pakistan are key members of the South Asian Association for Regional Cooperation, founded in 1985. They are also part of the SAFTA agreement, ratified in 2006, which was supposed to grant MFN status to all members. However, because Pakistan has still not granted India MFN status, though it came close to doing so in 2014, SAFTA is largely ineffective in providing trade initiatives to either New Delhi or Islamabad.

Pakistan maintains its negative list for goods from India, as well as a *sensitive list* under SAFTA, which imposes a higher tariff rate on select items allowed for import. India also maintains its own sensitive list, which is not Pakistan-specific. On Pakistan's negative list, the sectors of automobiles, iron and steel, paper and board, plastic, and textiles cover 64 percent of the 1,209 items. The automobiles sector is Pakistan's most protected when it comes to India (though interestingly, automobile imports from other countries are growing and vibrant)—and accounts for 32 percent of the negative list on its own. In 2012, India allowed Pakistani citizens or “any entity incorporated in Pakistan” that sought prior clearance from the Indian government to make investments in India, in all sectors other than defense, space, and atomic energy.⁶ Pakistan offers an “investor-friendly” foreign direct investment policy to Indians as well, but “investment from India has not yet entered the Pakistan market.”⁷

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Substantial informal trade takes place between India and Pakistan. Estimates vary, but a recent study conducted in India suggests about \$5 billion in 2015, which would mean that it was far greater than the actual formal trade that year. Calculations by Pakistani researchers show that informal imports from India were around \$1.8 billion. The major items imported informally from India into Pakistan were textiles, jewelry, and auto parts; the biggest hurdle was said to be Pakistan's negative list.⁸

The data over the last two decades show that when Pakistan started expanding its positive list, from around 2003–04 onward, Indian exports to Pakistan increased. What is surprising is that even though India granted MFN status to Pakistan in 1996, Pakistani exports to India have not increased significantly. India allows Pakistan open access to its markets, barring a sensitive list, has very few Pakistan-specific nontariff barriers (NTBs), and generally treats Pakistan like other trading partners.⁹ Certainly some issues affect this trade, but given relatively open access, why are Pakistan's exports to India so minimal?

Trade Facilitation and Nontariff Barriers

One cross-cutting theme in studies of India-Pakistan trade involves trade facilitation, NTBs, logistics, management, and transportation. Although every sector has its specific issues, these more generic issues affect most sectors, albeit some more than others.

Of the three nodes through which trade is transacted between India and Pakistan—road and rail via Wagah-Attari, and by sea, Mumbai-Karachi—sea trade constitutes around 65 percent, rail 8 percent, road 23 percent, and air the remaining 4 percent. Rail trade was dominant until 1965, when trade came to a halt, and today is the least preferred mode. Traders today find road transit to be speediest, cheapest, and easiest to organize and handle. However, numerous minor and some significant issues are a hindrance to enhancing trade. An important study examining the land routes finds that “improvements in the land route between India-Pakistan can help lower transaction costs which can increase trade potential.”¹⁰ The land route is the most flexible and cost-effective way to trade between the two countries, and as many as 80 to 90 percent of traders prefer it.¹¹

Pakistan allows only 137 items to be imported from India by road; all other items must be sent by rail or sea. This restrictive regime is said to exist to protect the Pakistani producer, and though Pakistani businessmen and traders constantly complain and accuse the Indian authorities of imposing NTBs, this limit on what India can export by road raises the costs of those goods because rail transportation is more costly—and is an NTB that Pakistan imposes. However, an examination of imports on the land route into Pakistan shows that as many as 80 percent of Indian exports in 2014 and 2015 were in only five categories. The remaining 20 percent were not exported to Pakistan and went to other countries instead. Hence, despite claims by many that the 137-item list is highly restrictive, it is still only partially met. The argument can be made, however, that all exportable goods should be allowed by land. What that volume would do to the already inadequate and overburdened road, warehousing, and infrastructure network is a different matter.

The Wagah-Attari border crossing is rife with numerous logistical issues that, if addressed, could increase trade substantially. Among them are severe congestion on the roads and at the customs posts in and around the area. Despite the limited articles of trade, the existing warehouses—which opened in 2012—filled up within six months and act as a serious constraint to any additional volume of goods. Traders report no “modern infrastructure” at the bor-

The land route is the most flexible and cost-effective way to trade between the two countries.

der, no scanners on the Indian side for trucks, “weak transport and logistics infrastructure,” no facility for handling containers, no testing labs at border posts, and a host of other management and logistical issues. Pakistani exporters to India have argued repeatedly that extensive “security checks” on their consignments cause delays and damage and are a disincentive to trade.¹²

Indian exporters have been asking Pakistan to lift restrictions on goods sent by road and to allow all items to be traded by the land route, but even at current limited levels, the Wagah-Attari road border trade reaches a breaking point repeatedly. Currently, the Indian side includes no provision to incorporate any expansion of tradable goods. Whether this becomes a chicken-and-egg problem requires further analysis. A reduction in congestion, better management, a single window each for exports and imports at land customs, more warehouses, and other such initiatives would increase trade in the limited existing goods regardless of whether new items are allowed. The Indian demand for an expansion of tradable goods by road to Pakistan will certainly increase exports there, but needs a number of priors from the Indian side first. The integrated check post at the border is unable to handle even existing trade volumes because the setup was initiated before the 2012 normalization of trade.¹³

Although Pakistan allows the import of only 137 commodities by road, it places few restrictions on goods by rail across the same border. The limited trade that takes place by rail exemplifies the poor management and poor logistics issue. Rail wagons allotted to Indian exporters are said to be hard to come by, demand far exceeding supply. The railway line is three kilometers from the integrated check post. Wagons are allocated manually rather than by computer program, however. In addition, refrigeration wagons and goods requiring containerization are also not permitted, and there is no provision for sending liquid or uncovered cargo. As Nisha Taneja and her colleagues point out, “Even though there are no restrictions on commodities that can be traded through the rail route, the restriction on the type of wagons permitted restricts the type of commodities that can be traded.”¹⁴ Clearly, just as road transportation facilitation would require better management from the Pakistani side, issues related to rail trade need to be addressed largely by the Indian side.

Long waiting periods are involved in the return of rail carriages from Lahore because India requires the carriages to be loaded with the limited Pakistani exports from Lahore before the carriages can return to India. No fixed schedule is set for goods trains, the Amritsar railway port has no laboratory testing facilities, no facilities for mechanized loading and unloading of goods have been built, and no custodian is assigned to cargo (resulting in theft, loss, and damage to goods).¹⁵ Few logistics firms work at the border, and those who have information about India-Pakistan trade can claim huge rents for it. The Wagah-Attari trading post is less automated than India’s other land routes. Only public-sector facilities under the Central Warehousing Corporation are permitted at land ports, unlike at sea ports, where, given the volume and scale of trade, private-sector facilities are in place.

Clearly, as Nisha Taneja and her colleagues argue, “removing restrictions to transport protocols could lead to substantial gains from trade” and “addressing infrastructure constraints, particularly on the land routes, and reforming protocols, could benefit almost everyone involved—traders, transporters, consumers, and government.”¹⁶ Even Pakistani studies have argued that “the exiting customs infrastructure at the border is inadequate for handling trade between the two even for the limited number of goods allowed to be traded through the land route.”¹⁷ Transport issues, however, are only one of several that restrict trade.

Numerous studies have shown that dissimilar customs procedures between India and Pakistan impede trade, nullifying any transaction cost arguments in favor of the land route.

Even Indian researchers understand the “multiplicity in Indian standards” and in rules, regulations, and enforcement agencies—the Border Security Force, Customs, Land Port Authority of India, Plant Quarantine Department, Bureau of Immigration, and Bureau of Indian Standards all following their own procedures with very little coordination among them.¹⁸ Pakistani consignments are also “subjected to excessive checks” and “importing a food consignment involves 14 steps against an ideal of 6 steps.”¹⁹ When it first opened, the Wagah-Attari land route allowed trucks to pass through for seven hours each day, later extended to twelve hours.²⁰ If the trading gates were opened for twenty-four hours and included three shifts for officials, much of the load and congestion could be cleared, opening the way for more goods to be traded. A comprehensive and integrated land transport policy would address many practical issues, as would fuller adherence to the World Trade Organization Agreement on Trade Facilitation.²¹

A frequent accusation by Pakistani businessmen and traders is that India has numerous Pakistan-specific NTBs. A more honest examination, however, shows that this claim is highly exaggerated and proves little more than an excuse for Pakistani businessmen and traders to not make the most of India’s fairly open trade environment. Some hindrances, inefficiencies, and constraints from the Indian side at the Wagah-Attari border have Pakistan-specific consequences. Others, however, such as a regulatory regime to administer imports or sanitary and phytosanitary standards affect all countries. Nevertheless, it has been pointed out that many land border issues and visa regimes are clearly specific to Pakistan (and India). This consequent lack of movement and information exchange is cited as a major reason why many otherwise commonly known protocols for trade are not well known between Indian and Pakistani traders.

Dissimilar customs procedures...impede trade, nullifying any transaction cost arguments in favor of the land route.

Sectoral Analysis

Four broad categories of sectors and commodities were selected for analysis: automobiles, pharmaceuticals, agricultural commodities, and textiles. These constitute a large part of the production and trade by both India and Pakistan to the world and offer possibilities for trade between the two countries. Sectors such as information technology, for example, though growing in India, are not only quite small in Pakistan but also would face far greater problems in bilateral trade. Similarly, the huge and growing services sector is not included in this analysis because it is clear that services would face even more constraints and difficulties in cross-border trade. This does not discount the possible trade potential, but given the numerous political and technical restrictions, trade in services seems unlikely to grow.

Automobiles

Despite understandable reasons for the nearly absent trade in the automobile sector, trade with India offers an opportunity for Pakistan’s automobile sector to improve, expand, and become far more efficient and competitive. Trade liberalization in the auto industry would allow huge gains to consumers, who are currently exploited by the few market players, as well as to the entire sector, if phased in cautiously and carefully. Much research has convincingly shown that the fear that India will wipe out Pakistan’s automobile industry is grossly exaggerated. Pakistan’s auto sector, despite having adopted policies to encourage localization, has failed to eliminate its dependence on imported components. The State Bank of Pakistan believes that opening the sector to imports will lead to a more balanced development of the auto industry by increasing competition.²²

The automobile industry in Pakistan can be best described as highly concentrated, its major manufacturers collaborating with Japanese firms. Not only is the car segment monopolized—the main players being Honda, Toyota, and Suzuki—it is also underutilized in that the industry produces around 150,000 units annually against the installed production capacity of 240,000. These numbers are in sharp contrast to the demand for cars, which some estimates put at half a million units annually, the market size required for achieving economies of scale. Both factors combined hardly provide enough choice for consumers.²³ The motorcycle segment is dominated by Atlas Honda (market share at 47 percent) and many Chinese assemblers, with concentration in 70cc engine units. The tractor segment, on the other hand, is successful, producing competitive and low-priced products; it is also unprotected by tariffs or any regulations.²⁴

Pakistan's local automobile industry was subject to a deletion or localization program from 1985 to 2006 aimed at shifting away from imported inputs and providing protection to local industry. This was followed by a tariff-based system in 2006, which imposed duties on imported cars, customs duty on completely built units and various tariff lines. Given that automobile production stood at 132,661 units against a target of 500,000 in 2011–12, many in Pakistan believe that both the localization program and the tariff-based system failed.²⁵ Even after decades of protectionist policies, the Pakistani automobile industry still seems to be in its infancy. Certainly it has not become as self-sufficient as it should have; for instance, only 15 percent of critical components used by Indus Motors (Toyota) and 5 percent by Honda are manufactured locally.²⁶

On the other hand, with continuous liberalization, India has become a global research and development and small-car manufacturing hub.²⁷ Indian automobile-component manufacturers are moving up the value chain and delivering complex products, largely for the domestic market. India's competitive edge in the auto sector lies in its economies of scale due to a large domestic market; compliance with emission and safety standards; greater indigenization and domestic availability of raw materials, also giving it protection from exchange-rate fluctuations; cheap labor, lower steel, and raw material prices compared with Japan and Thailand, thus leading to a lower cost of production; more focus on developing low-cost models; and greater efficiency due to high competition in the domestic market. Moreover, India can now produce all automotive parts, ranging from engines, transmission apparatus, suspensions, brakes, body parts, and chassis parts. Toyota is producing critical components of cars such as Etios, Innova, and Fortuner in India, much cheaper than those produced in Japan.²⁸ However, based on high import duties and restrictions on imports, India has adopted a highly protectionist regime for its automobile sector.²⁹

In sharp contrast, a lower than expected localization by Pakistan's auto sector means that it continues to rely heavily on imports. In 2012, various vehicles, mostly in completely knocked down form, made up 50 percent of all automobile imports. The top three source countries are Japan (47 percent), Thailand (22 percent), and China (17 percent).³⁰ In the vehicle segment, small cars and those with engines of 1000cc to 1500cc dominate imports, reflecting Pakistan's low per capita income and consumers' dissatisfaction with the local auto industry. The large number of used cars imported every year (17 percent of the market) points to the growing gap between consumer demand and local supply, consumers preferring to import vehicles on the basis of features related to road safety, quality of parts, and advanced technology.³¹ As many as five hundred independent dealers were involved in selling used cars at nearly twice the prices of locally manufactured cars in 2009.³²

In the auto parts sector, approximately two thousand local vendors in Pakistan supply basic components, which include sheet metal parts, interior trim, seats, rubber and plastic parts, batteries, wheel rims, tires, and lighting accessories. However, only a few critical components—such as starter motors, alternators, water pumps, flywheels, and transmission housing—are produced in Pakistan.³³ Fewer than half of locally made parts satisfy the quality requirements demanded by original equipment manufacturers assemblers.³⁴

Consequently, most of the critical components that require research and development, and sophisticated engineering technologies of international standards, cannot be produced locally and are imported from Japan, China, Thailand, Korea, and Indonesia.³⁵ These—because Pakistan does not have quality control equipment—include metal scrap, engines and engine parts, auto body parts, air conditioning elements, bearings, gears and gear components, as well as precision safety components. The import of completely knocked down components and engines for bigger cars (more than 1000cc) from Japan and Thailand is proof enough that Japanese manufacturers in Pakistan still depend on imported components, typically from trusted vendors in Thailand.³⁶ Japanese manufacturers have difficulty transferring technology to local players in Pakistan because of the lack of infrastructure, capability, precision machinery, and research and development facilities there. The dependence on Japanese imports not only leads to frequent increases in retail prices of cars through fluctuations in the Pakistani rupee and yen parity but also has a negative impact on Pakistan's balance of payments, a concern often cited by the State Bank of Pakistan.³⁷ In addition, the additional freight costs of importing from more distant countries, such as Japan and Thailand, ends up providing a protectionist cushion to local Pakistani industry and reduces the competitive advantage such countries have.³⁸

Although imports are high, Pakistan's exports in the automobile sector are negligible, only 0.2 to 0.3 percent of the total.³⁹ Auto part exports came to \$140 million in 2014, and primarily went to the United States, Europe, the Middle East, and Africa. Pakistan's auto parts exports compete successfully with those from India and Turkey in the EU, Italy, and the United States.

Pakistan's automobile trade with India is also negligible. Exports to India range from \$0.09 to \$1 million (mainly parts), and imports include mobile concrete mixers, as classified in trade under the Harmonized System Chapter 87.⁴⁰ Imports are primarily completely built units rather than auto parts.⁴¹ Although the trend in exports is a decline, that in imports is flat, indicating that current imports are a result of problems in administering the negative list.

Pakistan's low automobile imports from India are largely attributable to the protection afforded by the negative list, which bans 167 automobile products (21 percent of the list) and the SAFTA sensitive list, which applies nonconcessional tariffs to sixty-nine auto products.⁴² Pakistan has applied an import tariff of 30 to 35 percent on auto parts and another of 10 to 90 percent on completely built units. The top automobile items included on both the negative and sensitive list are automobiles smaller than 1000cc and between 1000 and 1500cc, motorcycles between 50 and 250cc, motor vehicle parts, and diesel trucks and tractors.⁴³ However, automobile products are also part of Pakistan's no-concession list applicable to China.⁴⁴ India also has twelve automobile items (of 614) on its SAFTA sensitive list applicable to Pakistan.⁴⁵

Despite the essential lack of direct auto part and component trade between India and Pakistan, estimates of the informal trade of auto parts are roughly 30 percent of the current market.⁴⁶ The substantial volume of informal trade suggests a demand in Pakistan for Indian auto parts, which are easily available in the Ranchor Lines and Al-Noor markets in Karachi, Badami Bagh in Lahore, and Peerwadhai in Rawalpindi.⁴⁷ The items most informally traded are auto parts—particularly gear boxes, differentials, and windscreens—as well as tires and

both rickshaw and motorcycle parts.⁴⁸ Although import of tires from India is legal, they are smuggled to Pakistan because of the high tariffs applicable to them (25 percent on motor car tires, 5 percent on bus and truck tires, and 20 percent on tractor tires).

In some ways, Pakistan has much to learn from India's experience with its automobile industry, which enjoyed protection similar to that of Pakistan until 2002.⁴⁹ Pakistan even has a successful example of trade liberalization. Its motorcycle industry, which outperformed the car segment in terms of both production and prices, was in fact partly helped by trade liberalization when it opened up to imported parts and components from China.⁵⁰ Therefore, the success of the motorcycle industry in Pakistan is not in any way attributed to the deletion program and presents a strong argument in favor of trade liberalization with India.

Trade liberalization with India in the auto sector is a case of long-term positive gains that the domestic auto industry can achieve from opening up, versus short-term negative effects in the form of less preference for domestic automobile products. Biswajit Nag argues that the Pakistani auto industry currently does not have the capability to move to the next stage of value addition.⁵¹ The Indian auto industry, on the other hand, is growing quickly, and is superior when compared with Pakistan for its technological upgrades and global safety standards.

The arguments against trade liberalization revolve around the fear that cheaper imports from India will hurt the automobile industry. These fears need to be considered skeptically, particularly given that Pakistan has a far more liberal trade regime with China (such as in motorcycles). Pakistan can also learn from its neighbors in South Asia—Bangladesh and Sri Lanka—which have benefited from opening their relatively smaller economies to India.⁵² Will imports from India wipe out the local automotive industry in Pakistan? They will merely replace imports from more expensive countries.

Pakistan should consider importing automobile products and components from India that it is currently importing from other countries, which would enable it to lower freight costs and increase consumer surplus. India can supply parts and components such as metal scrap, engine parts, air filters, transmission equipment, and bearing and gear parts. Pakistan can source its raw materials for auto parts manufacturing from India, such as steel, plastic, rubber, tools, dyes, jigs, and fixtures.⁵³ India is clearly a potential exporter of engine parts. Trade liberalization in the auto sector could help Pakistan procure the same completely knocked down components, semi knocked down units, and parts from India that it currently imports at a higher price from Japan and Thailand.⁵⁴ Furthermore, with the similarity in preference and culture between Pakistan and India, global manufacturers could introduce the same cars in Pakistan without much research and development.⁵⁵

When it comes to exports, it might appear that India's large population could be a potential market for Pakistan's tractors (lower prices than India's), motorcycles (smaller engines and lower prices than India's), and auto parts.⁵⁶ However, Pakistani tractors are fit for the local market only: low-performance engines, poor hydraulic distribution systems, and poor quality hooks and hinges. Only a few units are exported to Afghanistan at present.⁵⁷ The Pakistani government at one point even warned the industry to improve the quality of its products or it would allow competitors to enter the market. To be competitive, Pakistani tractors must not only be cheap, but also upgrade their technology and comply with international standards and specifications.

Pakistani auto manufacturers fear that Pakistan would not be able to increase its exports to India because of tariff and NTBs (including high environmental and safety standards). The question then arises of when Pakistani auto products will become competitive enough to enter

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India's markets. This does not seem likely anytime soon, given the protection provided to the domestic industry, which has no incentive to improve quality in the absence of a competitive environment. The current dealership and supply chain structure does not even allow for meaningful competition in that dealerships are merely agents of manufacturing companies.⁵⁸

Pakistan-India can replicate two examples of a buy-back auto trade agreement. First, the Argentina-Brazil Agreement of 1999, whereby duty-free exports from Brazil were linked to its auto imports from Argentina: the bigger economy (Brazil) had to import \$1 worth of cars for every \$1.50 Argentina imported.⁵⁹ Today, 80 percent of Argentina's units are bought by Brazil, and its automobile exports make up 13 percent of total exports. This has also helped Argentina make its auto sector more competitive. The second example is the Canada-United States Auto Pact of 1965, which required the United States to produce one unit in Canada for every U.S. car sold in Canada. This helped increase local employment and facilitated technology transfer, leading to an automobile industry valued today at \$35 billion and producing 2.6 million units.

So why should Pakistan open its automobile sector? Consumers need ample choice of passenger cars, Pakistan needs to upgrade its technology (particularly to meet emission and safety standards), and prices need to be competitive and lower. Opening bilateral trade between India and Pakistan would increase competition and spur development of a chain of local dealers.

Pharmaceuticals

Pakistan's pharmaceutical sector is still at a nascent stage relative to India's, partly because India was quick and active in attracting foreign investment and Pakistan depended on imports (primarily from India). Today, India has twenty-four thousand manufacturing units to Pakistan's six hundred.⁶⁰ In 2011, India's pharmaceutical industry was estimated at \$21.7 billion and Pakistan's at \$1.64 billion.⁶¹ Pakistan's is dominated by multinational corporations, holding a 53 percent market share; local entities hold 47 percent. The sector meets 85 percent of demand with locally produced products; the remaining 15 percent is met by foreign products, which are mostly imported from the United States, UK, Germany, Switzerland, Japan, Netherlands, and France.⁶²

India has seventy-four units approved by the U.S. Food and Drug Administration (FDA) and has gained significant access to the domestic U.S. market. India is the world's leading exporter of formulations.⁶³ Of the fifteen formulations it exports to Pakistan, twelve are global leading exports.⁶⁴ A major reason for India's comparative advantage in formulations is that the Indian industry produces 90 percent of its raw materials and the Pakistani only 5 percent.⁶⁵ According to 2013 data, the Indian pharmaceutical sector had a 1.35 percent share in global trade and the Pakistani a 0.08 percent share. Recent studies cite Indian pharmaceutical generics as being high quality in that they are being exported to the world, mainly Western markets. India's one hundred manufacturing units are foreign accredited, including by the FDA.⁶⁶ Thus the objection by Pakistani traders about low-quality Indian products entering Pakistan is questionable.

Many studies have highlighted that India and Pakistan have similar demographics, disease burden, and trade complementarities in inputs, yet bilateral trade tends to be low relative to their trade with the rest of the world. The untapped trade potential in 2012 was calculated as \$1.6 billion in pharmaceutical items, where India's export potential to Pakistan was \$1.5 billion.⁶⁷

India has...gained significant access to the domestic U.S. [pharmaceutical] market.

Issues such as lack of availability of drugs in government-run pharmacies or extremely high priced drugs in private pharmacies are a huge burden on Pakistanis, even though drug prices are regulated in the Pakistani market. A price comparison reveals that Indian medicines are cheaper than Pakistani, and that the “average Pakistani spends \$10 on drugs in Pakistan, an Indian spends about \$4.” Pakistan depends heavily on import of inputs in the sector because multinational corporations in Pakistan are allowed to import raw materials from their home countries, which results in higher transportation and freight costs. It is also surprising that some medicines in Pakistan are more expensive than in India even though the same multinational corporations operate in both the countries.⁶⁸

Evidence also suggests a high volume of informal trade between India and Pakistan. Cheap formulations from India are illegally imported into the Khyber Pakhtunkhwa province of Pakistan via Afghanistan because the domestic price is considered high.⁶⁹ Indian bulk drugs and intermediaries also enter Pakistan through Dubai when they can be imported directly from India, increasing freight costs.⁷⁰

Some studies have asserted that liberalizing trade with India can bring substantial gains not only to Pakistani consumers but also to the Pakistani pharmaceutical industry in terms of cheaper medicines, greater consumer surplus, and a wider penetration in rural markets. According to one evaluation, “Pakistan can save between \$400 and \$900 million on its import bill if the same products are imported from India rather than from other parts of the world.”⁷¹ The geographical proximity is advantageous for Pakistan, which can easily import prepared medicines or formulations from India.⁷²

Pakistan is already exporting medicines worth approximately \$150 million to forty-five countries, and exporting to the Indian market as well would be a lucrative opportunity.⁷³ Pakistan’s largest and fastest manufacturer, Getz Pharma, is exporting generic medicines to eighteen countries covering most of East and Southeast Asia, Africa, and other parts of Asia.⁷⁴ Studies show that Pakistan’s top export partners include Afghanistan, Sri Lanka, the United States, the Philippines, Nigeria, and India. The United States is a primary trading partner of both countries, as is China.

Researchers have explored the trade relationship between Pakistan and China, mainly because of the Pakistan-China Free Trade Agreement and the fact that Pakistan imports most of its bulk drugs and intermediaries from China. The agreement has led to *trade diversion* from Indian exports to Chinese exports into the Pakistani market. China has a comparative advantage in raw medicine and India in prepared medicine. In addition, China imports bulk formulations from India.⁷⁵ The competitiveness of Indian formulations in the international market has already been established. Pakistan should therefore consider importing prepared medicines from India by removing items from its sensitive and negative lists for India. Furthermore, tariffs charged on Chinese medicines should be on par with those on Indian medicines. That is, Chinese medicines should not be given preferential treatment in the form of lower tariffs. Pakistani-produced medicines, imports from China, and Indian medicines will then compete in the Pakistani market on an equal footing. This will not only trigger competition in the local market but also meet the demand and supply gap often met with trade taking place via informal or indirect channels.

Even though India’s pharmaceutical products are higher in price than their Chinese equivalent, an opportunity to liberalize trade with India by reducing items on the negative list will result in greater consumer surplus, healthy competition between Chinese, Indian, and locally produced pharmaceutical items, and survival of the highest quality products.

Differences between the way the pharmaceutical industry is regulated and controlled for quality in India and Pakistan have created barriers for Pakistani exporters and importers. Lack of FDA-approved manufacturing plants in Pakistan, coupled with India's strong system of intellectual property rights, and multiple sanitary and phytosanitary standards have made it difficult for Pakistani traders to enter into the Indian market.⁷⁶ Only fourteen drug inspectors in Pakistan monitor more than six hundred manufacturing facilities.⁷⁷ Moreover, India's extensive quality control procedures are extremely tedious and time consuming for imports, and Pakistan's are fairly simple and less time consuming—one of the reasons India can easily export to Pakistan.

After assessing the prospects of liberalizing trade, researchers suggest that bilateral trade could lead to a win-win situation. The perspectives of Pakistani manufacturers on liberalizing trade with India have been noted in various studies. India specializes in manufacturing active pharmaceutical ingredients (APIs) and Pakistan has only three manufacturers; thus APIs can be imported from India at less cost. Similarly, Pakistan can export herbal and veterinary medicines to India.⁷⁸ These manufacturers also believe that Pakistan can benefit from India's manufacturing skills, knowledge, and research. They think that trade should be liberalized across several phases and that "selective buying" should take place; the first step should be increasing imports of raw materials from India. Aside from these, they argue that medicines for cancer, HIV/AIDS, thalassemia, and vaccines for polio, BCG (*Bacillus Calmette-Guerin*), and tetra-valent should be imported from India.

A subset of trade liberalization, intra-industry trade offers the possibility of vertical integration between India and Pakistan, each country specializing in that part of the value chain in which it has a comparative advantage. India, for example, has a comparative advantage in producing APIs and formulations, which Pakistan can rely on importing in bulk to build an effective value chain. Research is another avenue that Pakistan could significantly benefit from, given that India has made sufficient investments in research and development. "India's pharmaceutical sector currently spends six to eight percent of revenues in research and development" and collaboration in research and development could yield returns for both countries. Trade liberalization could also take the form of foreign direct investment in Pakistan, considering the similar nature of the countries' investment policies.⁷⁹ Given that the Indian pharmaceutical industry is currently dominated by companies that have become multinationals, it seems as if India has the capacity, expertise, and technical know-how to produce high quality, competitive drugs. For Pakistan to develop its sector, and to make it one of the leading manufacturing sectors (just as India developed its pharmaceutical industry), it should engage in this category of trade with India.

The Indian pharmaceutical industry presents an excellent example for the Pakistani industry in various avenues, including research and development, contract manufacturing, good manufacturing practices, and in the strategies it used to develop its sector. Pakistan should take the Indian model as a case and understand the core reasons why and how India's pharmaceutical sector has developed more than Pakistan's. The Pakistani industry is still grappling with basic issues. High manufacturing costs could be reduced if the government were to extend its support to the manufacturing sector. Issues such as power cuts, high investment costs, under-invoicing and high tariffs on imported products, and lack of infrastructure facilities need to be resolved if the sector is to thrive not only locally but internationally as well.⁸⁰ To gain in terms of market access and production of competitive pharmaceutical products, Pakistan needs to develop a farsighted approach and integrate with the Indian pharmaceutical sector.

Agricultural Products

The agricultural sector has been key for both India and Pakistan in terms of its contribution to GDP and employment, employment of the rural population in particular. Issues around trade in the sector have not only sparked debate among agriculturalists and policymakers but have also raised key questions among researchers about the mechanism and dynamics of trade within the sector.

Agriculture contributes about 21 and 14 percent to Pakistan and India's respective GDPs and employs 45 and 58 percent of their respective labor forces.⁸¹ India's agricultural trade is six times that of Pakistan.⁸² Studies also indicate that after the implementation of SAFTA, the net trade balance has favored India more than Pakistan. Pakistan's export of agricultural items to India has been slow relative to India's exports to Pakistan, mainly due to supply side factors, which may be scrutinized further.⁸³ Thus far, trade in the sector has been crisis driven, but with proper trade policies and regulatory mechanisms it can become market driven.⁸⁴ Agricultural trade is a far greater share of Pakistan's total trade than it is of India's: exports at 18.4 percent and imports at 17.3 percent, versus India's respective 10.7 percent and 5.4 percent. The question is why Pakistan remains a net importer of agricultural commodities when India is a net exporter and has sector trade surpluses even though Pakistan can export sharply competitive products to India.⁸⁵ The volume of trade in this sector has more than doubled for both countries between 2005–06 and 2012–13: 85 percent is held by India's exports to Pakistan, and 15 percent by Pakistan's exports to India.⁸⁶

Many studies have shown that both economies have remained self-sufficient in producing major crops including wheat, rice, sugarcane, and cotton and that limited trade potential exists in these commodities given their low per capita production. However, cotton has emerged as a dominant item of export from India to Pakistan, holding a share close to 40 percent of all agricultural items in 2012–13.⁸⁷ Even though India is leading world production in milk, Pakistan imports milk mostly from the United States and Europe.⁸⁸ Tea and beverages are a significant share of Pakistan's imports, but Pakistan fulfills its demand mainly from Kenya; tea could also be imported from India.⁸⁹ A study by Ramesh Chand and Raka Saxena also argues that India has not been able to take advantage of the growth in Pakistan's imports, which has come mainly from other countries. Vegetables (including garlic, onions, ginger, and fats and oils), herbs (including curry leaves and thyme), and seeds (including sunflower, cumin, and coriander) can be imported from India.⁹⁰ Furthermore, exports to India of dates and animal skins from Pakistan have increased significantly over the years, and in the case of dates, we see that India imports more from Iraq than from Pakistan.⁹¹ In Pakistan, fresh vegetables, such as tomatoes from the Indian Punjab, are now a dominant import item from India because of the duty-free land route.⁹² Researchers see the import of fresh vegetables as proof of Pakistan's trade liberalization, or perhaps an approach to counter domestic shortages, whereas India's import of fruits from Pakistan is thought to be restrictive because of the applicability of the sensitive list for Pakistan.

India's export pattern is quite similar to Pakistan's import pattern, but the converse is not true and complementarities tend to be low. Dairy products, eggs, and oilseeds present large opportunities for India to export to Pakistan because Pakistan is already importing these goods from other countries. Pakistan should capitalize on export diversification because of the low complementarity in Pakistan's exports and India's imports. For example, the market for fresh table fruits in India seems to be a lucrative opportunity for Pakistan.⁹³ Many studies find that India has a comparative advantage in cotton, tomatoes, fresh vegetables, onion, seeds, ground-

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nuts, and coarse cereals, whereas Pakistan does in citrus fruits, mangoes, dates, leather, fish, sesame and oil seeds, hides, and skins. Given these, variation in items traded between the two countries is considerable, suggesting that trade in the sector is largely unorganized.

Recent studies indicate that each country has approached the way the agriculture sector is run differently. In Pakistan, the sector is largely unregulated and highly fragmented, and farmers face low financial returns to their investments, little informal credit, poor quality seeds, and high costs of irrigation facilities. India, on the other hand, heavily subsidizes its agriculture sector and protects its farmers with a diverse array of inputs, including pesticides, fertilizers, irrigation, electricity, and seeds.⁹⁴ Indian subsidies are reportedly five times Pakistan's, and in turn lead to higher yields—about 10 to 27 percent in most crops.⁹⁵ Pakistani farmers feel that they should be included in deciding bilateral terms with India, and that the government should announce an agriculture emergency to deal with the issues. Many Pakistani agriculturalists have argued for a level playing field with India because India's agricultural sector is largely regulated and heavily subsidized relative to Pakistan's, which is still grappling with reduced output prices, unforeseen losses, high diesel rates, and more.⁹⁶

A key question many researchers have brought up is whether agricultural trade between the two countries has existed merely as a stabilization process for the domestic markets or whether the countries have been able to exploit their revealed comparative advantages in agriculture commodities. According to various studies, imports of onions, sugar, cotton, and tomatoes have stabilized domestic shortages in Pakistan, whereas exports of onions and shallots have met domestic shortages in India. Such trade is usually “not based on strong comparative advantage but on climatic factors causing production fluctuations in the destination country” and helps deal with sudden price variations due to a shortfall.⁹⁷

One study points out the limited opportunities for intra-industry trade.⁹⁸ The stakeholders who participated saw potential for Pakistan to produce inputs and India to specialize in processing of those inputs. Thus Pakistan could be part of a value addition chain given that more than 40 percent of the agriculture sector is involved in processing inputs.⁹⁹ The juicing industry is an example, whereby Pakistan provides fruit pulp to India to process the juice, feeding that industry. A season complementarity exists in the case of mangoes, in that the end of India's mango season meets the peak of the Pakistani mango season.¹⁰⁰ Similarly, Pakistan imports raw cotton from India, processes it into woven fabrics, and exports them to India. This is cited as an “excellent example of a trade-led agriculture industry link between India and Pakistan.”¹⁰¹

To tap into the Indian market, Pakistani exporters could focus on India's testing, certification, calibration, accreditation, and labeling requirements for agricultural commodities.¹⁰² Quality control procedures in India have restricted the export of agricultural items from Pakistan.¹⁰³ However, India maintains such protocols not only for its agricultural items but also for other sectors. Furthermore, most of these restrictions are not specific to Pakistan.

Pakistan should allow all agricultural items to be imported via the duty-free land route instead of the sea route, so that transportation costs are low. Items such as peas, dried fruits, coriander seeds, cumin seeds, fennel seeds, thyme, bay leaves, and cinnamon allowed free of import duty could benefit local industry.¹⁰⁴ Most of these items are already imported from other countries when they could be imported from India duty free. Traders from both countries feel constrained in entering any markets because of sensitive and negative lists levied by neighboring countries. To increase bilateral trade, trade complementarity should therefore be a key factor in determining which items are on the sensitive and negative lists.

Many Pakistani agriculturalists also point out that low-priced imports from India might drive out local producers. One response to a potential surge in imports is that Pakistan can levy agriculture-related protocols and restrictions to protect its farmers against a surge in imports from India.¹⁰⁵ Moreover, other trade policy instruments can also be levied to restrict a surge in imports such as general waivers, emergency protection, countervailing duties, antidumping, and safeguard measures.¹⁰⁶

Trade in this sector will lead to positive gains for each country provided that trade is based on complementarities, diversification of items, and intra-industry trade (value chain addition) rather than on an ad hoc basis. Both countries would do well to adopt a policy that goes beyond their protectionist approaches so that the sectors can compete on the same level. If it is to become a competitive player, Pakistan needs to adhere to industry-specific issues.

Textiles

Currently, the largest proportion of trade between Pakistan and India (22 percent) is in the textile and clothing sector.¹⁰⁷ Nearly all of that trade—99 percent—is in textiles (Harmonized System Code 50-63), primarily cotton (not carded or combed), in which both Pakistan and India are competitive. However, further trade potential in this sector is hindered by the inclusion of the textile sector on the sensitive lists of both countries and by various NTBs.

As the world's fourth largest cotton producer (as of 2016), Pakistan relies heavily on the textile sector—56 percent of total exports—for building its foreign exchange reserves, which speaks volumes about the sector's importance.¹⁰⁸ It contributes, for example, to almost one-quarter of industrial value added and is the country's longest production chain—from cotton to ginning, spinning, fabric, dyeing and finishing, made-ups, and garments, a total of ten subsectors.¹⁰⁹ Cotton in Pakistan is produced primarily in the Punjab (87 percent), followed by Sindh (13 percent); the textile industry is concentrated in Karachi, Hyderabad, Multan, Lahore, and Faisalabad.¹¹⁰ Cotton spinning, the backbone of the textile sector and a highly organized ancillary industry, has been expanded with the help of cheap raw material and cheap labor; however, it specializes in producing coarse categories of yarn, with an average count of twenty.¹¹¹ Pakistan's cotton yarn is suited for the textile made-up sector, comprising bed wear, knitwear, towels, tents and canvas, denim, and ready-made garments. Pakistan's production of synthetic fabrics is not particularly competitive and is strong only in polyester staple fibers. The value-added garment sector has not seen much growth due to its limited product range, low usage of man-made fibers, and inability of manufacturing units to adapt to changing global requirements. Limited use of information technology and poor inventory control systems have not helped the industry either in that some value-added processes have a per capita productivity equal to 37 percent of the benchmark.¹¹² Capacity utilization is less than 70 percent in Pakistan but 90 percent in India. Most industry players still run on obsolete equipment and machinery because the textile sector in Pakistan is not technologically advanced and lacks funding; for instance, as the global textile industry moves toward increased automation, Pakistan will require an estimated twenty-one thousand new shuttleless looms to bring efficiency to the weaving sector.

The textile industry in India became robust only after radical changes in the domestic policy environment after 1991. The removal of licensing requirements, the exemption of small-scale and ancillary industries from location restrictions, rediversification of the knitting and garment sectors from small-scale industries, and implementation of the Technology Upgradation Fund

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Scheme and the Technology Mission on Cotton have, in particular, helped India liberalize and modernize its textile industry. The top textile and clothing export partners of India in 2013 were China, the United States, Bangladesh, and the UAE. Cotton textile exports—primarily cotton ready-made garments, cotton yarn, and cotton fabric—constitute 45 percent of India's total textile exports.¹¹³

Despite the removal of licensing requirements, textile and clothing appears to remain India's most protected sector. Until 2005, large firms were not allowed to enter into manufacturing of ready-made garments. Even after they were removed from the reserved list, these items continued to be on the sensitive lists of India, despite the lack of rationale to protect large firms.¹¹⁴ Similar protection was provided to the small-scale power-loom weaving sector. However, the mill sector produces high quality and high-value fabric, but power looms produce lower quality fabric at a lower price.¹¹⁵ Fabric imports from Pakistan are more likely to compete with the mill sector in India than the power loom. India fears that imports from Pakistan would hurt its small- and medium-scale sector. If fabrics are allowed to be imported from Pakistan, they would most probably compete with large firms.

Pakistan's share in the world textile and clothing exports decreased from 2.23 percent in 2005 to 1.6 percent in 2014; its low value-added exports put it at number twelve among the world's textile exporters; yet it remains the second largest exporter of home textiles in the world.¹¹⁶ The top textile and clothing export partners of Pakistan in 2013 were the United States, China, the UK, Germany, and Bangladesh. Exports to the European Union registered a 70 percent increase in textile and clothing after the Generalised System of Preferences Plus facility was granted.¹¹⁷ Pakistan's top exports lie mostly in cotton and cotton textiles, which include bed linens and denim trousers. It is one of the world's major suppliers of low to medium quality gray cloth. Demand for textile machinery is almost entirely met through imports from China, Japan, Italy, Germany, and Switzerland; Pakistan recently invested \$548.997 million in importing textile machinery, an increase of 58 percent from 2013 to 2014.¹¹⁸

Increases in the cost of production have made Pakistan less competitive than its neighbors. India, Bangladesh, and China have seen their textile exports grow, for example. Pakistan has seen the reverse.¹¹⁹ Formerly the largest cotton yarn supplier to China, Pakistan is also losing its market to India and Vietnam.¹²⁰ Pakistan's focus on the non-value-added segment's exports (such as yarn) makes its trade vulnerable to cotton production and prices, particularly when the world is demanding more man-made fibers and finished value-added products such as garments with a large proportion of man-made fiber content.¹²¹ Even though Pakistan's textile products are competitive in terms of prices, Pakistan trails competitors in reliability and political stability.¹²² Pakistan can increase product diversity by reducing barriers on imports so as to ease access to man-made fibers.

India's cotton production is higher than Pakistan's but its average yield is lower because Pakistan has an edge in productivity. Indian cotton is higher quality, however. India has a clear advantage over Pakistan in man-made fibers but is not price competitive. Pakistan's weaving industry is quite strong, in part because it uses advanced wider-width looms. Its Indian counterpart is relatively underdeveloped: forty thousand looms are old technology and 80 percent of the shuttle-less looms are secondhand.¹²³ All of India's looms are less than ten years old, against only one in four of Pakistan's, giving India a technological competitive advantage.¹²⁴ India produces both uppers (tops) and lowers (bottoms), but is not as competitive as Pakistan in lowers. India has a larger production base of both jute and silk than Pakistan. The cost of imported cotton from Pakistan in 2016 was lower than India's own (two years of droughts had

Increases in the cost of production have made Pakistan less competitive than its neighbors.

raised the prices of Indian cotton).¹²⁵ In fact, one of the key issues in textile trade between India and Pakistan is the variable demand and cost of cotton, year to year.

India, with its highly complex sector from fiber production to garment manufacture and packaging, is believed to be more competitive in good quality fabric (silk and other synthetic fiber). Pakistan, on the other hand, is competitive in cotton production, its intermediate goods (yarn and gray fabric), towels, and bed linens.

Nonconcessional Indian tariffs on the sensitive list for non-least developed countries under SAFTA coupled with Pakistan's negative list for India hinder textile and clothing bilateral trade. India and Pakistan have kept 182 and 224 textile items in their sensitive list, respectively, for each other. Seventy-eight are also on Pakistan's negative list for India.¹²⁶ Many of India's potential exports to Pakistan are on Pakistan's sensitive list, such as synthetic textured yarn, synthetic yarn, synthetic woven fabrics, and synthetic staple fibers (not carded), whereas India's sensitive list bans products in which Pakistan has a competitive advantage, including cotton (not carded or combed), T-shirts, singlets and vests, and trousers.¹²⁷

These two important textile trading countries have immense potential benefit from bilateral textile trade given the importance of the sector to employment and export earnings. Cotton yarn is the most traded item, followed by apparel. Indian exports are more likely to be high quality processed exports. Pakistan's imports from India in this sector are far greater than its exports, but trade figures do not show any specific trends. Cotton yarn is the item most imported from India followed by yarn of synthetic staple fiber. India actually might not have much to lose even if the existing trade with Pakistan is stopped, as Pakistan's cotton imports from India form a meager 5 percent of India's total global exports.

Trade in similar items of textile and clothing (cotton, especially woven fabrics) seems to be the hallmark of bilateral trade between India and Pakistan. This trade behavior suggests an interesting, rather striking feature about the trade policies in both countries. Even though Pakistan's textile industry would openly resist importing raw materials and products from India, in times of crisis they have no option but to turn to their neighbor. In 2015 and 2016, with a low quality and damaged cotton crop affecting as much as 35 percent of production, the All Pakistan Textile Mills Association was forced to turn to India for cotton imports.¹²⁸ India also appeared to have a crisis-based policy for textile imports when it sought to import cotton from Pakistan after a domestic shortage led to a price hike.

As is true of the automobile sector, textiles make up 20 percent of India's total informal exports to Pakistan.¹²⁹ Textiles are estimated at \$350 million and tires alone at \$243 million. Cloth and textile machinery are two main items imported informally from India. Items popular in informal trade include textile apparels, in particular ethnic garments such as Indian raw silk, cotton, Banarsi saris, muslin, and ready-made bridal dresses, all readily available in Karachi and Lahore.¹³⁰ Apparel and clothing are otherwise subject to a 25 percent customs duty through the formal channel. Pakistani officials have also reported that hybrid cotton seed from India is available in Sindh and sold under no label.¹³¹

Pakistan should consider switching its import of high-technology machinery from Germany, Europe, and China to India—spinning machines and weaving preparatory machines in particular. “Most of the Western countries companies—that supply textile machinery to Pakistan—have joint venture projects in India or have given franchise rights and licenses to Indian companies; Indian-made textile machinery from such franchisees will thus be cheaper,” said a former chairman of the SITE Association of Industry, a representative body of one of the biggest industrial estates of Pakistan.¹³² Imports from India will lead to lower freight, installation, and repair and maintenance costs. Bangladesh is a good example of a country whose

textile industry achieved modernization when it successfully managed to take duty concessions from India on the export of nearly forty-six textile products to India, which substantially increased textile exports to India, some of which have registered an increase of 600 percent.¹³³

In Pakistan, most of the resistance to trade liberalization in the textile sector comes from the cotton yarn manufacturers, who worry about cheap, good quality cotton yarn from India destroying the local market. Pakistan Senate's Standing Committee on National Food Security and Research once asked the government to "immediately stop cotton imports from India because it would ruin the country's cotton economy."¹³⁴ Textile and cotton ginning groups resist imports from India, just as the All Pakistan Textile Mills Association pushes to restrict cotton exports to India so as to ensure supply for domestic textiles production.¹³⁵ The textile, fabric, and fashion sectors, however, are enthusiastic about the possibility and potential of trade with India.

Conclusion

It has always been political intervention that has enabled trade to grow. Lately, however, despite significant political events, such as the Mumbai massacres of 2008 and the more recent skirmishes in 2016 and 2017 between India and Pakistan, trade between both countries continues to flow.¹³⁶ Trade seems to have its own dynamics and flows both ways despite vociferous demands on both sides that it come to an immediate halt.¹³⁷ Although political announcements are important, more mundane impediments often have far greater ramifications. The flip side of this persistence is that if either government were to announce and follow up on improving and expanding trade relations, the existing infrastructure and logistics issues, as well as domestic protectionist interests in both countries, would still undermine and hamper the expansion of trade.

High-profile political initiatives often lead to hurdles being imposed by lobbies and powerful groups, both economic and political, that are not interested in improved trade, economic, and political relations between the two countries. Pakistan's announcement that India was being given MFN status in 2013 is a case in point. Powerful interests in Pakistan, particularly the military establishment, created a political controversy, stalling progress. Trade issues between the two countries are more effectively dealt with through quieter discussions and engagement, which is more likely to yield significant results.

This approach is especially important given the region's changing economic and political dynamics, China becoming an even more dominant actor, especially in regard to Pakistan. With the China-Pakistan Economic Corridor now Pakistan's central growth strategy, trade with India—given its probable public and political repercussions—may be put on a backburner.¹³⁸ All evidence suggests that Pakistan would benefit far more were it to increase trade with India. Given China's huge investment in Pakistan in response to the China-Pakistan Economic Corridor, however, trade with India will lose its urgency for the Pakistani business community and for political groups that look to trade as a road to greater peace in South Asia.

Given the India-Pakistan political and diplomatic climate at the time of writing, then, the best way to enhance trade between the two countries is to do so quietly, taking simpler, more practicable measures such as removing infrastructural and logistics-related bottlenecks, leaving bold political announcements for a more settled and tranquil juncture.

Although political announcements are important, more mundane impediments often have far greater ramifications.

Recommendations

Pakistan allows only 137 items to be imported from India by road, with other items to be exported via rail or sea. However, despite claims by many Indians that the 137-item list is highly restrictive, it is still only partially met. An argument can be made that all goods exported from India to Pakistan should be allowed by land. This would require a significant improvement in the inadequate and overburdened road, warehousing, and infrastructure network.

Through trade switching, by importing automobile products and components from India rather than from countries farther away, as is the practice currently, Pakistani producers and thus consumers would have access to cheaper components and finished products. Allowing all goods by land would also increase consumer choice and bring the Pakistani automobile sector in line with emission and safety standards, which India has done. Local dealers who make parts and components in both countries could use their comparative advantage to develop and spur product integration.

The Pakistani pharmaceutical sector has much to learn from the rapidly growing Indian pharmaceutical industry and its adapting to international standards. Intra-industry trade offers the possibility of vertical integration between India and Pakistan, each country specializing in that part of the value chain in which it has a comparative advantage. Although resistance by sections of the pharmaceutical industry in Pakistan is likely given its protected market, Pakistan needs to develop a farsighted approach and integrate with the Indian sector, benefiting consumers and producers alike.

The agricultural and farmers' lobbies in Pakistan, as in many countries, are powerful, have a large vote bank, and resist increasing imports in agricultural products. India's import of agricultural products is governed by standards and certifications not specific to Pakistan. To increase its exports to India, Pakistan's agriculturalists and government need to improve testing, certification, calibration, accreditation, and labeling requirements. This would allow exports to grow to other markets, where standards are often a constraint. Pakistan should also allow all agricultural items, like automotive goods, to be imported by the duty-free land route rather than the sea route to lower transportation costs and benefit consumers. Trade in this sector will lead to positive gains for each country provided that trade is based on complementarities, diversification of items, and intra industry trade (value chain addition) rather than on the current ad hoc basis. Both countries would do well to adopt a policy that goes beyond their protectionist approaches so that the sectors can compete on the same level.

In the textiles sector, Pakistan should consider switching its import of high-technology machinery (spinning machines and weaving preparatory machines in particular) from Germany, Europe, and China to India, given the far lower transport costs, as long as transport mechanisms are also improved to allow the import of such machinery across land. Opening the protected textile sector would allow consumers to opt for cheaper and better quality high value-added products made by both countries. It could also allow for greater cooperation between producers, outsourcing products in the value chain when comparative advantage exists.

Notes

1. This does not include informal trade, which estimates show could be as much as \$5 billion (State Bank of Pakistan, "Annual Report 2015–2016, Statistical Supplement," Karachi, 2016, 128).
2. The large variation is due to different assumptions academics and researchers make. If total trade in 2015 or 2016 was around \$7 to \$8 billion (including informal trade), then trade potential would probably be six or seven times this much. The truth is that we really do not know how large the potential for trade really is.

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20. A prominent trader at Amritsar said that effectively the trading gates were opened for approximately ten hours.
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