



## In this Issue

*Greater trade with India offers an immediate and rich possibility of economic growth for both Pakistan and India.*

*By Hina Shaikh*

### PAK-INDIA TRADE: A REGIONAL PERSPECTIVE

“Our agenda has been clearly laid out in terms of preparing timelines for complete normalisation of trade relationship and implementation of committed SAFTA obligations,” said Indian Commerce Secretary Rahul Khullar in his opening remarks at the sixth round of talks between the commerce secretaries of India and Pakistan.

“I want to assure you that please have trust and faith in the process. Times have changed. World is coming closer,” said his Pakistani counterpart Zafar Mahmood. The statements made by both sides echoed the mandate given by their top leadership.

This dialogue clearly sets the tone for a different kind of diplomatic engagement, one that is committed to strengthening economic ties between the India and Pakistan, despite potential spoilers on both sides of the border. There is strong political will on both sides of the border to improve bilateral relations.

Pakistan has been stuck in a low-income and low-growth trap for a fairly lengthy stretch now. This low growth is slowly beginning to strangle its economy. Lacklustre economic performance is also threatening the very objective of sustained welfare improvement of its citizens. With a burgeoning population, energy shortages and a significant and rising number of unemployed youth, Pakistan needs a ‘growth vent’.<sup>2</sup>

Talks and actions towards normalising trade with India have emerged as one glimmer of hope for pulling Pakistan out of this crisis. Of course, no economist can deny the economic advantages of opening up trade. *The Economist* reports that trade with India can grow to as much as USD 30 billion a year, from a paltry sum of USD 2.7 billion. This means jobs for millions of Pakistanis and steady income streaming into hundreds of thousands of households.

Trade with India implies a not only better Pakistan but also a better 'region'. Let us look at how critical economic ties between India and Pakistan are to the region's overall growth.

### **Pak-India Trade for Regional Growth<sup>3</sup>**

Pakistan needs a growth rate of at least 7 percent or more for the next four decades to ensure that its GDP doubles every ten years and that there is significant improvement in its per capita income.<sup>4</sup> Given that the country has averaged similar growth rates for several decades in the past, this is not such a formidable task. To achieve this growth rate, Pakistan must look for a vent through which it can sustain high levels of growth and ensure regional equity. The surrounding political and economic climate must be conducive for this to happen. Pakistan is in need of larger and growing export markets to tap the potential of industrial hubs across the country, particularly in the face of diminishing marginal returns to traditional growth-leading sectors.

This search for growth avenues must begin with an assessment of the country's recent growth performance within the regional context. Pakistan's growth is in stark contrast to the rising prosperity in China, India, and Central Asia. Such fast improving regional prospects accentuate Pakistan's centrality as a connector of regional markets. In fact, the region constituting Pakistan has historically benefited as a trade hub.<sup>5</sup> In the pre-colonial era, several important trade routes ran through present-day Pakistan, extending from Iran, Afghanistan, and Central Asia in the west to India in the east. These routes were later severed by colonial-era borders and poor relations with India. Regaining this role can be seen as an important precursor to Pakistan becoming a full-fledged manufacturing hub.

For this to happen, Pakistan needs to tap into 'lucrative markets outside its borders in the neighbourhood in a manner that creates several growth nodes viz., Karachi, the Arabian Sea coastline of Sind and Baluchistan, Lahore and Peshawar.'<sup>6</sup> The creation of a strong and interdependent market for products, labour and financial flows across the border with India on the East and the Indus River on the West has already led to the formation of an integrated Indus Basin market that enjoys perhaps the best connectivity of any sub-region in South Asia.<sup>7</sup> The National Trade Corridor (NTC) that links Peshawar, through Lahore to Karachi and Port Qasim, 'handles the major part of Pakistan's external and internal trade'. (World Bank, 2006, 8) This connectivity has aided Pakistan's growth trajectory, sharing the welfare gains of that growth across a wide region.

Renewing the historical East-West routes to trade in goods and energy will revive the Indus basin market by enhancing the flow of economic transactions and also aid in restoring the economic and cultural vivacity of these regions. Modernisation of old trade routes in the subcontinent, such as the well-known and historical Grand Trunk Road, and the development of newfound natural resources in the Central Asian republics could allow the region to realise its true potential. As a facilitator of regional trade, Pakistan could use its centrality in the regional product value chain. Following enhanced India-Pakistan trade, overall investment would also increase and could be channelled to create new growth vents around existing industrial hubs in Pakistan.

However, it is pertinent to note that Pakistan's role as a hub of regional trade is incomplete without these trade routes (both North-South and East-West) extending to India. Deepening of trade ties with India would thus be an important action for enabling Pakistan to become an economic hub in Asia,

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allowing it to benefit from the rising affluence of China, Central Asia and India.

Moreover, India's long-term strategic interest is to help create an Asian market. That, in turn, requires strengthening Pakistan to be an effective regional hub that connects the Asia-wide market. Without normalising trade with India, the Indus Basin would just be a 'T-junction rather than a cross roads of economic transactions that would circumscribe the welfare gains from the new growth vent'.<sup>8</sup> For India, trade with Pakistan is not only advantageous in itself, but would also facilitate trade with Afghanistan, China, Iran, and the Central Asian countries.

Trade and economic ties with India remain critical to Pakistan's search for a new growth avenue. Enhanced economic ties are not only beneficial for the two countries but would also lead to the economic integration of the South Asian region. Intra-regional trade in SAARC currently stands at 5 percent, compared with 25 percent in ASEAN and 65 percent in the EU.

### **Towards Greater Economic Integration: Recent Developments**

In the recent past, both India and Pakistan have taken steps to show their unequivocal commitment to greater economic integration, clearly visible from the economic and political engagements in the past year. Pakistan's path breaking decision to grant India Most Favoured Nation (MFN) status in February 2012 and the inauguration of an integrated check post at Atari in April of the same year are two major developments in this regard. Pakistan will be granting India MFN status 16 years after India did the same for Pakistan, 'now paving the way for a normal, WTO consistent, trade relationship between the two largest economies of South Asia'.<sup>9</sup>

For the first time, India also announced that it would allow Foreign Direct Investment (FDI) from Pakistan. Two more changes are on the anvil: the opening of more trade routes, and the removal of Tariff and Non-Tariff Barriers (NTBs), something Pakistan has been demanding for a long time.

Clearly, 2010 onwards has been an important period for enhancing bilateral trade between the two countries. In fact, it has been the most productive phase of improving economic relations between India and Pakistan since the signing of the South Asian Free Trade Area (SAFTA) agreement in 2004 (which became operational in 2006). The number of positive policy decisions taken in the short phase is shown in the table below.

<b>Date</b>	<b>Important Developments</b>
April 28, 2011	Commerce Secretaries of India and Pakistan issue a joint statement with the objective of boosting trade
September 26, 2011	Pakistan's Commerce Minister assures progress on MFN status to India, seeks removal of NTBs
November 02, 2011	Pakistan's Cabinet approves MFN status to India, but later retracts and gives in-principle approval for 'trade normalisation' with India
November 13, 2011	Pakistan's Commerce Secretary visits India, assures a shorter negative list and removal of positive list
February 29, 2012	Pakistan announces transition from positive list to negative list and says the negative list would be removed by December

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March 20, 2012	Pakistan notifies negative list with India, banning 1,209 items and opening more than 7,500 tariff lines
April 13, 2012	ICP inaugurated at Atari
September 8, 2012	India and Pakistan sign on a liberalised visa accord that was approved by the Federal Cabinet on October 30, 2012
September 21, 2012	Pakistan and India sign three technical agreements on redressal of trade grievances, mutual recognition and customs cooperation

*Source: Maini, T.S and Vaid, M. (2012) Indo-Pak Trade: A Visit to Historical Relations, Briefing Paper, CUTS and Authors own additions*

Some people in Pakistan welcome the normalisation of trade relations between India and Pakistan, while others are sceptical of how it may pan out. The question often raised inside Pakistan is whether the expansion of trade with India is actually beneficial for Pakistan, or will the gains of trade be favourable only for its large neighbour.

A lot of preconceived notions and myths on this point have taken root in the public discourse. Empirical evidence, however, based on an examination of specific sectors, indicates that India-Pakistan trade is a win-win situation. A study by the State Bank of Pakistan has come to the conclusion that bilateral trade could increase fivefold if MFN status is granted and Non-Tariff Barriers removed by both India and Pakistan.<sup>10</sup> As trade increases, India and Pakistan may be able to build the trust needed to tackle their territorial disputes, while economic inter-dependence would help reduce the risk of conflict.

While the decision to liberalise trade with India may have come as a surprise to many domestic industries, it follows Pakistan's commitment made years ago to scale down its customs duties to between zero and five percent on 5,873 products from South Asian countries from Jan 1, 2013 under SAFTA.<sup>11</sup> Pakistan has replaced its positive list allowing only 2,000 different items to be imported from India with a negative list that bans just 1,209 goods, but allows all others, which is also eventually going to be phased out by the end of 2012. India has reduced its sensitive list under SAFTA by 30 percent from 878 to 614 tariff lines. After getting MFN status from Pakistan, India says it will further cut the sensitive list to 100 tariff lines by April 2013. Similarly Pakistan will also make efforts to cut its sensitive list in the coming years.

Trade is set to expand exponentially with Pakistan having agreed to allow trading of up to about 6,000 different products through the land border route, compared with just 137, such as fruits, vegetables, livestock, dry fruit and paper, at present. Tangible gains have already been realised, in less than a year since the resumption of the composite dialogue. Cross border trade reached Rs 15 billion in 2010-11 (from just Rs 6.5 billion in 2007).<sup>12</sup> With more recent developments, it is expected that India-Pakistan trade will reach USD 10 billion to 20 billion within the next few years, a significant improvement over the existing level of around USD 2.5 billion.<sup>13</sup>

## Moving Forward

The need to expedite trade liberalisation with India is an urgent one to ensure that Pakistan is able to have current entry point comparative advantage<sup>14</sup> in the cost of doing business, and infrastructure efficiency. This advantage could be eroded as India is taking steps to reduce business costs and improve its infrastructure. Pakistan's advantage in providing a better investment climate, however, has been eroded over time with India becoming relatively more stable and safer for investments.

This time around, prospects of expanding bilateral trade through diplomatic interaction between the two governments are brighter. In addition to the willingness of the two governments, the business community on both sides of the border has been keen to support the revitalisation of ties at every stage, and has supported the political leadership in taking bold initiatives to restart the process of dialogue. Policy makers also seem to have overcome their reservations, and momentum has been building over the last several months to move the process forward. Businesspeople in India and Pakistan have described these steps as a major breakthrough, signifying the mutually beneficial but long-awaited settlement of major issues.

Despite these developments, challenges remain. The liberalisation of trade between India and Pakistan will be a long and arduous process, particularly given the political history of this region. While the business community in Pakistan has been a strong lobby for normalising trade relations with India, there are elements on both sides of the border that tend to jeopardise the whole process. Hence both governments need to be more pro-active yet cautious at the same time.

Reservations have been expressed by various sectors of Pakistan's economy – the farming, automobile, leather, pharmaceutical and textile industries. Moreover, the ever-present threat of terrorist incidents, which have derailed the Pakistan-India peace process in the past, may disrupt the bilateral trade at any time. Most importantly, the military's view on increased economic integration of the two neighbours is key to developing and improving trade ties. Ultimately, where both sides go from here will depend on how well the military is able to balance its economic and security objectives.

However, there is a strong consensus among economists in both India and Pakistan that normalisation of trade relations would bring substantial economic benefits evenly. Pakistan realises that the liberalisation of bilateral trade will not only benefit both economies, but also remove barriers to regional integration within South Asia. India should seize upon Pakistan's newfound willingness to reciprocate India's granting of MFN status by taking concrete steps to reduce NTBs.

Stable relations between the two countries have far reaching positive consequences. A wider offer to its neighbouring countries in terms of opening up the markets and trade and removing barriers to mobility would ultimately benefit India, reducing hostility and favouring its exporting and importing industries, as well as benefiting Indian consumers with lower prices for goods imported from Pakistan. Ingenious steps at the border today will bring great rewards in future. A private sector-led approach, where problems are solved and the business community simply gets on with the job, has a much better chance of avoiding pitfalls and producing results. India's financial-services industry and its software professionals could offer their skills to Pakistani clients. That way they would gain a next-door market, while providing services that Pakistan could use to develop its economy. India can augment its exports

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to Pakistan in three categories – machinery, mechanical appliances and electrical equipment, and chemicals and textiles. These are all easy wins waiting to be pursued.

### **Conclusion**

Pakistan and India have embarked on a new era of economic ties. Granting the MFN status to India is a useful symbolic move to get talks back on track. This will change the face of South Asia, bringing the region into a new period of stability, peace and prosperity.

Greater trade with India offers an immediate and rich possibility of economic growth for both Pakistan and India. However, since Pakistan-India relations are complex and many factors can disrupt the smooth flow of trade and other economic transactions, it would be a mistake to assume sustained trade growth following the announcement. Pakistan and India both have to take a strategic and regional approach in managing their trade and economic relationship to maximise the benefits of this important announcement. A narrow, bilateral approach will not ensure smooth trade relations in the future.<sup>15</sup> Trade between Pakistan and India could go up manifold within the shortest possible time provided both the sides take sector-specific measures.

The fact that trade related dialogue has resumed at several levels suggests the strong desire to expand and facilitate trade between the two countries. While it is true that the current government is very supportive and politically committed to building strong economic and commercial ties with India, the efforts remained potentially constrained by the negative reactions of hard-line nationalists who question the government's commitment to national security, in particular Kashmir.

Moreover, some manufacturers in Pakistan who fear that increased competition will threaten the survival of their business have also opposed increased bilateral trade with India. Much, however, will depend on the ability of stakeholders to push forward the emerging trade ties that exist between the two neighbours, while dispelling the fears of both. Essentially the main task should now be to strengthen advocacy groups in both countries that can help overcome political obstacles hindering trade liberalisation between India and Pakistan.

## End Notes

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- <sup>2</sup> Nabi, I. (2012) 'Pakistan's Quest for a New Growth Vent: Lessons from History' in *Lahore Journal of Economics* September 2012 Special Edition Vol. 17
- <sup>3</sup> The ideas of growth vent and restoration of ancient trade routes for regional development have been inspired by the research done by Dr. Ijaz Nabi, Country Director, IGC and re-produced here from his papers cited below.
- <sup>4</sup> Nabi, I. & Javaid, K. (2011) Regional Trade Panel Report. DPRC Working Paper
- <sup>5</sup> Nabi, I. (2012) 'Pakistan's Quest for a New Growth Vent: Lessons from History' in *Lahore Journal of Economics* September 2012 Special Edition Vol. 17
- <sup>6</sup> Ibid.
- <sup>7</sup> Ibid.
- <sup>8</sup> Ibid.
- <sup>9</sup> Nabi, I. (2012) '*Pakistan India Trade: Avoiding the Pitfalls*'. Paper written for the Woodrow Wilson Center
- <sup>10</sup> State Bank of Pakistan, (2006), 'Implications of Liberalizing Trade and Investment with India', in *Research and Economic Policy Department Report*, Islamabad.
- <sup>11</sup> Khan M. Z., '*No clear roadmap for Pakistan-India trade*' 12<sup>th</sup> March 2012, Dawn  
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<http://www.brecorder.com/supplements/88/1269395/>
- <sup>13</sup> Khan, M. (2013) *India Pakistan Trade Relations – A New Beginning* written for The New America Foundation  
[http://security.newamerica.net/publications/policy/india\\_pakistan\\_trade\\_relations](http://security.newamerica.net/publications/policy/india_pakistan_trade_relations)
- <sup>14</sup> Ibid
- <sup>15</sup> Nabi, I. (2012) '*Pakistan India Trade: Avoiding the Pitfalls*'. Paper written for the Woodrow Wilson Center